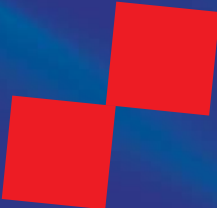


**Riding a wave of change**







**His Royal Highness Prime  
Minister Prince Khalifa Bin  
Salman Al Khalifa**



**His Majesty King Hamad Bin  
Isa Al Khalifa  
The King of Bahrain**



**His Royal Highness Prince  
Salman Bin Hamad Al Khalifa,  
Crown Prince & Deputy  
Supreme Commander of  
Bahrain Defence Force**



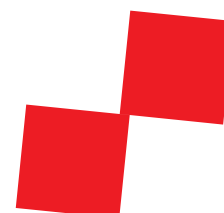
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### **Khaleeji Commercial Bank BSC**

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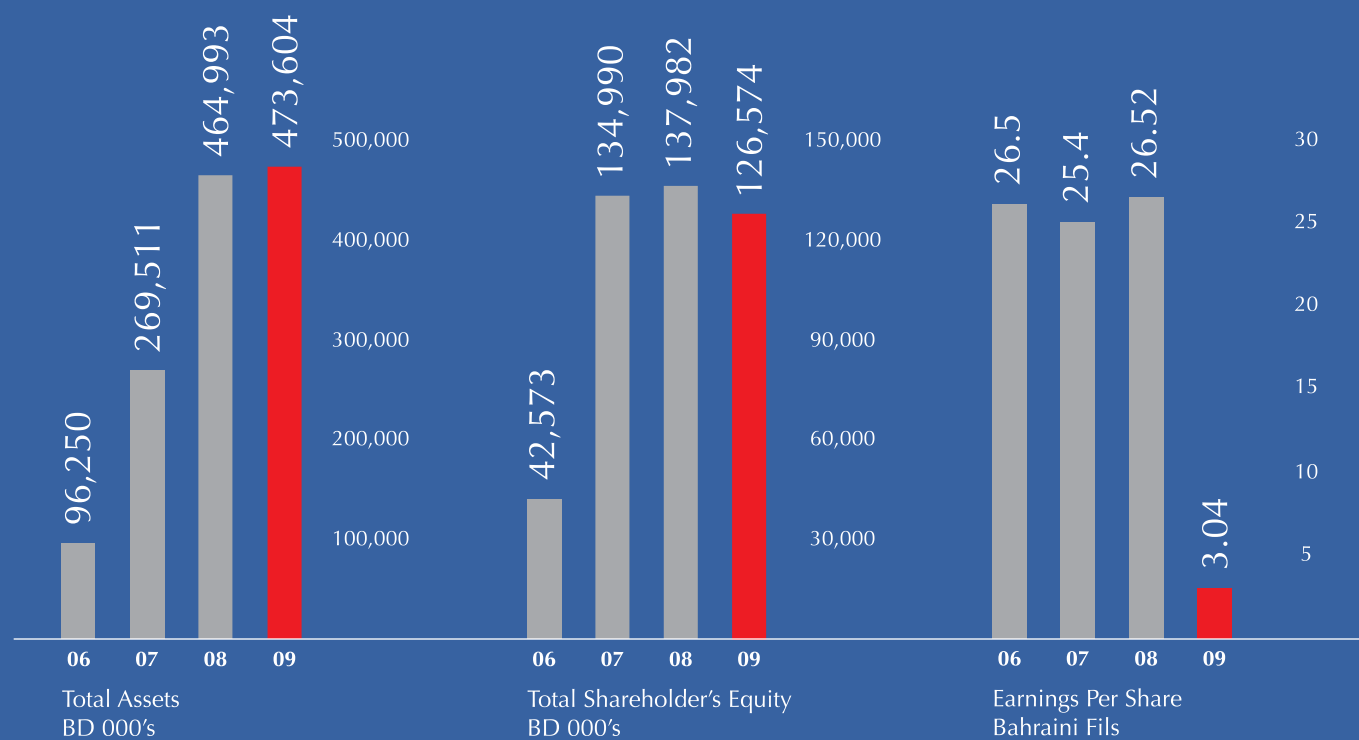
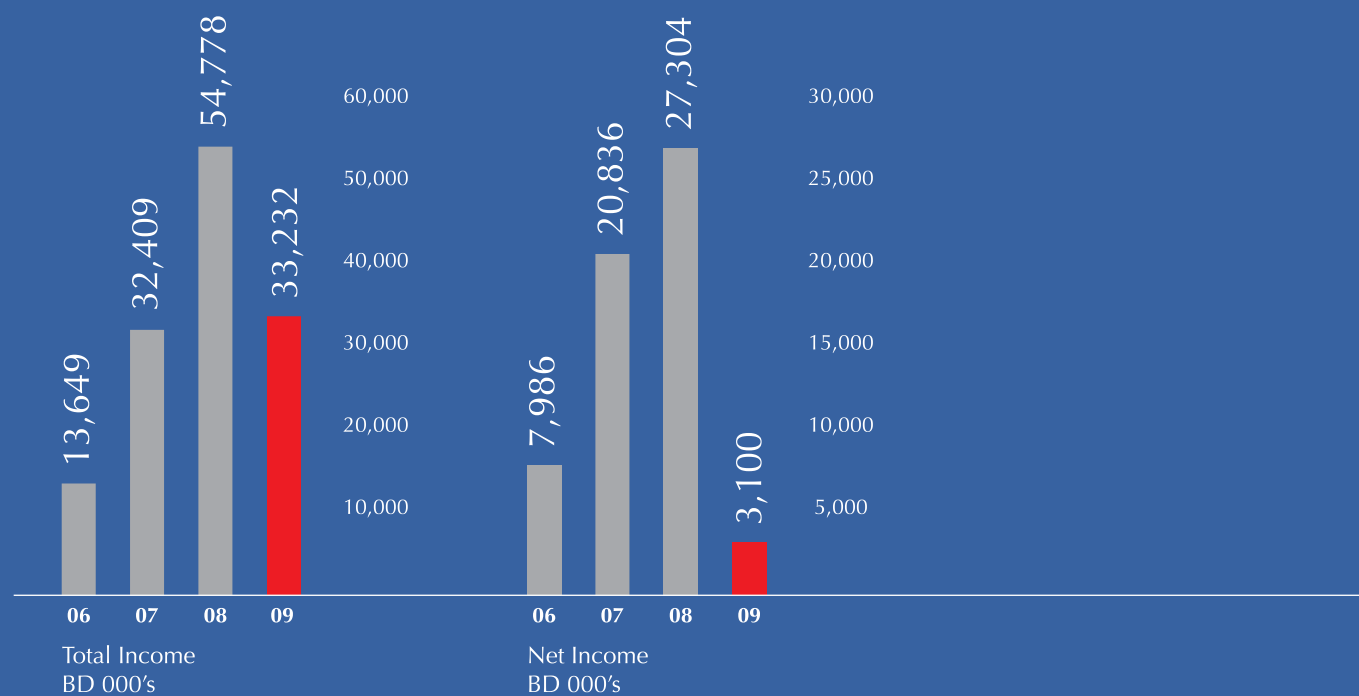


## Riding a wave of change

As the world changes around us, adaptability has become an essential key to success. That's why we're transforming the way we do business. A sophisticated new identity is just part of a transformation that extends from the products we offer to the service we provide. The focus is firmly on our customers, as we ride a wave of change towards a brighter future.



## Financial Highlights



## Board of Directors



**Dr. Fuad Abdulla Al-Omar**  
Chairman



**Dr. Esam Yousif Janahi**  
Vice Chairman  
(resigned in Feb 2010)



**Mr. Ebrahim H. Ebrahim**  
Director &  
Chief Executive Officer



**Mr. Rashad Y. Janahi**  
Director



**Mr. Talal Hazim Al Ghalib**  
Director  
(resigned in Nov. 2009)



**Mr. Abdul Latif Abdulla Al-Meer**  
Director



**Mr. A. Latif Al-Abdul Razaq**  
Director



**Mr. Hesham A. Latif Al Jabr**  
Director



**Mr. Abdulla Abdul Karim Showaiter**  
Director



**Mr. Khalid Althani**  
Director

## Shari'a Supervisory Board

**Khaleeji Commercial Bank is guided by a Shari'a Supervisory Board consisting of three distinguished scholars. This Board reviews the Bank's activities to ensure that all products and investment transactions comply fully with the rules and principles of Islamic Shari'a.**

**Dr. Fareed Yaqoob Al Miftah**  
Chairman

Member of the Supreme Council of Islamic Affairs, Undersecretary of the Ministry of Islamic Affairs, Kingdom of Bahrain; former Judge of the high shari'a court; lecturer, University of Bahrain; PhD from the University of Edinburgh, United Kingdom.

**Dr. Fareed Mohammed Hadi**  
Executive Member

Assistant Professor at the College of Arts, Department of Arabic and Islamic Studies, University of Bahrain; PhD in Ibn Hazm's Methodology of Jahala, University of Edinburgh, UK; PhD in Al-Bukhari's Methodology, University of Mohammed V, Morocco; Member of shari'a Supervisory Boards of a number of Islamic Banks.

**Shaikh Nizam Mohammed Saleh Yaquby**  
Member

Executive member of Shari'a Supervisory Board, Abu Dhabi Islamic Bank; member of Shari'a Supervisory Boards of Bahrain Islamic Bank and Shamil Bank; Board Member of Dow Jones Islamic Index; Member of Shari'a Supervisory Boards of a number of Islamic Banks.

## Chairman's Report 2009

for the year ended 31 December 2009

*In the name of Allah, the beneficent, the merciful, prayers and peace upon the last apostle and messenger, our prophet Muhammad.*

On behalf of the Board of Directors, it is my pleasure to present the annual financial statements of Khaleeji Commercial Bank (KHCB) for the year ended 31 December 2009. The year 2009, being the fifth year of operation for the Bank, has been a challenging year. Against the backdrop of the global financial crisis and the difficult regional environment, the Bank has achieved positive financial results in line with the long term objective of delivering consistent returns. The Bank continued to invest significantly in enhancing its institutional capacity by developing its human resources and implementing new technologies and systems.

### Overall Performance

The Bank continued to execute a business strategy based on a hybrid business model leveraging its investment banking capabilities while growing its commercial banking business and ensuring that a strong liquidity and adequate capital position is maintained. As with other financial institutions, the current market environment has had an adverse impact on the Bank, both directly and indirectly. However, I am pleased to report that through a combination of prudent management and conservative approach, the Bank was able to navigate this difficult period successfully. With the blessings of Allah the almighty, the Bank continued to maintain strong liquidity (30.5% liquid assets) and adequate capital (regulatory capital adequacy ratio of 34%). The total assets of the bank grew only marginally by 1.9% to BD473.6 million, a result of the subdued market as well as conservative liquidity management. In spite of this, the Bank managed to increase the financing portfolio by 26.5% to BD200.6 million and revenue from commercial banking activities by 41.4%, underpinning our strategy of expanding



**Dr. Fuad Abdulla Al-Omar**  
Chairman

commercial banking business. Unrestricted Investment Accounts (URIA) and Murabaha from customers also continued to grow, reaching BD216.1 million, a 32.8% growth over 2008.

During the year, revenue declined significantly by 49.9%, mainly on account of lower income from investment banking activities. Nevertheless, given the credit and economic environment, we have been proactive in increasing the Bank's impairment provision to BD9.3 million. Consequently, net income reduced to BD3.1 million compared to BD27.3 million in 2008, generating a return on average equity of 2.3% and a return on average assets of 0.7%.

### Operational Achievements

In spite of the difficult market conditions, we continued to launch new products to meet our clients' needs. In June, we closed subscription at US\$247 million for Global Logistics, which has been established to invest and develop a logistics park in Navi Mumbai, India. As a means of diversifying our customer base and funding sources, the Bank also launched the Al Waffer savings account in July. The Al Waffer account was well received in the market and offers customers cash prizes on their Unrestricted Investment Accounts.

Meanwhile, we remained committed to offer our clients with different means to reach our services through multiple delivery channels including more branches and electronic banking platform. During the year our main branch opened in the financial mall of the Bahrain Financial Harbour. The Bank was one of the leading banks in the Kingdom that introduced EMV compliant Visa branded debit cards and expanded its own ATM network by installing new offsite ATM machines in different locations of the country.

### Organizational Development

The year 2009 was a year of consolidation for the Bank as it had grown significantly in the previous two years. Although the staff numbers did not increase significantly, we continued to invest in the training and development of our human resources. We believe that a committed and well trained work force is a key enabler in achieving our long term objectives. We continued to develop and improve the graduate trainee program and also supported the HRD fund of the Kingdom of Bahrain as well as Tamkeen. During the year, the Board continued to enhance the Bank's corporate governance framework in line with global best practices and regulatory requirements.

### Awards and Accolades

I am pleased to report that KHCB received two prestigious industry awards during the year. In June 2009, the Bank won the award for the "Best Retail Product" during the Banker Middle East Industry Awards ceremony held in Bahrain. In December 2009, the Bank also received the award for the "Best Commercial Bank" during the Islamic Business and Finance event held in Dubai, UAE. These awards reflect the on-going commitment of the Bank towards developing its businesses through enhancing its services and offering new products.

### Corporate Social Responsibility

We are also aware that as a growing institution we have a responsibility to contribute to the communities within which we operate. We undertook to support a number of initiatives during the year and we will continue to increase this activity in the coming year through an on-going program of corporate social responsibility.

### Looking Ahead

One of the major challenges for us going forward is to diversify our assets, customers as well as revenue stream. During 2009 we have been successful in diversifying the Bank's assets and revenues to a certain extent. I am now pleased to report that CBB has permitted the Bank to offer the full range of retail banking products, which we believe

will enable it to offer a wider range of products and also diversify and expand its customer base. We will grow the retail banking business by expanding the Bank's branch network, electronic distribution channels and consumer finance products during the next three years. This will enable us to build a diversified and sustainable business in the medium term.

As we look to 2010, we foresee a challenging year ahead but also see many opportunities for growing the Bank's business not only in the primary markets in GCC but also in the wider MENA. We are confident that the Bank now has the scale, depth as well as financial strength to capitalize on the available opportunities.

### Appreciation

On behalf of the Board of Directors, I would like to express my gratitude to his Majesty King Hamad Bin Isa Al Khalifa, His Royal Highness Prince Khalifa Bin Salman Al Khalifa, the Prime Minister, and His Royal Highness Prince Salman Bin Hamad Al Khalifa, the Crown Prince and Deputy Supreme Commander of Bahrain Defense Force, for their encouragement for the growth of the private sector and the development of the banking and finance industry. I also extend my thanks to all government ministries and the Central Bank of Bahrain for their continued guidance and support.

Special appreciation is due to our shareholders, clients and business partners for their on-going confidence and loyalty; and to the Bank's management and staff for their hard work and dedication.

Allah the almighty is the purveyor of all success.



**Dr. Fuad Abdulla Al-Omar**

Chairman

## Management Team



*Standing from left to right: Mr. Silvan Varghese DGM & COO, Mr. Dimitry Blasi DGM, Head of Investment Banking, Mr. Mahdi A. Nabi AGM, Head of Operation & Administration.*

*Seated from left to right: Mr. Ebrahim H. Ebrahim Chief Executive Officer and Board Member, Mr. Fuad Taqi DGM, Head of Commercial Banking.*

## Chief Executive Officer's Report

*In the name of Allah, the Beneficent, the Merciful*

I am pleased to report that during 2009, KHCB continued to grow and expand its business operations in line with its long term objective of delivering consistent returns and providing innovative Islamic financial products and services to the GCC and MENA markets. The global and regional market environment remained challenging throughout 2009, continuing from the deterioration in the last quarter of 2008. KHCB was able to respond positively to the unpredictable environment by adapting its strategy to meet short term needs and continuing to execute a long term strategy based on a hybrid business model. Our business units performed well given the difficult environment.

The Bank continues to maintain a strong financial position as reflected in a regulatory capital adequacy ratio of 34% and liquid asset ratio of 30.5%. As the Bank has done in the past years, it has continued to grow its business while ensuring that sufficient liquidity is maintained and a strong capital position. The Bank will continue to expand and diversify its business and customer base through introducing new products and enhancing its existing services. The Central Bank of Bahrain has now permitted the Bank to offer the full range of retail banking products and we have taken steps to launch these products including mortgage finance, auto finance, personal finance and credit cards during the second and third quarter of 2010.

### Commercial Banking

In 2009, the Bank continued to grow and diversify its commercial banking business. The Bank achieved good growth in its customer base by more than 87.5% as a result of enhancing its products and services and strengthening its branch operations. Unrestricted Investment Accounts



**Ebrahim H. Ebrahim**  
Chief Executive Officer

(URIA) and Murabaha from customers also grew by 32.8% to BD216.1 million. We continued to enhance our market penetration in local corporate and business markets. Islamic financing assets, which included Ijarah, Murabaha, Musharakah etc., grew by 26.5% to BD200.6 million from BD158.7 million in 2008. As a result, income from commercial banking activities grew by 41.4% during the year compared to 2008 and now forms 45.2% of the total revenue of the Bank. We are increasingly focusing on delivering a comprehensive range of services, both personal and business, to our clients, which has helped us in growing and diversifying our customer base.

Growth in financing assets and Unrestricted Investment Accounts coupled with an increase in our customer base during the year indicates continuing confidence of our customers in the Bank and in our ability to utilize the opportunities ahead.

### Retail Banking and Delivery Channels

During the year the Bank opened its main branch in the Bahrain Financial Harbour Mall. In its effort to increase its reach, the Bank also expanded its own ATM network and installed new ATM's in Seef Mall and Bahrain City Center, and a drive thru ATM in Awali petrol station. With the launch of our Visa electron Debit card, our customers will be able to access their accounts from ATMs throughout the world. We continued to enhance our electronic banking channels including internet banking and SMS banking. In order to provide more secure card transactions, the Bank issued chip based debit cards to comply with EMV regulations. The Bank's systems including ATM switch, and other peripheral systems were already made compliant with EMV.

As a prelude to full-fledged retail and consumer finance offerings, we launched the Al Waffer saving account, which is an Unrestricted Investment Account that offers clients monthly, quarterly and annual prizes on their investment up

to a total of one million dollar every year. The new product has been well received in the market and is expected to attract more deposits and customers during the coming years.

### Investment Banking

Investment Banking has been key to the Bank's growth and success in the last few years. In 2009 investment banking business continued to grow albeit at a slower pace, a reflection of the impact of the global financial crisis in the regional markets. Investment banking business contributed 54.8% of our revenues. Adapting to the changed circumstances, while continuing to explore new opportunities around MENA, our focus was to protect our existing assets by providing necessary support. In 2009, the appetite for new investment products was low, further compounded by negative developments in the region during the last two quarters. Nevertheless, we succeeded in closing the subscription for Global Logistix Navi Mumbai India at USD247 million (BD93 million). Global Logistix Navi Mumbai Investment Company is a company registered in the Cayman Islands to indirectly own 100% beneficial interest in a 400 acre site in Navi Mumbai, to develop a premium logistics park inclusive of a broad range of ancillary services.

### Organizational Developments

During 2009, we continued to strengthen our institutional capacity in line with the growth in size and scope of our business.

The Bank continued to enhance its operational systems and applications including the core banking system. During the year, the Bank completed the implementation of a trade finance system to support the new business initiative in this regard. Further, a new human resources and general administration system has been implemented based on a platform that coexists with the rest of the systems in the Bank. In line with the directive from the CBB, KHCB was amongst the first banks to be certified as a EMV compliant chip-card issuer providing enhanced levels of security for

users. We are also actively pursuing the business continuity management program and expect to have the full system deployed in first half of 2010.

The Bank continued to invest in development of human resources. Several training programs were conducted both internally and externally in order for staff to update their skills and qualifications. We have enhanced the graduate trainee program to recruit and train graduates, who will in time, occupy senior positions in the Bank. We also built upon the progress made during earlier years in developing the Bank's corporate governance, risk management, and corporate policies, processes and procedures.

### Social Responsibility

The Bank takes very seriously its corporate social responsibility to contribute to the well being of the local community. During the year, we continued to provide financial assistance for a number of diverse number of organizations involved in a wide range of humanitarian, medical, social and educational initiatives. We actively support both governmental and private sector initiatives for development and training of Bahraini nationals. These include partnership with the Bahrain Institute of Banking & Finance (BIBF) and TAMKEEN, financial support for the Human Resource Development Fund for the banking and financial sector and participation in the training program of the Waqf Fund.

The Bank also sponsored - for the second consecutive year - the Forum "Gulf economies, the challenges and vision," which was organized by the Business College Society at the University of Bahrain.

### Conclusion

In the short history of KHCB, 2009 was a challenging year, one that presented complex challenges to the financial sector in general and KHCB in particular. We can take satisfaction from the fact we have been flexible enough to adapt to the changing environment and navigate the difficult period successfully.

The Bank is now well positioned to capitalise on opportunities available locally and regionally. Based on our new corporate strategic plan, we will focus on diversifying our revenues, assets and customer base and will grow our retail banking business by offering a comprehensive range of products. In the medium term, we will expand our branch network, enhance our delivery channels and explore opportunities to grow in key markets in the region. Finally, it is my pleasure to extend sincere appreciation to our Board of Directors for their on-going support and valuable guidance, to the Central Bank of Bahrain, Bahrain Stock Exchange, to our loyal customers and finally to all our dedicated staff members who worked so hard, individually and collectively during 2009.



**Ebrahim H. Ebrahim**  
Chief Executive Officer and Board Member



## Product Award



Mr. Fuad Taqi DGM, Head of Commercial Banking receives the Bank's New Retail Product Award.

## Corporate Governance Structure

The Bank's corporate governance framework focuses on Board responsibility, oversight and management accountability vis-à-vis governing regulations and better practices. The framework is in line with global best practices and regulatory requirements which seek to balance entrepreneurship, control and transparency, while creating value for all stakeholders.

Corporate governance, the way the Board and Management is organized and how they operate in practice ultimately aims at leading the Bank toward successfully meeting its strategic objectives. The Board of Directors is accountable to the Bank's shareholders for the creation and delivery of strong sustainable financial performance and long-term shareholder value. To achieve this, the Board approves and monitors the Bank's strategy and financial performance, within a framework of sound corporate governance and effective risk management.

The Bank is committed to continuously reviewing and developing its corporate governance standards to ensure compliance with the requirements of the revised corporate governance framework being implemented by the Central Bank of Bahrain and other regulatory bodies, and also to keep abreast with international best practices.

### Board of Directors

The Board of Directors comprises of ten members. The chairman of the Board of Directors is charged with regular supervision and assessment of executive management and is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the CEO and maintaining a dialogue with the Bank's stakeholders. The Board has constituted certain committees with specific delegated authorities to oversee and guide the management in specific areas of the Bank's operations and decision-making. The Board, either directly or through its various committees, will oversee the management of the Bank.

### Board Committees Structure

The Board of Directors has constituted four committees with specific delegated authorities.

- Board Audit Committee, which is responsible for internal and external audit, compliance and anti-money laundering.
- Board Investment & Credit Committee, which is responsible for investment and credit approval, setting limits and investment policies, asset liability management and maintaining banking relationships, as well as for the oversight of the off-balance sheet vehicles.
- Board Nominations, Remunerations and Governance Committee, which is responsible for setting policies for compensation and incentives, human resources and administration. It is also responsible for the corporate governance framework of the Bank.
- Board Risk Management Committee, which is responsible for ensuring that the Bank's overall risk management framework is effective and that key risks are managed within parameters established by the Board.

The Chairman, the Board of Directors and the Board Committees have direct access to the heads of Internal Audit, Risk Management, Regulatory Compliance and Shari'a Compliance.

During 2009, the Board of Directors held 4 meetings, the Board Investment & Credit Committee held 4 meetings, the Board Nomination, Remuneration & Governance Committee held 2 meetings, the Board Risk Management Committee held 3 meetings and the Board Audit Committee held 3 meetings.

BOARD COMMITTEES

BOARD OF DIRECTORS			
<b>BOARD NOMINATIONS, REMUNERATIONS &amp; GOVERNANCE COMMITTEE (BNRGC)</b> <ul style="list-style-type: none"> <li>• HR &amp; Related Policies</li> <li>• Compensation and Incentives</li> <li>• Human Resources</li> <li>• Administration</li> <li>• Corporate Governance</li> </ul>	<b>BOARD INVESTMENT &amp; CREDIT COMMITTEE (BICC)</b> <ul style="list-style-type: none"> <li>• Investment &amp; Credit Approval</li> <li>• Asset Liability Management</li> <li>• Provisions</li> </ul>	<b>BOARD AUDIT COMMITTEE (BAC)</b> <ul style="list-style-type: none"> <li>• Internal Audit</li> <li>• External Audit</li> <li>• Accounting Policies</li> <li>• Compliance</li> <li>• Anti Money Laundering</li> </ul>	<b>BOARD RISK MANAGEMENT COMMITTEE (BRMC)</b> <ul style="list-style-type: none"> <li>• Risk Management</li> <li>• Policies related to Risk Management</li> </ul>

Executive / Management Committee Structure

The Board of Directors delegates the authority for day-to-day management of the business to the Chief Executive Officer who is responsible for implementing the Bank’s strategic plan. The CEO manages the Bank through the following management committees.

EXECUTIVE/MANAGEMENT COMMITTEES

CHIEF EXECUTIVE OFFICER			
<b>MANAGEMENT COMMITTEE</b> <ul style="list-style-type: none"> <li>• Strategy</li> <li>• Performance Review</li> <li>• Budget</li> <li>• Human Resources</li> <li>• Administration</li> </ul>	<b>ASSET LIABILITY MANAGEMENT COMMITTEE</b> <ul style="list-style-type: none"> <li>• Balance Sheet Management</li> <li>• Funding</li> <li>• Liquidity</li> <li>• Banking Relationships</li> </ul>	<b>EXECUTIVE CREDIT &amp; INVESTMENT COMMITTEE</b> <ul style="list-style-type: none"> <li>• Review of Investments, Exit and Credit Proposals</li> <li>• Monitoring of Investments</li> </ul>	<b>EXECUTIVE RISK MANAGEMENT COMMITTEE</b> <ul style="list-style-type: none"> <li>• Risk Management Policies</li> <li>• Risk Review</li> <li>• Provisions and Impairment</li> </ul>



## Branch Opening



The opening of KHCB main branch in the Financial Mall at BFH.

## Risk Management

### Risk Management Framework

Risk is inherent in the Bank's business and effective management of that risk is seen as a core requirement to create shareholder value. The Board of Directors of the Bank has overall responsibility for establishing the Bank's risk culture and ensuring that an effective risk management framework is in place. The Board approves and periodically reviews the risk management policies and risk strategies of the Bank.

The assumption of risks by the Bank is guided by certain fundamental principles such as protection of investor and shareholder funds by adoption of sound credit and investment analysis, adoption of effective "risk reward" strategy to optimize stakeholders' returns, adherence to prudent levels of exposure concentration, while focusing on the target market segments such as high net worth individuals, corporate and public sector clients and products which generate high profitability and growth. The Board has established an Executive Risk Management Committee (ERMC), which is responsible for developing and implementing the Bank's risk management policies in all areas of the Bank's operations. The committee consists of heads of business and other functional units in the Bank and reports regularly to the Board Risk Management Committee. The Risk Management Department of the Bank, independent of the business units, is responsible for the day to day oversight and management of the various risks faced by the Bank. The Risk Management Department, together with the Internal Audit and Compliance Departments, provides independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board of Directors.

### Risk Policies

The Bank's risk management policies are established to identify and analyze the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor adherence to such limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, as well as products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive

control environment, in which all employees understand their roles and obligations. The Bank's risk policies identify approval authorities, reporting requirements, and the procedures for referring risk related issues to executive management, ERMC and the Board, as appropriate. Policies are in place to address all major categories of risk including liquidity, investment and credit, currency, operational, legal and regulatory risks.

### Credit and Investment Risk

The Bank has well defined policies for managing credit and investment risks. These include delegated approval authority limits, concentration limits, maximum exposure limits, counterparty limits etc. Credit and investment limits, are approved after thorough assessment of counterparty, legal and market risks associated with the project. In most cases exposures are fully or partially secured by collateral securities. The Board of Directors has delegated responsibility for the management of credit and investment risk to its Executive Risk Management Committee (ERMC). A separate Bank Risk and Credit Management Department independent of the business units is responsible for oversight of the Bank's credit and investment risk. Fair valuation of the investments and impairment tests for credit exposures take place periodically as per the Bank's approved policies. This exercise is performed by the business units with inputs from Risk Management Department and is followed by a review by the external auditors. It is the Bank's policy to ensure that adequate provisions are made for expected credit or investment losses. The Bank's policy on Impairment & Provisioning lays down guidelines for the creation of adequate allowance for impairment losses that represents the estimated future loss on its portfolio.

### Market Risks

Market risk is the risk that changes in market parameters, such as profit rates, equity prices, foreign exchange rates and credit spreads, (not relating to changes in the obligor's / issuer's credit standing), will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control

market risk exposures within acceptable parameters, while optimizing the return on risk. As on date, the Bank does not have an active trading book and therefore the impact of market volatility on the Bank's revenues is well defined and under control.

### Operational Risk

Operational risk is the risk of loss arising from systems and control failures, as well as fraud and human errors, which can result in financial and reputation loss and legal and regulatory consequences. The Bank manages operational risk through appropriate controls including a framework of policies and procedures to identify, control and manage these risks, an established system of segregation of duties, as well as through internal checks and balances, including internal audit and compliance. The Bank undertakes operational risk assessment in all divisions as part of internal risk assessment process. The risk parameters are monitored through an operational risk management software and the findings are periodically reported to the Board of Directors.

### Liquidity Risk

Liquidity risk is defined as the risk that funds will not be available to meet liabilities as they fall due. The Asset and Liability Management committee (ALCO), which is chaired by the CEO and has senior executives of the Bank as members, has overall responsibility for managing the balance sheet and liquidity of the Bank. ALCO provides broad guidelines with regard to minimum liquid assets to be maintained and uses a maturity ladder approach for managing and monitoring the liquidity risk. The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

### Profit Rate Risk

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of changes in market profit rates. The Bank's policy on profit rate risk management aims to assist in the identification, measurement, monitoring, control and reporting of profit

rate risks in a timely manner. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for repricing bands. The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios.

### Foreign Exchange Risk

Foreign exchange risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank's foreign exchange risk is managed on the basis of limits on net open positions set by the Board of Directors and a continuous assessment of current and expected exchange rate movements. The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various foreign exchange scenarios. The Bank does not engage in foreign exchange trading and, where necessary, matches currency exposures inherent in certain assets with liabilities in the same or correlated currency.

### Legal and Regulatory Risk

Legal risk includes the risk of unexpected loss from transactions and/or contracts not being enforceable under applicable laws or from unsound documentation. The Bank manages the legal risk through effective use of internal and external legal advisers. Regulatory risk includes the risk of non-compliance with regulatory and legal requirements. The Bank has established a compliance function, to act as the coordinating department in respect of matters relating to the regulator, i.e. CBB. The Compliance Department is also responsible for the Bank's anti-money laundering initiatives.

### Capital Adequacy & the Internal Capital Adequacy Assessment Process (ICAAP)

The Bank's regulatory capital adequacy ratio is calculated in accordance with the guidelines issued by the CBB. In accordance with the Basel II guidelines, CBB requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. In addition to the above,

the Board of Directors has approved an Internal Capital Adequacy Assessment Process (ICAAP), which seeks to relate capital adequacy to risks not covered under the regulatory mechanism to maintain investor, creditor and market confidence and to sustain future development of the business. The ICAAP is a requirement under Pillar 2 of the Basel II accord and seeks to ensure appropriate identification, measurement, aggregation and monitoring of the Bank's risks and to relate the level of internal capital of the Bank to its overall risk profile and business plan. The Bank has adopted a structured approach to identify and assess capital required for each of the major risk categories by employing appropriate methodologies and the total of such individual risk capitals is taken as the overall capital requirement. The ICAAP also incorporates guidelines to assess the future capital needs of the Bank in line with its business plans over its strategic time horizon.

### Stress Testing

Regulatory and internal capital adequacy computations are based on past data. While future projections are done, these are on the assumption that the business environment continues to be normal. It is essential for the Bank to measure sensitivity of its capital to changes in external and internal risk environment and changes in business cycles. The Bank has developed a stress testing model for the purpose. The first step in the process is identifying relevant stress factors that can affect the bank's revenues, liquidity, asset quality, business growth etc. Each item in the Bank's balance sheet is then revalued on the basis of different combinations of these risk factors and at various levels of severity. The capital adequacy levels at these stress scenarios

are computed on current as well as forecasted balance sheets to identify the likely worst case scenarios and to take preventive management actions where necessary.

### Reputational Risk

Reputational risk is the risk that negative perception regarding the Bank's business practices or internal controls, whether true or not, will cause a decline in the Bank's investor base. Such a development may also lead to costly litigation that would in turn have an adverse impact on liquidity or capital of the Bank. The senior management, through the relevant committees, examines issues that can have adverse impact on the Bank's reputation and issues guidelines to address these. The Bank also under its ICAAP provides separate capital against this risk.

### Disclosures

The Bank recognizes its continuous disclosure obligations set forth by the Central Bank of Bahrain (CBB), Bahrain Stock Exchange and other relevant regulatory bodies. The Bank has approved policies related to external communications & disclosures in line with Basel & CBB requirements which ensure disclosure of all relevant information to stakeholders in a timely manner. The Pillar 3 disclosure requirements prescribed by the Central Bank of Bahrain (CBB) are part of this annual report.

## Report of Shari'a Supervisory Board

On the Activities of Khaleeji Commercial Bank BSC  
for The Financial Year Ending 31 December 2009

*In the name of Allah, the Beneficent, the Merciful  
Prayers and Peace Upon the Last Apostle and Messenger,  
Our prophet Mohammed, His Family and companions.*

The Shari'a Supervisory Board ("SSB") of Khaleeji Commercial Bank has reviewed the Bank's activities through its annual review and through the Shari'a Compliance Department and compared them with the previously issued fatwas and rulings during the financial year ending 31 December 2009 and found them compatible with the already issued fatwas and rulings.

The Shari'a Compliance Department in collaboration with the SSB has audited the Shari'a aspects arising from the Bank's businesses, and submitted its report to the SSB, which in turn, reviewed the observations contained therein, and emphasized that the management must be in compliance with the rules and principles of Islamic Shari'a. The SSB has decided based on this report and the jobs done by Shari'a Compliance Department to supervised the Banks adherence to the decisions and fatwa's of the SSB under rules and principles of Islamic Sharia'a.

The SSB believes that it has expressed its opinion in respect of the activities carried on by the Bank and it

is the responsibility of the management to ensure the implementation of such decisions. It is the duty of the SSB to express an independent opinion on the basis of its control and review of the Bank's operations and to prepare a report about them.

A representative of the Bank's management explained and clarified the contents of the Balance Sheet, attached notes and Income Statement for the financial year ended on 31st December 2009 to our satisfaction. The report of the SSB has been prepared based on the contents provided by the Bank.

The SSB is further satisfied that any income which is not in compliance with the Glorious Islamic Shari'a has been dispersed to charity account and that the responsibility of the payment of the Zakat lies with the shareholders in their shares.

The SSB is satisfied that the Bank's activities and services are in compliance with the Glorious Islamic Shari'a.

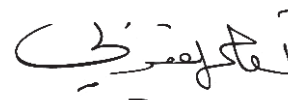
Praise be to Allah, Lord of the Worlds.  
Prayers on Prophet Mohammed (Peace Be Upon Him),  
all his Family and companions.



**Dr. Fareed Yaqoob Al Miftah**  
Chairman



**Dr. Fareed Mohammed Hadi**  
Executive Member



**Sh. Nizam Mohammed Saleh Yaquby**  
Member

# Independent Auditors' Report to the Shareholders

Khaleeji Commercial Bank BSC  
9 February 2010  
Manama, Kingdom of Bahrain

## Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Khaleeji Commercial Bank B.S.C. ("the Bank") and its subsidiaries (together the "Group"), which comprise the consolidated statement of financial position as at 31 December 2009, and the consolidated income statement, the consolidated statement of changes in equity, the consolidated statement of cash flows, the consolidated statement of changes in restricted investment accounts and the consolidated statement of sources and uses of charity fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## Respective responsibilities of board of directors and auditors

These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a rules and principles are the responsibility of the board of directors of the Bank. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

## Basis of opinion

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by Accounting and Auditing Organisation for Islamic Financial Institutions. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as

evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

## Opinion

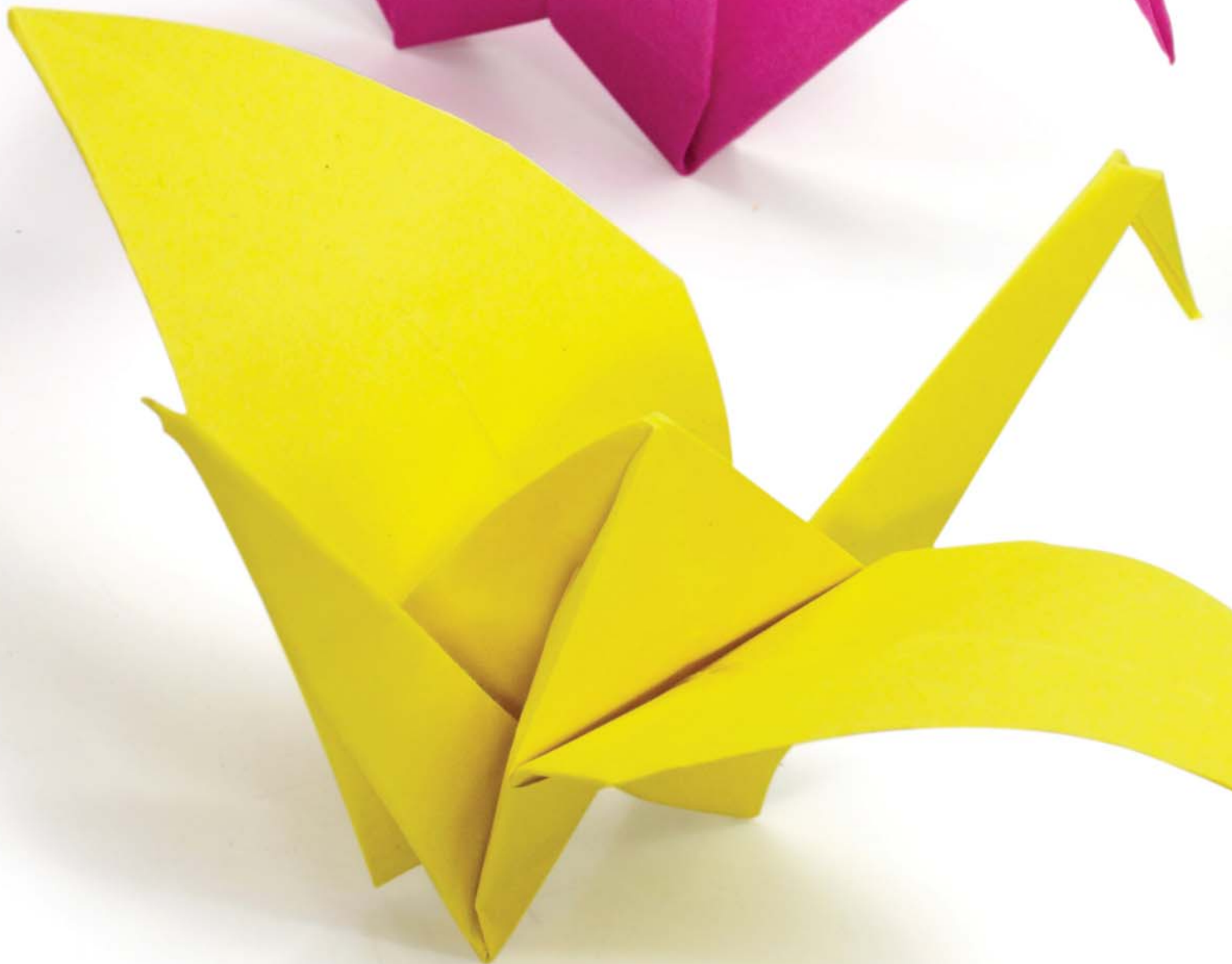
In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2009 and the results of its operations, its cash flows and changes in equity, restricted investment accounts and sources and uses of charity fund for the year then ended, in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

## Report on other legal and regulatory requirements

In addition, in our opinion, the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith. We have reviewed the accompanying report of the chairman and confirm that the information contained therein is consistent with the consolidated financial statements. We are not aware of any violations of the Bahrain Commercial Companies Law 2001, the Central Bank of Bahrain and Financial Institutions Law 2006, terms of the Bank's license or its memorandum and articles of association having occurred during the year that might have had a material effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by the management in response to all our requests.

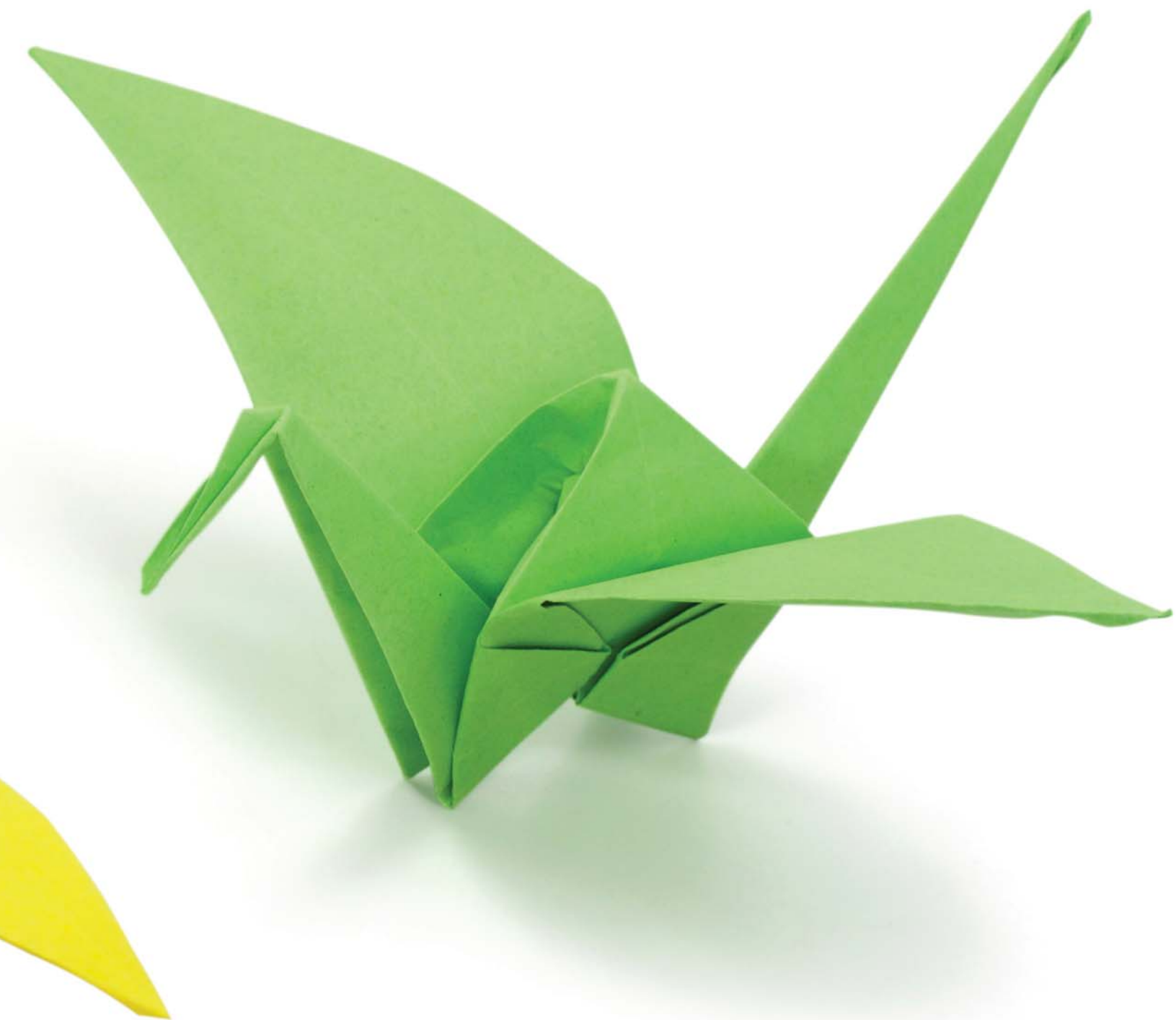


**KPMG**  
9 February 2010



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## Consolidated Financial Statements



## 28 Consolidated Statement of Financial Position

as at 31 December 2009

	Note	2009	BD 000's 2008
<b>ASSETS</b>			
Cash and bank balances	3	19,975	23,378
Placements with financial institutions	4	122,193	131,952
Islamic financing assets	5	192,085	140,143
Investment securities	6	92,354	102,398
Assets acquired for leasing	7	8,544	18,511
Lease rentals receivables	7	4,889	4,971
Asset held-for-sale	8	4,852	5,655
Investment in associates	9	6,521	6,385
Other assets	10	17,843	26,077
Equipment	11	4,348	5,523
<b>Total assets</b>		<b>473,604</b>	<b>464,993</b>
<b>LIABILITIES</b>			
Placements from financial institutions and others		101,730	30,229
Customers' current accounts		35,097	122,383
Other liabilities	12	6,615	11,583
<b>Total liabilities</b>		<b>143,442</b>	<b>164,195</b>
<b>Unrestricted Investment Accounts</b>	<b>13</b>	<b>203,588</b>	<b>162,816</b>
<b>EQUITY</b>			
Share capital	14	104,924	100,000
Share premium		958	581
Statutory reserve		6,298	5,988
Treasury shares		(5,216)	(4,915)
Unvested employee incentive scheme shares		(1,648)	(2,380)
Share grant reserve		367	442
Available-for-sale investments fair value reserve		30	-
Retained earnings		20,861	38,266
<b>Total equity (page 30)</b>		<b>126,574</b>	<b>137,982</b>
<b>Total liabilities, Unrestricted Investment Accounts and equity</b>		<b>473,604</b>	<b>464,993</b>
<b>Off-balance sheet items</b>			
Restricted investment accounts (page 33)		46,742	47,445

The consolidated financial statements, which consist of pages 28 to 79, were approved by the Board of directors on 9 February 2010 and signed on its behalf by:



**Dr. Fuad Abdulla Al-Omar**  
Chairman



**Ebrahim Hussain Ebrahim**  
Chief Executive Officer &  
Board member

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

for the year ended 31 December 2009

			BD 000's
	Note	2009	2008
Income from investment banking services		13,798	34,487
Placement, management and arrangement fees		1,013	1,349
Income from placements with financial institutions		1,477	3,612
Income from Islamic financing assets and assets acquired for leasing		15,024	10,628
Income from investment securities	15	1,280	2,651
Share of profits from associate companies	9	136	762
Other income		504	1,289
<b>Total income before return on Unrestricted Investment Accounts</b>		<b>33,232</b>	<b>54,778</b>
Less: Return on Unrestricted Investment Accounts	13	(9,331)	(7,050)
<b>Total net income</b>		<b>23,901</b>	<b>47,728</b>
Staff cost	16	5,073	7,992
Financing expenses		1,270	2,190
Investments related expenses		664	861
Other expenses	18	4,537	3,557
<b>Total expenses</b>		<b>11,544</b>	<b>14,600</b>
<b>Profit for the year before impairment allowances</b>		<b>12,357</b>	<b>33,128</b>
Impairment allowances	17	(9,257)	(5,824)
<b>PROFIT FOR THE YEAR</b>		<b>3,100</b>	<b>27,304</b>
Basic earnings per share (fils)	23	3.04	26.52
Diluted earnings per share (fils)	23	3.04	26.32

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

## 30 Consolidated Statement of Changes In Equity

for the year ended 31 December 2009

BD 000's

2009	Share capital	Share premium	Statutory reserve	Treasury shares	Unvested employee incentive scheme shares	Share grant reserve	Available-for-sale investments fair value reserve	Retained earnings	Total
Balance at 1 January 2009	100,000	581	5,988	(4,915)	(2,380)	442	-	38,266	137,982
Fair value changes	-	-	-	-	-	-	30	-	30
Profit for the year	-	-	-	-	-	-	-	3,100	3,100
<b>Total recognised income and expense for the year</b>	-	-	-	-	-	-	30	3,100	3,130
Transfer to statutory reserve	-	-	310	-	-	-	-	(310)	-
Treasury shares acquired	-	-	-	(1,581)	-	-	-	-	(1,581)
Treasury shares sold	-	-	-	1,280	-	-	-	-	1,280
Vesting charge for the year	-	-	-	-	-	434	-	-	434
Adjustment for vesting and issue of shares	-	377	-	-	732	(509)	-	-	600
Transfer to charity fund (2008)	-	-	-	-	-	-	-	(250)	(250)
Bonus shares (2008)	4,924	-	-	-	-	-	-	(4,924)	-
Directors fees (2008)	-	-	-	-	-	-	-	(250)	(250)
Dividend declared (2008)	-	-	-	-	-	-	-	(14,771)	(14,771)
<b>Balance at 31 December 2009</b>	<b>104,924</b>	<b>958</b>	<b>6,298</b>	<b>(5,216)</b>	<b>(1,648)</b>	<b>367</b>	<b>30</b>	<b>20,861</b>	<b>126,574</b>
2008	Share capital	Share premium	Statutory reserve	Treasury shares	Unvested employee incentive scheme shares	Share grant reserve	Available-for-sale investments fair value reserve	Retained earnings	Total
Balance at 1 January 2008	100,000	-	3,258	-	-	2,630	-	29,102	134,990
Profit for the year	-	-	-	-	-	-	-	27,304	27,304
Total recognised income and expense for the year	-	-	-	-	-	-	-	27,304	27,304
Transfer to statutory reserve	-	-	2,730	-	-	-	-	(2,730)	-
Treasury shares acquired	-	-	-	(8,368)	-	-	-	-	(8,368)
Treasury shares sold	-	-	-	3,453	-	-	-	-	3,453
Treasury shares acquired for employee incentive scheme (note 20)	-	-	-	-	(3,648)	-	-	-	(3,648)
Reserve utilised towards acquisition of shares for employee incentive scheme	-	-	-	-	-	(2,106)	-	-	(2,106)
Vesting charge for the year	-	-	-	-	-	499	-	-	499
Adjustment for vesting and issue of shares	-	581	-	-	1,268	(581)	-	-	1,268
Transfer to charity fund (2007)	-	-	-	-	-	-	-	(250)	(250)
Directors fees (2007)	-	-	-	-	-	-	-	(160)	(160)
Dividend declared (2007)	-	-	-	-	-	-	-	(15,000)	(15,000)
Balance at 31 December 2008	100,000	581	5,988	(4,915)	(2,380)	442	-	38,266	137,982

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

for the year ended 31 December 2009

	Note	2009	BD 000's 2008
<b>OPERATING ACTIVITIES</b>			
Proceeds from investment banking services		27,422	28,390
Islamic financing, net		(43,392)	(56,881)
Placement, management and arrangement fees received		1,013	2,480
Income from placements with financial institutions received		1,477	3,612
Returns paid to Unrestricted Investment Accounts		(8,938)	(6,159)
Receipts from unrestricted Investment Account Holders, net		40,772	98,716
Payment for expenses		(12,798)	(9,846)
Receipts from / (disbursements) for lease assets, net		10,049	(10,339)
Directors fees paid		(250)	(160)
Net (decrease)/increase in customers' current accounts		(87,286)	98,831
Proceeds from other income		504	324
Net receipt/(payment) in CBB reserve account		5,679	(9,549)
<b>Cash flows from operating activities</b>		<b>(65,748)</b>	<b>139,419</b>
<b>INVESTING ACTIVITIES</b>			
Purchase of investment securities		(7,663)	(50,150)
Proceeds from sale of investment securities		17,897	11,912
Payment for advance towards investment securities		(9,583)	-
Dividend/ income from investment securities received		1,481	5,045
Distributions from investment in associates received		-	1,060
Purchase of asset held-for-sale		-	(5,655)
Proceeds from sale of asset held-for-sale		1,070	-
Proceeds from sale of investments in properties		-	621
Purchase of equipment and capital advances made		(135)	(4,620)
<b>Cash flows from investing activities</b>		<b>3,067</b>	<b>(41,787)</b>
<b>FINANCING ACTIVITIES</b>			
Placements from financial institutions and other, net		71,501	(11,332)
Payment for treasury shares, net		(301)	(4,915)
Purchase of treasury shares for employee incentive scheme		-	(3,648)
Finance expenses paid		(1,270)	(2,190)
Dividends paid		(14,732)	(15,000)
<b>Cash flows from financing activities</b>		<b>55,198</b>	<b>(37,085)</b>
<b>Net (decrease) / increase in cash and cash equivalents</b>		<b>(7,483)</b>	<b>60,547</b>
Cash and cash equivalents at 1 January		142,716	82,169
<b>Cash and cash equivalents at 31 December</b>		<b>135,233</b>	<b>142,716</b>
Cash and cash equivalent comprise:			
Cash and bank balances (excluding CBB reserve account)	3	13,040	10,764
Placements with financial institutions	4	122,193	131,952
		<b>135,233</b>	<b>142,716</b>

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

## 32 Consolidated Statement of Changes In Restricted Investment Accounts

for the year ended 31 December 2009

BD 000's

31 December 2009	Balance at 1 January 2009			Movements during the year						Balance at 31 December 2009		
	No of units (000)	Average value per share BD	Total BD 000's	Investment (withdrawals) BD 000's	Revaluation BD 000's	Gross income BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Administration expenses BD 000's	No of units (000)	Average value per share BD	Total BD 000's
Al Hareth French Property Fund	17.05	537.97	9,172	-	31	159	(159)	-	-	17.05	539.76	9,203
Safana Investment WLL (RIA 1)	9,563	1.00	9,563	-	-	-	-	-	-	9,563	1.00	9,563
Janayen Holding Limited (RIA 4)	52,685	0.39	20,610	-	-	2,248	(1,911)	-	(2,142)	52,685	0.36	18,805
Shaden Real Estate Investment WLL (RIA 5)	8,100	1.00	8,100	-	-	-	-	-	-	8,100	1.00	8,100
Locata Corporation Pty Ltd (RIA 6)	-	-	-	1,071	-	-	-	-	-	2,841	0.38	1,071
			47,445	1,071	31	2,407	(2,070)	-	(2,142)			46,742

31 December 2008	Balance at 1 January 2008			Movements during the year						Balance at 31 December 2008		
	No of units (000)	Average value per share BD	Total BD 000's	Investment (withdrawals) BD 000's	Revaluation BD 000's	Gross income BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Administration expenses BD 000's	No of units (000)	Average value per share BD	Total BD 000's
Al Hareth French Property Fund	17.05	556.51	9,489	-	(317)	918	(871)	(46)	(1)	17.05	537.95	9,172
Safana Investment WLL (RIA 1)	9,563	1.00	9,563	-	-	-	-	-	-	9,563	1.00	9,563
Hajer Tower, Mecca (RIA 2)	3,021	0.377	1,139	(1,139)	-	170	(170)	-	-	-	-	-
Aramis (RIA 3)	7,685	0.377	2,912	(2,912)	-	-	-	-	-	-	-	-
Janayen Holding Limited (RIA 4)	52,684	0.377	19,862	-	-	3,506	(2,180)	-	(578)	52,684	0.39	20,610
Shaden Real Estate Investment WLL (RIA 5)	-	-	-	8,100	-	-	-	-	-	8,100	1.00	8,100
			42,965	4,049	(317)	4,594	(3,221)	(46)	(579)			47,445

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

for the year ended 31 December 2009

	2009	2008
		BD 000's
<b>Sources of charity</b>		
Contributions by the Bank	250	250
Non-Islamic income	1	4
Late payment fees collected from customers	-	32
<b>Total sources</b>	<b>251</b>	<b>286</b>
<b>Uses of charity</b>		
Contributions to charitable organisations	100	-
<b>Total uses</b>	<b>100</b>	<b>-</b>
<b>Excess of sources over uses</b>	<b>151</b>	<b>286</b>
Balance at the beginning of the year	442	156
<b>Undistributed charity fund at 31 December (note 12)</b>	<b>593</b>	<b>442</b>

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

### 1 Incorporation and Principal Activity

Khaleeji Commercial Bank BSC (“the Bank”) was incorporated on 24 November 2004 in the Kingdom of Bahrain under Commercial Registration No. 55133. The Bank operates under a retail banking license granted by the Central Bank of Bahrain (“CBB”) on 20 October 2003. The Bank’s shares are listed on the Bahrain Stock Exchange (BSE).

The Bank’s activities are regulated by the Central Bank of Bahrain (CBB) and supervised by a Religious Supervisory Board whose role is defined in the Bank’s Articles of Association.

The principal activities of the Bank include financing real estate and related activities, investment advisory services, other retail banking services and investment transactions which comply with Islamic Shari’a rules and principles according to the opinion of the Bank’s Shari’a Supervisory Board.

#### Consolidated financial statements

The Bank has a wholly owned subsidiary, Hawafiz Khaleeji Management Company BSC (c) (‘Hawafiz’), to manage its employee incentive scheme. In the normal course of its business, the Bank also sets-up other special purpose entities as subsidiaries to hold stake in certain proprietary investments. The financial statements for the year ended 31 December 2009 has been prepared on a consolidated basis and comprise the financial statements of the Bank and its subsidiaries (together referred to as “the Group”) and the Group’s interest in associates.

### 2 Significant Accounting Policies

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been consistently applied by the Group and are consistent with those used in the previous year.

#### (a) Statement of compliance

The financial statements have been prepared in accordance with Financial Accounting Standards (‘FAS’) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). In line with the requirement of AAOIFI and the CBB Rule Book, for matters that are not covered by AAOIFI standards, the Group uses guidance from the relevant International Financial Reporting Standards.

#### (b) Basis of preparation

The consolidated financial statements are presented in Bahraini Dinars, being the principal currency of the Bank’s operations. They are prepared on the historical cost basis except for the measurement at fair value of certain available-for-sale investments and risk management instruments.

The Group classifies its expenses in the income statement by the nature of expense method.

The preparation of the consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group’s accounting policies. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and the Group’s consolidated financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 20.

## 2 Significant accounting policies (continued)

### (c) Basis of consolidation

#### (i) Subsidiaries

The consolidated financial statements of the Group comprise the financial statements of the Bank and its subsidiaries. Subsidiaries are those enterprises (including special purpose entities) controlled by the Bank. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases.

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of a specific borrowing or investment transaction. An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the SPE's risks and rewards, the Group concludes that it controls the SPE. The assessment of whether the Group has control over an SPE is carried out at inception and normally no further reassessment of control is carried out in the absence of changes in the structure or terms of the SPE, or additional transactions between the Group and the SPE. Where the Group's voluntary actions, such as lending amounts in excess of existing liquidity facilities or extending terms beyond those established originally, change the relationship between the Group and an SPE, the Group performs a reassessment of control over the SPE. The Group in its fiduciary capacity manages and administers assets held in trust and other investment vehicles on behalf of investors. The financial statements of these entities are not included in these consolidated financial statements except when the Group controls the entity. Information about the Group's fiduciary assets under management is set out in note 21.

#### (ii) Associates

Associates are those enterprises in which the Group holds, directly or indirectly, more than 20% of the voting power and exercises significant influence, but not control, over the financial and operating policies. Investments in associates are initially recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

#### (iii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Intra-group gains on transactions between the Group and its equity accounted associates are eliminated to the extent of the Group's interest in the investees. Unrealised losses are also eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment. Accounting policies of the subsidiaries and associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

#### (d) Foreign currency transactions

Items included in the consolidated financial statements of the Group are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Bahraini Dinars, which is the Bank's functional and presentation currency.

## 2 Significant accounting policies (continued)

Foreign currency transactions are translated using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary items carried at their fair value, such as certain available-for-sale equity securities, are included in investments fair value reserve.

The other Group companies functional currencies are either denominated in Bahraini dinars or US dollars which is effectively pegged to the Bahraini dinar. Hence, the translation of financial statements of the group entities that have a functional currency different from the presentation currency do not result in exchange differences.

### (e) Investment securities

Investment securities comprise equity investments in entities where the Bank holds less than 20% of the equity interest in an entity and investments in sukuk (Islamic bonds). Investment securities exclude investments in subsidiaries and associate companies.

#### (i) Classification

The Group allocates its investments to the following categories: trading; held-to-maturity investments and available-for-sale investments.

**Trading investments** are those investments which the Group acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed together for short-term profit or position taking. The Bank currently does not have a trading portfolio.

**Held-to-maturity investments** are securities with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity, and which are not designated as trading or as available-for-sale. These include investments in medium to long-term sukuk.

Available-for-sale investments are those investments that are not classified as trading investments or are held-to-maturity. These include investments in certain quoted and unquoted equity securities and short-term sukuk which the Bank may not hold till maturity.

#### (ii) Recognition and de-recognition

Investment securities are recognised at the trade date i.e. the date that the Group contracts to purchase or sell the asset, at which date the Group becomes party to the contractual provisions of the instrument. Investment securities are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risk and rewards of ownership.

#### (iii) Measurement

Investment securities are measured initially at fair value, which is the value of the consideration given. Trading investments are initially recognised at fair value and transaction cost are expensed in the income statement. Other investment securities are recognised initially at fair value, plus attributable transaction costs.

Subsequent to initial recognition, trading and available-for-sale investments are re-measured to fair value. Gains and losses arising from a change in the fair value of trading investments are recognised in the income statement in the period in which they arise. Gains and losses arising from a change in the fair value of available-for-sale investments are recognised in the

## 2 Significant accounting policies (continued)

consolidated statement of changes in equity and presented in a separate fair value reserve within equity. When the available-for-sale investments are sold, impaired, collected or otherwise disposed of, the cumulative gain or loss previously recognised in the statement of changes in equity is transferred to the income statement.

Available-for-sale investments which do not have a quoted market price or other appropriate methods from which to derive reliable fair values, are stated at cost less impairment allowances.

Subsequent to initial recognition, held-to-maturity investments are measured at amortised cost using the effective profit method less any impairment allowances.

### (iv) Measurement principles

#### Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus capital repayments, plus or minus the cumulative amortisation using the effective profit method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment. The calculation of the effective profit rate includes all fees and points paid or received that are an integral part of the effective profit rate.

#### Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

The Group measures the fair value of quoted investments using the market bid-prices in an active market for that instrument.

### (f) Islamic financing assets

Islamic financing assets comprise shari'a compliant financing provided by the Group with fixed or determinable payments. These include financing provided through Murabaha, Musharaka, Istisna and Wakala contracts. Islamic financing assets are recognised on the date at which they are originated and are carried at their amortised cost less impairment allowances, if any.

### (g) Placements with and from financial institutions

These mainly comprise inter-bank placements made and received using shari'a compliant contracts. Placements are usually for short-term and are stated at their amortised cost.

### (h) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash and balances and placement with financial institutions with maturities of three months or less when acquired which are subject to insignificant risk of changes in fair value and are used by the Group in the management of its short-term commitments.

### (i) Risk management instruments

The Bank enters into shari'a compliant foreign exchange risk management transactions to hedge economic risks to cover significant open positions under its risk management guidelines. The Group also enters into shari'a compliant foreign exchange risk management instruments on behalf of its customers/ projects on a back-to-back basis and does not retain significant open positions.

**2 Significant accounting policies (continued)**

These derivative-type risk management instruments are initially recognised at fair value on the date on which the contract is entered into and are subsequently re-measured at their fair value. The fair value of such instruments is the equivalent of the unrealised gain or loss from marking to market the instrument using prevailing market rates. Instruments with positive market values (unrealised gains) are disclosed under other assets and instruments with negative market values (unrealised losses) are disclosed under other liabilities in the Statement of financial position. For risk management instruments that are not designated in a qualifying hedge relationship, all changes in its fair value are recognised immediately in the income statement.

**(j) Assets acquired for leasing**

Assets acquired for leasing (Ijarah Muntahia Bittamleek) are stated at cost less accumulated depreciation and any impairment in value. Under the terms of lease, the legal title of the leased asset passes to the lessee at the end of the lease term, provided that all lease instalments are settled. Depreciation is calculated on a straight line basis at rates that systematically reduce the cost of the leased assets over the period of the lease. The Group assesses at each statement of financial position date whether there is objective evidence that the assets acquired for leasing are impaired. Impairment losses are measured as the difference between the carrying amount of the asset and the estimated recoverable amount. Impairment losses, if any, are recognised in the income statement.

**(k) Assets held-for-sale**

The Group classifies non-current assets or disposal groups as held for sale if its carrying amount is expected to be recovered principally through a sale transaction rather than through continuing use within twelve months. Non-current assets or disposal groups classified as held for sale are measured at the lower of its carrying amount and fair value less costs to sell.

If the criteria for classification as held for sale are no longer met, the entity shall cease to classify the asset (or disposal group) as held for sale and shall measure the asset at the lower of its carrying amount before the asset (or disposal group) was classified as held for sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale and its recoverable amount at the date of the subsequent decision not to sell. The Bank continues to classify non-current assets or disposal groups as held for sale where events or circumstances beyond the control of the Bank extend the period to complete the sale beyond twelve months and the Bank remains committed to its plan to sell.

**(l) Equipment**

Equipment is stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method to write-off the cost of the assets over their estimated useful lives ranging from 3 to 5 years. The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each statement of financial position date.

**(m) Impairment of assets**

The Group assesses at each statement of financial position date whether there is objective evidence that an asset is impaired. Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of financing facility or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

## 2 Significant accounting policies (continued)

### Financial assets carried at amortised cost

For financial assets carried at amortised cost impairment is measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses are recognised in income statement and reflected in an allowance account. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the income statement. The Group considers evidence of impairment for financial assets carried at amortised cost at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. All individually significant financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Financial assets that are not individually significant are collectively assessed for impairment by grouping together assets with similar risk characteristics.

### Available-for-sale investments

In the case of investments in equity securities classified as available-for-sale and measured at fair value, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale investments, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in income statement – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are subsequently reversed through equity.

For available-for-sale investments carried at cost, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

### Other non-financial assets

The carrying amount of the Group's assets (other than for financial assets covered above), are reviewed at each statement of financial position date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. The recoverable amount of an asset is the greater of its value in use or fair value less costs to sell. An impairment loss is recognised whenever the carrying amount of an asset exceeds its estimated recoverable amount.

Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount.

### (n) Customers' current accounts

Balances in current (non-investment) accounts are recognised when received by the Bank. The transactions are measured by the amount received by the Bank at the time of contracting. At the end of the accounting period, the accounts are measured at their book value.

### (o) Unrestricted Investment Accounts

Unrestricted investment accounts are funds held by the Bank, which it can invest at its own discretion. The unrestricted investment account holder authorises the Bank to invest the account holders' funds in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested.

The Bank charges management fee (Mudarib fees) to unrestricted investment account holders. Of the total income from unrestricted investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions,

## 2 Significant accounting policies (continued)

reserves (Profit equalisation reserve and Investment risk reserve) and deducting the Bank's share of income. The allocation of income is determined by the management of the Bank within the allowed profit sharing limits as per the terms and conditions of the unrestricted investment accounts. Administrative expenses incurred in connection with the management of the funds are borne directly by the Bank and are not charged separately to investment accounts.

Unrestricted investment accounts are carried at their book values and include amounts retained towards profit equalisation and investment risk reserves. Profit equalisation reserve is the amount appropriated by the Bank out of the Mudaraba income, before allocating the mudarib share, in order to maintain a certain level of return to the deposit holders on the investments. Investment risk reserve is the amount appropriated by the Bank out of the income of unrestricted investment account holders, after allocating the mudarib share, in order to cater against future losses for investment account holders. Creation of these reserves results in an increase in the liability towards the pool of unrestricted investment accounts.

### (p) Restricted Investment Accounts

Restricted investment accounts represents assets acquired by funds provided by holders of restricted investment accounts and their equivalent and managed by the Bank as an investment manager based on either a Mudaraba contract or agency contract. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders. Assets that are held in such capacity are not included as assets of the Bank in the consolidated financial statements.

### (q) Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee contract is recognised from the date of its issue. The liability arising from a financial guarantee contract is recognised at the present value of any expected payment, when a payment under the guarantee has become probable.

### (r) Treasury shares

The amount of consideration paid including all directly attributable costs incurred in connection with the acquisition of the treasury shares are recognised in equity. Consideration received on sale of treasury shares is presented in the financial statements as a change in equity. No gain or loss is recognised on the Group's income statement on the sale of treasury shares.

### (s) Statutory reserve

The Bahrain Commercial Companies Law 2001 requires that 10 percent of the annual net profit be appropriated to a statutory reserve which is normally distributable only on dissolution. Appropriations may cease when the reserve reaches 50 percent of the paid up share capital.

### (t) Revenue recognition

**Income from investment banking services** is recognised as per contractual terms when the service is provided and income is earned. This is usually when the Bank has performed all significant acts in relation to a transaction and it is highly probable that the economic benefits from the transaction will flow to the Bank. Significant acts in relation to a transaction is determined based on the terms agreed in the private placement memorandum/ contracts for each transaction. Income from investment banking services received in-kind in the form of shares is measured at the fair value of the consideration received. Generally the shares received are in privately held entities and there is no immediate market for trading. Fair value of consideration received in-kind is measured by reference to the transaction price paid by investors and as per the agreed pricing terms specified in the private placement memorandums.

## 2 Significant accounting policies (continued)

**Fees and commission income** that are integral to the effective profit rate on a financial asset carried at amortised cost are included in the measurement of the effective profit rate of the financial asset. Other fees and commission income, including account servicing fees, sales commission, management fees, placement and arrangement fees and syndication fees, are recognised as the related services are performed.

**Income from Murabaha contracts** are recognised on a time-apportioned basis over the period of the contract. Profit or losses in respect of the Bank's share in **Musharaka financing** transaction that commence and end during a single financial period is recognised in the income statement at the time of liquidation (closure of the contract). Where the Musharaka financing continues for more than one financial period, profit is recognised to the extent that such profits are being distributed during that period in accordance with profit sharing ratio as stipulated in the Musharaka agreement.

**Istisna'a revenue** and the associated profit margin is recognised in the Bank's books according to the percentage of completion method.

**Income from assets acquired for leasing** (ijarah muntahia bittamleek) are recognised proportionately over the lease term.

**Income from sukuk** is recognised at its effective profit rate over the term of the sukuk.

**Dividend income** is recognised when the right to receive is established.

### (u) Earnings prohibited by Shari'a

The Bank is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Bank uses these funds for charitable purposes.

### (v) Zakah

In accordance with its articles of association, the Bank is not required to pay Zakah. However, the Bank is required to calculate and notify, under a separate report, shareholders of their pro-rata share of the Zakah payable amount. These calculations are approved by the Shari'a Supervisory Board.

### (w) Employee benefits

#### (i) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

#### (ii) Post-employment benefits

Pensions and other social benefits for Bahraini employees are covered by the General Organisation for Social Insurance scheme, which is a "defined contribution scheme" in nature, and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis. Contributions by the Bank are recognised as an expense in income statement when they are due.

## 2 Significant accounting policies (continued)

Expatriate employees on fixed contracts are entitled to leaving indemnities payable under the Bahraini Labour Law for the Private Sector of 1976, based on length of service and final remuneration. Provision for this unfunded commitment has been made by calculating the notional liability had all employees left at the statement of financial position date. These benefits are in the nature of "defined benefit scheme" and any increase or decrease in the benefit obligation is recognised in the income statement.

The Bank also operates a voluntary employees saving scheme under which the Bank and the employee contribute monthly on a fixed percentage of salaries basis. The scheme is managed and administered by a board of trustees who are employees of the Bank. The scheme is in the nature of a defined contribution scheme and contributions by the Bank are recognised as an expense in the income statement when they are due.

### (iii) Share-based employee incentive scheme

The Bank operates a share-based incentive scheme for its employees (the "Scheme") whereby employee are granted the Bank's shares as compensation on achievement of certain non-market based performance conditions and additional service conditions (the 'vesting conditions').

The grant date fair value of equity instruments granted to employees is recognised as an employee expense, with a corresponding increase in equity over the period in which the employees become unconditionally entitled to the share awards. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of share awards that do meet the related service and non-market performance conditions at the vesting date.

### (x) Dividends and board remuneration

Dividends to shareholders and board remuneration are recognised as liabilities in the period in which they are declared.

### (y) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

## 3 Cash and Bank Balances

	2009	2008
Cash	793	309
Balances with banks	9,642	4,867
Balances with the Central Bank:		
- Current account	2,605	5,588
- Reserve account	6,935	12,614
	<b>19,975</b>	<b>23,378</b>

The reserve account with the Central Bank of Bahrain is not available for day-to-day operational purposes.

for the year ended 31 December 2009

**4 Placements with Financial Institutions**

	BD 000's	
	2009	2008
Gross receivable	122,275	132,016
Less: Deferred profits	(82)	(64)
	<b>122,193</b>	131,952

The average profit rate on placement with financial institutions for 2009 was 1.6% per annum (2008: 2.3% per annum).

**5 Islamic Financing Assets**

	BD 000's	
	2009	2008
Murabaha	152,323	123,325
Musharaka	24,688	13,278
Wakala	23,793	7,096
Istisna	1,533	688
	<b>202,337</b>	144,387
Less: Impairment allowances – specific	(7,897)	(2,828)
Less: Impairment allowances – collective	(2,355)	(1,416)
	<b>192,085</b>	140,143

Murabaha financing receivables are net of deferred profits of BD 16,690 thousand (2008: BD 9,296 thousand).

The movement in impairment allowances are as follows:

2009	Specific	Collective	Total
At 1 January	2,828	1,416	4,244
Additions during the year	5,069	939	6,008
At 31 December	7,897	2,355	10,252
2008	Specific	Collective	Total
At 1 January	-	-	-
Additions during the year	2,828	1,416	4,244
At 31 December	2,828	1,416	4,244

## 44 Notes to the Consolidated Financial Statements (Continued)

for the year ended 31 December 2009

### 6 Investment Securities

	BD 000's	
	2009	2008
<b>Available-for-sale investments</b>		
- Quoted equity securities	187	170
- Unquoted equity securities	62,924	54,930
- Sukuk	-	16,910
<b>Held-to-maturity investments</b>		
- Sukuk	29,243	30,388
<b>At 31 December</b>	<b>92,354</b>	<b>102,398</b>

Unquoted available-for-sale investments comprise investments in closed companies managed by external investment managers or represent investments in projects promoted by the Group. These investments are carried at cost less impairment in the absence of a reliable measure of fair value. The Group intends to exit these investments principally by means of private placements, strategic buy outs, sale of underlying assets or through initial public offerings.

The movement in impairment allowances for available-for-sale investments were as follows:

	2009	2008
At 1 January	1,580	-
Impairment allowances on quoted equity securities	12	396
Impairment allowances on unquoted equity securities	2,943	1,184
<b>At 31 December</b>	<b>4,535</b>	<b>1,580</b>

Held-to-maturity investments are net of collective impairment allowances of BD 158 thousand (2008: Nil).

### 7 Assets Acquired for Leasing

	Property	Equipment	2009	2008
<b>Cost</b>				
At 1 January	16,974	8,055	25,029	12,863
Additions during the year	-	-	-	12,816
Settlements/adjustments during the year	(6,530)	-	(6,530)	(650)
<b>At 31 December</b>	<b>10,444</b>	<b>8,055</b>	<b>18,499</b>	<b>25,029</b>
<b>Accumulated depreciation</b>				
At 1 January	3,489	3,029	6,518	2,033
Charge for year	2,255	1,841	4,096	5,135
Settlements during the year	(659)	-	(659)	(650)
<b>At 31 December</b>	<b>5,085</b>	<b>4,870</b>	<b>9,955</b>	<b>6,518</b>
<b>Net book value at 31 December</b>	<b>5,359</b>	<b>3,185</b>	<b>8,544</b>	<b>18,511</b>

At 31 December 2009, accrued lease rental receivable amounted to BD 4,889 thousands (2008: 4,971 thousands). Lease rental receivable is net of collective provision of BD 136 thousands (2008: Nil).

for the year ended 31 December 2009

**8 Asset Held-for-Sale**

Assets-held-for sale comprise investment in an associate company which the Bank is currently down selling to its investors. During the year, the Bank sold investments amounting to BD 803 thousands and recognised income of BD 267 thousands from the transaction.

**9 Investment in Associates**

	2009	BD 000's 2008
At 1 January	6,385	6,683
Distributions during the year	-	(1,060)
Share of profits for the year	136	762
<b>At 31 December</b>	<b>6,521</b>	<b>6,385</b>

*Summarised financial information of associates that have been equity accounted not adjusted for the percentage ownership held by the Group (based on their most recent unaudited management accounts)*

	2009	BD 000's 2008
Total assets	31,033	31,513
Total liabilities	7,738	7,829
Total revenues	915	2,084
Total net profits	551	1,599

**10 Other Assets**

	2009	BD 000's 2008
Income from investment banking services receivable	3,236	17,128
Income from sukuk receivable	601	803
Advance towards purchase of investments	11,310	5,000
Prepayments and other receivables	2,696	3,146
	<b>17,843</b>	<b>26,077</b>

## 46 Notes to the Consolidated Financial Statements (Continued)

for the year ended 31 December 2009

### 11 Equipment

	BD 000's						2008
	Furniture and fixtures	Computers	Motor Vehicle	Other Equipment	Work-in- progress	2009 Total	Total
<b>Cost</b>							
At 1 January	3,430	1,930	73	98	792	6,323	1,703
Additions/ capitalisation	382	92	-	73	(411)	136	4,620
<b>At 31 December</b>	<b>3,812</b>	<b>2,022</b>	<b>73</b>	<b>171</b>	<b>381</b>	<b>6,459</b>	<b>6,323</b>
<b>Accumulated Depreciation</b>							
At 1 January	242	528	8	22	-	800	324
Charge for year	706	564	15	26	-	1,311	476
Disposals	-	-	-	-	-	-	-
<b>At 31 December</b>	<b>948</b>	<b>1,092</b>	<b>23</b>	<b>48</b>	<b>-</b>	<b>2,111</b>	<b>800</b>
<b>Net book value at 31 December 2009</b>	<b>2,864</b>	<b>930</b>	<b>50</b>	<b>123</b>	<b>381</b>	<b>4,348</b>	<b>5,523</b>
Net book value at 31 December 2008	3,188	1,402	65	76	792	5,523	-

### 12 Other Liabilities

	BD 000's	
	2009	2008
Employee related accruals	2,889	5,852
Accounts payable	1,311	3,546
Charity payable (page 35)	593	442
Payable for Istisn'a contracts	143	-
Other payables and accrued expenses	1,679	1,743
	<b>6,615</b>	<b>11,583</b>

for the year ended 31 December 2009

**13 Unrestricted Investment Accounts**

The funds received from unrestricted investment account holders have been commingled and jointly invested with the Bank in the following asset class as at 31 December:

	2009	2008
Investment in sukuk	29,243	47,298
Islamic financing assets	174,345	115,518

BD 000's

The return on joint invested assets and distribution to unrestricted investment account holders were as follows:

	2009	2008
Returns from comingled assets	11,103	8,953
Banks share of Mudarib fees	(1,772)	(1,903)
<b>Return on unrestricted investment accounts</b>	<b>9,331</b>	<b>7,050</b>
Investment risk reserve	(452)	(344)
Profit equalisation reserve	(560)	(438)
<b>Distributions to unrestricted investment account holders'</b>	<b>8,319</b>	<b>6,268</b>

The average gross rate of return in respect of unrestricted investment accounts during the year was 6.1% (2008: 7.0%). Approximately 5.6% (2008: 5.5%) was distributed to investors and the balance was either set aside for provisions and/or retained by the Bank as a Mudarib fee. Unrestricted investment accounts include profit equalisation reserve of BD 1,209 thousand (2008: BD 649 thousand) and investment risk reserve of BD 925 thousand (2008: BD 473 thousand).

**14 Share Capital**

	2009	2008
<b>Authorised:</b>		
3,000,000,000 ordinary shares of BD 0.100 each	300,000	300,000
<b>Issued and fully paid up:</b>		
1,049,237,349 ordinary shares (2008: 1,000,000,000) of BD 0.100 each	104,924	100,000

BD 000's

During the year, the paid up capital of the Bank increased from BD 100,000 thousand to BD 104,924 thousand as a result of issue of bonus shares (five shares for every hundred shares held) for 2008 amounting to BD 4,924 thousand.

The Bank has only one class of equity shares and the holders of these shares have equal voting rights. At 31 December 2009, the Bank holds 17,490,527 number of treasury shares (2008: 15,283,024)

## 48 Notes to the Consolidated Financial Statements (Continued)

for the year ended 31 December 2009

### 14 Share Capital (continued)

Distribution schedule of equity shares, setting out the number of holders and percentage in the following categories:

Categories*	Number of Shares	Number of Shareholders	% of total outstanding shares
Less than 1%	144,105,180	553	13.73
1% up to less than 5% **	170,499,691	10	16.25
5% up to less than 10%	94,500,000	1	9.01
10% up to less than 20%	252,000,000	2	24.02
20% and less than 50%	388,132,478	1	36.99
	<b>1,049,237,349</b>	<b>567</b>	<b>100.00</b>

\* Expressed as a percentage of total outstanding shares of the Bank.

\*\* Includes treasury shares and unvested employee incentive scheme shares

Names and nationalities of the major shareholders and the number of equity shares held in which they have an interest of 5% or more of outstanding shares

	Nationality	Number of shares	% of total outstanding shares
Gulf Finance House BSC	Bahrain	388,132,478	36.99
Al Imtiaz Investment Company KSCC	Kuwait	147,000,000	14.00
Dr. Esam Yousif Abdulla Janahi	Bahrain	105,000,000	10.00
Emirates Islamic Bank PJSC	UAE	94,500,000	9.01

### 15 Income from Investment Securities

	2009	BD 000's 2008
Income from available-for-sale investments:		
- Dividend income	123	659
- Profit on sale of investments	-	10
- Income from Sukuk	121	91
	<b>244</b>	760
Income from held-to-maturity investments - Sukuk	<b>1,036</b>	1,891
	<b>1,280</b>	2,651

for the year ended 31 December 2009

**16 Staff Cost**

	BD 000's	
	<b>2009</b>	2008
Salaries and benefits	<b>4,481</b>	7,667
Social insurance expenses	<b>451</b>	203
Other staff expenses	<b>141</b>	122
	<b>5,073</b>	7,992

**17 Impairment Allowances**

	BD 000's	
	<b>2009</b>	2008
Islamic financing assets (note 5)	<b>6,008</b>	4,244
Available-for-sale equity securities (note 6)	<b>2,955</b>	1,580
Held-to-maturity investments (note 6)	<b>158</b>	-
Lease rentals receivable (note 7)	<b>136</b>	-
	<b>9,257</b>	5,824

**18 Other Expenses**

	BD 000's	
	<b>2009</b>	2008
Administration and support services	<b>172</b>	146
Premises	<b>862</b>	667
Advertisement and marketing	<b>646</b>	720
Printing and stationery	<b>75</b>	168
Professional fees	<b>438</b>	578
Shari'a committee expenses	<b>31</b>	49
Board expenses	<b>209</b>	139
Depreciation on equipment	<b>1,311</b>	477
Others	<b>793</b>	613
	<b>4,537</b>	3,557

**19 Share-Based Employee Incentive Scheme**

The Bank operates an equity-settled share-based incentive scheme for its employees (the "Scheme") whereby eligible employees are granted the Bank's shares as compensation on achievement of certain non-market performance conditions. The Group has incorporated a special purpose vehicle, Hawafiz Khaleeji Management Company BSC (c) ('Hawafiz'), to hold the shares for the beneficial interest of the Scheme until they vest.

The shares granted vest to eligible employees in a staggered manner over a 5 year vesting period (service condition). The shares granted shall be eligible to receive dividends. The vested shares will be settled by physical delivery on completion of vesting conditions. In case the employee leaves before satisfying the vesting conditions, he/ she would be entitled for a cash payment for

**19 Share-Based Employee Incentive Scheme (Continued)**

the unvested shares in accordance with the terms of the Scheme. Such unvested shares will be retained by Hawafiz and may be offered to other employees as per the terms of the Scheme.

The maximum number of shares to be issued to employees under the scheme is 30.4 million ordinary shares at an exercise price of BD 0.12 per share, to be issued over the vesting period in accordance with the terms of the Scheme. Up to 31 December 2009, on a cumulative basis, 30.4 million share grants have been awarded of which 16.599 million shares have vested up to 31 December 2009 and 0.069 million shares were forfeited due to failure to satisfy the service condition. No new grants have been made in 2009. The vesting expense for the year, net of reversals due to forfeitures, amounted to BD 434 thousand (2008: BD 499 thousand).

**20 Critical Accounting Estimates and Judgements in Applying Accounting Policies**

The Bank makes estimates and assumptions that effect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances.

**Judgements****Classification of investments**

In the process of applying the Group's accounting policies, management decides on acquisition of an investment whether it should be classified as held-to-maturity or available-for-sale investments. The classification of each investment reflects the management's intention in relation to each investment and is subject to different accounting treatments based on such classification [refer note 2 (e)].

**Special purpose entities**

The Bank sponsors the formation of special purpose entities (SPE's) primarily for the purpose of allowing clients to hold investments. The Bank provides corporate administration, investment management and advisory services to these SPE's, which involve the Group making decisions on behalf of such entities. The Bank administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments. The Bank does not consolidate SPE's that it does not have the power to control. In determining whether the Bank has the power to control an SPE, judgements are made about the objectives of the SPE's activities, its exposure to the risks and rewards, as well as about the Group's intention and ability to make operational decisions for the SPE and whether the Group derives benefits from such decisions.

**Estimations****Impairment of available-for-sale investments**

The Group determines that available-for-sale equity securities are impaired when there is an objective evidence of impairment and there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment. In case of quoted equity securities, the Group considers a decline of more than 30% in the fair value below cost to be significant and considers a decline below cost which persists for more than 6 months as prolonged. Where fair values are not readily available and the investments are carried at cost, the recoverable amount of such investment is estimated to test for impairment.

In making this judgment, the Bank evaluates among other factors, evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

## 20 Critical Accounting Estimates and Judgements in Applying Accounting Policies (Continued)

### Impairment of Islamic financing assets

Islamic financing assets are evaluated for impairment on a basis described in accounting policy 2 (m). Each counterparty exposure is evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realisable value of any underlying assets/ collaterals. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently evaluated by the Risk Management Department and approved by the Board of Directors. For evaluation of the portfolio for impairment on a collective basis, management uses estimates based on historical loss experience for assets and loss experience in the industry for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio. For the purposes of a collective evaluation of impairment, Islamic financing assets are grouped on the basis of similar credit risk characteristics (that is, on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). The methodology and assumptions used for the grading process and estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. In view of the management, the current level of provisioning is adequate and no additional impairment allowances are required on a collective basis.

## 21 Assets under Management

The Bank provides corporate administration, investment management and advisory services to its project entities, which involve the Group making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the statement of financial position date, the Group had assets under management of BD 323.65 million (2008: BD 297.15 million). During the year, the Bank has charged management fees amounting to BD 450 thousands (2008: BD 188 thousands) for the management of assets.

## 22 Related Party Transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include the significant shareholders and entities over which the Bank and the shareholders exercises significant influence, directors and executive management of the Bank.

A significant portion of the Bank's income from investment banking services and management fees arises from entities over which the Bank or its significant shareholders exercises influence (assets under management). Although these entities are considered related parties, the Bank administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments.

Details of Directors' interests in the Bank's ordinary shares as at the end of the year were :

Categories*	BD 000's	
	Number of Shares	Number of Directors
Less than 1%	7,859,801	5
1% up to 10%	100,000,000	1

\* Expressed as a percentage of total outstanding shares of the Bank.

## 52 Notes to the Consolidated Financial Statements (Continued)

for the year ended 31 December 2009

### 22 Related Party Transactions (Continued)

The related party balances and transactions (except for compensation of key managerial personnel) included in these financial statements are as follows:

BD 000's

2009	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Assets</b>					
Placements with financial institution	-	-	-	-	-
Investment securities	-	-	5,655	36,261	41,916
Islamic financing assets	1,479	-	-	4,348	5,827
Asset-held-for-sale	4,852	-	-	-	4,852
Investment in associates	6,521	-	-	-	6,521
Other assets	139	-	-	2,978	3,117
<b>Liabilities</b>					
Placement from financial institutions and others	-	-	10,475	-	10,475
Customers' current accounts	5,608	1	46	3,110	8,765
Unrestricted investment accounts	230	1,547	1,531	44,179	47,486
Other liabilities	-	1,648	-	-	1,648

2009	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Income</b>					
Income from investment banking services	-	-	-	13,798	13,798
Placement, management and arrangement fees	-	-	-	1,007	1,007
Income from placements with financial institutions	-	-	85	-	85
Income from Islamic financing assets and assets acquired for leasing	128	-	681	-	809
Income from investment securities	-	-	130	120	250
Share of profits from associates	136	-	-	-	136
Other income	-	-	-	73	73
<b>Expenses</b>					
Financing expenses	-	-	578	-	578
Return on unrestricted investment accounts	12	66	62	1,831	1,971
Investments related expenses	45	19	-	448	512
Impairment allowances	-	-	-	4,126	4,126

for the year ended 31 December 2009

**22 Related Party Transactions (Continued)**

BD 000's

2008	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Assets</b>					
Placements with financial institution	-	-	154	-	154
Available-for-sale investments	-	-	-	35,953	35,953
Islamic financing assets	3,727	-	13,045	746	17,518
Other assets	-	-	-	19,022	19,022
Investment in associates	6,385	-	-	-	6,385
Investments in sukuk	-	-	5,665	-	5,665
<b>Liabilities</b>					
Placement from financial institutions and others	-	-	11,328	-	11,328
Customers' current accounts	154	2	3,638	8,339	12,133
Unrestricted investment accounts	5,707	1,292	590	6,399	13,988
Other liabilities	-	2,090	-	-	2,090

2008	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Income</b>					
Income from investment banking services	-	-	-	32,338	32,338
Placement, management and arrangement fees	-	-	-	964	964
Income from placements with financial institutions	-	-	503	-	503
Income from Islamic financing assets and assets acquired for leasing	81	-	473	33	587
Income from investment securities	-	-	291	597	888
Share of profits from associate companies	762	-	-	-	762
Other income	-	-	-	811	811
<b>Expenses</b>					
Financing expenses	-	-	366	-	366
Return on unrestricted investment accounts	266	56	10	274	605
<b>Equity transactions</b>					
Purchase of shares for the employee incentive scheme	-	-	3,648	-	3,648

## 54 Notes to the Consolidated Financial Statements (Continued)

for the year ended 31 December 2009

### Compensation with key management personnel

Key management personnel of the Bank comprise of the Board of Directors and key members of management having authority and responsibility for planning, directing and controlling the activities of the Bank. The key management personnel compensation during the year is as follows:

	2009	BD 000's 2008
Board member fees	250	250
Board member allowances	185	109
Salaries and other short-term benefits	803	2,050
Equity settled-share based payments	-	1,853

### Transactions with restricted investment accounts

Transactions involving transfer/ sale of assets to restricted investment accounts are generally executed based on the pre-agreed values as per the terms of the contracts for each restricted investment product. During the year, in its normal course of business, the Bank sold certain investments at agreed contractual values amounting to BD 803 thousand (2008: BD 8,100 thousand) to its restricted investment accounts at a profit of BD 267 thousand (2008: BD 2,100 thousand).

## 23 Earnings Per Share

Basic earnings per share is calculated by dividing the profit for the year by the weighted average number of equity shares outstanding during the year ended 31 December 2009. The Bank has dilutive equity instruments in the form of share grants in issue.

<b>Basic EPS</b>	<b>2009</b>	2008
Profit for the year (BD 000's)	<b>3,100</b>	27,304
Weighted average number of equity shares (Nos. in 000's)	<b>1,019,127</b>	1,029,456
Basic earnings per share (in fils)	<b>3.04</b>	26.52

<b>Diluted EPS</b>	<b>2009</b>	2008
Profit for the year (BD 000's)	<b>3,100</b>	27,304
Weighted average number of equity shares (Nos. in 000's)	<b>1,019,127</b>	1,037,560
Diluted earnings per share (in fils)	<b>3.04</b>	26.32

As the average market value of shares during the current period were lower than the assumed issue price of shares under the scheme, the share awards are not considered to be dilutive for the year ended 31 December 2009 for the purposes of computation of earnings per share.

## 24 Shari'a Supervisory Board

The Bank's Shari'a Supervisory Board consists of three Islamic scholars who review the Bank's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Bank to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

## 25 Zakah

Zakah is directly borne by the shareholders on distributed profits and investors in restricted investment accounts. The Bank currently does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually. During the year the Shari'a Supervisory Board has computed Zakah payable of BD 4,218 thousand of which BD 1,941 thousand represents the Zakah computed on the cumulative statutory reserve and retained earnings as at 31 December 2009, payable by the Bank (refer note 31). The remaining Zakah balance amounting to BD 2,277 thousand or 2.17 fils per share (2008: BD 2,249 thousand or 2.2 fils per share) is due and payable by the shareholders.

## 26 Segment Reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, whose operating results are regularly reviewed by the Group's chief operating decision maker (Board of Directors) to make decisions about resource allocation to each segment and assess its performance and for which discrete financial information is available.

An operating segment is divided into business segment and geographic segments. For management purposes the Group is organised into two major business segments:

### Retail banking

Providing customer services such as accepting mudaraba deposits, savings account and current account facilities, fund transfer facilities, bill payment facilities. It also provides Islamic financing facilities (in form of Commodity Murabaha, Musharaka, Istisna and Ijarah facilities) to corporate clients and High-Networth-Individuals. Provides money market and treasury services (in form of short term commodity murabaha) to banks, financial institutions and corporate and also used to manage funding of the Group.

### Investment banking

Primarily relates to conceptualising of investment deals and performing roles of a arranger, lead manager, and administrator of the funds (involves structuring of deals, raising of funds through private placement and fund administration). Bank also offers products like Restricted Investment Accounts (RIA) and management of funds raised through the RIA structures. Also involves carrying out strategic investments in the form of equity contribution (either in the funds created and managed by the Bank or other institutions) and Sukuk investments.

Segment performance is measured based on results for each department as mentioned in the internal management reports that are reviewed by the Board of Directors on a quarterly basis. Segment results is used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate in these industries.

The Bank reports directly attributable revenue and cost relating to transactions originating from respective segments as segment revenue and segment cost respectively. Indirect costs and corporate overheads are treated as unallocated. The internal management reports are designed to reflect revenue and cost for respective segments which are measured against the budgeted figures.

The Group primarily operates from Bahrain and does not have any overseas branches/divisions. The geographic concentration of assets and liabilities is disclosed in Note 28 (b) to the consolidated financial statements.

These segments are the basis on which the Group reports its primary segment information. Transactions between segments if any are conducted on an arm's length basis.

## 56 Notes to the Consolidated Financial Statements (Continued)

for the year ended 31 December 2009

### 26 Segment Reporting (Continued)

BD 000's

2009	Investment Banking	Retail Banking	Unallocated	Total
Cash and bank balances	-	19,975	-	19,975
Placements with financial institutions	8,122	114,071	-	122,193
Islamic financing assets	2,262	189,823	-	192,085
Investment securities	63,112	29,242	-	92,354
Assets acquired for leasing (including lease rental receivable)	-	13,433	-	13,433
Asset held-for-sale	4,852	-	-	4,852
Investment in associates	6,521	-	-	6,521
Other assets	15,694	465	1,684	17,843
Equipment	-	-	4,348	4,348
<b>Total segment assets</b>	<b>100,563</b>	<b>367,009</b>	<b>6,032</b>	<b>473,604</b>
Placements from financial institutions and others	89,179	12,551	-	101,730
Customers' current accounts	8,122	26,975	-	35,097
Other liabilities	-	1,598	5,017	6,615
<b>Total segment liabilities</b>	<b>97,301</b>	<b>41,124</b>	<b>5,017</b>	<b>143,442</b>
<b>Unrestricted Investment Accounts</b>	<b>-</b>	<b>203,588</b>	<b>-</b>	<b>203,588</b>
<b>Restricted Investment Accounts</b>	<b>46,742</b>	<b>-</b>	<b>-</b>	<b>46,752</b>

for the year ended 31 December 2009

**26 Segment Reporting (Continued)**

BD 000's

<b>2009</b>	<b>Investment Banking</b>	<b>Retail Banking</b>	<b>Unallocated</b>	<b>Total</b>
Income from investment banking services	13,798	-	-	13,798
Placement, management and arrangement fees	1,013	-	-	1,013
Income from placements with financial institutions	98	1,379	-	1,477
Income from Islamic financing assets and assets acquired for leasing	-	15,024	-	15,024
Income from investment securities	123	1,157	-	1,280
Share of profits from associate companies	136	-	-	136
Other income	431	73	-	504
Total income before return on unrestricted investment accounts	15,599	17,633	-	33,232
Less: Return on unrestricted investment accounts	-	(9,331)	-	(9,331)
<b>Total segment revenue</b>	<b>15,599</b>	<b>8,302</b>	<b>-</b>	<b>23,901</b>
Staff cost	909	591	3,573	5,073
Financing expenses	-	1,270	-	1,270
Investments related expenses	664	-	-	664
Other expenses	-	-	4,537	4,537
<b>Total segment cost</b>	<b>1,573</b>	<b>1,861</b>	<b>8,110</b>	<b>11,544</b>
Segment results before impairment allowances	14,026	6,441	8,110	12,357
Impairment allowances	(6,223)	(3,034)	-	(9,257)
<b>Segment results</b>	<b>7,803</b>	<b>3,407</b>	<b>(8,110)</b>	<b>3,100</b>

**58 Notes to the Consolidated Financial Statements (Continued)**

for the year ended 31 December 2009

**26 Segment Reporting (Continued)**

BD 000's

2008	Investment Banking	Retail Banking	Unallocated	Total
Cash and bank balances	-	23,378	-	23,378
Placements with financial institutions	53,359	78,593	-	131,952
Islamic financing assets	2,262	137,881	-	140,143
Investment securities	85,488	16,910	-	102,398
Assets acquired for leasing (including lease rental receivable)	-	23,482	-	23,482
Asset held-for-sale	5,655	-	-	5,655
Investment in associates	6,385	-	-	6,385
Other assets	23,645	803	1,629	26,077
Equipment	-	-	5,523	5,523
Total segment assets	176,794	281,047	7,152	464,993
Placements from financial institutions and others	-	30,229	-	30,229
Customers' current accounts	53,359	69,024	-	122,383
Other liabilities	-	1,257	10,326	11,583
Total segment liabilities	53,359	100,510	10,326	164,195
Unrestricted Investment Accounts	-	162,816	-	162,816
Restricted Investment Accounts	47,445	-	-	47,445

for the year ended 31 December 2009

**26 Segment Reporting (Continued)**

BD 000's

31 December 2008	Investment Banking	Retail Banking	Unallocated	Total
Income from investment banking services	34,487	-	-	34,487
Placement, management and arrangement fees	1,349	-	-	1,349
Income from placements with financial institutions	1,461	2,151	-	3,612
Income from Islamic financing assets and assets acquired for leasing	-	10,628	-	10,628
Income from investment securities	670	1,981	-	2,651
Share of profits from associate companies	762	-	-	762
Other income	1,273	16	-	1,289
Total income before return on unrestricted investment accounts	40,002	14,776	-	54,778
Less: Return on unrestricted investment accounts	-	(7,050)	-	(7,050)
Segment revenue	40,002	7,726	-	47,728
Staff cost	704	439	6,849	7,992
Financing expenses	-	2,190	-	2,190
Investments related expenses	861	-	-	861
Other expenses	-	-	3,557	3,557
Segment cost	1,565	2,629	10,406	14,600
Segment results before impairment allowances	38,437	5,097	(10,406)	33,128
Impairment allowances	(4,408)	(1,416)	-	(5,824)
Segment results	34,029	3,681	(10,406)	27,304

## 60 Notes to the Consolidated Financial Statements (Continued)

for the year ended 31 December 2009

### 27 Maturity Profile

The maturity profile of placements with and from financial institutions, Islamic financing assets, assets acquired for leasing and commitments (including lease rental receivable) has been presented using their contractual maturity period. For other balances, maturity profile is based on expected cash flows/ settlement profile of the respective assets and liabilities.

2009	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
<b>Assets</b>						
Cash and bank balances	19,975	-	-	-	-	19,975
Placements with financial institutions	122,193	-	-	-	-	122,193
Islamic financing assets	18,714	36,494	31,136	50,287	55,454	192,085
Investment securities	17,142	21,405	4,398	47,045	2,364	92,354
Assets acquired for leasing (including lease rental receivable)	443	-	5,651	1,823	5,516	13,433
Asset-held-for-sale	-	4,852	-	-	-	4,852
Investment in associates	-	2,571	3,950	-	-	6,521
Other assets	5,001	-	-	12,842	-	17,843
Equipment	-	-	-	-	4,348	4,348
<b>Total assets</b>	<b>183,468</b>	<b>65,322</b>	<b>45,135</b>	<b>111,997</b>	<b>67,682</b>	<b>473,604</b>
<b>Liabilities</b>						
Placements with financial institutions and others	90,030	11,700	-	-	-	101,730
Customer current account	35,097	-	-	-	-	35,097
Other liabilities	6,615	-	-	-	-	6,615
<b>Total liabilities</b>	<b>131,742</b>	<b>11,700</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>143,442</b>
<b>Unrestricted Investment Accounts</b>	<b>161,592</b>	<b>23,839</b>	<b>15,786</b>	<b>244</b>	<b>2,127</b>	<b>203,588</b>
<b>Restricted Investment Accounts</b>	<b>-</b>	<b>18,766</b>	<b>-</b>	<b>26,905</b>	<b>1,071</b>	<b>46,742</b>
<b>Commitments</b>	<b>5,230</b>	<b>750</b>	<b>5,106</b>	<b>5,258</b>	<b>-</b>	<b>16,344</b>

for the year ended 31 December 2009

**27 Maturity Profile (Continued)**

	BD 000's					
2008	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
<b>Assets</b>						
Cash and bank balances	23,378	-	-	-	-	23,378
Placements with financial institutions	131,952	-	-	-	-	131,952
Islamic financing assets	28,499	27,105	22,725	39,171	22,643	140,143
Investment securities	12,410	1,195	21,008	38,251	29,534	102,398
Assets acquired for leasing (including lease rental receivable)	1,561	1,839	692	9,221	10,169	23,482
Asset-held-for-sale	5,655	-	-	-	-	5,655
Investment in associates	-	-	2,572	3,813	-	6,385
Other assets	26,077	-	-	-	-	26,077
Equipment	-	-	-	-	5,523	5,523
<b>Total assets</b>	<b>229,532</b>	<b>30,139</b>	<b>46,997</b>	<b>90,456</b>	<b>67,869</b>	<b>464,993</b>
<b>Liabilities</b>						
Placements with financial institutions and others	30,229	-	-	-	-	30,229
Customer current account	101,038	-	21,345	-	-	122,383
Other liabilities	11,583	-	-	-	-	11,583
<b>Total liabilities</b>	<b>142,850</b>	<b>-</b>	<b>21,345</b>	<b>-</b>	<b>-</b>	<b>164,195</b>
Unrestricted Investment Accounts	144,322	-	18,494	-	-	162,816
Restricted Investment Accounts	-	-	-	47,445	-	47,445
Commitments	16,278	9,181	6,717	-	-	32,176

## 62 Notes to the Consolidated Financial Statements (Continued)

for the year ended 31 December 2009

### 28 Concentration of Assets, Liabilities, Unrestricted and Restricted Investment Accounts

BD 000's

#### (a) Industry sector

2009	Banks and financial institutions	Real estate	Others	Total
<b>Assets</b>				
Cash and bank balances	19,975	-	-	19,975
Placements with financial institutions	122,193	-	-	122,193
Islamic financing assets	17,308	96,041	78,736	192,085
Investments securities	15,884	65,734	10,736	92,354
Assets acquired for leasing (including lease rental receivable)	3,005	6,835	3,593	13,433
Asset-held-for-sale	-	4,852	-	4,852
Investment in associates	-	6,521	-	6,521
Other assets	3	2,508	15,332	17,843
Equipment	-	-	4,348	4,348
<b>Total assets</b>	<b>178,368</b>	<b>182,491</b>	<b>112,745</b>	<b>473,604</b>
<b>Liabilities</b>				
Placements from financial institutions and others	89,179	-	12,551	101,730
Customers' current accounts	-	-	35,097	35,097
Other liabilities	-	-	6,615	6,615
<b>Total liabilities</b>	<b>89,179</b>	<b>-</b>	<b>54,263</b>	<b>143,442</b>
<b>Unrestricted Investment Accounts</b>	<b>16,915</b>	<b>61,158</b>	<b>125,515</b>	<b>203,588</b>
Restricted Investment Accounts	-	45,671	1,071	46,742
Commitments	-	3,612	12,732	16,344

for the year ended 31 December 2009

**28 Concentration of Assets, Liabilities, Unrestricted and Restricted Investment Accounts (Continued)**

BD 000's

2008	Banks and financial institutions	Real estate	Others	Total
<b>Assets</b>				
Cash and bank balances	23,378	-	-	23,378
Placements with financial institutions	131,952	-	-	131,952
Islamic financing assets	9,279	98,857	32,007	140,143
Investments securities	40,108	62,120	170	102,398
Assets acquired for leasing (including lease rental receivable)	-	15,965	7,517	23,482
Asset-held-for-sale	-	-	5,655	5,655
Investment in associates	-	6,385	-	6,385
Other assets	987	18,458	6,632	26,077
Equipment	-	-	5,523	5,523
<b>Total assets</b>	<b>205,704</b>	<b>201,785</b>	<b>57,504</b>	<b>464,993</b>
<b>Liabilities</b>				
Placements from financial institutions and others	30,229	-	-	30,229
Customers' current accounts	737	101,844	19,802	122,383
Other liabilities	-	-	11,583	11,583
<b>Total liabilities</b>	<b>30,966</b>	<b>101,844</b>	<b>31,385</b>	<b>164,195</b>
<b>Unrestricted Investment Accounts</b>	<b>12,675</b>	<b>42,086</b>	<b>108,055</b>	<b>162,816</b>
<b>Restricted Investment Accounts</b>	<b>-</b>	<b>47,445</b>	<b>-</b>	<b>47,445</b>
<b>Commitments</b>	<b>-</b>	<b>15,080</b>	<b>17,096</b>	<b>32,176</b>

**64 Notes to the Consolidated Financial Statements (Continued)**

for the year ended 31 December 2009

**28 Concentration of Assets, Liabilities, Unrestricted and Restricted Investment Accounts (Continued)****(b) Geographic sector**

BD 000's

2009	GCC countries	Europe	USA	Asia	Australia	Africa	Total
<b>Assets</b>							
Cash and bank balances	12,615	468	6,846	46	-	-	19,975
Placements with financial institutions	109,308	12,885	-	-	-	-	122,193
Islamic financing assets	190,524	1,561	-	-	-	-	192,085
Investment securities	63,304	2,216	-	24,944	-	1,890	92,354
Assets acquired for leasing (including lease rental receivable)	13,433	-	-	-	-	-	13,433
Asset-held-for-sale	-	-	-	-	4,852	-	4,852
Investment in associates	6,521	-	-	-	-	-	6,521
Other assets	7,157	-	-	2,015	-	8,671	17,843
Equipment	4,348	-	-	-	-	-	4,348
<b>Total assets</b>	<b>407,210</b>	<b>17,130</b>	<b>6,846</b>	<b>27,005</b>	<b>4,852</b>	<b>10,561</b>	<b>473,604</b>
<b>Liabilities</b>							
Placements from financial institutions and others	101,730	-	-	-	-	-	101,730
Customers' current accounts	35,097	-	-	-	-	-	35,097
Other liabilities	6,615	-	-	-	-	-	6,615
<b>Total liabilities</b>	<b>143,442</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>143,442</b>
<b>Unrestricted Investment Accounts</b>	<b>203,588</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>203,588</b>
<b>Restricted Investment Accounts</b>	<b>45,671</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,071</b>	<b>-</b>	<b>46,742</b>
<b>Commitments</b>	<b>14,459</b>	<b>-</b>	<b>-</b>	<b>1,885</b>	<b>-</b>	<b>-</b>	<b>16,344</b>

Concentration by location for Islamic financing assets is measured based on the location of the counterparty, which has a high correlation with the location of the collateral for the exposure.

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**28 Concentration of Assets, Liabilities, Unrestricted and Restricted Investment Accounts (Continued)**

BD 000's

2008	GCC countries	Europe	USA	Asia	Australia	Africa	Total
<b>Assets</b>							
Cash and bank balances	21,699	207	1,472	-	-	-	23,378
Placements with financial institutions	125,725	6,227	-	-	-	-	131,952
Islamic financing assets	133,190	6,953	-	-	-	-	140,143
Investment securities	76,869	5,039	-	18,605	-	1,885	102,398
Assets acquired for leasing (including lease rental receivable)	23,482	-	-	-	-	-	23,482
Asset-held-for-sale	-	-	-	-	5,655	-	5,655
Investment in associates	6,385	-	-	-	-	-	6,385
Other assets	26,077	-	-	-	-	-	26,077
Equipment	5,523	-	-	-	-	-	5,523
<b>Total assets</b>	<b>418,950</b>	<b>18,426</b>	<b>1,472</b>	<b>18,605</b>	<b>5,655</b>	<b>1,885</b>	<b>464,993</b>
<b>Liabilities</b>							
Placements from financial institutions and others	30,229	-	-	-	-	-	30,229
Customers' current accounts	122,383	-	-	-	-	-	122,383
Other liabilities	11,583	-	-	-	-	-	11,583
<b>Total liabilities</b>	<b>164,195</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>164,195</b>
<b>Unrestricted Investment Accounts</b>	<b>162,816</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>162,816</b>
<b>Restricted Investment Accounts</b>	<b>38,273</b>	<b>9,172</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>47,445</b>
<b>Commitments</b>	<b>15,395</b>	<b>1,701</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>15,080</b>	<b>32,176</b>

**29 Fair Value**

Fair value is an amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair values of quoted held-to-maturity Sukuk carried at amortised cost of BD 18,292 thousand (31 December 2008: 18,236 thousand) amounts to BD 16,598 thousand as at 31 December 2009 (31 December 2008: 15,569 thousand).

Other than available-for-sale investments of BD 62,111 thousand (2008: BD 71,840 thousand), asset held-for-sale of BD 4,852 thousand (2008: BD 5,655 thousand) and unquoted held-to-maturity investment in sukuk of BD 29,243 thousand (2008: 12,152 thousand) that are carried at cost, the estimated fair values of the Bank's other financial instruments are not significantly different from their carrying values.

### **30 Risk Management**

#### **Introduction and overview**

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risks
- operational risks

This note presents information about the Group's exposure to each of the above risks, its objectives, policies and processes for measuring and managing risk, and the Bank's management of capital.

#### **Risk management framework**

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established an Executive Risk Management Committee, which is responsible for developing and monitoring the Bank's risk management policies in the specified areas. The committee also continuously monitors consistent implementation of the Board approved policies in the Bank and reports deviations if any to the Board. The committee consists of heads of business and other functional units in the Bank and reports regularly to the Risk Management Committee of the Board.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Bank's Audit Committee is responsible for monitoring compliance with the risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

#### **Credit risk**

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's exposures to placements with financial institutions, Islamic financing assets, outstanding assets acquired for leasing, investment in Sukuk and receivables classified under other assets. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual and group exposure risk, country and sector concentration risk, related party exposure etc). The Bank monitors the total exposure to assets acquired for leasing (including lease rental receivables) on a cumulative basis for monitoring of market risk and credit risk.

The Board of Directors has delegated responsibility for the management of credit risk to its Executive Risk Management Committee (ERMC). A separate Risk and Credit Management Department (RMD), reporting to the ERMC is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements and submitting the same for approval to the Board of Directors.

### 30 Risk Management (Continued)

- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are not at present allocated to business units. Smaller exposures are approved by the Executive Credit & Investment Committee consisting of heads of business units and the Deputy General Manager and Chief Operating Officer. Larger facilities require approval by the Chief Executive Officer, Chairman, Board Investment and Credit Committee or the full Board, as the case may be.
- Reviewing and assessing credit risk. RMD assesses all credit exposures and signs off on the relevant proposals prior to approval of the facilities by the appropriate authorities. Renewal and review of facilities are subject to the same process.
- Limiting concentrations of exposure to counterparties, countries and industries in respect of Islamic Financing assets, assets acquired for leasing as well as investments.
- Developing and maintaining the Bank's risk gradings in order to categorise exposures according to the degree of probable risk of financial loss to focus management on the attendant risks. The risk grading system is also used to identify specific exposures for which impairment provisions may be required. The risk grading framework for the Bank's financing portfolio consists of ten grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. Investments in equity securities are not currently being graded and are evaluated individually on a case-by-case basis. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate, on the recommendations of the RMD. Risk grades are subject to regular reviews by RMD.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are submitted to the Board on the compliance levels. RMD also provides advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.
- Each business unit is required to implement the Bank credit policies and procedures in respect of exposures assumed by them and are responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, irrespective of the approving authority for the exposure. Regular audits of business units and Bank credit processes are undertaken by Internal Audit.

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## 30 Risk Management (Continued)

## Exposure to credit risk

BD 000's

2009	Placements with financial institutions	Islamic financing assets	Assets acquired for leasing (including lease rental receivable)	Investment securities- Sukuk	Other financial assets	Total
<b>Impaired</b>						
Grade 9: Impaired	-	9,796	-	-	-	9,796
Allowance for impairment	-	(7,897)	-	-	-	(7,897)
<b>Carrying amount</b>	-	<b>1,899</b>	-	-	-	<b>1,899</b>
<b>Past Due but not impaired</b>						
Grade 1-6 Low-Fair Risk	-	2,792	-	-	-	2,792
Grade 7-8 Watch list	-	4,086	-	-	-	4,086
Unrated	-	-	-	-	-	-
Past due comprises:						
0-30 days	-	6,788	-	-	-	6,788
30-60 days	-	68	-	-	-	68
60-90 days	-	3	-	-	-	3
90-180days	-	19	-	-	-	19
180 days +	-	-	-	-	-	-
<b>Carrying amount</b>	-	<b>6,878</b>	-	-	-	<b>6,878</b>
<b>Neither past due nor impaired</b>						
Grade 1-6 Low-Fair Risk	122,193	158,310	13,569	29,401	-	323,473
Grade 7,8: Watch list	-	27,353	-	-	-	27,353
Unrated	-	-	-	-	17,343	17,343
<b>Carrying amount</b>	<b>122,193</b>	<b>185,663</b>	<b>13,569</b>	<b>29,401</b>	<b>17,343</b>	<b>368,169</b>
Less:						
<b>Collective impairment provisions</b>	-	<b>(2,355)</b>	<b>(136)</b>	<b>(158)</b>		<b>(2,649)</b>
<b>Total</b>	<b>122,193</b>	<b>192,085</b>	<b>13,433</b>	<b>29,243</b>	<b>17,343</b>	<b>374,297</b>

for the year ended 31 December 2009

**30 Risk Management (Continued)**

BD 000's

2008	Placements with financial institutions	Islamic financing assets	Assets acquired for leasing (including lease rental receivable)	Investment securities- Sukuk	Other financial assets	Total
<u>Impaired</u>						
Grade 9: Impaired	-	6,600	-	-	-	6,600
Allowance for impairment	-	(2,828)	-	-	-	(2,828)
Carrying amount	-	3,772	-	-	-	3,772
<u>Past Due but not impaired</u>						
Grade 1-6 Low-Fair Risk	-	658	-	-	-	658
Grade 7-8 Watch list	-	4,610	-	-	-	4,610
Unrated	-	-	-	-	17,128	17,128
<u>Past due comprises:</u>						
0-30 days	-	658	-	-	17,128	17,786
30-60 days	-	4,610	-	-	-	4,610
60-90 days	-	-	-	-	-	-
90-180days	-	-	-	-	-	-
180 days +	-	-	-	-	-	-
Carrying amount	-	5,268	-	-	17,128	22,396
<u>Neither past due nor impaired</u>						
Grade 1-6 Low-Fair Risk	131,952	129,089	23,482	47,298	-	331,821
Grade 7,8: Watch list	-	3,430	-	-	-	3,430
Unrated	-	-	-	-	8,681	8,681
Carrying amount	131,952	132,519	23,482	47,298	8,681	343,932
<u>Less:</u>						
Collective impairment provisions	-	(1,416)	-	-	-	(1,416)
Total	131,952	140,143	23,482	47,298	25,809	368,684

**Impaired financial assets**

Impaired financial assets are those for which the Bank determines that it is probable that it will be unable to collect all or part of the principal and profit due according to the contractual terms of the exposure. Generally these assets fall under risk grades 9 or 10, for other financial assets impairment is assessed on an individual basis for each exposure under the Bank's internal credit risk grading system.

**30 Risk Management (Continued)****Past due but not impaired exposures**

The exposure pertains to Islamic financing assets where contractual profit or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of subsequent collections, the level of security / collateral available and / or the stage of collection of amounts owed to the Bank.

**Renegotiated facilities**

Exposures classified as neither past due nor impaired financing facilities include facilities renegotiated during the year amounting to BD 34,917 thousand (2008: BD 1,344 thousand) that would otherwise be past due as per their original repayment terms. The renegotiated terms usually require settlement of profits accrued till date on the facility and/or part payment of the principal and / or obtaining of additional collateral coverage. The renegotiated facilities are subject to revised credit assessments and independent review by the RMD.

**Allowances for impairment**

The Bank makes provisions for impairment on individual assets classified under grades 9 and 10. This is done on the basis of the present value of projected future cash flows from the assets themselves and consideration of the value of the collateral securities available. On a collective basis, the Bank has provided for impairment losses based on management's judgement of the extent of losses incurred but not identified based on the current economic and credit conditions.

**Write-off policy**

The Bank writes off an asset / security balance (net of any related allowances for impairment losses) when it determines that the asset / security are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the counterparty's financial position such that he can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. As on date the Bank has not made any write off.

**Collaterals**

The Bank holds collateral against Islamic financing assets and receivables from assets acquired for leasing in the form of mortgage/pledge over property, listed/ unlisted securities, other assets and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and updated periodically, generally at annual intervals. Collateral generally is not held against exposure to other banks and financial institutions. An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below. This includes the value of financial guarantees from banks, but not corporate and personal guarantees as the values thereof are not readily quantifiable.

for the year ended 31 December 2009

**30 Risk Management (Continued)**

	As at 31 December 2009			As at 31 December 2008		
	Islamic financing assets	Assets acquired for leasing (including lease rental receivable)	Total	Islamic financing assets	Assets acquired for leasing (including lease rental receivable)	Total
BD 000's						
<u>Against impaired</u>						
Other	495	-	495	-	-	-
<u>Against past due but not impaired</u>						
Property	25,381	-	25,381	4,671	-	4,671
Equities	8,014	-	8,014	-	-	-
Other	-	-	-	-	-	-
<u>Against neither past due nor impaired</u>						
Property	173,000	26,710	199,710	150,537	36,270	186,807
Equities	3,824	-	3,824	11,833	-	11,833
Other	70,172	10,188	80,360	23,048	8,659	31,707
<b>Total</b>	<b>280,886</b>	<b>36,898</b>	<b>317,784</b>	<b>190,089</b>	<b>44,929</b>	<b>235,018</b>

For analysis of concentration of total assets and liabilities refer note 28.

## 72 Notes to the Consolidated Financial Statements (Continued)

for the year ended 31 December 2009

Further, for Islamic financing assets and assets acquired for leasing the Bank monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk at the reporting date is shown below:

BD 000's

Concentration by sector	As at 31 December 2009			As at 31 December 2008		
	Islamic financing assets	Assets acquired for leasing (including lease rental receivable)	Total	Islamic financing assets	Assets acquired for leasing (including lease rental receivable)	Total
Financial	17,308	3,005	20,313	9,279	3,000	12,279
Real estate:						
- Property	47,452	6,835	54,287	45,378	12,404	57,782
- Infrastructure development	30,261	-	30,261	28,731	-	28,731
- Land	18,329	-	18,329	21,046	468	21,514
Construction	5,478	-	5,478	3,431	5,966	9,397
Trading	27,359	-	27,359	15,969	-	15,969
Manufacturing	7,216	-	7,216	4,031	-	4,031
Others	38,682	3,593	42,275	12,278	1,644	13,922
<b>Total carrying amount</b>	<b>192,085</b>	<b>13,433</b>	<b>205,518</b>	<b>140,143</b>	<b>23,482</b>	<b>163,625</b>

### Settlement risk

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed.

Settlement limits form part of the credit approval / limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from RMD.

### Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial assets.

### Management of liquidity risk

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

Financial Control Department (FCD) collates data from treasury and other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. FCD communicates the information to the treasury who manages the Bank's portfolio of short-term liquid assets, largely made up of short-term placements with other banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

for the year ended 31 December 2009

**30 Risk Management (Continued)**

The daily liquidity position is monitored by FCD. The Bank has in place a Liquidity Contingency Plan, the elements of which are periodically tested. Tools for implementation of regular stress testing under various scenarios are in place. All liquidity policies and procedures are subject to review by ALCO and approval by appropriate authorities. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO members.

**Exposure to liquidity risk**

The key measure used by the Bank for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For computation of this, net liquid assets are considered as including cash and bank balances and placements with financial Institutions less placements from financial institution, and deposits comprise current accounts and unrestricted investment accounts.

Details of the reported Bank ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	<b>2009</b> %	2008 %
At 31 December	<b>22.00</b>	49.80
Average for the period	<b>26.07</b>	61.30
Maximum for the period	<b>44.00</b>	108.60
Minimum for the period	<b>18.02</b>	45.90

For maturity profile of assets and liabilities refer note 27.

**Market risks**

Market risk is the risk that changes in market prices, such as profit rate, equity prices, foreign exchange rates and credit spreads will affect the Bank's income, future cash flows or the value of its holdings of financial instruments. Market risk comprises three types of risk: currency risk, profit rate risk and other price risk. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

**Management of market risks**

The Bank separates its exposure to market risk between trading and non-trading portfolios. The Bank has no trading positions in equity or commodities and the main source of market risk for the Bank is its foreign exchange exposure and profit rate gap.

The Bank does not do any trading in foreign exchange. The Bank does not engage in proprietary trading of foreign exchange derivatives. However, the Bank enters into shari'a compliant foreign exchange risk management transactions to hedge economic risks to cover significant open positions under its risk management guidelines. All foreign exchange income/losses arising out of customer transactions and revaluation of statement of financial position assets and liabilities are booked by the treasury operations. The responsibility for monitoring and managing the related risks also rests with the Treasury department.

Overall authority for market risk management is vested with ALCO. The RMD is responsible for the development of detailed risk management policies (subject to review and approval by appropriate approval authorities) and the Financial Control Department is responsible for the day-to-day review of their implementation.

**30 Risk Management (Continued)****Exposure to profit rate risk – non-trading portfolios**

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for repricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by the Bank's Risk Management Department in its day-to-day monitoring activities.

A summary of the Bank's profit rate gap position at 31 December 2009 is as follows:

BD 000's

<b>2009</b>	<b>Up to 3 months</b>	<b>3 - 6 months</b>	<b>6 months - 1 year</b>	<b>1 - 3 years</b>	<b>More than 3 years</b>	<b>Total</b>
<b>Assets</b>						
Placements with financial institutions	122,193	-	-	-	-	122,193
Islamic financing assets	34,130	39,064	24,651	48,187	46,053	192,085
Assets acquired for leasing (including lease rental receivable)	11,471	-	100	-	1,862	13,433
Investments securities (sukuk)	18,192	5,555	-	3,770	1,727	29,244
<b>Total profit rate sensitive assets</b>	<b>185,986</b>	<b>44,619</b>	<b>24,751</b>	<b>51,957</b>	<b>49,642</b>	<b>356,955</b>
<b>Liabilities</b>						
Placements from financial institutions and others	(90,030)	(11,700)	-	-	-	(101,730)
Investors funds	(8,121)	-	-	-	-	(8,121)
Unrestricted investments accounts	(161,592)	(23,839)	(15,786)	(244)	(2,127)	(203,588)
<b>Total profit rate sensitive liabilities</b>	<b>(259,743)</b>	<b>(35,539)</b>	<b>(15,786)</b>	<b>(244)</b>	<b>(2,127)</b>	<b>(313,439)</b>
<b>Profit rate gap</b>	<b>(73,757)</b>	<b>9,080</b>	<b>8,965</b>	<b>51,713</b>	<b>47,515</b>	<b>43,516</b>

for the year ended 31 December 2009

**30 Risk Management (Continued)**

	BD 000's					
2008	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
<b>Assets</b>						
Placements with financial institutions	131,952	-	-	-	-	131,952
Islamic financing assets	37,326	27,105	22,725	30,753	22,234	140,143
Assets acquired for leasing (including lease rental receivable)	18,388	3,261	692	332	809	23,482
Investments securities (sukuk)	29,703	10,055	1,885	-	5,655	47,298
Total profit rate sensitive assets	217,369	40,421	25,302	31,085	28,698	342,875
<b>Liabilities</b>						
Placements from financial institutions and others	(30,230)	-	-	-	-	(30,230)
Investors funds	(32,015)	-	(21,344)	-	-	(53,359)
Unrestricted investments accounts	(144,322)	-	(17,373)	-	-	(161,695)
Total profit rate sensitive liabilities	(206,567)	-	(38,717)	-	-	(245,284)
Profit rate gap	10,802	40,421	(13,415)	31,085	28,698	97,591

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis point parallel fall or rise across all yield curves and a 50 bp rise or fall of all yield curves.

An analysis of the Bank's sensitivity to an increase or decrease in market profit rates (assuming no asymmetrical movement in yield curves and a constant statement of financial position position) is as follows:

	<b>100bp parallel increase/decrease</b>	<b>50bp increase/decrease</b>
<b>At 31 December 2009</b>	<b>± 435</b>	<b>± 218</b>
At 31 December 2008	± 990	±495

Overall non-trading profit rate risk positions are managed by Treasury, which uses short term investment securities, placement with banks and placement from banks to manage the overall position arising from the Bank's non-trading activities.

**30 Risk Management (Continued)****Exposure to foreign exchange risk**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group had the following significant net exposures denominated in foreign currency as of 31 December:

	2009 BHD Equivalent	2008 BHD Equivalent
Sterling Pounds	2,961	2,960
Euros	9,899	5,163
US Dollars*	59,640	74,525
Kuwaiti Dinars	3,031	2,838
Other GCC Currencies *	33,030	2,147
Indian Rupee	45	-

BD 000's

(\*) The exposure in US dollars and other GCC currencies does not create any foreign exchange risk for the Bank since Bahraini Dinars and other GCC Currencies are effectively pegged to the US Dollars.

The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various foreign exchange scenarios. Standard scenarios that are considered on a monthly basis include a 5% plus / minus increase in exchange rates, for currencies other than US Dollars ,GCC currencies.

An analysis of the Bank's sensitivity to an increase or decrease in foreign exchange rates (assuming all other variables, primarily profit rates, remain constant) is as follows:

	2009 BHD Equivalent	2008 BHD Equivalent
Sterling Pounds	±148	148
Kuwaiti Dinars	±152	±142
Euros	±495	±258
Indian Rupees	±2	-

**Exposure to other price risks – non-trading portfolios**

Credit spread risk on debt securities is subject to regular monitoring by RMD, but is not currently significant in relation to the overall results and financial position of the Bank.

The Group's available-for-sale equity securities carried at cost are exposed to risk of changes in equity values. Refer note 20 for significant estimates and judgements in relation to impairment assessment of available-for-sale equity investments carried at cost. The Group manages exposure to other price risks by actively monitoring the performance of the equity securities. The performance assessment is performed on a quarterly basis and is reported to the Board Investment Committee.

### 30 Risk Management (Continued)

#### Operational risk

Operational risk is the risk of loss arising from systems and control failures, fraud and human errors, which can result in financial and reputation loss, and legal and regulatory consequences. The Bank manages operational risk through appropriate controls, instituting segregation of duties and internal checks and balances, including internal audit and compliance. The Risk Management Department is in charge of identifying, monitoring and managing operational risk in the bank. The Bank already has an approved policy for doing this and all required organisational and physical infrastructure are in place.

The Bank has completed conducting Risk Control Self Assessment of Operational risk for majority of the departments of the Bank to identify the important Key Risk Areas, Key Risk Indicators and Key Risk Triggers. A software for monitoring these triggers and recording actual and near miss losses is already in place. The medium term objective of the Bank is to generate statistically reliable data to upgrade to more sophisticated modes of Operational Risk Control both to manage the risk better and to reduce capital commitment.

#### Capital management

The Central Bank of Bahrain (CBB), sets and monitors capital requirements for the Bank as a whole. In implementing current capital requirements CBB requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. Capital adequacy regulations of CBB is based on the principles of Basel II of the IFSB guidelines.

The Bank's regulatory capital is analysed into two tiers:

- Tier 1 capital, includes ordinary share capital, disclosed reserves including share premium, general reserves, legal / statutory reserve as well as retained earnings after deductions for goodwill and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes. As on 31 December 2009, the deductions to Tier 1 was Nil.
- Tier 2 capital, includes interim retained profits reviewed by the auditors and an allowed portion profit equalisation reserve (PER) and investment risk reserves (IRR). As per CBB, the PER & IRR can be up to a maximum amount equal to the capital charge pertaining to 30% of the risk weighted assets financed by unrestricted investment accounts.

Certain limits are applied to elements of the capital base in line with regulatory requirements. Tier 1 capital should represent at least half of the total eligible capital, i.e., Tier 2 capital is limited to 100% of Tier 1 capital. The limit on Tier 2 capital is based on the amount of Tier 1 capital after all deductions of investments pursuant to Prudential Consolidation and Deduction Requirements (PCD) Module of the CBB. The PCD Module sets out the regulatory rules for prudential consolidation, pro-rata consolidation or deduction where the own controlling or significant minority stakes in regulated financial entities, insurance entities and have significant exposures to investment in commercial entities. It also sets out the framework for the prudential deductions from capital for various instances including exposures to counterparties exceeding the large exposure limits as set out by CBB. As on 31 December 2009, the Bank was not required to make any deductions under the requirements of the PCD Module.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

**30 Risk Management (Continued)**

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank has adopted the standardised approach to credit and basic indicator approach for management of operational risk under the CBB capital adequacy framework. The Bank on a conservative basis for capital management does not claim any of the benefits for permissible credit risk mitigants against credit exposure.

The Bank's regulatory capital position at 31 December was as follows:

	2009	2008
<b>Total risk weighted assets</b>	<b>376,444</b>	328,906
Tier 1 capital	<b>126,544</b>	138,247
Tier 2 capital	<b>2,148</b>	649
<b>Total regulatory capital</b>	<b>128,692</b>	138,896
<b>Total regulatory capital expressed as a percentage of total risk weighted assets</b>	<b>34.19</b>	42.23

The Bank has complied with all externally imposed capital requirements throughout the year.

**Capital allocation**

The allocation of capital between specific operations and activities is primarily driven by regulatory requirements. The Bank's capital management policy seeks to maximise return on risk adjusted while satisfying all the regulatory requirements. The Bank's policy on capital allocation is subject to regular review by the Board

**31 Proposed Appropriations**

The Board of Directors propose the following appropriations of profits for 2009 which are subject to shareholders approval in the ensuing Annual General Meeting:

	2009	2008
Directors' remuneration	-	250
Proposed cash dividend	-	15,000
Proposed issue of bonus shares as dividend	<b>10,492</b>	5,000
Charity	<b>150</b>	250
Zakah	<b>1,941</b>	-

for the year ended 31 December 2009

### 32 Commitments

The commitments contracted in the normal course of business of the Bank:

	2009	2008
Undrawn commitments to extend finance	7,474	12,076
Financial guarantees	5,258	5,020
Underwriting commitments	-	15,080
Commitment to investments	3,612	-
	<b>16,344</b>	32,176

#### Performance obligations

During the ordinary course of business, the Group may enter into performance obligations in respect of certain of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2009 due to the performance of any of its projects.

### 33 Social Responsibility

The Bank discharges its social responsibilities through donations to charitable causes and organisations.

### 34 New Standards and Interpretations Issued but not yet Adopted

The following accounting standards and interpretations have been issued by AAOIFI during 2009 and are mandatory for the Group's accounting for annual periods beginning on or after 1 July 2009 or later periods and are expected to be relevant to the Group:

- FAS 23 Consolidation (effective for annual periods beginning on or after 1 January 2010); and
- FAS 24 Investment in Associates (effective for annual periods beginning on or after 1 January 2010)

The requirements of these standards are largely in line with the current policies followed by the Group for accounting of subsidiaries and associates and the adoption of these standards are not expected to have any material impact on the consolidated financial statements.

### 35 Comparatives

Certain prior period amounts have been regrouped to conform to current year's presentation. Such regrouping did not affect previously reported profit or equity.



## **Risk Management Disclosures** **(based on Basel 2 and IFSB guidelines)** 31 December 2009

These disclosures have been prepared in accordance with the Public Disclosure Module (“PD”), Section PD-1.3: Disclosures in Annual Reports, CBB Rule Book, Volume II for Islamic Banks. To avoid any duplication, information required under PD module but already disclosed in other sections of annual report has not been reproduced. These disclosures are part of the annual report for the year ended 31 December 2009 and should be read in conjunction with the financial statements for the year ended 31 December 2009 and other sections of the annual report.

### Executive summary

The Central Bank of Bahrain's (CBB) Basel 2 guidelines outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1 January 2008. These disclosures have been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module ("PD"), Section PD-1.3: Disclosures in Annual Reports and CBB Rule Book, Volume II for Islamic Banks. Section PD-1.3 reflects the requirements of Basel 2 - Pillar 3 and the Islamic Financial Services Board's (IFSB) recommended disclosures for Islamic banks.

The disclosures in this report are in addition to or in some cases, serve to clarify the disclosures set out in the consolidated financial statements for the year ended 31 December 2009, presented in accordance with the Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). To avoid any duplication, information required under PD module but already disclosed in other sections of Annual report has not been reproduced in these disclosures.

All figures presented in this section are reported in BD thousands and are as of 31 December 2009 unless otherwise stated.

Khaleeji Commercial Bank BSC (the "Bank") has adopted different approaches as permissible under the Basel II guidelines for determining its capital requirements for Credit, Market and Operations Risks, details of which is given in section 2. This document contains a description of the Bank's risk management and capital adequacy policies and practices including detailed quantitative information on risk components and capital adequacy.

The Bank's Tier I and total capital adequacy ratios comply with the minimum capital requirements under the CBB's Basel 2 framework.

The Banks total risk weighted assets as at 31 December 2009 amounted to BD 376,444. Credit risk accounted for 81.42%, operational risk 15.17%, and market risk 3.42% of the total risk weighted assets. Tier I and regulatory capital were BD 126,544 and BD 128,692 respectively.

At 31 December 2009, Bank's Tier I and total adequacy ratios were 33.62% and 34.19% respectively.

### 1 Group structure

The Bank operates under a retail banking license granted by the Central Bank of Bahrain ("CBB") on 20 October 2003. The Bank does not have significant operating subsidiaries. The subsidiaries set-up are primarily special purpose entities with nominal capital to execute specific investment transactions. The subsidiaries qualify as commercial entities as per the CBB capital computation guidelines and are risk weighted as investments for capital.

### 2 Introduction to Basel II & risk management

The CBB has mandated that the Basel Committee on Banking Supervision's (Basel Committee) Basel II capital adequacy framework is applicable to all banks incorporated in the Kingdom of Bahrain from 1st January 2008. The Bank has accordingly taken steps to comply with these requirements. The Basel II framework is intended to strengthen risk management practices and processes within the financial institutions.

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CBB's capital adequacy framework is based on three pillars, consistent with the Basel II framework adopted by the Basel Committee, as follows:

- Pillar I: calculation of the risk weighted assets (RWAs) and capital requirement.
- Pillar II: the supervisory review process, including the Internal Capital Adequacy Assessment Process (ICAAP).
- Pillar III: rules for disclosure of risk management and capital adequacy information.

#### Pillar I

Pillar I defines the regulatory minimum capital requirements for each bank to cover the credit risk, market risk and operational risk inherent in its business model. It also defines the methodology for measurement of these risks and the various elements of qualifying capital. The capital adequacy ratio is calculated by dividing the regulatory capital base by the total Risk Weighted Assets (RWAs). CBB has mandated that the ratio be maintained at a minimum of 12 % and has set a trigger ratio of 12.5%. If the capital adequacy ratio falls below 12.5%, additional prudential reporting requirements apply, and a formal action plan to restore the ratio above the trigger level is to be formulated and submitted to the CBB.

The table below summarizes the Pillar I risks and the approach used by the Bank to calculate the RWAs in each case in accordance with the CBB's Basel II capital adequacy framework:

Risk Type	Approach used by KHCB
Credit Risk	Standardised Approach
Market Risk	Standardised Approach
Operational Risk	Basic Indicator Approach

#### Pillar II

Pillar II defines the process of supervisory review of an institution's risk management framework and, ultimately its capital adequacy.

Pillar II comprises two processes:

- An Internal Capital Adequacy Assessment Process (ICAAP), and
- A supervisory review and evaluation process.

The Bank has in place ICAAP procedures for computation of economic capital for all risks including those not covered under Pillar I. The Bank regularly monitors its internal capital adequacy ratio to ensure that there is adequate cover for all risks faced by the Bank.

Under the supervisory review and evaluation process each bank is individually assessed by the CBB and an individual minimum capital adequacy ratio is to be determined for each bank, depending on their overall risk profile. For this purpose we had at that instance appointed an external consultant to assess the risk profile of KHCB and the extent of its compliance with Basel II requirements. The consultant's report was submitted to CBB and is under their consideration. In the meanwhile, Bank's in Bahrain are required to maintain minimum regulatory capital adequacy ratio of 12 %.

**Pillar III**

Pillar III complements the other two pillars and focuses on enhanced transparency in disclosure of information by the Banks to promote better market discipline. The information to be disclosed covers all areas including business performance, capital adequacy, risk management etc. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all banks, via market pressures, to move toward more advanced forms of risk management.

In April 2008, the Central Bank of Bahrain published a paper covering the detailed disclosure requirements to be followed by licensed banks in Bahrain to be in compliance with Pillar III under the Basel II framework. This document is prepared in accordance with these directives.

**2.1 The risk management function**

The Board of Directors has overall responsibility for risk management in the Bank. The Board lays down the risk management policies of the Bank and quantifies its risk appetite through appropriate definitions of various risk limits and tolerances. The Board discharges its risk management responsibilities through the Board Risk Management Committee (BRMC).

The Board has established an Executive Risk Management Committee (ERMC), which is responsible for developing and monitoring Bank risk management policies in the specified areas. The committee consists of heads of business and other functional units in the Bank and reports regularly to the Board Risk Management Committee.

The day to day risk management functions are performed by the Risk Management Department (RMD) of the Bank. RMD is responsible to ensure that the policies laid down by the Board are consistently implemented across the Bank and to review the adequacy of these policies periodically. It monitors all risk taking activities and ensures that the risk limits defined by the Board are complied with. The department has specialised personnel dealing with Credit, Market and Operational Risks. It is independent of all risk taking functions in the Bank and reports to the BRMC through the Executive Risk Management Committee (ERMC) chaired by the Chief Executive Officer (CEO).

The Asset Liability Management Committee (ALCO) of the Bank acting through the Treasury department monitors the Bank's liquidity position and recommends appropriate action to the Board where necessary. There is a high level of co-ordination between the RMD, ERMC and ALCO.

The RMD prepares a risk overview report which covers in detail the various risks faced by the Bank and the same is discussed at the ERMC, BRMC and the Board on a quarterly basis.

The RMD, together with the Internal Audit and Compliance departments, provides independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board of Directors.

**3 Capital management and capital adequacy ratio****3.1 Capital management**

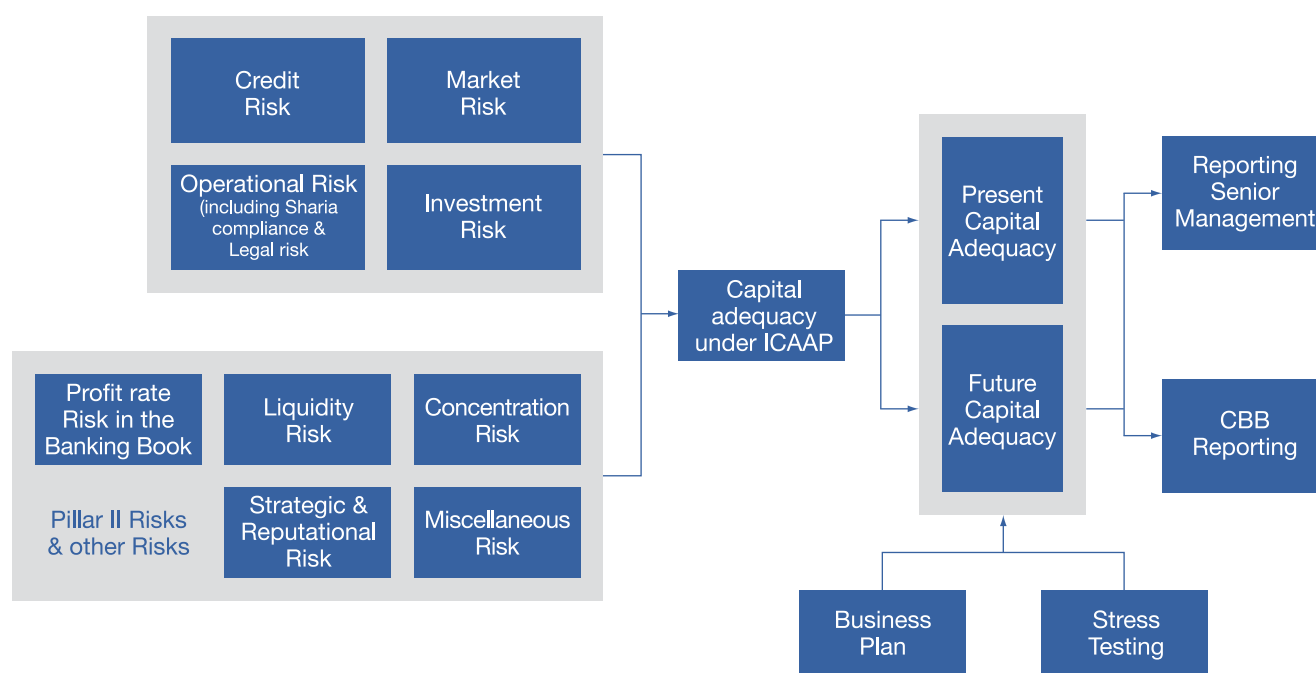
The Bank's policy is to maintain a strong capital base to develop and retain investor, creditor and market confidence and to sustain business growth. The Bank recognises the impact of a high level of capital on shareholders' returns, while not losing sight of the security and market confidence afforded by a sound capital base. The Bank aims to maintain a minimum total capital adequacy ratio significantly in excess of that mandated by the CBB.

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### 3.2 Internal capital adequacy assessment process (“ICAAP”)

The Bank has an established Internal Capital Adequacy Assessment Process (“ICAAP”) as per the requirements under Pillar II of Basel II. ICAAP prescribes procedures and measures designed to ensure appropriate identification, measurement, aggregation and monitoring of the Bank’s risks. It also defines an appropriate level of internal capital in relation to the Bank’s overall risk profile and business plan.

#### ICAAP framework at the Bank



#### 3.2.1 Risk addressed by the ICAAP

Risk Type	Metrics based on which internal capital is allocated
Credit risk Market risk Investment risk Operational risk	Regulatory capital adequacy guidelines to be used as proxy for internal capital for Pillar I risks
Liquidity risk	Maximum cumulative maturity gap, Liquidity ratio, Financing to deposit ratio
Profit rate risk (banking book)	Revaluation sensitivity of the re-pricing gaps
Credit concentration risk	Thresholds for counterparty, country, sector exposures
Fiduciary Risk	Size of off balance sheet vehicles (RIAs) & Large Investment Products
Reputational risk	Credit quality, Operational risk, Reputation related loss
Other Risks (strategic, Shari’a/regulatory compliance, business cycle)	Additional capital based on Pillar 1 risk weighted exposures

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**3.3 Capital structure, minimum capital requirements and capital adequacy**

<b>Net available capital</b>	<b>31 December 2009</b>
Issued and fully paid ordinary shares	104,924
Less: Treasury shares	(5,216)
Less: ESOP shares	(1,648)
Statutory reserve	6,298
Share premium	958
Others reserves	367
Retained earning	20,861
<b>Tier 1 capital</b>	<b>126,544</b>
Unrealised gains arising from fair valuing equities	14
Profit equalisation reserve	1,209
Investment risk reserve	925
Tier 2 capital	2,148
<b>Net available capital</b>	<b>128,692</b>
<b>Risk weighted assets</b>	<b>31 December 2009</b>
Credit risk weight exposures	306,493
Market risk weight exposures	12,863
Operational risk weight exposures	57,088
<b>Total risk weighted assets</b>	<b>376,444</b>
<b>Capital adequacy ratio ( Tier 1 )</b>	<b>33.62%</b>
<b>Capital adequacy ratio ( Total capital)</b>	<b>34.19%</b>

The above capital adequacy ratios are calculated by dividing the respective regulatory capital base by the total Risk Weighted Assets (RWAs).

**Regulatory capital components**

The above components of Tier I and Tier II capital are as per the relevant CBB guidelines. According to these Tier II capital is restricted to 100 % of Tier I capital after all deductions of investments pursuant to PCD module of CBB rule book. As at 31 December 2009 Bank was not required to make any prudential deduction from its regulatory capital base.

**Risk weighted assets****Credit risk**

For regulatory reporting purposes, the Bank calculates the capital requirements for credit risk based on the standardised approach. Under this approach, the on and off-balance sheet credit exposures are assigned risk weights based on the type of counterparty,

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type of the exposure, and source of funding – URIA or own funds. The risk weights for types of counterparties and exposures are prescribed by CBB. Further for capital adequacy computations 100% of the RWA's is reckoned for self financed assets while only 30 % is considered for assets funded through URIA.

#### Market risk

The Bank uses the standardised approach to measure market risk. Market risk is primarily on account of the foreign exchange exposures that are considered as specific risks. As per the CBB guidelines, capital for foreign exchange risk is computed at 8% of overall net open foreign currency positions of the Bank and this is multiplied by 12.5 to derive the market RWAs.

#### Operational risk

The Bank adopts the Basic Indicator Approach to evaluate operational risk charge in accordance with the CBB capital adequacy module for Islamic Banks. According to this approach, Bank's average gross income for past three financial years is multiplied by a fixed coefficient alpha of 15% set by CBB to arrive at the capital required and a multiple of 12.5 is used to arrive at the risk weighted assets that are subject to capital charge.

Break-up of capital requirement in accordance with the Capital Adequacy Module of the CBB for the year ended 31 December 2009:

Risk Weighted Assets	Exposure			Risk weighted assets			Capital requirement		
	Self – Financed	URIA	Total	Self – Financed	URIA	Total	Self – Financed	URIA	Total
Cash and collection items	793	-	<b>793</b>	-	-	-	-	-	-
Sovereigns	9,555	2,350	<b>11,905</b>	-	-	-	-	-	-
Banks	132,044	-	<b>132,044</b>	43,993	-	<b>43,993</b>	5,279	-	<b>5,279</b>
Corporates	60,739	172,211	<b>232,950</b>	60,739	51,663	<b>112,402</b>	7,289	6,200	<b>13,489</b>
Investments in equities/funds	8,922	26,893	<b>35,815</b>	13,290	12,102	<b>25,392</b>	1,595	1,452	<b>3,047</b>
Holdings of real estate	59,763	-	<b>59,763</b>	119,526	-	<b>119,526</b>	14,343	-	<b>14,343</b>
Other assets	5,180	-	<b>5,180</b>	5,180	-	<b>5,180</b>	622	-	<b>622</b>
<b>Credit Risk</b>	<b>276,996</b>	<b>201,454</b>	<b>478,450</b>	<b>242,728</b>	<b>63,765</b>	<b>306,493</b>	<b>29,128</b>	<b>7,652</b>	<b>36,780</b>
<b>Market Risk</b>	-	-	-	<b>12,863</b>	-	<b>12,863</b>	<b>1,544</b>	-	<b>1,544</b>
<b>Operational Risk</b>	-	-	-	-	-	<b>57,088</b>	-	-	<b>6,851</b>
<b>Total</b>	<b>276,996</b>	<b>201,454</b>	<b>478,450</b>	<b>255,591</b>	<b>63,765</b>	<b>376,444</b>	<b>30,672</b>	<b>7,652</b>	<b>45,175</b>

## 4 Credit Risk

### 4.1 Credit risk management

Credit Risk is the risk that a counterparty fails to meet its obligations in accordance with agreed terms and conditions. The major sources of credit risk in the Bank are under the following classes of assets:

- Placements with other Banks and financial institutions.
- Islamic financing assets.
- Assets acquired for leasing (including lease rentals receivable).
- Investments in Sukuk.

For the purpose of capital adequacy computation (as well as certain other tables below) the following have also been considered as a part of credit risk:

- Investments in quoted and unquoted equity.
- Assets-held-for-sale.
- Investment in associates.
- Other assets.

The Bank has the necessary internal processes for assessing, monitoring and controlling credit risk both at the individual credit and portfolio levels. Credit limits are approved after a thorough assessment which takes into account the financial strength of the counterparty, the technical feasibility and economic viability of the business being financed, the adequacy and quality of the cash flow available for repayment etc. in addition to availability of collateral security by way of physical assets or guarantees. The RMD reviews every credit proposal and incorporates its remarks on the proposal before the same is considered by the appropriate authority as per delegated approval levels granted by the Board of Directors.

At the portfolio level, the Board has established risk concentration limits for single counterparties and related counterparties forming a business group, geographical and economic sectors as well as exposures to counterparties related to the Bank and/or its major shareholders. The RMD regularly monitors compliance with these limits and deviations if any are reported regularly to the Senior Management, Risk Management Committees and the Board of Directors.

#### 4.2 Growth in exposure levels

The year 2009 saw a modest growth in overall credit exposure levels. The table below shows the movement of gross credit exposure during the period along with average credit exposure broken down under different exposure classes.

#### Gross / Average Credit Exposures

	BD'000		
	Average Exposure <sup>[1]</sup>	Gross Exposure	
		Self	URIA
Cash and bank balances <sup>[2]</sup>	28,616	19,975	-
Placement with banks/FIs	112,220	122,193	-
Islamic financing assets	171,775	19,874	172,211
Investment securities - quoted and unquoted equity	60,422	63,111	-
Investment securities - sukuks	39,759	-	29,243
Assets acquired for leasing (including lease rentals receivables)	19,225	13,433	-
Investments in associates	6,495	6,521	-
Asset held for sale	5,334	4,852	-
Other assets	28,067	17,843	-
<b>Total Funded Credit Exposure</b>	<b>471,913</b>	<b>267,802</b>	<b>201,454</b>
Guarantees issued	4,563	5,258	-
Other non funded commitments	13,590	11,086	-
<b>Total Non Funded Credit Exposure</b>	<b>18,153</b>	<b>16,344</b>	<b>-</b>

<sup>[1]</sup>Represents quarterly average balances for the year 2009.

<sup>[2]</sup>Includes cash balance of BD 793 thousand

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**4.3 Concentration of credit risk****4.3.1 Geographic distribution**

The geographical exposure profile as at 31 December 2009 was as follows:

BD 000's

<b>2009</b>	<b>GCC countries</b>	<b>Europe</b>	<b>USA</b>	<b>Asia</b>	<b>Australia</b>	<b>Africa</b>	<b>Total</b>
Assets							
Cash and Bank balances <sup>(1)</sup>	12,615	468	6,846	46	-	-	<b>19,975</b>
Placements with financial institutions	109,308	12,885	-	-	-	-	<b>122,193</b>
Islamic financing assets	190,524	1,561	-	-	-	-	<b>192,085</b>
Investment securities	63,304	2,216	-	24,944	-	1,890	<b>92,354</b>
Assets acquired for leasing	13,433	-	-	-	-	-	<b>13,433</b>
Asset held for sale	-	-	-	-	4,852	-	<b>4,852</b>
Investment in associates	6,521	-	-	-	-	-	<b>6,521</b>
Other assets	7,157	-	-	2,015	-	8,671	<b>17,843</b>
<b>Total Funded Exposures</b>	<b>402,862</b>	<b>17,130</b>	<b>6,846</b>	<b>27,005</b>	<b>4,852</b>	<b>10,561</b>	<b>469,256</b>
Commitments to finance	7,474	-	-	-	-	-	<b>7,474</b>
Commitments to invest	1,727	-	-	1,885	-	-	<b>3,612</b>
Guarantees	5,258	-	-	-	-	-	<b>5,258</b>
<b>Total Unfunded Exposures</b>	<b>14,459</b>	<b>-</b>	<b>-</b>	<b>1,885</b>	<b>-</b>	<b>-</b>	<b>16,344</b>

<sup>(1)</sup>Includes cash balance of BD 793 thousand

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#### 4.3.2 Industry/ sector wise distribution of exposure

The Board of Directors has stipulated maximum exposures to various industry sectors. The industry sector wise exposure is as follows:

BD 000's				
2009	Banks and financial institutions	Real estate	Others	Total
<b>Assets</b>				
Cash and Bank balances <sup>[1]</sup>	19,975	-	-	19,975
Placements with financial institutions	122,193	-	-	122,193
Islamic financing assets	17,308	96,041	78,736	192,085
Investments securities	15,884	65,734	10,736	92,354
Assets acquired for leasing	3,005	6,835	3,593	13,433
Asset held for sale	-	4,852	-	4,852
Investment in associates	-	6,521	-	6,521
Other assets	3	2,508	15,332	17,843
<b>Total funded exposures</b>	<b>178,368</b>	<b>182,491</b>	<b>108,397</b>	<b>469,256</b>
<b>Unfunded exposure</b>				
Commitments to finance	-	-	7,474	7,474
Commitments to invest	-	3,612	-	3,612
Guarantees	-	-	5,258	5,258
<b>Total unfunded exposures</b>	<b>-</b>	<b>3,612</b>	<b>12,732</b>	<b>16,344</b>

<sup>[1]</sup>Includes cash balance of BD 793 thousand

#### 4.3.3 Transactions with connected counterparties

Connected counterparties are those entities which are connected to the Bank through significant shareholding or control or both. Wherever the Bank has entered into business transactions with such counterparties, such transactions have been done at an arm's length basis and on commercial terms that bring no disadvantage to the Bank. For the purpose of identification of connected counterparties the Bank strictly follows the guidelines issued by Central Bank of Bahrain for the purpose.

Detailed break up is presented in note no 22 in the notes to the consolidated financial statements for the year ended 31 December 2009.

#### 4.3.4 Exposures in excess of 15% of capital base

Single exposures in excess of 15 % of the Bank's capital base on individual counterparties require prior approval of CBB except where exempted under para CM 4.5 of the rule book. The Bank does not have any such 'large exposures' that are not exempted and therefore warrants prior approval of CBB. Exposures exceeding single exposure limits as of 31 December 2009:

BD 000's	
	Amount
Bank A	26,151
Bank B	22,686
<b>Total</b>	<b>48,837</b>

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#### 4.3.5 Exposures in highly leveraged counterparties

The Bank has no exposure to highly leveraged and other high risk counterparties as per definition provided in the CBB rule book PD 1.3.24.

#### 4.3.6 Residual contractual maturity of the credit portfolio and Investment in sukuk

The Bank's policy allows exposures up to a maximum period of 7 years with any exceptions to be approved by the Board of Directors. However, most of the Bank's exposures are limited to an original maturity of 5 years. The Bank constantly monitors the residual maturity profile of its assets to ensure that any mismatch with the maturity of its liabilities is kept within acceptable limits. The contractual residual maturity profile of the Bank's credit portfolio and investment in sukuk is given in the table below.

	BD 000's							
<b>Maturity Scale</b>	<b>&lt;1 M</b>	<b>1 - 3 M</b>	<b>3 - 6 M</b>	<b>6M - 1 Y</b>	<b>1 - 3 Y</b>	<b>3 - 5 Y</b>	<b>&gt;5 Y</b>	<b>Total</b>
<b>Credit Portfolio:*</b>								
Murabaha	7,051	4,576	23,863	23,696	45,975	36,910	-	142,071
Musharaka	-	985	10,594	7,440	3,573	2,096	-	24,688
Wakala	4,430	1,672	2,038	-	209	6,044	9,400	23,793
Istisna	-	-	-	-	530	-	1,003	1,533
Ijarah	-	443	-	5,651	1,823	2,505	3,011	13,433
<b>Total</b>	<b>11,481</b>	<b>7,676</b>	<b>36,495</b>	<b>36,787</b>	<b>52,110</b>	<b>47,555</b>	<b>13,414</b>	<b>205,518</b>
<b>Investment securities</b>								
Investment in sukuk	-	1,885	2,350	4,398	18,247	1,885	478	29,243
<b>Total</b>	<b>-</b>	<b>1,885</b>	<b>2,350</b>	<b>4,398</b>	<b>18,247</b>	<b>1,885</b>	<b>478</b>	<b>29,243</b>
<b>Grand Total</b>	<b>11,481</b>	<b>9,561</b>	<b>38,845</b>	<b>41,185</b>	<b>70,357</b>	<b>49,440</b>	<b>13,892</b>	<b>234,761</b>

\* Credit Portfolio includes Islamic financing assets, Assets acquired for leasing and lease rental receivable.

#### 4.4 Equity risk in banking book

The Bank does not have a trading book and hence all of its equity investments are classified in the banking book and are subject to credit risk weighting under the capital adequacy framework. For regulatory capital computation purposes, the Bank's equity investments in the banking book include available-for-sale investments, and associate investments in non-financial entities.

Please refer to the notes to the consolidated financial statements for policies covering the accounting of equity holdings, including the accounting policies and valuation methodologies used, key assumptions and practices affecting valuation.

The RMD works alongside the Investment Department at all stages of the deal cycle, from pre-investment due diligence to exit, and provides an independent review of every transaction. An impairment assessment of investments takes place every quarter with inputs from the Investment department and RMD. Quarterly updates of investments are reviewed by the Board of Directors. Regular audits of business units and processes are undertaken by Internal Audit.

The Bank's equity investments are predominantly in its own projects, which include private equity and infrastructure development products. The intent of such investments is a later stage exit along with the investors, by means of strategic sell outs at the project

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level or through initial public offerings. The Bank also has a strategic investment portfolio which is aligned with the long term investment objectives of the Bank.

BD 000's

**Information on equity investments**

Privately held	75,019
Quoted in an active market	187
Realised gain/ (loss) during the year	-
Unrealised gain in equity (Tier 2)	30

The following are the categories under which equity investments are included in the capital adequacy computations as per the requirements of the CBB rules:

BD 000's

Equity investments in banking book	Gross exposure		Risk weighted exposure		Capital charge	
	Self financed	URIA	Self financed	URIA	Self financed	URIA
Quoted equity investment	187	-	187	-	22	-
Unquoted equity investment	15,256	-	19,624	-	2,355	-
Investment in managed funds	-	-	-	-	-	-
Real estate investment	*59,763	-	119,526	-	14,343	-
<b>Total</b>	<b>75,206</b>	<b>-</b>	<b>139,337</b>	<b>-</b>	<b>16,720</b>	<b>-</b>

\*Includes commitments to Invest of BD 722 thousands

**4.5 Risk grading of exposures**

The Bank has an internal risk grading system for credit exposures based on a 10 point scale in which grades 8 through 10 are non performing with grades 9 and 10 classified as impaired exposures. Each counterparty credit exposure is assigned a risk grade based on several quantitative and qualitative factors, including financial strength, past record and availability of collateral security. The grading is done at the time of assuming an exposure and on each renewal of the same. The grading sheets are prepared by the Business Department and reviewed by the RMD. Grades are continuously monitored by the Bank's credit administration unit within RMD and exposures are downgraded as and when the quality of the exposure is found to have deteriorated, based on clear criteria laid out in the Bank's credit policy.

For exposures or potential exposures on Banks and Financial Institutions, the Bank has established internal ratings with a six point scale from A to F, in descending order of creditworthiness. These ratings are derived on the basis of the external credit ratings provided by Moody's, Standard & Poor (S&P), Capital Intelligence (CI) & Fitch. When the ratings of S&P and/or Moody's are available, those ratings will be used. In case of differences in ratings of these agencies, the more conservative rating will be used for classification. The ratings of these agencies have been mapped to internal categories as follows:

External Rating Agencies	Internal Ratings					
	A	B	C	D	E	F
S & P	>= AA-	>=A-	>=BBB-	>=B-	Below B-	Unrated
Moody's	>=aa3	>=A3	>=Baa3	>=B3	C & D	
CI	>= AA-	>=A-	>=BBB-	>=B-	C & D	
Fitch	>= AA-	>=A-	>=BBB-	>=B-	Below B-	

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Please refer to note 30 in the notes to the consolidated financial statements for the year ended 31 December 2009, for details of the rating profile of exposures of the Bank.

#### 4.6 Past dues, impaired accounts, provisions

Customers may occasionally fail to meet their obligations to the Bank on due dates. Any amount not paid when due is classified as past due and the Bank initiates focused recovery efforts on such accounts. Any account which is past due for 30 days or more are classified as 'remedial assets'/ Grade 7 and clearly defined procedures are in place for follow up and monitoring of such accounts.

However if the account remains past due for a continuous period of 90 days it is considered as non-performing and classified as Grade 8. The Bank conducts a comprehensive review of all such accounts on a quarterly basis and where provisions are necessary; those exposures are classified as impaired (Grade 9/10). Provisions are created through Profit & Loss (P&L) account where necessary. Such provisions are made on the basis of expected shortfall in present value of projected future cash flows from the assets / securities and the estimates of such cash flows are done on a conservative basis.

On each balance sheet date, the Bank reviews all assets classified as Available-for-sale for any objective evidence that the financial assets are impaired. In case of any such evidence, the asset is revalued at lower of cost of acquisition and its estimated recoverable amount and a provision is created for the difference amount through the profit and loss account.

For a detailed policy on impairment of financial assets, refer note 2 (m) in the notes to the consolidated financial statements for the year ended 31 December 2009.

For the quantitative disclosures relating to exposure which were past due or impaired as of 31 December 2009, please refer to note 30 in the notes to the consolidated financial statement for the year ended 31 December 2009.

During the year 2009, the Bank has undertaken a detailed assessment of its credit portfolio and has considered specific impairment allowances where necessary. In the view of the current market conditions, Bank has maintained the collective provisions at a certain percentage based on the internal risk grades assigned to counterparties, resulting in an average of approximately 1.2% of its Islamic financing assets, assets acquired for leasing, lease rental receivables and Sukuk portfolios. The Bank is in the process of developing a detailed risk and ratings based model to identify and maintain collective provision on portfolio basis going forward.

##### 4.6.1 Geographical and Sector-wise break up of impaired/past due accounts of credit portfolio and Investment in sukuk

							BD 000's
	GCC countries	Europe	USA	Asia	Australia	Africa	Total
Impaired	3,199	-	6,597	-	-	-	9,796
Allowance for impairment	(1,959)	-	(5,938)	-	-	-	(7,897)
Carrying amount	1,240	-	659	-	-	-	1,899
Past due but not impaired	6,878	-	-	-	-	-	6,878
Collective impairment	(2,573)	(76)	-	-	-	-	(2,649)

BD 000's

	<b>Banks and financial institutions</b>	<b>Real estate</b>	<b>Others</b>	<b>Total</b>
Impaired	-	6,597	3,199	9,796
Allowance for impairment	-	(5,938)	(1,959)	(7,897)
Carrying amount	-	659	1,240	1,899
Past due but not impaired	-	3,602	3,276	6,878
Collective impairment	(352)	(1,302)	(995)	(2,649)

#### 4.7 Restructured/renegotiated credit facilities

For disclosure of renegotiated loans refer note 30 in the notes to the consolidated financial statements for the year ended 31 December 2009.

#### 4.8 Legal action and write off of exposures

The Bank has policies for initiation and prosecution of legal action when all amicable avenues for settlement of dues from a customer have been exhausted. The Bank has, as of date, initiated legal action against one client involving a claim of BD 3,372 thousand.

The Bank has a policy that permits write off of exposures when there is no possibility of recovery of the dues through legal and other means. However the Bank has so far not written off any such dues or exposures.

#### 4.9 Penalties for delayed payments

In cases where customers delay the payments of dues to the Bank, the Bank has the right to collect penalties, subject to the provisions of the agreement between the customer and the Bank. The Bank recovers such penalties from customers when the amounts are significant. As per policy, such penalties are maintained in a separate account and used for charity purposes approved by the Bank's Shari'a Board.

For quantitative disclosures refer page 35 of the consolidated financial statements for the year ended 31 December 2009.

#### 4.10 Credit risk mitigation

The Bank uses a variety of tools to mitigate its credit risk, the primary one being that of securing the exposure by suitable collateral security. While existence of collateral security is not a policy precondition for financing, in practice a large part of existing exposures are at least partially collateralised. The Bank has clear policies on the type of assets that can be accepted as collateral security and the mode of valuation of these assets. In general all assets accepted as collateral are valued at least once in a year. The legal validity and enforceability of the documents used for creating these collaterals have been established by external legal experts.

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The position of collateral cover for all credit exposures categorised on the basis of the type of security is given in the table below.

Extent of collateral security cover for credit exposures for the year ended 31 December 2009:

Collateral Type	Murabaha	Musharaka	Wakala	Istisna	Ijarah	Total Gross Exposure <sup>[2]</sup>	Value of Collateral <sup>[1]</sup>	BD 000's	
								%age of cover	%age of total
Real Estate	152,005	23,007	19,231	4,138	26,710	103,603	225,091	217	71
Listed Securities	847	1,402	-	-	-	3,321	2,249	68	1
Unlisted Securities	10,084	-	-	-	-	7,101	10,084	142	3
Bank Guarantee	10,839	-	-	-	-	8,876	10,839	122	3
Cash Collateral	11,635	-	57	-	-	22,722	11,692	51	4
Unsecured	-	-	-	-	-	41,110	-	-	-
Others	10,781	31,239	5,621	-	10,188	21,275	57,829	272	18
<b>Total</b>	<b>196,191</b>	<b>55,648</b>	<b>24,909</b>	<b>4,138</b>	<b>36,898</b>	<b>208,008</b>	<b>317,784</b>	<b>153</b>	<b>100</b>

<sup>[1]</sup> (Represents the last valuation carried out based on the Bank's valuation policy)

<sup>[2]</sup> (Excludes collective provisions of BD 2,491 thousand)

Real Estate properties are reckoned at values certified by qualified valuers. Other physical assets like machinery are valued at book value, invoice value or as certified by an outside expert. Listed securities are valued at market price while unlisted ones are at book value. The Bank has an approved panel of valuers for real estate property. Valuation exercise is supervised by the Risk Management Department of the Bank, independent of the business units.

Facilities are also often secured by personal/ corporate guarantees, assignment of contract proceeds, assignment of insurance policies, etc. However under the Bank's credit policy these are not treated as tangible securities and the value of such guarantees/ assignments though significant in many cases are taken as nil for the purpose of the above analysis.

Assets financed under Ijara Muntahia Bittamleek are considered at par with physical collateral and included under Real Estate or Others in the above calculations.

The declared value of exposures in all cases is the gross exposure net of specific provision. The Bank does not carry out any on balance sheet or off balance sheet netting for the securities held. The Bank has not claimed any capital relief for Credit Risk Mitigation under Section CA 4 of the Capital Adequacy module of CBB rule book and hence all exposures are risk weighted at their gross values.

The Bank has a policy of disposal of asset held as collateral not readily convertible into cash, after completion of necessary legal formalities. During the year there has been no such instance.

## 4.11 Regulatory Capital Requirements by type of Islamic financing contracts

BD 000's

Islamic financing contracts	Exposures		Credit Risk Weighted Assets		Capital requirement	
	Self	URIA	Self	URIA	Self	URIA
Murabaha	19,874	122,197	19,874	36,659	2,385	4,399
Ijarah assets (including lease rental receivables)	13,433	-	13,433	-	1,025	-
Mudaraba	-	-	-	-	587	-
Musharaka	-	24,688	-	7,406	-	889
Wakala	-	23,793	-	7,138	-	857
Istisna'a	-	1,533	-	460	-	55
<b>Total</b>	<b>33,307</b>	<b>172,211</b>	<b>33,307</b>	<b>51,663</b>	<b>3,997</b>	<b>6,200</b>

## 5 Market Risk

## 5.1 Market risk management

Market risk is the risk that changes in market prices, such as foreign exchange rates, profit rates, equity prices, and commodity prices will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Bank separates its exposure to market risk between trading and non-trading portfolios. The Bank has no trading positions in equity or commodities and the main source of market risk for the Bank is its foreign exchange exposure, although this is quite limited. There is also an extent of profit rate risk arising out of mismatches in its asset liability structure. The Bank has well defined policies approved by the Board with clear risk limits and thresholds to effectively manage its market risk.

Details on market risk management, net exposures and sensitivities are given as part of the note 30 in the notes to the consolidated financial statements for the year ended 31 December 2009.

## 5.2 Regulatory Capital Allocation against Market Rate Risk

Table below shows the market risk position for each category of the market risk as at year end along with the maximum and minimum values during the period:

BD 000's

	As at 31 December	Max	Min
Equity position risk	-	-	-
Market risk on trading positions in sukuk	-	-	-
Foreign exchange risk	1,029	1,029	349
Commodity risk	-	-	-
<b>Total</b>	<b>1,029</b>	<b>1,029</b>	<b>349</b>

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## 6 Operational Risk

### 6.1 Operational risk management

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, systems and/ or from external events which includes but is not limited to, legal risk and Shari' a compliance risk. Operational risk is an inherent part of normal business operations. Whilst operational risk cannot be eliminated entirely, the Bank endeavors to minimise it by ensuring that a strong control infrastructure is in place throughout the organisation. Various procedures and processes used to manage operational risk include effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, close monitoring of risk limits, segregation of duties, and financial management and reporting.

Details on operational risk management are given as part of the note 30 in the notes to the consolidated financial statements for the year ended 31 December 2009.

The Risk Management Department monitors all operational processes to ensure that the Board directives are fully implemented and also reports deviations if any to the Senior Management and the Board. The department has specialised personnel engaged in this process. The Bank has implemented an OR system which monitors Key Risk Indicators across all major areas of operation and generates appropriate triggers as and when predefined risk events occur ( through breach of triggers set) and also generates periodical reports for Management reporting. In addition, the Bank's policy dictates that the operational functions of booking, recording and monitoring of transactions are carried out by staff that are independent of the individuals initiating the transactions.

The Bank's operational risk management framework includes components such as Key Risk Indicators (KRIs), operational loss data and Risk & Control Self Assessment across the Bank. KRIs are monitored on an ongoing basis by the Risk Management Department through a specialised operational risk system, which generates KRI alerts and appropriate reports. This helps in quickly detecting and correcting deficiencies in processes and procedures for managing operational risk. This process also assists the Bank in the long term to create a loss data base which will provide the basis for introducing more advanced approaches for computation of capital for operational risk.

### 6.2 Litigation

As on the reporting date, the Bank has no material legal contingencies including pending legal actions except as reported in para 4.8 above. The Bank has a dedicated legal team which provides legal advice and services to all units of the Bank.

### 6.3 Shari'a compliance

The Shari'a Supervisory Board (SSB) is entrusted with the duty of directing, reviewing and supervising the activities of the Bank in order to ensure that they are in compliance with the rules and principles of Islamic Shari'a. The Bank also has a dedicated internal shari'a reviewer, who performs an ongoing review of the compliance with the fatwas and rulings of the SSB on products and processes and also reviews compliance with the requirements of the Shari'a standards prescribed by AAOIFI. The SSB reviews and approves all products and services before launching and offering to the customers and also conducts periodic reviews of the transactions of the Bank. An annual audit report is issued by the SSB confirming the Bank's compliance with shari'a rules and principles.

### 6.4 Regulatory capital allocation against operational risk

The Bank uses the Basic Indicator Approach (BIA) in calculating its regulatory capital requirement for operational risk.

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The risk weighted assets and capital requirement for operational risk as at 31 December is as given below:

	BD 000's
Average gross income for 3 years (A)	30,447
Operational Risk Weighted Assets B = (A * 15% * 12.5)	57,088
Capital requirement (B * 12%)	6,851

## 7 Other risks

### 7.1 Liquidity Risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting its financial obligations on account of a maturity mismatch between assets and liabilities. The Bank's approach to managing liquidity is to ensure that it will always have sufficient funds to meet its liabilities when due without incurring unacceptable losses or risking damage to the Bank's reputation.

The Bank has a liquidity risk policy in place, which describes the roles and responsibilities of the Asset Liability Management Committee (ALCO), Treasury and other concerned departments in management of liquidity. It also stipulates various liquidity ratios to be maintained by the bank, as well as gap limits under each time bucket of the maturity ladder. It is the Bank's policy to keep adequate level of high quality liquid assets such as inter-bank placements, CBB sukus to ensure that funds are available to meet maturing deposits and other liabilities, as and when they fall due.

The day to day management of liquidity risk is the responsibility of the Treasury Department, which monitors the sources and maturities of assets and liabilities closely, and ensures that limits stipulated by the ALCO are complied with. RMD and Financial Control Department (FCD) monitors the liquidity position and any violations are reported to ALCO, ERM and the Board of Directors.

For maturity profile of assets and liabilities, refer note 27 in the notes to the consolidated financial statements for the year ended 31 December 2009. The following are the key liquidity ratios which reflect the liquidity position of the Bank:

	Figures in %				
	2009	2008	2007	2006	2005
Interbank assets to interbank liabilities	137.02	436.50	190.24	157.01	100.00
Liquid assets to total assets	30.02	37.04	31.63	37.53	74.65
Liquid assets to total deposits	59.56	60.39	98.22	119.68	143.89
Net liquid assets to total deposits	22.00	49.79	50.33	50.39	143.89

### 7.2 Profit rate risk in the banking book

The other principal risk to which the banking book is exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for re-pricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by the Bank's Risk Management Department in its day-to-day monitoring activities.

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis point (bps) parallel fall or rise across all yield curves and a 50 bps rise or fall of all yield curves. An

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analysis of the Bank's sensitivity to an increase or decrease in market profit rates has been disclosed in note 30 in the notes to the consolidated financial statements for the year ended 31 December 2009.

### 7.3 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity and credit markets defaults prior to maturity of the contract. The Bank does not engage in proprietary trading of equity, foreign exchange or its derivatives. However, the Bank enters into shari'a compliant foreign exchange risk/ profit rate risk transactions to hedge its risks arising out of mismatch in its asset liability portfolios. Clear policies for such transactions are in place. For other credit markets transactions (primarily inter-bank placements), the Bank has established a matrix of counterparty limits based on external credit rating of such counterparties. Such limits are constantly monitored by the Bank's Risk Management Department. As at 31 December 2009, the Bank did not have open position in foreign currency risk management instruments.

### 7.4 Concentration risk

Concentration risks arises when a number of obligors, counterparties or investees 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. Accordingly, such concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or region. The Bank has established exposure limits to various geographic regions and industry sectors. For break-up of exposure industry/sector wise refer point 4.3.1 and 4.3.2 above.

### 7.5 Reputational risk

Reputation risk is the risk that negative perception regarding the Bank's business practices or internal controls, whether true or not, will cause a decline in the Bank's investor base, lead to costly litigation that could have an adverse impact on liquidity or capital of the Bank. Being an Islamic Bank, reputation is an important asset and among the issues that could affect the Bank's reputation is the inability to exit from investments, lower than expected returns on investments and poor communication to investors. The Bank has a well developed and coherently implemented communication strategy to cover such contingencies. The Bank also allocates additional capital for such risks under its ICAAP.

### 7.6 Displaced commercial risk

Displaced commercial risk refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by Unrestricted Investment Accounts. This can be due to the return on such assets being lower than that of competitors. The Bank has adequate policies and procedures in place to identify, monitor and address all potential risks that may arise from such activities. Please refer to section 8.3 below for further details.

### 7.7 Other risks

Other risks include strategic risk, fiduciary risks, regulatory risks etc. which are inherent in all business and are not easily measurable or quantifiable. The Bank's Board has overall responsibility for approving and reviewing the risk strategies and amendments to the risk policies. The Bank senior management is responsible for implementing the risk strategy approved by the Board. The management also ensures that internal systems of corporate governance and regulatory compliance for management of fiduciary and reputational risks are robust and effective. The Bank also allocates additional capital for such risks under its ICAAP.

### 8 Product disclosures

#### 8.1 Product descriptions & consumer awareness

The Bank offers a comprehensive mix of Shari'a compliant commercial and investment banking products. This include, apart from traditional Islamic financing products, a range of innovative structured investment products like funds, repackaged investments and restricted murabahas. The investment department of the Bank has expertise in creating innovative high end and value added products offering a wide range of structures, expected returns, tenors and risk profiles.

Proposal for any new product is initiated by individual business lines within the Bank. The Executive Risk Management Committee (ERMC) of the Bank reviews such proposal to ensure that the new product/ business is in line with the Bank's business and risk strategy. All new products will need the approval of the Board of Directors and the Shari'a Supervisory Board of the Bank.

Information on new products or any change in existing products will be placed on the Bank's website [www.khcbonline.com](http://www.khcbonline.com) and/ or published in the media. Product details are also shared with customers and the general public through brochures and/ or, advertisements.

#### 8.2 Complaint handling

The Bank takes disputes and complaints from all customers very seriously. These have the potential for a breakdown in relationships and can adversely affect the Bank's reputation. Left unattended these can also lead to litigation and possible censure by the regulatory authorities. The Bank has a comprehensive policy on handling of external complaints, approved by the Board. All employees of the Bank are aware of and abide by this policy.

The Bank has a designated nodal officer for handling of all external complaints and his contact details are displayed on the website and also at the Branch and in all printed publicity materials. Complaints are normally investigated by persons not directly related to the subject matter of the complaint. The Bank endeavors to address all complaints within five working days. Wherever this is not possible, the customer is contacted directly and a time frame for rectification of his complaint advised. A periodical report on status of complaints is also submitted to the Board.

#### 8.3 Unrestricted Investment Accounts (URIAs)

The Bank offers Unrestricted Investment Accounts (URIAs) to both small investors and high net worth individuals. Unrestricted Investment Accounts (URIAs) represents funds offered by customers to the Bank to be invested in a Sharia compliant manner, at the Bank's discretion as Mudarib. All URIA accounts are on profit sharing basis, but the Bank does not guarantee any particular level of return. Any loss arising from the investment will be borne by the customer except in the case of the Bank's negligence. The Bank charges a Mudarib fee as its share of profit.

The Bank offers Unrestricted Investment Accounts in Bahraini Dinar, US Dollar and Euro for maturity periods ranging from 1 month to 12 months. The Bank completes its full range of KYC due diligence prior to accepting any investment. The customer also signs a written agreement covering all terms and conditions of the investment including tenor, basis of profit allocation, early withdrawal, etc.

In the current year, Bank has launched a savings account product called "Al Waffer" which entitles the investors to certain cash prizes, decided based on a raffle draws held on monthly, quarterly, and annual basis apart from the normal share of profits declared and distributed after reducing the Mudarib fees.

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URIA is a significant funding source for the Bank. However, the failure to pay the expected return to URIA holders exposes the Bank to Displaced Commercial Risk leading to loss of reputation and business. The Bank regularly monitors rate of return offered by competitors to evaluate the expectations of its Investment Account Holders. Bank's policy also provides for whole or partial waiver of the Mudarib share of income from investments due to it, to provide a reasonable return to its investors. Bank further mitigates this risk by setting up and maintaining an appropriate level of Profit Equalisation Reserve (PER) and Investment Risk Reserve (IRR) to smoothen return to URIA holders.

The Bank comingles its own funds and URIA funds which are invested together. The Bank has an identified pool of assets where the URIA funds are invested and the income from which is allocated to such accounts. Out of the gross income, the investor's share is computed after deducting the Mudarib share and contribution to PER and IRR. The profit allocation schedule signed by the customer prior to investment contains the scheme of allocation of the Mudarib share and reserves. Administrative expenses incurred for management of the funds are borne directly by the Bank and are not charged separately to investment accounts. Bank has not allocated any losses on its credit portfolio to the investors; (i.e. assets financed by URIA funds); hence the specific and collective provisions on assets are only allocated to the self financed portfolio.

URIAs are carried at their book values and include amounts retained towards PER and IRR. Creation of these reserves results in an increase in the liability towards the pool of URIAs.

Till date, the Bank has not made any withdrawals on PER or IRR. Any movements on these accounts are therefore only on account of additional reserves added.

Subject to the provisions thereof, deposits held with the Bahrain office of Khaleeji Commercial Bank are covered by the Deposit Protection Scheme established by the Central Bank of Bahrain regulation concerning the establishment of a Deposit Protection Scheme and a Deposit Protection Board.

The details of income distribution to URIA holders for the last five years is given below.

	BD 000's				
	2009	2008	2007	2006	2005
Allocated Income to URIA	<b>11,103</b>	8,953	3,012	917	279
Distributed Profit	<b>9,331</b>	7,050	2,446	628	207
Mudarib Fees	<b>1,772</b>	1,903	566	289	72
<b>As at 31 Dec</b>					
URIA <sup>(1)</sup>	<b>184,394</b>	128,814	38,405	12,803	4,857
Profit Equalisation Reserve (PER)	<b>1,209</b>	649	206	60	14
Investment Risk Reserve (IRR)	<b>925</b>	473	134	43	9
Profit Equalisation Reserve-to-URIA	<b>0.66%</b>	0.50%	0.54%	0.50%	0.29%
Investment Risk Reserve-to-URIA	<b>0.50%</b>	0.37%	0.35%	0.36%	0.18%

<sup>(1)</sup> Represents average balance

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## Ratio of profit distributed to PSIA by type of URIA (based on tenor)

BD 000's

Tenor	Profit distribution amount					Ratio of profit paid as a percentage of total				
	2009	2008	2007	2006	2005	2009	2008	2007	2006	2005
1 Month Mudaraba <sup>[2]</sup>	4,271	3,346	1,576	335	108	45.8	47.5	64.4	53.4	52.1
3 Months Mudaraba	1,443	1,314	148	78	39	15.5	18.6	6.1	12.4	19.0
6 Months Mudaraba	736	373	71	26	9	7.9	5.3	2.9	4.1	4.4
12 Months Mudaraba	1,196	690	106	45	27	12.8	9.8	4.3	7.1	13.3
VIP Mudaraba	673	545	309	64	-	7.2	7.7	12.6	10.2	0
PER and IRR expenses	1,012	782	236	80	24	10.8	11.1	9.7	12.8	11.2
<b>Total</b>	<b>9,331</b>	<b>7,050</b>	<b>2,446</b>	<b>628</b>	<b>207</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

<sup>[2]</sup> Includes saving account products.

Year	Avg. profit earned from URIA assets (%age of asset)	PER set aside as a %age of URIA assets	IRR set aside as a %age of URIA assets	Mudharib fees as a %age of URIA assets	Profit paid as a %age of URIA assets
2009	6.09	0.30	0.24	0.96	4.58
2008	7.07	0.34	0.26	1.60	4.87
2007	7.84	0.38	0.24	1.47	5.75
2006	7.59	0.38	0.29	2.39	4.53
2005	5.74	0.29	0.18	1.48	3.80

## Market benchmark rates:

The Bank refers to the group of commercial Islamic banks incorporated in the Kingdom of Bahrain so as to benchmark the rate of return on URIA.

Following are the profit rates declared and distributed to the investors by the Bank:

	2009	2008	2007
1 Month Mudaraba <sup>[2]</sup>	4.00%	4.80%	6.30%
3 Months Mudaraba	4.94%	5.25%	5.20%
6 Months Mudaraba	5.30%	5.13%	5.15%
12 Months Mudaraba	5.79%	5.40%	5.30%
VIP Mudaraba	4.20%	4.52%	5.09%

<sup>[2]</sup> Includes saving account products.

## 8.4 Restricted Investment Accounts (RIAs)

The Bank offers Restricted Investment Accounts ("RIAs") to both small investors and high net worth individuals in the GCC. The Bank structures its RIA products to offer its customers an opportunity to choose from a wide range of returns, maturity periods, sectors, asset classes and risk levels.

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All RIA offering documents (“Offering Document”) are drafted and issued with input from the Bank’s Investment Banking, Shari’a, Financial Control, Legal and Risk Management Departments to ensure that the Investors have sufficient information to make an informed decision after considering all relevant risk factors.

The Board of Directors is responsible for providing clear guidelines for the development, management and risk mitigation of its’ RIA investments and to ensure that there exist sound management and internal control systems to ensure that the interests of the investment account holders are protected at all times. Wherever it is necessary for the Bank to establish Special Purpose Vehicles (SPV’s) for management of the investment, the Board ensures that the management of such SPV’s are conducted in a professional and transparent manner by a duly appointed Board.

The Bank is aware of its fiduciary responsibilities in management of the RIA investments and has clear policies on discharge of these responsibilities. The Bank’s Policy regarding its’ fiduciary responsibilities to the RIA investors and their funds, includes the following:

- Ensuring that the investment structure, Offering Documents and the investment itself are fully compliant with Islamic Shari’a principles and the CBB regulations;
- Appropriately advising Investors, as part of the RIA Offering Document, of all the relevant and known risk factors and making it clear that the investment risk is to be borne by the Investor before accepting the investment funds;
- Completing all necessary legal and financial due diligence on investments undertaken on behalf of the Investors with the same level of rigor as the Bank requires for its’ own investments;
- Ensuring that the funds are invested strictly in accordance with the provisions outlined in the Offering Documents;
- Putting in place suitable resources and systems to manage and administer the investment and any necessary RIA SPV(s) and to proactively manage all risks;
- Preparing and disseminating periodical investment updates to Investors on a regular basis during the tenor of the investment;
- Distributing the capital and profits to the Investor in a just and equitable manner as Mudarib; and
- In all matters related to the RIA, RIA SPV(s) and the investment, act with the same level of care, good faith and diligence as the Bank would apply in managing its own investments.

Within the Bank, the abovementioned responsibilities and functions are provided, managed and monitored by qualified and experienced professionals from the Investment Banking, Shari’a, Financial Control, Legal, Investment Administration and the Risk Management Departments.

Investment update reports are prepared and disseminated by the Bank to the RIA Investors on a periodic (at least on a half yearly) basis outlining any material contracts/decisions, investment performance, distribution (if any) or exit criteria/information.

RIA Name	Details	Launch Date	Projected Returns	Return Frequency	Returns annualised				
					2009	2008	2007	2006	2005
Al Hareth French Property Fund	An investment product designed to deliver attractive return from income producing properties in France, which is currently yielding 9.5% p.a. exceeding the 9% promised to investors. Approximate capital redemption of 30% was completed in April 2007. The product generated a capital gain of 6% on the redeemed portion.	2005	9%	Annual	1.75%	9.5%	9.5%	9.5%	4.4%
RIA-1 Safana	An investment structure designed to participate in the equity interest of Safana Investment WLL. A company established for the purpose of acquiring reclaimed land to subdivide and sell. The product has a three year term with the distribution expected upon exit in May 2010.	2007	61.78% over three years	Bullet payment on maturity	-	-	-	-	-
RIA-2 Hajer Tower	A restricted investment structure designed to acquire the 21st floor of Al-Hajer Tower in the Holy City of Mecca. The exit of this product was completed in June 2008 with the expected return of 14.90% been met.	2007	14.90%	Bullet payment on maturity	-	14.9%	-	-	-
RIA-3 Aramis	Participation in Murabaha backed by a promissory issued by a guarantor SPV with BBB+ rating. KHCB offered this as a short-term investment to investors with 3 month term on a renewal option and successfully exited all investors from this project during quarter ended 31 March 2008.	2007	3 month USD Libor+187 bps per quarter	Quarterly	-	7.50%	7.72%	6.34%	-
RIA 4 Janayen	A restricted Mudarabah product designed to invest in income generating property mainly designed for labour accommodation. Janayen is expected to exit on completion of 43 months in February 2011.	2007	2.5% per quarter	Quarterly	9.62%	10.65%	-	-	-

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RIA-5 North Gate	A restricted Mudharabah product which owns a 6.0% stake in Shaden Real Estate Investment WLL which will in turn through its subsidiaries, hold a parcel of reclaimed land and measuring approximately 3.875 million sq. meter located in Al Hidd, Muharraq. The mixed-use plot will be sold to end-users subsequent to the completion of infrastructure works. The distribution is expected to be in a bullet payment.	2008	90.66% over 3 years	Bullet return at maturity	-	-	-	-	-
RIA-6 Locata	A Restricted Mudharabah product which entitles the investors beneficial ownership of 25% equity share capital of Locata Corporation Pty Ltd., a company incorporated in Australia. The Company has invented a new and patented wireless radiolocation technology and shall use this funding to scale up its production capacity, sales/marketing channels and further product enhancement capabilities.	2009	110.54% over 3 years	Bullet return at maturity	-	-	-	-	-

## 9 Corporate Governance & Other Disclosures

### 9.1 Corporate governance structure

The Bank's corporate governance framework focuses on Board responsibility, oversight and management accountability vis-à-vis governing regulations and better practices. The framework is in line with global best practices and regulatory requirements which seek to balance entrepreneurship, control and transparency, while creating value for all stakeholders.

Corporate governance, the way the Board and Management is organised and how they operate in practice ultimately aims at leading the Bank towards successfully meeting its strategic objectives. The Board of Directors is accountable to the Bank's shareholders for the creation and delivery of strong sustainable financial performance and long-term shareholder value. To achieve this, the Board approves and monitors the Bank's strategy and financial performance, within a framework of sound corporate governance and effective risk management.

The Bank is committed to continuously reviewing and developing its corporate governance standards to ensure compliance with the requirements of the revised corporate governance framework being implemented by the Central Bank of Bahrain and other regulatory bodies, and also to keep abreast with international best practices.

### 9.2 Board of Directors

The Board of Directors currently comprises of ten members. During the year 2008, the shareholders during the Annual General Meeting (AGM), elected a new Board which represents the new and changed shareholding of the Bank. The Chairman of the Board of Directors is charged with regular supervision and assessment of executive management and is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the Chief Executive Officer (CEO), and maintaining a dialogue

with the Bank's stakeholders. The Board has constituted certain committees with specific delegated authorities to oversee and guide the management in specific areas of the Bank's operations and decision-making. The Board, either directly or through its various committees will oversee the management of the Bank.

The names, title, and other positions held by the Board of Directors are set out below.

**Dr. Fuad Abdulla Al-Omar****Chairman**

Director Since 2004 (Independent and Non-Executive)  
Over 30 years of experience in financial and commercial sector  
Chairman of MENA Real Estate Company, Kuwait  
Vice Chairman of Gulf Real Estate Development Co.  
Director – Gulf North Africa Company Holding, Dana Capital

**Essam Yousif Janahi****Vice Chairman (Resigned in Feb 2010)**

Director Since 2004 (Non-Executive)  
Over 21 years of experience in the financial Industry  
Nominated by Gulf Finance House BSC  
Chairman - Gulf Finance House  
Member -Shura Council of the Kingdom of Bahrain  
Chairman - Bahrain Financial Harbour Holding Company  
Chairman - Bayan Holding Company  
Vice Chairman - Al Areen Holding Company  
Board Member - Arab Finance House  
Board Member - Abu Dhabi Investment House

**Abdul Latif Abdulla Al-Meer****Director**

Director Since 2004 (Non-Executive)  
Over 34 years experience in the financial industry  
Nominated by Gulf Finance House BSC  
Managing Director & Board Member - QInvest  
Board member – Qatar Damman Islamic Insurance Co. (Bima), Qatar  
Board member – Arab Finance House, Beirut  
Board member – European Finance House, London  
Board member – Gulf Finance House, Bahrain.

**Hesham Abdullatif H. Al Jaber****Director**

Director Since February 2008 (Non-Executive)

Over 12 years of experience in commercial sector  
Nominated by Gulf Finance House BSC  
Board Member - Al-Jabr Trading Company, KSA  
Board Member - United Gas Transmission Co, UAE  
Board Member - Advanced Electronics Equipment, KSA  
Board Member - Golden Chip Company, KSA  
Board Member - Nattily Company, KSA

**Khalid Rashid Al Thani****Director**

Director Since February 2009 (Independent and Non-Executive)  
Over 19 years of experience in financial and commercial sectors  
Deputy General Secretary Awqaf and Minors Affairs Foundation, Dubai.  
Head of Finance Department Dubai land Department from 1999 to 2004  
Board of Directors Member Dubai International Holy Quran Award 1997 to 2004

**Talal Hazim R. Al Ghalib****Director (Resigned in November 2009)**

Nominated by Gulf Finance House BSC  
Director Since February 2008 (Non-Executive)  
Executive Director - Gulf Finance House

**Rashad Yusuf Abdulla Janahi****Director**

Director Since February 2008 (Non-Executive)  
Over 18 years of experience in financial sector  
Nominated by Esam Yousif Janahi  
CEO - Abu Dhabi Investment House  
Chairman- Qatar Entertainment City  
Board Member - Al Arabi Private Equity Fund  
Board Member - Gulf Holding Company  
Board Member - Global Banking Corporation (GBCorp)

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**Abdulla A. Karim Showaiter****Director**

Director Since February 2008 (Independent & Non-Executive)

Over 32 years experience in the banking industry

Nominated by Emirates Islamic Bank

General Manager – Corporate & Investment, Emirates Islamic Bank

Board Member - Bahrain Islamic Investment Co, Bahrain

Board member - Saba Islamic Bank, Yemen

CEO - Khaleeji Commercial Bank

Chairman - Capital Real Estate Company

Chairman - Janayen Holding Company

Chairman - Danat India investment Company

Chairman – Global Logistix Navi Mumbai, Holding Company.

Chairman – Global Logistix Navi Mumbai, Investment Company.

Board member – Eqarat Al Khaleej

Board member – First Gulf Real Estate Company SPC

Board member – Gulf German Residences

Board member – Amlak II Bahrain

Board member – Amlak II Walkers

Board member – Surooh Bahrain SPC

Board member – Danat India Holding Company

Board member – Jawhara Greens Company

**Abdullateef Moosa Al Abdul Razzaq****Director**

Director Since February 2008 (Non-Executive)

Over 30 years of experience in financial and commercial sector

Nominated by Al Imtiaz Investment Company

CEO Consultant - Al Imtiaz Investment Company

Note: The qualifying criteria for 'Independent' Directors are as per the Corporate Governance guidelines of the Central Bank of Bahrain.

**Ebrahim Hussain Ebrahim****Director**

Director Since February 2008 (Executive)

Over 26 years of experience in financial sector

The Chairman, the Board of Directors and the Board Committees have direct access to the heads of Internal Audit, Risk Management, Regulatory Compliance & Shari'a Compliance.

**9.3 Board of Directors' interests**

The non-executive members of the Board collectively held 107,859,801 shares in the Bank as of the year ended 31 December 2009 (2008: 102,005,556 shares).

**9.4 Code of conduct**

The Board has approved a code of conduct for all staff of the Bank as well as the Board members. The code which includes how to deal with areas of conflict of interest, binds the directors, executive management and staff to the highest standards of professionalism and due diligence on discharging their duties.

**9.5 Insider trading**

The Bank has a Board approved policy on Insider Trading in line with regulatory requirements with the main objective of preventing abuse of inside information. Insiders include all board members, all executive management and any person from the Bank or working on assignments related to the Bank who have access to material and price sensitive information.

### 9.6 Board committees

The Board of Directors has constituted four Committees with specific delegated authorities.

Committee	Members	Primary Responsibilities
Board Nominations, Remunerations & Governance Committee (BNRGC)	Dr. Esam Yusuf Janahi Mr. Abdulla Abdulkarim Showaiter Mr. A. Latif Moosa Al Abdulrazzaq	HR & related policies, Compensation and incentives, Human resources, Administration, Corporate governance.
Board Audit Committee (BAC)	Mr. A.Latif Abdulla Al Meer Mr. Rashad Yousif Janahi Mr. Khalid Rashid Al Thani	Internal audit, External audit, Accounting policies, Compliance, Anti Money Laundering.
Board Investment & Credit Committee (BICC)	Dr. Fuad Abdulla Al Omar Dr. Esam Yusuf Janahi Mr. Abdulla Abdulkarim Showaiter Mr. A. Latif Moosa Al Abdulrazzaq Mr. Ebrahim Hussain Ebrahim	Investment & credit approval, Limits, Investment policies, Asset Liability Management.
Board Risk Management Committee (BRMC)	Mr. A.Latif Abdulla Al Meer Mr. Hesham Hamad Abdulatif Al Jabr Mr. Khalid Rashid Al Thani	Risk management, Policies related To Risk management.
Insiders Committee	Dr. Fuad Abdulla Al Omar Dr. Esam Yusuf Janahi Mr. Ebrahim Hussain Ebrahim	Insider trading.

The Board of Directors and its committees receive regular reports on various aspects of the Bank's business from senior management as well as from Internal Audit, Risk Management, Operations and Finance Departments.

### 9.7 Shari'a Supervisory Board

The Bank's Shari'a Supervisory Board consists of three Islamic scholars who review the Bank's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Bank to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

#### Dr. Fareed Yaqoob Al Miftah

##### Chairman

Member of the Supreme Council of Islamic Affairs  
Undersecretary of the Ministry of Islamic Affairs, Kingdom of Bahrain  
Former judge of the high Shari' a Court  
Former Lecturer at the University of Bahrain.  
PhD from the University of Edinburgh, United Kingdom.

#### Dr. Fareed Mohammed Hadi

##### Executive Member

Assistant Professor at the College of Arts, Department of Arabic and Islamic studies, University of Bahrain  
Member of Shari'a Supervisory Boards of a number of Islamic banks  
PhD in Ibn Hazm's Methodology of Jahala, Edinburgh university, UK  
PhD in Al-Bukhari's Methodology, University of Mohammed V, Morocco

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**Shaikh Nizam Mohammed Saleh Yaqoobi****Member**

Executive Member of the Shari'a Supervisory Board of Abu Dhabi Islamic Bank

Executive Member of the Shari'a Supervisory Board of Bahrain Islamic Bank

Executive Member of the Shari'a Supervisory Board of and Shamil Bank

Member of Shari'a Supervisory Boards of a number of Islamic banks

Board Member of the Dow Jones Islamic index

**Abdulnasser Al Mahmood****Head of Shari'a Compliance - Regulatory Shari'a & Compliance****9.8 Executive / Management committee**

The Board of Directors delegates the authority for day-to-day management of the business to the Chief Executive Officer (CEO) who is responsible for implementing the Bank's strategic plan. The CEO manages the Bank through the following management committees:

Committee	Primary Responsibilities
Management Committee	Strategy, Performance review, Budget, Human Resources, Administration
Asset Liability Management Committee	Balance sheet management, Funding, Liquidity, Banking Relationships
Executive Credit & Investment Committee	Review of investments, Exit and credit proposals, Monitoring of investments
Executive Risk Management Committee	Risk Management policies, Risk review, Provisions and impairment

**Executive Management & Other Senior Management**

The names & title of each member of our Executive and other Senior Management are set out below:

**Mr. Ebrahim Hussain Ebrahim****Chief Executive Officer & Board Member**

**Experience** - Over 26 years of experience in both Islamic and conventional banks and financial institutions. Joined the Bank in 2004.

**Qualification** - Master of Business Administration with a concentration in Finance.

**Mr. Silvan Varghese****Deputy General Manager & COO**

**Experience** - Over 17 years experience in banking and financial services industry in the areas of risk and credit management, project finance and corporate banking.

Joined the Bank in 2007.

**Qualification** - BS in Chemical Engineering from BITS, Pilani, India, MBA from the Indian Institute of Management (IIM), Lucknow, India, certified by Global Association of Risk Professionals (GARP) as a Financial Risk Manager (FRM).

**Fuad Ali Taqi****Deputy General Manager- Commercial Banking**

**Experience** - Over 28 years of banking experience in Islamic and conventional banks. Joined the Bank in 2006.

**Qualification** - Business Studies Diploma, currently enrolled in an MBA program.

**Dimitry Blasi****Deputy General Manager- Investment Banking**

**Experience** - Over 13 years of experience in Islamic and conventional banking including a number of prominent

international jurisdictions. Joined the Bank in 2005.

**Qualification** - ACA (United Kingdom), qualified lawyer (NSW, Australia)

### **Mahdi A. Nabi Mohammed**

**Assistant General Manager – Operations & Administration**

**Experience** - Over 29 years of banking experience. Joined the Bank in 2005.

**Qualification** - Certified Diploma in Accounting & Finance from The Chartered Association of Certified Accountants (ACCA), MBA from the University of Strathclyde, United Kingdom.

### **Khalil Zaabi**

**Head of Investment Placement- Investment Banking**

**Experience** - Over 25 years of banking experience in Islamic, conventional bank and financial institutions. Joined the Bank in 2006.

**Qualification** - Diploma in Mathematics from Arthur King Collage, Canada, Diploma in Computer Programming from Computer Institute of Canada.

### **Ahmed Ali Bucheery**

**Head of Internal Audit**

**Experience** - 16 years of internal audit experience with banks. Joined the Bank in 2007.

**Qualification** - Certified Internal Auditor (from the Institute of Internal Audit, USA), BS Accounting from King Fahad University of Petroleum and Minerals.

### **Hussam Saif**

**Head of Treasury**

**Experience** - 20 years of experience in treasury and Islamic banking. Joined the Bank in 2007.

**Qualification** - Graduate of Western International University - London with a degree in Business Administration & Management.

### **T N Ramesan**

**Head of Risk & Credit Management**

**Experience** - 30 years of banking experience. Joined the Bank in 2007.

**Qualification** - MSc in Physics from the Indian Institute

of Technology, Madras, India, Diploma in International Finance & Investment from Hong Kong Management Association, Certified Associate of the Indian Institute of Bankers.

### **Yaser Mudhafar**

**Head of Financial Control**

**Experience** - 12 years extensive experience in the Islamic banking industry. Joined the Bank in 2005.

**Qualification** - CPA, CIPA, Executive MBA and a Bachelor of Science in accounting from University of Bahrain.

### **FetooH Al Mannai**

**Head of Human Resources**

**Experience** - 14 years of experience in human resources, training and administration. Joined the Bank in 2007.

**Qualification** - MBA and a BA (Hons) in Human Resource Management, Member of Bahrain Society for Training and Development (BSTD), Member of Bahrain Management Society (BMS), Fellow of the Chartered Institute of Personnel & Development (Chartered FCIPD), Member of Society of Human Resource Management (SHRM).

### **Ramnath Narayanan**

**Head of Legal- Legal Department**

**Experience** - Over 12 years experience in Legal and Banking industry. Joined the Bank in 2008.

**Qualification** - Master of Laws from the University of Virginia School of Law, USA, Bachelor of Laws from the University of Madras, India, and a Certified associate of the New York Attorney and Solicitors Regulation Authority.

### **Abdulnasser Al Mahmood**

**Head of Shari'a Compliance - Regulatory Shari'a & Compliance**

**Experience** - Over 19 years of experience in Shari'a Audit and Islamic banking. Joined the Bank in 2008.

**Qualification** - BS in Shari'a and Islamic studies, Associate Diploma in Shari'a Control, MBA from Gulf University, Kingdom of Bahrain.

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**Mohammed Abdulla Ebrahim**

**Corporate Secretary**

**Experience** - Over 7 years of experience working at the Office of the Asst. Undersecretary for Planning and Organisation, Ministry of Interior, Bahrain and at the Secretariat General Office of the GCC in Riyadh as Liaison Officer for the Kingdom of Bahrain. Joined the Bank in April 2009.

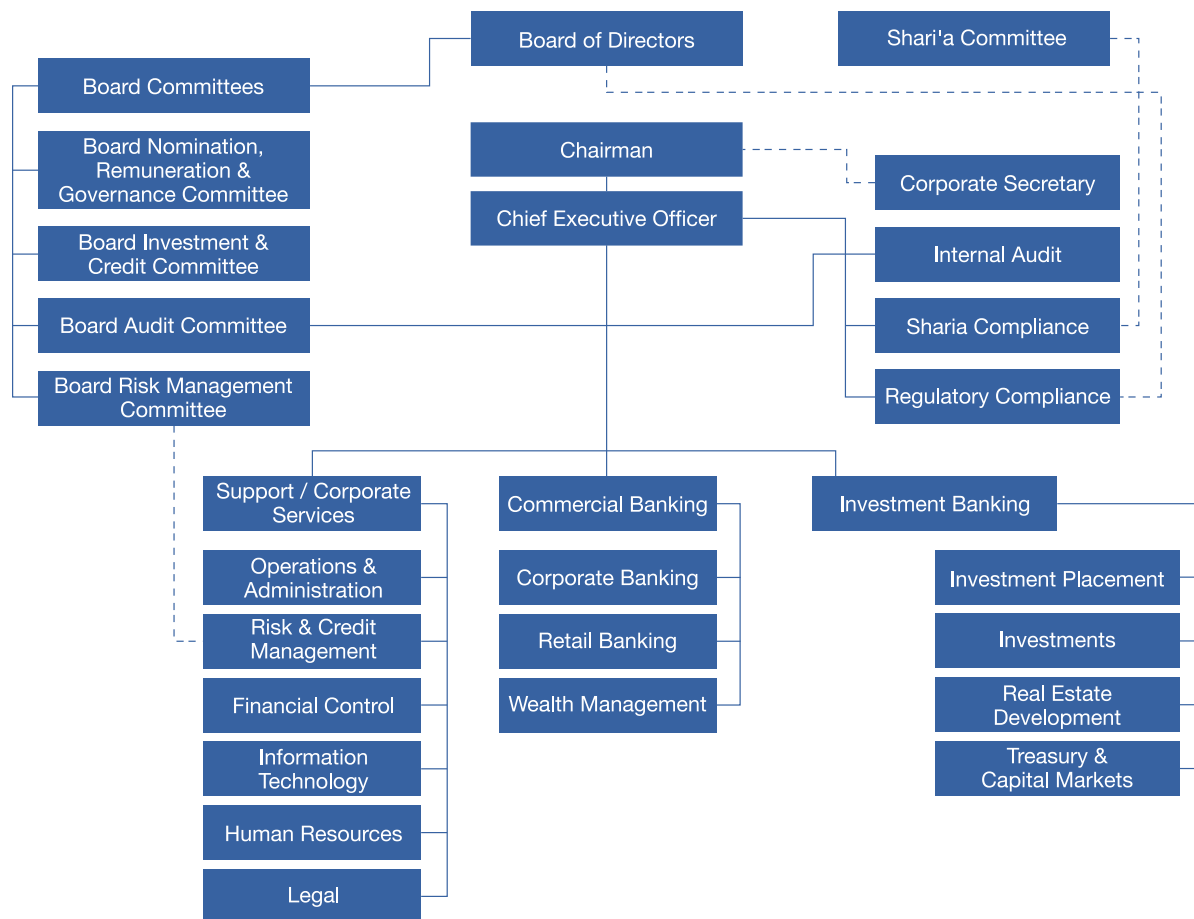
**Qualification** - Masters in IT, Media and E-Commerce Law from the University of Essex, UK, an Advanced Diploma in Islamic Finance by the Bahrain Institute of Banking and Finance (BIBF), a Diploma in Business Management from the University of Bahrain and a B.Sc. in Law from Dubai Police Academy.

**9.9 Executive and Senior Management interests**

The members of the executive and senior management team held 14,343,069 shares as at 31 December 2009 (2008: 8,294,853 shares).

**9.10 Organisation chart**

Set out below is the Bank's organisation chart, which outlines the different committees and the lines of reporting.



There have been no major structural changes to the organisation structure from the previous year.

**9.11 Executive compensation**

The Bank has both a short-term and long-term compensation structure for its executive management which has been developed based on current market surveys and industry norms. The Bank also operates an incentive scheme where in eligible employees are awarded a combination of shares and cash incentives on achievement of pre-determined performance targets. For further details please refer note 19 in the notes to the consolidated financial statements for the year ended 31 December 2009. The Board of Directors is entitled to sitting fees and their annual remuneration is subject to the approval of the shareholders at the end of each year.

**9.12 Shari'a compliance, regulatory compliance and anti-money laundering**

Compliance with Shari'a laws, regulatory and statutory requirements is an ongoing process and the Bank is conscious of its responsibilities in observing all applicable provisions and best international practices in its functioning. The Bank has established the Shari'a Compliance Function and the Regulatory Compliance Function in keeping with Basel and CBB guidelines. The respective units act as a focal point for all Shari'a and regulatory compliance and for adapting other best practice compliance principles.

Anti-Money Laundering measures form an important area of the Compliance Function. The Bank has an Anti-Money Laundering and Combating Terrorist Financing Policy and Procedure approved by the Board, which contains sound Customer due diligence measures, procedure for identifying and reporting suspicious transactions, a programme for periodic awareness training to staff, record-keeping, and a designated Money Laundering Reporting Officer (MLRO). The Bank's Anti-Money Laundering measures are audited by independent external auditors every year and their report is submitted to the CBB. The Bank is committed to combating money laundering and, towards this end, implements all 'Prevention of Money Laundering Regulations' and other guidelines issued by the CBB.

**10 Financial performance**

Following are basic quantitative indicators of the financial performance:

	<b>2009</b>	2008	2007	2006	2005
Return on average equity	<b>2.47%</b>	20.00%	23.50%	20.89%	13.00%
Return on average assets	<b>0.65%</b>	7.40%	11.50%	9.54%	8.11%
Financing income to financing expense ratio	<b>155.66%</b>	154.11%	187.97%	144.59%	261.19%
Cost-to-Income Ratio*	<b>48.30%</b>	30.59%	30.46%	38.67%	35.63%

\* Cost has been considered excluding impairment allowances.

For detailed discussion on the performance for the year, kindly refer Chairman's report on of the consolidated financial statement for the year ended 31 December 2009.