



2010
ANNUAL REPORT

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ



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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IN TIMES OF CHANGE,
KHCB RECOGNISES A SEA
OF OPPORTUNITIES.
WE ARE COMMITTED
TO NAVIGATE THROUGH,
DIRECTING WITH
A MORAL COMPASS.
WE WILL LEAD THE BANK,
OUR SHAREHOLDERS,
CLIENTS AND BUSINESS
PARTNERS TO
A SUCCESSFUL FUTURE



FINANCIAL HIGHLIGHTS

TOTAL INCOME

19,585

NET INCOME

(6,533)

TOTAL ASSETS

419,216

TOTAL EQUITY

118,158

EARNINGS PER SHARE

(5.78)

BOARD OF DIRECTORS



*Dr. Fuad Abdulla Al Omar
Chairman*



*Mr. Abdulla Showaiter
Vice Chairman*



*Mr. Ebrahim H. Ebrahim
Director & CEO*



*Mr. A. Latif Al Meer
Director*



*Mr. Khalid Al Thani
Director*



*Mr. Rashad Y. Janahi
Director*



*Mr. Hesham Aljabr
Director*



*Mr. Yousef Khalaf
Director*



*Mr. Mohammed Al Mutair
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 MUFTAH CHAIRMEN

Member of Supreme Council of Islamic Affairs, Undersecretary of the Ministry of Islamic Affairs, Kingdom of Bahrain; former judge of High Shari'a Court; lecturer at University of Bahrain; PhD from 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 Board of numerous Islamic banks.

SHAIKH NIZAM MOHAMMED SALEH YAQUBY MEMBER

Executive member of Shari'a Supervisory Board, Abu Dhabi Islamic Bank and Shamil Bank; Board Member of Dow Jones Islamic Index; Member of Shari'a Supervisory Board of numerous Islamic banks.

CHAIRMAN'S REPORT

Dr. Fuad Abdulla Al Omar



In the name of Allah, the beneficent, the merciful, prayers and peace upon the last apostle and messenger, our Prophet Muhammad (pbuh). On behalf of the Board of Directors, it is my pleasure to present the annual financial statements of Khaleeji Commercial Bank for the year ended 31 December 2010.

This, the sixth year of operations for the Bank, has been an extremely challenging one. The regional economic and business environment continues to remain difficult against the backdrop of the global financial crisis and unsettled capital markets.

The Bank's business model has in the past been designed with a focus on investment and private banking, which was in part a result of the restrictions on the Bank's original licence and to a greater extent a reflection of the attractive opportunities in those areas and the abundant liquidity in the regional markets during the period from 2005 to 2008. I am pleased to report that the Central Bank of Bahrain has now removed the restrictions on the Bank's licence which prevented it from engaging in retail consumer finance activities other than those related to real estate.

In view of the changed circumstances in the global financial markets and in the terms of the Bank's licence, the Board decided to review the Bank's business model and the strategic direction of the Bank. The Board concluded that in order to remain a successful financial institution that provides sustainable returns

to its shareholders, the Bank had to reshape its business model and implement a new strategic plan. The Bank's new strategic plan is focused on expanding its commercial banking business. Key elements of the plan include launching and growing the retail banking business in Bahrain, increasing the Bank's share of business in the local corporate and business markets and expanding the Bank's commercial banking business in the regional markets, while continuing to leverage on its investment banking capabilities. In connection with these aims, the Bank is also looking to extend its local branch network and electronic distribution channels.

OVERALL PERFORMANCE

Like 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 and conservative management, the Bank was able to navigate this difficult period successfully. The Bank has focused on diversifying and expanding its business while maintaining conservative liquidity and capital positions.

With the blessings of Allah The Almighty, the Bank continues to maintain strong liquidity (with 20.9% of the Bank's assets being liquid) and adequate capital (the Bank has a regulatory capital adequacy ratio of 31.8%), both comfortably in excess of regulatory requirements. As a result of conservative liquidity and balance sheet management, the

CHAIRMAN'S REPORT

total assets of the Bank declined by 11.5% to BD 419.2 million during 2010. However, the Bank managed to increase its financing portfolio by 2.8% to BD 211.1 million and revenue from commercial and retail banking activities by 7.1%, confirming the success of the Bank's strategy of expanding its commercial banking business. Unrestricted Investment Accounts (URIA) and Murabaha from customers also increased marginally, reaching BD 217.2 million, which reflects the market's confidence in the Bank's products and services.

During the year, revenue declined significantly by 41.1%, mainly due to lower income from investment banking activities when compared with previous years. Given the challenging credit and economic conditions, the Board also took the prudent step of increasing the Bank's impairment provision by BD 8.6 million. Consequently, and for the first time in its history, the Bank has to report a net loss for 2010 of BD 6.5 million compared to a profit of BD 3.1 million in 2009.

In line with the Bank's revised business model and strategic direction, the Bank launched several new products to meet clients' needs. In October 2010 a full suite of consumer finance products including auto financing, personal financing and mortgage financing were launched in addition to a Visa-branded credit card. I am happy to report that these products were well received by the Bank's customers. The Al-Waffer savings account continued to expand and attract new customers and helped the Bank in diversifying its customer base and sources of funds. The Bank's investment banking team has been actively managing the portfolio of investment products and Restricted Investment Accounts (RIA), to enhance the

value of the assets held in those products and to work towards potential exits.

ORGANISATIONAL DEVELOPMENT

The Board believes that to remain competitive in the long run, building organisational capacity, including human capital, is imperative. A committed and well trained work force is a key enabler in achieving the Bank's long term objectives. During 2010, the Bank hired 22 employees, mainly for the Bank's retail banking business in a market where new jobs were not being created. The Bank also continued to invest in the training and development of its human resources through external and in-house training programmes and the enhanced graduate trainee programme. The Board takes pride in the fact that 91% of the Bank's employees are Bahrainis. In addition, the Bank has supported the Human Resource Development fund (HRD) of the Kingdom of Bahrain, the Waqf Fund and Tamkeen in addition to providing training opportunities to students from different local and international universities.

Full compliance with the rules and guidelines of the Central Bank of Bahrain and other regulatory agencies is another fundamental element of the Bank's strategy. During the year the Board undertook significant initiatives to improve the knowledge and practice of Corporate Governance within the Bank. These steps included holding a workshop for Directors and Executive Management to familiarise them with the new Corporate Governance Code and undertaking a strategic review of the Bank's current corporate governance practices.

I am happy to report that the Bank has already



From left to right: Fuad Taqi - DGM, Commercial Banking; Silvan Varghese - DGM & COO; Dimitry Blasi - DGM, Investment Banking; Ebrahim H. Ebrahim - CEO & Board Member; Mahdi A. Nabi - AGM, Administration & Operations.

CHAIRMAN'S REPORT

complied with most of the requirements under the new Code and the Board remains committed to taking all necessary action to ensure the Bank's continued compliance.

CORPORATE SOCIAL RESPONSIBILITY

The Board believes that, as a growing institution, the Bank has a responsibility to contribute towards the communities in which it operates, and in the past, the Bank has supported several initiatives that provide benefits to the local community. In 2010, a wide range of organisations involved in humanitarian, education, health and other activities received support from the Bank both in cash and in kind. The Board is committed to continuing to expand these through the Bank's ongoing programme of corporate social responsibility.

LOOKING AHEAD

The Board believes that the recent challenges facing the banking sector will continue in 2011 and the Bank will not be immune to these challenges. However, the Board also sees many opportunities for growing the Bank's business, not only in the primary markets of the GCC, but also in the wider MENA region. In the last two years, the Bank has taken several steps to diversify its assets, revenue streams and widening its customer base. The launch of the Bank's suite of consumer finance products will further this endeavour.

The key challenge for the Board in the medium term is to build the scale necessary for the Bank to become a leading player in the local and regional market. The Bank will continue to aggressively grow its commercial and retail banking business while exploring other

options including viable acquisitions of other entities and asset portfolios. The Board will also look to continue to expand the Bank's network of branches and distribution channels to reach a larger number of customers.

The Board believes that the Bank has established a solid foundation from which to execute the new strategic plan and capitalise on opportunities currently available in the market.

APPRECIATION

On behalf of the Board, I would like to express my gratitude to His Majesty King Hamad Bin Isa Al Khalifa, His Royal Highness Shaikh Khalifa Bin Salman Al Khalifa, the Prime Minister, and His Royal Highness Shaikh Salman Bin Hamad Al Khalifa, the Crown Prince and Deputy Supreme Commander of Bahrain Defense Force, for their encouragement of the growth of the private sector and the development of the banking and finance industry in Bahrain. 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 the Bank's shareholders, clients and business partners for their ongoing 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

BUSINESS REPORT

Ebrahim H. Ebrahim



The year 2010 was an extremely challenging one for the Bank. The impact of the global financial crisis continued to be felt across the region, although some markets recovered faster than others.

Credit and Investment environment remained unsettled and increasingly commercial and retail customers were feeling the negative effects of the real estate bubble. With investment in infrastructure and real estate not recovering to the pre-crisis levels, market activity continued to remain low. This was reflected in increasing cases of non-performing assets and lack of growth in credit. The sukuk market showed some signs of activity but investors continued to stay away from private equity markets, a key target market for the Bank in the past.

Operating under difficult market conditions, the management remained focused on prudent management of the balance sheet and expansion and diversification of the business in line with the Bank's revised business model and strategy. I am pleased to report that during 2010, KHCB continued to launch new products and grow and expand its business operations in line with its long term strategy.

The first step in our revised strategy and diversification of our business was the launch of our new logo. Designed to reflect the wave of change the Bank is riding into, the logo retains key elements of the earlier design. It is simple yet elegant, with a vibrant icon that is in keeping with the Bank's new vitality

and dynamism. Its corporate red and blue colours have been fashioned into two sleek sails that pioneer paths through new waters, signifying the new momentum. For us the new brand marks a watershed, a transformation in keeping with the changing times. The sails of the new logo signify the spirit of change that will take us into the exciting future. The image it creates is of strength and flexibility, of having an open mind and the vision to venture onto new paths. We truly believe we will live up to the promise of the new logo by fashioning a distinct identity for the Bank and diversifying into other business segments.

COMMERCIAL BANKING

Commercial Banking is the key focus area for expansion for the Bank and I am pleased to note that despite operating in this difficult environment, we have progressed considerably in this regard. During the year, consumer finance products were launched targeting a new segment of customers for the Bank. Our customer deposits including Unrestricted Investment Accounts (URIA) grew marginally but the customer base diversified substantially. Corporate and wholesale banking business also continued to grow and diversify.

CORPORATE AND WHOLESALE BANKING

2010 was a particularly challenging year for corporates and businesses. At the local level, several key sectors like real estate, construction and tourism have been adversely affected and activity levels continued to remain low.

Real estate sector, a major contributor to the local economy, has been particularly affected, reflected in the decline in property values and limited number of transactions and low levels of activity. This to some extent contributed to deterioration in the credit quality of existing assets in the banking sector. Nevertheless, KHCB continued to grow and diversify its corporate and wholesale banking business. Financing assets, which included Ijarah, Murabaha, and Musharakah, grew by 2.8% to BD 211 million from BD 206 million in 2009. The Bank also started targeting customers for trade finance business which was newly launched in 2009. The Bank continued to support local and regional business houses in their growth plans. In July 2010, the Bank concluded a USD 25 Million facility for Bukhathir Investment Company, a diversified conglomerate based in Sharjah and provided a USD 26 million facility for Al Jazeera Finance Company in Qatar. The Bank also financed several projects in the Kingdom of Bahrain. We have however been selective in our approach to building assets as we aim to create a high quality portfolio with a local and regional client base.

RETAIL BANKING

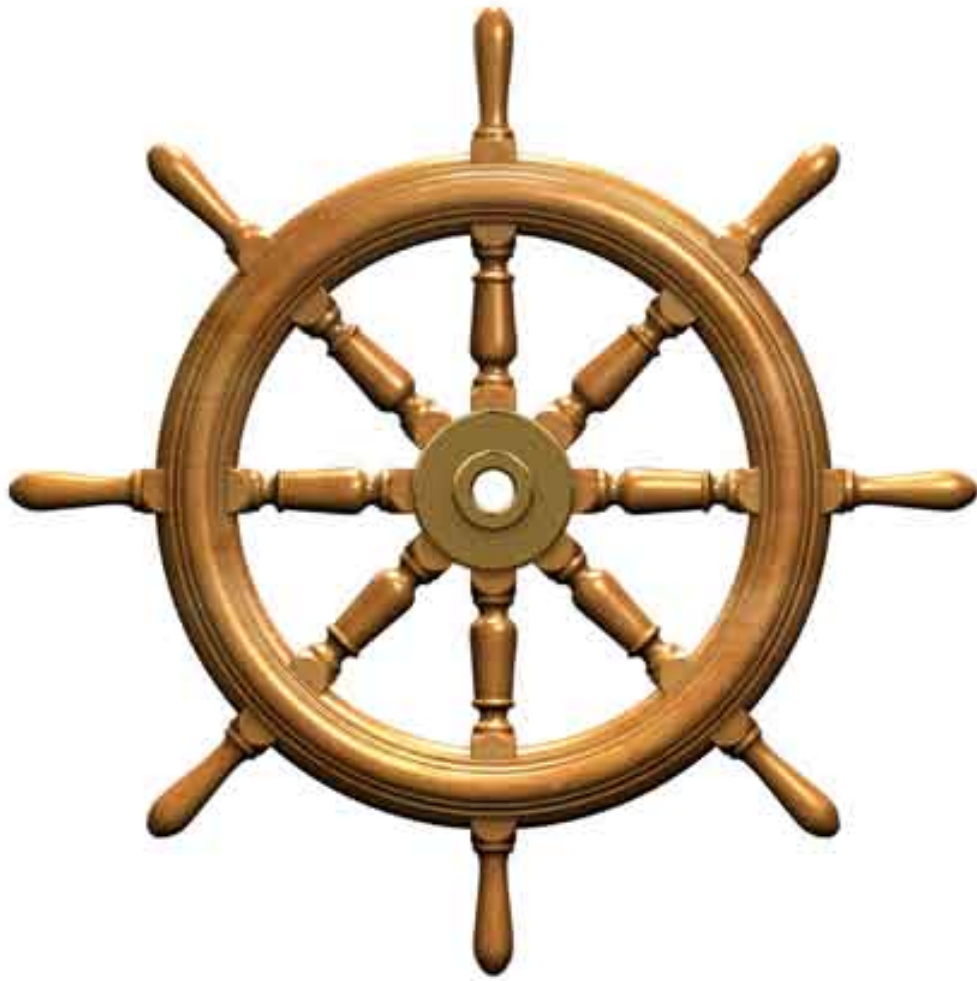
The Bank's retail banking business was constrained by restrictions on the Bank's license which prevented it from engaging in retail consumer finance activities other than those related to real estate. Consequently, the Bank's target customers were mainly High Net Worth Individuals and Institutions, which is reflected in its limited branch network. In 2010 the CBB removed the restrictions on the Bank's license, allowing it to offer the full suite of commercial banking products including consumer finance.

One of the key elements of the Bank's revised business model is to launch and grow the Bank's retail banking business in Bahrain. Several new products and campaigns targeting a new customer segment was launched while enhancing existing products and services. In the third quarter of the year, the Bank launched personal finance, auto finance and mortgage finance products with attractive features targeted at Bahraini and expat residents of Bahrain. The launch was accompanied by a highly visible advertisement campaign. I am pleased to report that the response to the campaign was very positive. The Bank also launched four types of credit cards (i.e. Corporate Platinum, Gold, and classic). With the launch of these products KHCB will offer its customers a comprehensive range of products to meet all their personal financing needs.

Al Waffer savings account, an Unrestricted Investment Account that offers clients monthly, quarterly and annual prizes on their investment, completed a full year with the grand draw held in September 2010. A total cash prize of USD 1,000,000 was distributed to 240 winners over the 12 months of the program. The product was re-launched in October 2010 with a larger number of prizes and total prize money exceeding USD 1,000,000. I am pleased to report that the Al Waffer was well received in the market and we expect the product to attract more customers and deposits in the future.

INVESTMENT BANKING

Investment Banking has been key to the Bank's growth and success in the last few years. The assets under management of the Bank are



2010 MARKED THE SUCCESSFUL
TRANSFORMATION OF THE BANK
INTO A BRAND THAT SYMBOLISES
POSITIVE CHANGE.

currently BD 700 Million, a reflection of the Bank's strong relationship with investors as well as the unique and attractive investment opportunities brought to the market. At a portfolio level, the assets under management retained a positive valuation trend in 2010, hence preserving the underlying value to investors.

In light of the changed market environment caused by the global financial crisis, investors withdrew from the markets bringing the private equity and sukuk markets to a standstill. Although there were signs of revival in the sukuk and credit markets, investors in the private equity and project based products continued to be risk averse and preferred to wait on the sidelines. The situation gave rise to distressed asset prices for real estate assets especially in the GCC countries.

In view of the limited appetite for new investment products in the market, the management focused on protecting and adding value to our investments and working towards potential exits in 2011 and 2012. While the exit dates were extended for many of the investment products, I am pleased to report that in 2010 we redeemed 34% of the invested capital in Amlak 2. The investment team led the restructuring of Euro 525 Million syndicated third party financing for the Gulf German residence portfolio resulting in considerable savings and making the portfolio cash flow positive. Completion of the restructuring generated much needed funds for capital expenditure which in turn will continue to drive further valuation growth and higher occupancy rates into 2011 and beyond.

Certain other property investment products

managed by the Bank, principally Eqarat Al Khaleej and Janayen, while suffering some valuation losses on account of depressed property prices across the Gulf region, continued to generate returns albeit at a level lower than previous years. The Surooh residential villa project in Bahrain has been completed with power also being supplied and delivery of sold villas to purchasers is now taking place. Further projects, in which the Bank has partnered with another prominent Bahraini financial institution, such as Safana and North Gate, have incurred some delays due to their scale and complexity but remain on track from a valuation perspective.

The prospects for the large investment products in India, Global Logistix Navi Mumbai and Danat India, New Delhi, continued to be good with positive valuation fundamentals continuing into 2010. Considerable progress has been achieved on both these projects and our investment team is actively working with local partners and advisers to develop the projects further for potential exit. Jawhara Greens, the multi-use development project in Qatar, while delayed has now received a boost with plans for FIFA World Cup 2022. The project has gone against the trend of reduced GCC valuations in 2010 and reported a valuation increase of 50% for the calendar year.

At an overall level, the Investment Banking division will maintain a focus on achieving investor exits in 2011.

ORGANIZATIONAL DEVELOPMENTS

During 2010, we continued to strengthen our institutional capacity in line with the growth in size and scope of our business.



The Bank's success, is to a large extent, dependent on knowledge, skills, creativity, and motivation of its employees. Our human resources strategy is therefore focused on building a high performance team that is sustainable with a diversified level of competence. Attracting, developing and retaining talented professionals have been key priorities for the Bank.

In 2010 the Bank recruited 22 employees to meet the requirements of our expansion and diversification. Total number of employees increased from 138 to 150 and we are proud of the fact that 91% of our employees are Bahrainis.

The Bank continued to invest in employee development through training programs both, internal and external. Our employees have made use of the many courses made available by BIBF and we also organized a specialized training program in Islamic Banking conducted by experienced faculty from the industry. Beyond development of employees, the Bank also continued to support the youth of the country by providing short term training opportunities for university students. KHCB has also been a major supporter of the Waqf Fund's Training Program.

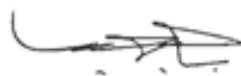
The Bank continued to enhance its operational systems and applications including the core banking system. Significant projects in the Information Technology (IT) were to accommodate the new consumer and retail financing products and ensure compliance with regulatory requirements. The card management system was enhanced to include a VISA branded credit card and third party service providers for the same and

integrate with an outsourced call centre. The Bank completed its Disaster Recovery (DR) and Business Continuity Plan (BCP) projects in the third quarter of the year. I'm pleased to report that the Bank now has fully-functional DR and BCP sites.

CONCLUSION

2010 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 2010.



Ebrahim H. Ebrahim
CEO & Board Member



CREATING A NEW REALITY,
THROUGH ADDING VALUE.
AS WE EXPAND AND DIVERSIFY,
WE ENSURE SAFE SAILING TO
A BRIGHT NEW FUTURE.

CORPORATE GOVERNANCE

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 in compliance with the Corporate Governance Code (CGC), the Public Disclosure Module and the Stock Exchange Disclosure Standards set by the CBB. The corporate governance philosophy of the Bank is to be fully ethical and transparent in all dealings. In pursuit of this goal the Board of Directors have approved a Corporate Governance Framework, Director's Conflict of Interest Policy, Insiders' Trading Policy, and the Bank Key Persons' Dealing Policy. The Bank, through its Board and Committees, endeavors to deliver the highest governing standards for the benefit of its stakeholders.

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 practice.

BOARD OF DIRECTORS

The Board of Directors comprises of 9 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, monitoring asset



CORPORATE GOVERNANCE

impairment and creation of loss provisions, 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 2010, the Board of Directors held 7 meetings, the Board Investment & Credit Committee held 4 meetings, the Board Nomination, Remuneration & Governance Committee held 2 meetings, the Board Risk Management Committee held 4 meetings and the Board Audit Committee held 4 meetings.

BOARD COMMITTEES

BOARD OF DIRECTOR



EXECUTIVE/MANAGEMENT COMMITTEES

CHIEF EXECUTIVE OFFICER



RISK MANAGEMENT

RISK MANAGEMENT FRAMEWORK

Risk is inherent in the Bank's business and effective management of 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 risks 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 interventions, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and responsibilities. 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 risks 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, etc. Credit and investment limits to clients 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

RISK MANAGEMENT

Committee (ERM). A separate Risk and Credit Management Department independent of the business units is responsible for oversight of the Bank's credit and investment risk. The Risk Management Department reviews every credit and investment proposal and records its views before the same is submitted for approval. 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 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 limits, 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 minimal.

OPERATIONAL RISK

Operational risk is the risk of loss arising from inadequacies or failures in systems and processes, human errors, or external events.

Failure to manage operational risk can result in financial and reputational loss as well as legal and regulatory consequences. The Bank manages operational risk through ongoing monitoring of predefined risk triggers and through a system of internal checks and balances. These include well defined procedures for transaction processing, hierarchical authority structure for transaction approvals, and continuous oversight by internal audit and compliance departments. The Risk Management Department is responsible for identifying, monitoring and managing operations risk in the Bank. The Board has approved a detailed policy for this purpose and all the operational and physical infrastructure is in place. The Risk Management Department conducts Operational Risk assessment of each department of the Bank on an ongoing basis and also provides guidance to the operating staff. The department also submits periodical reports to the Top Management and the Board on operational risk events that have occurred including near misses and on corrective actions taken.

LIQUIDITY RISK

Liquidity risk is defined as the risk that funds will not be available to meet liabilities as and when they fall due. While the policy guidelines for management of liquidity risk are laid down by the Board of Directors, all operations regarding day-to-day management of balance sheet and liquidity is handled by the Financial Control and Treasury Departments. The Asset Liability Management Committee (ALCO), which is chaired by the CEO and has senior executives of the Bank as members, exercises effective supervision of this process. ALCO periodically monitors the level of liquid assets maintained by the Bank and uses a maturity ladder approach



WE ARE LINKING EXPERTISE
WITH OPPORTUNITY TO
CHARTER AN EXCITING COURSE,
LEADING THE BANK TO
A BRIGHT NEW HORIZON.

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 and the right maturity profile to meet its liabilities under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

PROFIT RATE RISK

The principle 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 enable 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 nonstandard 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 possible, matches currency exposures inherent in certain assets with liabilities in the same or correlated currency. The Risk Management Department in association with the Treasury Department is responsible for all operations related to foreign exchange risk management in the Bank.

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 has a full-fledged legal department which provides necessary inputs and guidance to all other departments on any legal issues that may arise. The Bank also hires external legal advisors for advice when necessary, and to handle litigations. Regulatory risk includes the risk of non-compliance with regulatory and legal requirements. The Bank has an Independent Compliance Department which monitors the level of compliance with regulatory requirements by other departments of the Bank. It also acts as the focal point in all interaction with the Central Bank of Bahrain. 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. Under this, the Bank is expected to maintain a minimum prescribed ratio of total capital to total risk weighted assets.



RISK MANAGEMENT

The CBB also requires the Bank to establish a process to monitor the overall capital adequacy of the Bank, taking into account all relevant risk factors. The Board of Directors has approved an Internal Capital Adequacy Assessment Process (ICAAP) to satisfy this requirement. The ICAAP is a requirement under Pillar 2 of the Basel II Accord and seeks to ensure appropriate identification, measurement, aggregation and monitoring of all risks by the Bank 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 for identifying and assessing capital required for each of the major risk categories by employing appropriate methodologies.

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 serious adverse changes in external and internal risk environment and changes in business cycles. The Bank has developed a stress testing model for the purpose which provides an estimate of capital adequacy under a variety of stress scenarios.

The first step in the process is identifying relevant stress factors that can affect the bank's revenues, liquidity, asset quality, and 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 which will help the Bank identify preventative management actions where necessary.

REPUTATIONAL RISK

Reputational risk arises from negative public perception of the Bank arising out of losses, faulty business practices, and failure of internal controls etc. Such a perception whether true or not, can have serious impact on the Bank's business by undermining investor confidence. It may also lead to costly litigation that would in turn have an adverse impact on liquidity and capital adequacy 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 II & CBB requirements which ensure disclosure of all relevant information to stakeholders in a timely manner. The Pillar 3 disclosure and Corporate Governance Code requirements prescribed by the Central Bank of Bahrain (CBB) are part of this annual report.



SHARI'A REPORT

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 31st December 2010 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 supervise the Bank's adherence to the decisions and fatwa's of the SSB under rules and principles of Islamic Shari'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 a 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.

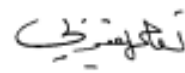
Praise be to Allah, Lord of the Worlds. Prayers on Prophet Mohammed (Peace Be Upon Him), all his Family and companions.



Dr. Fareed Yacoub Al-Muftah
Chairman



Dr. Fareed Mohammed Hadi
Executive Member



Sh. Nizam bin Mohammed
Saleh Yaquby
Member

INDEPENDENT AUDITORS' REPORT TO SHAREHOLDERS

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 2010, 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 and zakah 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 2010 and of the results of its operations, its cash flows, changes in equity, changes in restricted investment accounts and sources and uses of charity and Zakah 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.



26 January 2011
Manama, Kingdom of Bahrain

FINANCIALS



CONSOLIDATED STATEMENT OF FINANCIAL POSITION

as at 31 December 2010

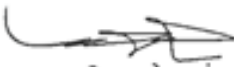
BD 000's

	Notes	31 December 2010	31 December 2009
ASSETS			
Cash and bank balances	3	12,290	19,975
Placements with financial institutions	4	74,959	122,193
Financing assets	5	203,210	192,085
Investment securities	6	100,279	92,354
Assets acquired for leasing	7	5,979	8,544
Lease rentals receivable	7	2,001	4,889
Asset held-for-sale	8	-	4,852
Investment in associates	9	4,113	6,521
Investment property	10	3,943	-
Other assets	11	2,476	17,843
Property and equipment	12	9,966	4,348
Total assets		419,216	473,604
LIABILITIES			
Placements from financial institutions and others	13	84,935	101,730
Customers' current accounts		10,928	35,097
Other liabilities	14	6,975	6,615
Total liabilities		102,838	143,442
Unrestricted investment accounts	15	198,220	203,588
EQUITY			
Share capital	16	115,416	104,924
Share premium		1,213	958
Statutory reserve		6,298	6,298
Treasury shares		(6,018)	(5,216)
Unvested employee incentive scheme shares		(937)	(1,648)
Share grant reserve		324	367
Available-for-sale investments fair value reserve		117	30
Retained earnings		1,745	20,861
Total equity (page 7)		118,158	126,574
Total liabilities, unrestricted investment accounts and equity		419,216	473,604
Restricted investment accounts (page 10)		42,615	46,742

The consolidated financial statements, which consist of pages 5 to 65, were approved by the Board of Directors on 26 January, 2011 and signed on its behalf by:


Dr. Fuad Abdulla Al-Omar
Chairman

Abdulla Abdulkarim Showaiter
Vice - Chairman


Ebrahim Hussain Ebrahim
Chief Executive Officer & Board
Member

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2010

BD 000's

	Notes	2010	2009
Income from investment banking services		47	13,798
Placement, management and arrangement fees		1,260	1,013
Income from placements with financial institutions		915	1,477
Income from financing assets and assets acquired for leasing		16,092	15,024
Income from investment securities	17	2,198	1,280
Share of (losses)/profits from associate companies	9	(1,005)	136
Other income		78	504
Total income before return on unrestricted investment accounts		19,585	33,232
Less: Return on unrestricted investment accounts before Bank's share as Mudarib	15	(8,254)	(11,103)
Bank's share as a Mudarib	15	2,469	1,772
Return on unrestricted investment accounts		(5,785)	(9,331)
Expense on placement from financial institutions and others		(1,295)	(1,270)
Total net income		12,505	22,631
Staff cost	18	5,070	5,073
Depreciation	12	1,342	1,311
Other expenses	20	4,066	3,890
Total expenses		10,478	10,274
Profit for the year before impairment allowances		2,027	12,357
Impairment allowances	19	(8,560)	(9,257)
(LOSS) / PROFIT FOR THE YEAR		(6,533)	3,100
Basic earnings per share (fils)	25	(5.87)	3.04
Diluted earnings per share (fils)	25	(5.87)	3.04

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2010

BD 000's

31 December 2010	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 01 January 2010	104,924	958	6,298	(5,216)	(1,648)	367	30	20,861	126,574
Fair value changes	-	-	-	-	-	-	87	-	87
Loss for the year	-	-	-	-	-	-	-	(6,533)	(6,533)
Total recognised income and expense for the year	-	-	-	-	-	-	87	(6,533)	(6,446)
Treasury shares acquired	-	-	-	(992)	-	-	-	-	(992)
Treasury shares sold	-	-	-	190	-	-	-	-	190
Vesting charge for the year (note 21)	-	-	-	-	-	212	-	-	212
Adjustment for vesting and issue of shares	-	255	-	-	711	(255)	-	-	711
Transfer to charity fund (2009)	-	-	-	-	-	-	-	(150)	(150)
Transfer zakah fund (2009)	-	-	-	-	-	-	-	(1,941)	(1,941)
Bonus shares (2009)	10,492	-	-	-	-	-	-	(10,492)	-
Balance at 31 December 2010	115,416	1,213	6,298	(6,018)	(937)	324	117	1,745	118,158

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2010 (continued)

BD 000's

31 December 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 01 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
Total recognised income and expense for the year	-	-	-	-	-	-	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 (note 21)	-	-	-	-	-	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)
Balance at 31 December 2009	104,924	958	6,298	(5,216)	(1,648)	367	30	20,861	126,574

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

for the year ended 31 December 2010

BD 000's

	Notes	2010	2009
OPERATING ACTIVITIES			
Proceeds from investment banking services		3,227	27,422
Net disbursements on financing assets		871	(43,392)
Placement, management and arrangement fees received		1,523	1,013
Income from placements with financial institutions received		915	1,477
Returns paid to unrestricted investment accounts		(7,772)	(8,938)
(Repayment to) / receipts from unrestricted investment account holders, net		(5,368)	40,772
Payment for expenses		(9,233)	(12,798)
Receipts from lease of assets, net		5,453	10,049
Directors fees paid		-	(250)
Net withdrawals in customers' current accounts		(24,169)	(87,286)
Other income received		78	504
Net (payment)/ receipt in CBB reserve account		(1,420)	5,679
Net cash used in operating activities		(35,895)	(65,748)
INVESTING ACTIVITIES			
Purchase of investment securities		(12,684)	(7,663)
Proceeds from sale of investment securities		8,967	17,897
Payment for advance towards investment securities		-	(9,583)
Dividend/ income from investment securities received		781	1,481
Distributions from investment in associates received		1,403	-
Proceeds from sale of asset held-for-sale		223	1,070
Purchase of equipment and capital advances made		(243)	(135)
Net cash (used in)/ generated from investing activities		(1,553)	3,067
FINANCING ACTIVITIES			
Placements from financial institutions and others, net		(16,795)	71,501
Purchase of treasury shares, net		(802)	(301)
Expense paid on placement from financial institutions and others		(1,295)	(1,270)
Dividends paid		-	(14,732)
Net cash (used in)/ generated from financing activities		(18,892)	55,198
Net decrease in cash and cash equivalents		(56,340)	(7,483)
Cash and cash equivalents at 1 January		135,233	142,716
Cash and cash equivalents at 31 December		78,893	135,233
Cash and cash equivalent comprise:			
Cash and bank balances (excluding CBB reserve account)	3	3,934	13,040
Placements with financial institutions	4	74,959	122,193
		78,893	135,233

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS

for the year ended 31 December 2010

BD 000's

31 December 2010	Balance at 1 January 2010			Movements during the year							Balance at 31 December 2010		
	No. of units (000)	Average value per share BD	Total BD 000's	Investment (withdrawals) BD 000's	Revaluation BD 000's	Gross income/ (loss) BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Admin- istration expenses BD 000's	No. of units (000)	Average value per share BD	Total BD 000's	
Al Hareth French Property Fund	17.05	539.76	9,203	-	(603)	-	-	-	-	17.05	504.40	8,600	
Safana Investment WLL (RIA 1)	9,563	1.00	9,563	-	-	-	-	-	-	9,563	1.00	9,563	
Janayen Holding Limited (RIA 4)	52,685	0.36	18,805	(558)	(2,742)	(229)	(216)	-	-	52,685	0.29	15,060	
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)	2,841	0.38	1,071	221	-	-	-	-	-	3,427	0.38	1,292	
			46,742	(337)	(3,345)	(229)	(216)	-	-			42,615	

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	Admi- nistration 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	

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF SOURCES AND USES OF CHARITY AND ZAKAH FUND

for the year ended 31 December 2010

BD 000's

	2010	2009
Sources of charity and zakah fund		
Contributions by the Bank	2,091	250
Non-Islamic income	36	1
Total sources	2,127	251
Uses of charity and zakah fund		
Contributions to charitable organisations	654	100
Total uses	654	100
Excess of sources over uses	1,473	151
Balance at the beginning of the year	593	442
Undistributed charity fund at 31 December (note 14)	2,066	593

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS for the year ended 31 December 2010

1. INCORPORATION AND PRINCIPAL ACTIVITY

Khaleeji Commercial Bank BSC ("the Bank"), a public shareholding company, was incorporated on 24 November 2004 in the Kingdom of Bahrain under Commercial Registration No. 55133. The Bank operates under an Islamic 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 to ensure adherence to shari'a rules and principles in its transactions and activities.

The principal activities of the Bank include providing banking and investment products and services to retail customers, high net worth individuals, corporate entities, and financial institutions. These include commercial and corporate banking, consumer finance, wealth management, structured investment products and project financing facilities which comply with Islamic Shari'a rules and principles as determined by the Bank's Shari'a Supervisory Board.

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, except for those changes arising from revised/new AAOIFI standards, FAS 23 *Consolidation* and FAS 24 *Investment in Associates*, that are effective for annual reporting periods beginning 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 did not result in any material impact on the consolidated financial statements.

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.

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

The preparation of 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 on-going 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 22.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

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 23.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS for the year ended 31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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 classifies its investment securities in 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 Group 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

e. Investment securities (continued)

iii. Measurement (continued)

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 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. Financing assets

Financing assets comprise shari'a compliant financing contracts with fixed or determinable payments. These include financing provided through Murabaha, Musharaka, Istisna and Wakala contracts. 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 and others

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS for the year ended 31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

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 Group from time to time 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. 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 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

l. Investment property

Properties held for rental, or for capital appreciation purposes, or both, are classified as Investment property. Investment property are carried at cost less impairment allowances, if any. Cost includes expenditure that is directly attributable to the acquisition of the investment property. Investment property of the Group includes a plot of land held for capital appreciation purposes.

m. Property and equipment

Property and equipment is stated at cost, net of accumulated depreciation and impairment allowances, if any. Property includes land which is not depreciated. Other equipment is depreciated 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 balance sheet date.

n. Impairment of assets

The Group assesses at each statement of financial position date whether there is objective evidence that a 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.

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 equity 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS for the year ended 31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

n. Impairment of assets (continued)

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.

o. Customers' current accounts

Balances in current (non-investment) accounts are recognised when received by the Bank. The transaction is measured at the cash equivalent 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.

p. 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, reserves (Profit equalisation reserve and Investment risk reserve) and deducting the Bank's share of income as a Mudarib. 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 unrestricted 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

q. 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.

r. 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.

s. 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.

t. 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.

u. 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.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS for the year ended 31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

u. Revenue recognition (continued)

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.

v. 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.

w. Zakah

Zakah is calculated on the Zakah base of the Group in accordance with FAS 9 Zakah using the net assets method. Zakah is paid by the Group based on the statutory reserve and retained earnings balances at the end of the year and the remaining Zakah is payable by individual shareholders. The Bank calculates and notifies the shareholders of their pro-rata share of the Zakah payable annually. The calculations of Zakah is approved by the Shari'a Supervisory Board.

Payment of Zakah on the unrestricted investment and other accounts is the responsibility of the investment account holders.

x. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

x. Employee benefits (continued)

ii. Post-employment benefits (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 eligible employees 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.

y. Dividends and board remuneration

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

z. Offsetting

Financial assets and liabilities are offset only when there is a legal or religious enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

aa. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

3. CASH AND BANK BALANCES

	31 December 2010	31 December 2009
Cash	1,310	793
Balances with banks	2,101	9,642
Balances with the Central Bank:		
- Current account	523	2,605
- Reserve account	8,356	6,935
	12,290	19,975

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

4. PLACEMENTS WITH FINANCIAL INSTITUTIONS

	31 December 2010	31 December 2009
Gross Murabaha and Wakala receivable	75,003	122,275
Less: Deferred profits	(44)	(82)
	74,959	122,193

The average profit rate on placement with financial institutions for 2010 was 1.51% per annum (2009: 1.50% per annum).

5. FINANCING ASSETS

	31 December 2010	31 December 2009
Murabaha	163,866	152,323
Musharaka	34,306	24,688
Wakala	20,392	23,793
Istisna	998	1,533
	219,562	202,337
Less: Impairment allowances – specific	(14,189)	(7,897)
Less: Impairment allowances – collective	(2,163)	(2,355)
	203,210	192,085

Murabaha financing receivables are net of deferred profits of BD 16,719 thousand (2009: BD 16,690 thousand).

Of the total financing asset portfolio, consumer financing receivables amounted to BD 1,039 thousand (31 December 2009: Nil)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

5. FINANCING ASSETS (continued)

The movement in impairment allowances are as follows:

2010	Specific	Collective	Total
At 1 January	7,897	2,355	10,252
Additions/(write back) during the year	6,292	(192)	6,100
At 31 December	14,189	2,163	16,352

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

6. INVESTMENT SECURITIES

	31 December 2010	31 December 2009
Available-for-sale investments		
- Quoted equity securities (at fair value)	274	187
- Unquoted equity securities (at cost)	82,444	62,924
- Sukuk (at fair value)	310	-
Total available-for-sale investments (net of impairment)	83,028	63,111
Held-to-maturity investments		
- Sukuk (at amortised cost)	17,251	29,243
At 31 December	100,279	92,354

Unquoted available-for-sale equity securities 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

6. INVESTMENT SECURITIES (continued)

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

	2010	2009
At 1 January	4,125	1,170
Impairment allowances on quoted equity securities	-	12
Impairment allowances on unquoted equity securities	1,793	2,943
At 31 December	5,918	4,125

Held-to-maturity investments are net of collective impairment allowances of BD 52 thousand (2009: BD 158 thousand).

7. ASSETS ACQUIRED FOR LEASING

	Property	Equipment	2010	2009
Cost				
At 1 January	10,444	8,055	18,499	25,029
Addition during the year	1,340	-	1,340	-
Settlements/adjustments during the year	(4,145)	(4,869)	(9,014)	(6,530)
At 31 December	7,639	3,186	10,825	18,499
Accumulated depreciation				
At 1 January	5,085	4,870	9,955	6,518
Charge for year	1,444	2,461	3,905	4,096
Settlements during the year	(4,145)	(4,869)	(9,014)	(659)
At 31 December	2,384	2,462	4,846	9,955
Net book value at 31 December	5,255	724	5,979	8,544

At 31 December 2010, accrued lease rental receivable amounted to BD 2,001 thousand (2009: BD 4,889 thousand). Lease rental receivable is net of collective provision of BD 136 thousand (2009: BD 136 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

8. ASSET HELD FOR SALE

Assets-held-for sale included investment in an associate company which the Bank intended to down sell to its investors. During the year, the Bank sold a portion of its investments amounting BD 167 thousand (31 December 2009: BD 803 thousand) to its investors and recognised income of BD 55 thousand (31 December 2009: BD 267 thousand) from the transaction and has retained the balance investment. The retained investment does not qualify as an 'associate' and has been classified as an available-for-sale investment during the year.

9. INVESTMENT IN ASSOCIATES

	2010	2009
At 1 January	6,521	6,385
Distribution during the year	(1,403)	-
Share of (losses)/profits for the year	(1,005)	136
At 31 December	4,113	6,521

Investment in associates comprise:

Name	Country of incorporation	% holding	Nature of business
Capital Real Estate Projects Company BSC (c)	Bahrain	30%	Real estate holding and development
Amlak II SPV	Cayman islands	23.1%	Purchase and sale of real estate in Bahrain

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)

	2010	2009
Total assets	23,152	31,033
Total liabilities	8,185	7,738
Total revenues	717	915
Total net (losses)/profits	(3,084)	551

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

10. INVESTMENT PROPERTY

During the year, in consideration for sale of an available-for-sale investment, the Bank received two plots of land in the Bahrain Financial Harbour project. Of the two plots of land received, one plot is intended for the Group's own use and has been classified under "Property and equipment" (refer note 12). The second plot of land is held for capital appreciation purposes and hence has been classified as "Investment property".

11. OTHER ASSETS

	31 December 2010	31 December 2009
Income from investment banking services receivable	-	3,236
Income from sukuk receivable	800	601
Advance towards purchase of investments	-	11,310
Prepayments and other receivables	1,676	2,696
	2,476	17,843

Other receivables is net of impairment provision of BD 773 thousand (2009: Nil)

12. EQUIPMENT

	Land (note 10)	Furniture and fixtures	Computers	Motor vehicle	Other equipment	Work-in- progress	2010 total	2009 total
Cost								
At 1 January	-	3,810	2,021	73	171	382	6,457	6,323
Additions/ capitalisation	6,714	34	223	-	27	209	7,207	136
Disposal	-	(420)	(49)	-	(17)	(106)	(592)	-
At 31 December	6,714	3,424	2,195	73	181	485	13,072	6,459
Accumulated Depreciation								
At 1 January	-	947	1,090	23	48	-	2,108	800
Charge for year	-	710	580	15	37	-	1,342	1,311
Disposal	-	(344)	-	-	-	-	(344)	-
At 31 December	-	1,313	1,670	38	85	-	3,106	2,111
Net book value at 31 December 2010	6,714	2,111	525	35	96	485	9,966	4,348
Net book value at 31 December 2009	-	2,864	930	50	123	381	4,348	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

13. PLACEMENTS FROM FINANCIAL INSTITUTIONS AND OTHERS

	31 December 2010	31 December 2009
Banks and other Financial institutions	65,916	89,179
Other Institutions	14,478	11,361
Individuals	4,541	1,190
	84,935	101,730

These represent placements in the form Murabaha and Wakala contracts.

14. OTHER LIABILITIES

	31 December 2010	31 December 2009
Employee related accruals	1,071	2,889
Accounts payable	1,484	1,311
Charity and zakah payable (page 11)	2,066	593
Payable for Istisn'a contracts	160	143
Other payable and accrued expenses	2,194	1,679
	6,975	6,615

15. 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:

	31 December 2010	31 December 2009
CBB reserve account	8,356	-
Placement with financial institutions	74,959	-
Investment in sukuk	17,561	29,243
Financing assets	97,344	174,345

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

15. UNRESTRICTED INVESTMENT ACCOUNTS (continued)

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

	2010	2009
Returns from comingled assets	8,254	11,103
Banks share of Mudarib fees	(2,469)	(1,772)
Return on unrestricted investment accounts	5,785	9,331
Investment risk reserve utilised/(created), net	948	(452)
Profit equalisation reserve utilised/(created), net	1,039	(560)
Distributions to unrestricted investment account holders'	7,772	8,319

The average gross rate of return in respect of unrestricted investment accounts during the year was 4.03% (31 December 2009: 6.1%). Approximately 5.27% (31 December 2009: 5.6%) 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 169 thousand (2009: BD 1,209 thousand) and investment risk reserve Nil (2009:BD 925 thousand).

16. SHARE CAPITAL

	31 December 2010	31 December 2009
Authorised:		
3,000,000,000 ordinary shares of BD 0.100 each	300,000	300,000
Issued and fully paid up:		
1,154,161,084 ordinary shares (2009: 1,049,237,349) of BD 0.100 each	115,416	104,924

During the year, the paid up capital of the Bank increased from BD 104,924 thousand to BD 115,416 thousand as a result of issue of bonus shares (one shares for every ten shares held) for 2009 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 2010, the Bank holds 27,805,198 as treasury shares (2009: 17,490,527)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2010**

BD 000's

6. 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%	168,896,972	541	14.63
1% up to less than 5% **	177,168,386	9	15.35
5% up to less than 10%	103,950,000	1	9.01
10% up to less than 20%	161,700,000	1	14.01
20% and less than 50%	542,445,726	1	46.99
	1,154,161,084	553	100.00

* 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

Categories*	Nationality	Number of shares	% of total outstanding shares
Gulf finance house BSC *	Bahrain	542,445,726	46.99
Al Imtiaz Investment Company KSCC	Kuwait	161,700,000	14.01
Emirates Islamic Bank PJSC	UAE	103,950,000	9.00

* As at 31 December 2010, 426,945,726 shares representing 36.99% were held by KHCB Asset Company and 115,500,000 shares representing 10% were held by Esam Janahi, resident of Bahrain, on behalf of Gulf Finance House BSC before 31 December 2010.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

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17. INCOME FROM INVESTMENT SECURITIES

	2010	2009
Income from available-for-sale investments:		
- Dividend income	132	123
- Fair value gain on investment acquisition	1,244	-
- Income from Sukuk	7	121
	1,383	244
Income from held-to-maturity investments - Sukuk	815	1,036
	2,198	1,280

18. STAFF COST

	2010	2009
Salaries and benefits	3,952	4,481
Social insurance expenses	507	451
Other staff expenses	611	141
	5,070	5,073

19. IMPAIRMENT ALLOWANCES

	2010	2009
Financing assets (note 5)	6,100	6,008
Available-for-sale equity securities (note 6)	1,793	2,955
Held-to-maturity investments (note 6)	(106)	158
Lease rentals receivable (note 7)	-	136
Other receivable (note 11)	773	-
	8,560	9,257

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20. OTHER EXPENSES

	2010	2009
Investment related expenses	286	664
Premises	905	862
Advertisement and marketing	1,113	646
Printing and stationery	73	75
Professional fees	436	438
Shari'a committee expenses	43	31
Board expenses	225	209
Communication expenses	157	220
Traveling and transportation expenses	16	38
Information technology expenses	469	419
Insurance expenses	62	68
Distribution channel expenses	74	47
Other administrative expenses	207	173
	4,066	3,890

21. 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 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS for the year ended 31 December 2010

21. SHARE-BASED EMPLOYEE INCENTIVE SCHEME (continued)

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 2010, on a cumulative basis, 30.4 million share grants have been awarded of which 22.591 million shares (2009: 16.599 million shares) have vested up to 31 December 2010 and 0.198 million shares (2009: 0.069 million shares) were forfeited due to failure to satisfy the service condition. No new grants have been made since 2009. The vesting expense for the year, net of reversals due to forfeitures, amounted to BD 212 thousand (31 December 2009: BD 434 thousand).

22. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

22. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

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.

Impairment of financing assets

Financing assets are evaluated for impairment on a basis described in accounting policy 2 (n). 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. For evaluation of the portfolio for impairment on a collective basis, management, where available, 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, 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.

23. ASSETS UNDER MANAGEMENT

The Bank provides corporate administration, investment management and advisory services to its investment 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 427.93 million (2009: BD 323.65 million). During the year, the Bank has charged management fees amounting to BD 1,260 thousands (31 December 2009: BD 450 thousands) for the management of these assets.

24. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

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24. RELATED PARTY TRANSACTIONS (continued)

A significant portion of the Bank's income from investment banking services and management fees arises from entities (assets under management) over which the Bank or its significant shareholders exercises influence. 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*	Number of shares	Number of directors
Less than 1%	9,467,167	5
1% up to 10%	14,005,641	1

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

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

31 December 2010	Associates	Key management personnel	Significant shareholders/entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
Investment securities	-	-	-	44,690	44,690
Financing assets	1,102	-	-	11,832	12,934
Investment in associates	4,113	-	-	-	4,113
Other assets	385	-	-	946	1,331
Liabilities					
Placement from financial institutions and others	-	-	-	-	-
Customers' current accounts	262	1	25	1,138	1,426
Unrestricted investment accounts	130	1,734	330	29,822	32,016
Other liabilities	-	1,649	78	-	1,727
Transactions					
Acquisition of investment securities	-	-	22,991	-	22,991
Disposal of investment securities	-	-	18,850	-	18,850
Purchase of properties	-	-	10,657	-	10,657

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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24. RELATED PARTY TRANSACTIONS (continued)

31 December 2009	Associates	Key management personnel	Significant shareholders/entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
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
Liabilities					
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	47,487
Other liabilities	-	1,648	-	-	1,648

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

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24. RELATED PARTY TRANSACTIONS (continued)

2010	Associates	Key management personnel	Significant shareholders/ entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
Income from investment banking services	-	-	-	47	47
Placement, management and arrangement fees	-	-	-	1,260	1,260
Income from financing assets and assets acquired for leasing	95	-	-	643	738
Income from investment securities	-	-	1,244	50	1,294
Share of losses from associates	(1,005)	-	-	-	(1,005)
Other income					
Expenses					
Return on unrestricted investment accounts	112	-	74	992	1,178
Other expenses	-	16	-	138	154
Impairment allowances	-	-	-	1,433	1,433

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

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24. RELATED PARTY TRANSACTIONS (continued)

2009	Associates	Key management personnel	Significant shareholders/entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
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 financing assets and assets acquired forleasing	128	-	681	-	809
Income from investment securities	-	-	130	120	250
Share of profits from associates	136	-	-	-	136
Other income	-	-	-	73	73
Expenses					
Financing expenses	-	-	578	-	578
Return in unrestricted investment accounts	12	66	62	1,831	1,971
Investments related expenses	45	19	-	448	512
Impairment allowances	-	-	-	4,126	4,126

Compensation of 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:

	2010	2009
Board members fee	35	267
Board member allowances	164	168
Salaries and other short-term benefits	1,142	803

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

24. RELATED PARTY TRANSACTIONS (continued)

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 167 thousand (31 December 2009: BD 803 thousand) to its restricted investment accounts at a profit of BD 55 thousand (31 December 2009: BD 267 thousand).

25. 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.

Basic EPS	2010	2009
(Loss)/profit for the year (BD 000's)	(6,533)	3,100
Weighted average number of equity shares (Nos. in 000's)	1,113,440	1,019,127
Basic earnings per share (fils)	(5.87)	3.04

Diluted EPS	2010	2009
(Loss)/profit for the year (BD 000's)	(6,533)	3,100
Weighted average number of equity shares (Nos. in 000's)	1,113,440	1,019,127
Diluted earnings per share (fils)	(5.87)	3.04

As the average market value of shares during the current period were lower than the assumed issue price of shares under the Scheme (refer note 21), the share awards are not considered to be dilutive for the purposes of computation of earnings per share

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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26. 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.

27. ZAKAH

Zakah is directly borne by the shareholders on distributed profits and investment account holders. 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 2,506 thousand (2009 BD 4,218 thousand) of which BD 250 thousand (2009: 1,941 thousand) represents the Zakah computed on the cumulative statutory reserve and retained earnings as at 31 December 2010, payable by the Bank (refer note 33). The remaining Zakah balance amounting to BD 2,256 thousand or 1.95 fils per share (2009: BD 2,277 thousand or 2.17 fils per share) is due and payable by the shareholders.

28. 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:

Commercial banking

Providing customer services such as accepting mudaraba deposits, savings account and current account facilities, fund transfer facilities, bill payment facilities. It also provides financing facilities (in form of Commodity Murabaha, Musharaka, Istisna and Ijarah facilities) to corporate clients and High-Networth-Individuals and consumer finance products. 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 an 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

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28. SEGMENT REPORTING (continued)

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 30 (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.

31 December 2010	Investment Banking	Commercial Banking	Unallocated	Total
Cash and bank balances	-	12,290	-	12,290
Placements with financial institutions	981	73,978	-	74,959
Financing assets	651	202,559	-	203,210
Investment securities	82,718	17,561	-	100,279
Assets acquired for leasing (including lease rental receivable)	-	7,980	-	7,980
Investment in associates	4,113	-	-	4,113
Investment property	3,943	-	-	3,943
Other assets	909	800	767	2,476
Property and equipment	-	-	9,966	9,966
Total segment assets	93,315	315,168	10,733	419,216
Placements from financial institutions and others	65,916	19,019	-	84,935
Customers' current accounts	982	9,946	-	10,928
Other liabilities	-	1,525	5,450	6,975
Total segment liabilities	66,898	30,490	5,450	102,838
Unrestricted investment accounts	-	198,220	-	198,220
Restricted investment accounts	42,615	-	-	42,615

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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28. SEGMENT REPORTING (continued)

2010	Investment Banking	Commercial Banking	Unallocated	Total
Income from investment banking services	47	-	-	47
Placements, management and arrangement fees	1,260	-	-	1,260
Income from placements with financial institutions	12	903	-	915
Income from financing assets and assets acquired for leasing	-	16,092	-	16,092
Income from investment securities	1,376	822	-	2,198
Share of losses from associate companies	(1,005)	-	-	(1,005)
Other income	(30)	108	-	78
Total income before return on unrestricted investment accounts	1,660	17,925	-	19,585
Less: Return on unrestricted investment accounts before Bank's share as mudarib	-	(8,254)	-	(8,254)
Less: Bank's share as a Mudarib	-	2,469	-	2,469
Return on unrestricted investment accounts	-	(5,785)	-	(5,785)
Less: Expense on placement from financial institutions and others	(320)	(975)	-	(1,295)
Total segment revenue	1,340	11,165	-	12,505
Staff cost	1,189	1,012	2,869	5,070
Depreciation	-	-	1,342	1,342
Other expenses	284	-	3,781	4,066
Total segment cost	1,474	1,012	7,992	10,478
Segment results before impairment allowances	(134)	10,153	(7,992)	2,027
Impairment allowances	(2,565)	(5,994)	-	(8,560)
Segment results	(2,407)	4,185	(7,991)	(6,533)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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BD 000's

28. SEGMENT REPORTING (continued)

31 December 2009	Investment Banking	Retail/ Commercial 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	15,540	601	1,702	17,843
Equipment	-	-	4,348	4,348
Total segment assets	100,409	367,145	6,050	473,604
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
Total segment liabilities	97,301	41,124	5,017	143,442
Unrestricted investment accounts	-	203,588	-	203,588
Restricted investment accounts	46,742	-	-	46,752

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2010**

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28. SEGMENT REPORTING (continued)

31 December 2009	Investment Banking	Commercial Banking	Unallocated	Total
Income from investment banking services	13,798	-	-	13,798
Placements, management and arrangement fees	1,013	-	-	1,013
Income from placements with financial institutions	17	1,460	-	1,477
Income from financing assets and assets acquired for leasing	-	15,024	-	15,024
Income from investment securities	119	1,161	-	1,280
Share of profits from associate companies	136	-	-	136
Other income	431	73	-	504
Total income before return on unrestricted investment accounts	15,514	17,718	-	33,232
Less: Return on unrestricted investment accounts before Bank's share as mudarib	-	(11,103)	-	(11,103)
Less: Bank's share as a Mudarib	-	1,772	-	1,772
Return on unrestricted investment accounts	-	(9,331)	-	(9,331)
Less: Expense on placement from financial institutions and others	(1,032)	(238)	-	(1,270)
Total segment revenue	14,482	8,149	-	22,631
Staff cost	1,189	1,013	2,871	5,073
Depreciation	-	-	1,311	1,311
Other expenses	664	3,226	-	3,890
Total segment cost	1,853	4,239	4,182	10,274
Segment results before impairment allowances	12,629	3,910	(4,182)	12,357
Impairment allowances	(6,223)	(3,034)	-	(9,257)
Segment results	6,406	876	(4,182)	3,100

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29. MATURITY PROFILE

The maturity profile of placements with and from financial institutions, financing assets, assets acquired for leasing assets unrestricted investment accounts (including lease rental receivable) and investment in sukuk 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.

31 December 2010	Up to 3 months	3 to 6 months	6 months- 1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	12,290	-	-	-	-	12,290
Placements with financial institutions	74,959	-	-	-	-	74,959
Financing assets	23,805	17,997	4,788	93,549	63,071	203,210
Investment securities	3,765	1,609	18,520	45,996	30,389	100,279
Assets acquired for leasing (including lease rental receivable)	822	-	725	79	6,354	7,980
Investment in associates	-	-	1,168	-	2,945	4,113
Investment property	-	-	-	3,943	-	3,943
Other assets	271	-	476	853	876	2,476
Property and equipment	-	-	-	-	9,966	9,966
Total assets	115,912	19,606	25,677	144,420	113,601	419,216
Liabilities						
Placements from financial institutions and others	78,353	1,409	5,110	24	39	84,935
Customers current account	10,928	-	-	-	-	10,928
Other liabilities	487	268	45	5,897	278	6,975
Total liabilities	89,768	1,677	5,155	5,921	317	102,838
Unrestricted investment accounts	35,949	29,756	48,657	77,943	5,915	198,220
Restricted investment accounts	23,160	18,163	-	-	1,292	42,615
Commitments	6,012	4,737	4,815	20	6	15,590

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29. MATURITY PROFILE (continued)

31 December 2009	Up to 3 months	3 to 6 months	6 months- 1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	19,975	-	-	-	-	19,975
Placements with financial institutions	122,193	-	-	-	-	122,193
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
Total assets	183,468	65,322	45,135	111,997	67,682	473,604
Liabilities						
Placements from financial institutions and others	90,030	11,700	-	-	-	101,730
Customers current account	35,097	-	-	-	-	35,097
Other liabilities	6,615	-	-	-	-	6,615
Total liabilities	131,742	11,700	-	-	-	143,442
Unrestricted investment accounts	161,592	23,839	15,786	244	2,127	203,588
Restricted investment accounts	-	18,766	-	26,905	1,071	46,742
Commitments	5,230	750	5,106	5,258	-	16,344

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30. CONCENTRATION OF ASSETS, LIABILITIES, UNRESTRICTED AND RESTRICTED INVESTMENT ACCOUNTS

a. Industry sector

31 December 2010	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	12,290	-	-	12,290
Placements with financial institutions	74,959	-	-	74,959
Financing assets	14,169	105,303	83,738	203,210
Investment securities	20,986	59,113	20,180	100,279
Assets acquired for leasing (including lease rental receivable)	2,504	4,065	1,411	7,980
Investment in associates	-	4,113	-	4,113
Investment property	-	3,943	-	3,943
Other assets	673	936	867	2,476
Property and equipment	-	-	9,966	9,966
Total assets	125,581	177,473	116,162	419,216
Liabilities				
Placements from financial institutions and others	68,378	-	16,557	84,935
Customers' current account	-	-	10,928	10,928
Other liabilities	-	-	6,975	6,975
Total liabilities	68,378	-	34,460	102,838
Unrestricted investment accounts	24,635	52,095	121,490	198,220
Restricted investment accounts	-	41,323	1,292	42,615
Commitments	-	4,318	11,272	15,590

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30. CONCENTRATION OF ASSETS, LIABILITIES, UNRESTRICTED AND RESTRICTED INVESTMENT ACCOUNTS (continued)

a. Industry sector (continued)

31 December 2009	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	19,975	-	-	19,975
Placements with financial institutions	122,193	-	-	122,193
Financing assets	17,308	96,041	78,736	192,085
Investment 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
Total assets	178,368	182,491	112,745	473,604
Liabilities				
Placements from financial institutions and others	89,179	-	12,551	101,730
Customers' current account	-	-	35,097	35,097
Other liabilities	-	-	6,615	6,615
Total liabilities	89,179	-	54,263	143,442
Unrestricted investment accounts	16,915	61,158	125,515	203,588
Restricted investment accounts	-	45,671	1,071	46,742
Commitments	-	3,612	12,732	16,344

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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30. CONCENTRATION OF ASSETS, LIABILITIES, UNRESTRICTED AND RESTRICTED INVESTMENT ACCOUNTS (continued)

b. Geographic sector

2010	GCC countries	Europe	USA	Asia	Australia	Africa	Total
Assets							
Cash and bank balances	10,630	1,642	-	-	18	-	12,290
Placements with financial institutions	64,026	7,540	-	-	-	3,393	74,959
Financing assets	188,202	11,194	651	3,163	-	-	203,210
Investment securities	64,656	2,927	-	26,333	4,685	1,678	100,279
Assets acquired for leasing (including lease rental receivable)	7,980	-	-	-	-	-	7,980
Investment in associates	4,113	-	-	-	-	-	4,113
Investment property	3,943	-	-	-	-	-	3,943
Other assets	2,341	-	-	135	-	-	2,476
Property and equipment	9,966	-	-	-	-	-	9,966
Total assets	355,857	23,303	651	29,631	4,703	5,071	419,216
Liabilities							
Placements from financial institutions and others	75,882	1,886	-	-	-	7,167	84,935
Customers' current account	9,848	463	-	617	-	-	10,928
Other liabilities	6,975	-	-	-	-	-	6,975
Total liabilities	92,705	2,349	-	617	-	7,167	102,838
Unrestricted investment accounts	182,508	321	-	15,391	-	-	198,220
Restricted investment accounts	32,722	8,600	-	-	1,293	-	42,615
Commitments	15,588	2	-	-	-	-	15,590

Concentration by location for 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

30. CONCENTRATION OF ASSETS, LIABILITIES, UNRESTRICTED AND RESTRICTED INVESTMENT ACCOUNTS (continued)

b. Geographic sector (continued)

2009	GCC countries	Europe	USA	Asia	Australia	Africa	Total
Assets							
Cash and bank balances	12,615	468	6,846	46	-	-	19,975
Placements with financial institutions	109,308	12,885	-	-	-	-	122,193
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
Total assets	407,210	17,130	6,846	27,005	4,852	10,561	473,604
Liabilities							
Placements from financial institutions and others	99,996	1,734	-	-	-	-	101,730
Customers' current account	32,789	419	-	1,889	-	-	35,097
Other liabilities	6,615	-	-	-	-	-	6,615
Total liabilities	139,400	2,153	-	1,889	-	-	143,442
Unrestricted investment accounts	180,576	984	-	22,028	-	-	203,588
Restricted investment accounts	45,671	-	-	-	1,071	-	46,742
Commitments	14,459	-	-	1,885	-	-	16,344

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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31. 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 10,240 thousand (31 December 2009: 18,292 thousand) amounts to BD 9,076 thousand as at 31 December 2010 (31 December 2009: 16,598 thousand).

Other than available-for-sale investments of BD 82,444 thousand (2009: BD 62,924 thousand), asset held-for-sale of Nil (2009: BD 4,852 thousand) and unquoted held-to-maturity investment in sukuk of BD 7,011 thousand (2009: 5,951 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.

32. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

32. RISK MANAGEMENT (continued)

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, 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.
- 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 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 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

32. RISK MANAGEMENT (continued)

Exposure to credit risk

2010	Placements with financial institution	Financing assets	Assets acquired for leasing (including lease rental receivable)	Investment securities- Sukuk	Other financial assets	Total
Impaired						
Grade 9: <i>Impaired</i>	-	28,548	-	-	-	28,548
Unrated	-	-	-	-	773	773
Allowance for Impairment	-	(14,189)	-	-	(773)	(14,962)
Carrying amount	-	14,359	-	-	-	14,359
Past due but not impaired						
Grade 1-6: <i>Low-Fair Risk</i>	-	3,356	-	-	-	3,356
Grade 7-8: <i>Watch list</i>	-	15,377	-	-	-	15,377
Past due comprises:						
0-30 days	-	1,854	-	-	-	1,854
30-60 days	-	2,832	-	-	-	2,832
60-90 days	-	3,788	-	-	-	3,788
90-180 days	-	1,945	-	-	-	1,945
180 days +	-	8,314	-	-	-	8,314
Carrying amount	-	18,733	-	-	-	18,733
Neither past due nor impaired						
Grade 1-6: <i>Low-Fair risk</i>	74,959	151,400	6,208	17,613	-	250,181
Grade 7-8: <i>Watch list</i>	-	20,881	1,908	-	-	22,789
Unrated	-	-	-	-	1,948	1,948
Carrying amount	74,959	172,281	8,116	17,613	1,948	274,917
Less: Collective impairment provisions	-	(2,163)	(136)	(52)	-	(2,351)
Total	74,959	203,210	7,980	17,561	1,948	305,658

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

32. RISK MANAGEMENT (continued)

Credit risk (continued)

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS for the year ended 31 December 2010

32. RISK MANAGEMENT (continued)

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.

Past due but not impaired exposures

The exposure pertains to 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 30,474 thousand (2009: BD 34,917 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. Of the total past due facilities of BD 18,733 thousand only installments of BD 7,307 thousand are past due as at 31 December 2010

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 judgment 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

32. RISK MANAGEMENT (continued)

Collaterals

The Bank holds collateral against 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.

	As at 31 December 2010			As at 31 December 2009		
	Financing assets	Assets acquired for leasing (including lease rental receivable)	Total	Financing assets	Assets acquired for leasing (including lease rental receivable)	Total
<u>Against impaired</u>						
Property	9,195	-	9,195	-	-	-
Equities	1,979	-	1,979	-	-	-
Other	-	-	-	495	-	495
<u>Against past due but not impaired</u>						
Property	33,104	-	33,104	25,381	26,710	25,381
Equities	1,579	-	1,579	8,014	10,188	8,014
Other	-	-	-	-	36,898	-
<u>Against neither past due nor impaired</u>						
Property	174,995	10,833	185,828	173,000		199,710
Equities	6,732	-	6,732	3,824		3,824
Others	34,911	12,584	47,495	70,172		80,360
Total	262,495	23,417	285,912	280,886		317,784

For analysis of concentration of total assets and liabilities refer note 30.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

32. RISK MANAGEMENT (continued)

Further, for 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:

Concentration by sector	As at 31 December 2010			As at 31 December 2009		
	Financing assets	Assets acquired for leasing (including lease rental receivable)	Total	Financing assets	Assets acquired for leasing (including lease rental receivable)	Total
Banking and finance	8,332	2,504	10,836	17,308	3,005	20,313
Real estate:						
- Property	70,037	4,065	74,102	47,452	6,835	54,287
- Infrastructure developmet	35,266	-	35,266	30,261	-	30,261
-Land	15,761	-	15,761	18,329	-	18,329
Construction	5,094	725	5,819	5,478	-	5,478
Trading	31,525	-	31,525	27,359	-	27,359
Manufacturing	5,880	-	5,880	7,216	-	7,216
Others	31,315	686	32,001	38,682	3,593	42,275
Total carrying amount	203,210	7,980	211,190	192,085	13,433	205,518

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2010**

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32. RISK MANAGEMENT (continued)

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.

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, customer reverse murabah account 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:

	2010 %	2009 %
At 31 December	10.50	22.00
Average for the period	19.44	26.07
Maximum for the period	10.52	44.00
Minimum for the period	15.79	18.02

For maturity profile of assets and liabilities refer note 29.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS for the year ended 31 December 2010

32. RISK MANAGEMENT (continued)

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.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

32. RISK MANAGEMENT (continued)

A summary of the Bank's profit rate gap position at 31 December 2010 is as follows:

2010	Up to 3 months	3-6 months	6 months-1 year	1-3 years	More than 3 years	Total
Assets						
Placements with financial institutions	74,959	-	-	-	-	74,959
Financing assets	39,360	27,390	2,882	88,961	44,617	203,210
Assets acquired for leasing (including lease rental receivable)	4,042	2,504	-	79	1,355	7,980
Investments securities (sukuk)	7,082	4,141	-	4,713	1,625	17,561
Total profit rate sensitive assets	125,443	34,035	2,882	93,753	47,597	303,710
Liabilities						
Placements from financial institutions and others	78,353	1,409	5,110	24	39	84,935
Current accounts	981	-	-	-	-	981
Unrestricted investment accounts	154,804	27,714	15,113	220	369	198,220
Total profit rate sensitive liabilities	234,138	29,123	20,223	244	408	284,136
Profit rate gap	(108,695)	4,912	(17,341)	93,509	47,189	19,574

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

BD 000's

32. RISK MANAGEMENT (continued)

2009	Up to 3 months	3-6 months	6 months- 1 year	1-3 years	More than 3 years	Total
Assets						
Placements with financial institutions	122,193	-	-	-	-	122,193
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	1,726	29,244
Total profit rate sensitive assets	185,986	44,619	24,751	51,957	49,641	356,955
Liabilities						
Placements from financial institutions and others	(90,030)	(11,700)	-	-	-	(101,730)
Current accounts	(8,121)	-	-	-	-	(8,121)
Unrestricted investment accounts	(161,592)	(23,839)	(15,786)	(244)	(2,127)	(203,588)
Total profit rate sensitive liabilities	(259,743)	(35,539)	(15,786)	(244)	(2,127)	(313,439)
Profit rate gap	(73,757)	9,080	8,965	51,713	47,515	43,515

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) is as follows:

	100bp parallel increase/decrease	50bp increase/decrease
At 31 December 2010	± 196	± 98
At 31 December 2009	± 435	± 218

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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BD 000's

32. 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:

	2010 BHD Equivalent	2009 BHD Equivalent
Sterling pounds	2,695	2,961
Euros	5,787	9,899
US Dollars *	78,539	59,640
Kuwaiti Dinars	2,941	3,031
Other GCC currencies *	30,577	33,030
Indian Rupee	60	45
Australian Dollars	4,703	-

(*) The exposure in US dollars and other GCC currencies does not create any foreign exchange risk for the Bank since Bahrain 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, other 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:

	2010 BHD Equivalent	2009 BHD Equivalent
Sterling pounds	±135	±148
Kuwaiti Dinars	±147	±152
Euros	±289	±495
Indian Rupee	±3	±2
Australian Dollars	±235	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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32. RISK MANAGEMENT (continued)

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 22 for significant estimates and judgments 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.

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 one cycle of Risk Control Self Assessment (RCSA) 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: the RCSA process is a continuous process and will be conducted at regular frequencies across the Bank. 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

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32. RISK MANAGEMENT (continued)

Capital management (continued)

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 2010, 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. For computation of credit risk on assets financed by unrestricted investment accounts 30% of risk weight assets are considered as against 100% for assets self financed.

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:

	31 December 2010	31 December 2009
Total risk weighted assets	416,941	376,444
Tier 1 capital	118,041	126,544
Tier 2 capital	222	2,148
Total regulatory capital	118,263	128,692
Total regulatory capital expressed as a percentage of total risk weighted assets	28.36	34.19

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

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33. PROPOSED APPROPRIATIONS

The Board of Directors propose the following appropriations for 2010 which are subject to shareholders approval in the ensuing Annual General Meeting:

	2010	2009
Directors' remuneration	-	-
Proposed cash dividend	-	-
Proposed issue of bonus shares as dividend	-	10,492
Charity	-	150
Zakah	250	1,941

34. COMMITMENTS

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

	2010	2009
Undrawn commitments to extend finance	13,923	7,474
Financial guarantees	1,667	5,258
Commitment to investments	-	3,612
	15,590	16,344

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 2010 due to the performance of any of its projects.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2010

35. SOCIAL RESPONSIBILITY

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

36. NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET ADOPTED

The following accounting standards and interpretations have been issued by AAOIFI during 2010 and are mandatory for the Group's accounting for annual periods beginning on or after 1 January 2011 and are expected to be relevant to the Group:

FAS 25 Investment in sukuk, shares and similar instruments

FAS 25 was issued in July 2010 and replaced FAS 17 *Investments* for accounting of investments. FAS 25 retains and simplifies the mixed measurement model and establishes two measurement categories for investments: amortised cost and fair value. The standard requires each investment to be first segregated as either debt-type or equity type instruments, and the basis of classification depends on the entity's business model and the contractual cash flow characteristics of the investment. For equity-type investments, an irrevocable election can be made at initial recognition, to recognise unrealised fair value gains and losses through equity rather than through the income statement. Reclassification between categories is not permitted. The guidance in FAS 17 on 'investment in real estate' continues to apply. The new standard requires retroactive application.

The Group is currently in the process of evaluating the potential effect of this standard. Given the nature of the Group's operations, this standard is expected to have a pervasive impact on the Group's financial statements.

37. COMPARITIVES

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 AND CAPITAL MANAGEMENT DISCLOSURES

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 of the 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 2010, 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 2010 unless otherwise stated.

Khaleeji Commercial Bank BSC (the "Bank / KHCB") has adopted the Standardised Approach for Credit Risk and Market Risk and the Basic Indicator Approach for Operational Risk to determine its capital requirements, details of which is given in section 2. This section 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 Bank's total risk weighted assets as at 31 December 2010 amounted to BD 416,941. Credit risk accounted for 84.21 per cent, operational risk 12.61 per cent, and market risk 3.18 per cent of the total risk weighted assets. Tier I and total regulatory capital were BD 118,041 and BD 118,263 respectively as at 31 December 2010.

At 31 December 2010, Bank's Tier I and total adequacy ratios were 28.31 per cent and 28.36 per cent respectively.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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 guidelines and are risk weighted as investments for capital adequacy computation purposes.

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.

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 per cent, 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

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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 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 frame work. This document is prepared in accordance with these directives.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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 Bank considers that its overall risk management strategies used have been effective throughout the reporting period.

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

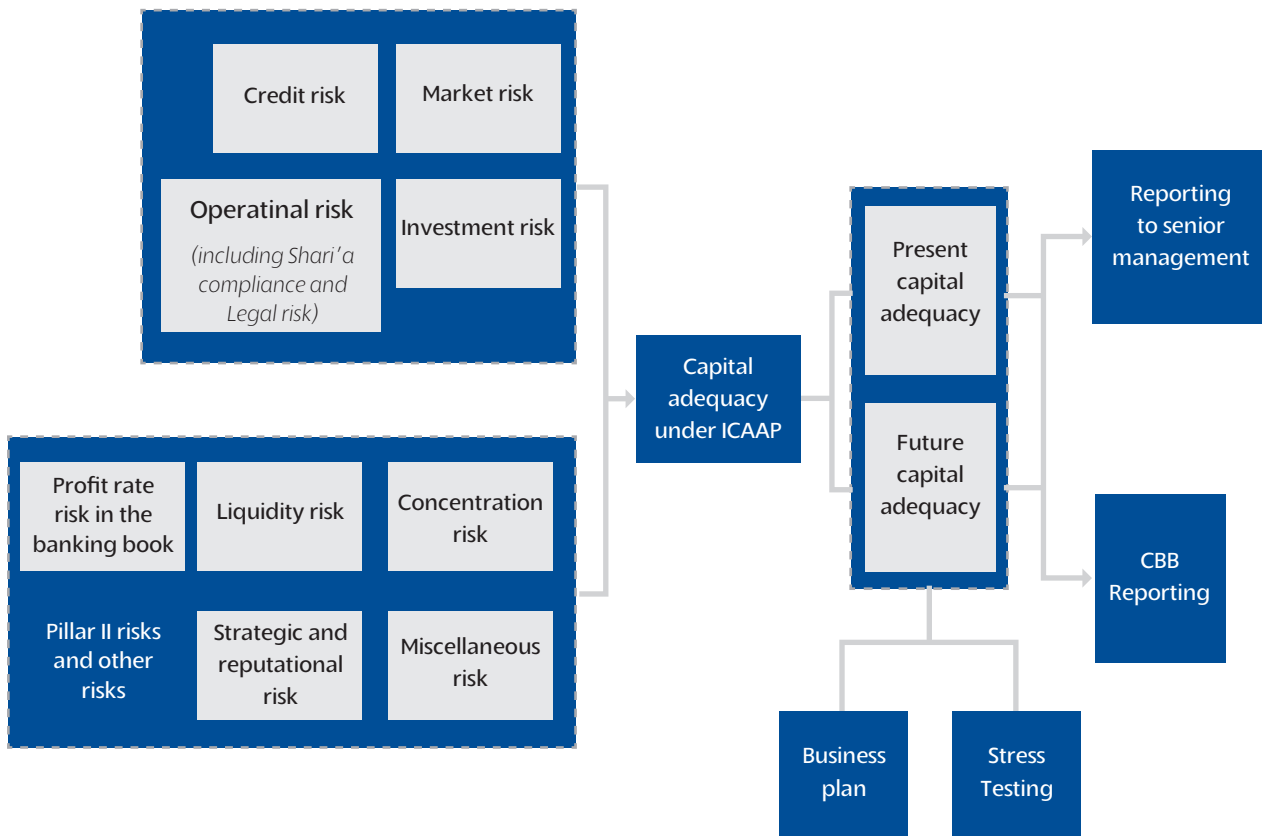
The Bank's policy is to maintain a strong capital base to develop and retain investor, creditor and market confidence and to sustain business growth. The Bank recognises the impact of a high level of capital on shareholders' returns, while not losing sight of the security and market confidence afforded 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.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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



RISK AND CAPITAL MANAGEMENT DISCLOSURES

BD 000's

3.2.1. Risk addressed by the ICAAP

Risk Type	Metrics based on which internal capital is allocated
Credit risk	Regulatory capital adequacy guidelines to be used as proxy for internal capital
Market risk	for Pillar I risks
Investment risk	
Operational risk	
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 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

3.3. Capital structure, minimum capital requirements and capital adequacy

During the year, the paid up capital of the Bank increased from BD 104,924 thousand to BD 115,416 thousand as a result of issue of bonus shares (one share for every ten shares held) for 2010 amounting to BD 10,492 thousand. Following is the break-up of the capital structure as at 31 December 2010:

	31 December 2010
Net available capital	
Issued and fully paid ordinary shares	115,416
Less: Treasury shares	(6,018)
Less: ESOP shares	-
Statutory reserve	6,298
Share premium	1,213
Other reserves	(613)
Retained earning	1,745
Tier 1 capital	118,041
Eligible portion of unrealised gains arising from fair valuing equities	53
Profit equalisation reserve	169
Investment risk reserve	-
Tier 2 capital	222
Net available capital	118,263

RISK AND CAPITAL MANAGEMENT DISCLOSURES

BD 000's

	31 December 2010
Risk weighted assets	
Credit risk weight exposures	351,107
Market risk weight exposures	13,250
Operational risk weight exposures	52,584
Total risk weighted assets	416,941
Capital adequacy ratio (Tier 1)	28.31%
Capital adequacy ratio (Total capital)	28.36%

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 2010, the 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, 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.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

BD 000's

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.

The Bank does not have a trading book and hence all exposures are part of the banking book for the purpose of assessing the applicable capital treatment.

Break-up of capital requirement in accordance with the Capital Adequacy Module of the CBB for the year ended 31 December 2010 is as follows:

Exposure classification	Exposure			Risk weighted assets*			Capital requirement @ 12%		
	Self – Financed	URIA	Total	Self – Financed	URIA	Total	Self – Financed	URIA	Total
Cash and collection items	1,310	-	1,310	-	-	-	-	-	-
Sovereigns	538	11,016	11,554	-	-	-	-	-	-
Banks	2,101	74,959	77,060	508	6,714	7,222	61	806	867
Corporates	104,055	97,175	201,230	104,055	29,152	133,207	12,487	3,498	15,985
Past due facilities	14,359	-	14,359	14,359	-	14,359	1,723	-	1,723
Investments in equities/sukuk	8,842	14,901	23,743	13,126	6,705	19,831	1,575	805	2,380
Holdings of real estate	89,624	-	89,624	172,534	-	172,534	20,704	-	20,704
Other assets	3,954	-	3,954	3,954	-	3,954	474	-	474
Credit Risk	224,783	198,051	422,834	308,536	42,571	351,107	37,024	5,109	42,133
Market Risk	-	-	-	-	-	13,250	-	-	1,590
Operational Risk	-	-	-	-	-	52,584	-	-	6,310
Total	224,783	198,051	422,834	308,536	42,571	416,941	37,024	5,109	50,033

*For capital adequacy computations, 100% of the RWAs is reckoned for self financed assets while only 30 % is considered for assets funded through URIA.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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 financial institutions
- 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.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

BD 000's

4.2. Levels of Exposure

The year 2010 saw a modest growth in overall credit exposure levels. The table below shows gross credit exposure along with average credit exposure broken down under different exposure classes as at 31 December 2010.

Gross / Average Credit Exposures

	Average Exposure ⁽¹⁾	Gross Exposure		
		Self	URIA	Total
Cash and bank balances ⁽²⁾	14,404	3,934	8,356	12,290
Placement with financial institutions	79,746	-	74,959	74,959
Financing assets	199,420	106,035	97,175	203,210
Investments in equity securities	84,598	82,718	-	82,718
Investment in sukuk	20,154	-	17,561	17,561
Assets acquired for leasing (including ijarah rental receivable)	11,118	7,980	-	7,980
Investment in associates	5,795	4,113	-	4,113
Asset held-for-sale	4,769	-	-	-
Other assets	12,485	16,385	-	16,385
Total On Balance Sheet Credit Exposure	432,489	221,165	198,051	419,216
Undrawn financing facilities	14,811	13,923	-	13,923
Guarantees	1,526	1,667	-	1,667
Commitments to invest	3,691	-	-	-
Total Off Balance Sheet Credit Exposure	20,028	15,590	-	15,590

⁽¹⁾ Represents quarterly average balances for the year ended 31 December 2010.

⁽²⁾ Includes cash balance of BD 1,301 thousand.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

BD 000's

4.3. Concentration of credit risk

4.3.1. Geographic distribution

The geographical exposure profile as at 31 December 2010 was as follows:

2010	GCC countries	Europe	USA	Asia	Australia	Africa	Total
Assets							
Cash and bank balances	10,630	1,642	-	-	18	-	12,290
Placement with financial institutions	64,026	7,540	-	-	-	3,393	74,959
Financing assets	188,202	11,194	651	3,163	-	-	203,210
Investment securities	64,656	2,927	-	26,333	4,685	1,678	100,279
Assets acquired for leasing (including lease rental receivable)	7,980	-	-	-	-	-	7,980
Investment in associates	4,113	-	-	-	-	-	4,113
Investment property	3,943	-	-	-	-	-	3,943
Other assets	2,341	-	-	135	-	-	2,476
Property and equipment	9,966	-	-	-	-	-	9,966
Total funded exposure	355,857	23,303	651	29,631	4,703	5,071	419,216
Undrawn financing facilities	13,921	2	-	-	-	-	13,923
Guarantees	1,667	-	-	-	-	-	1,667
Total unfunded exposures	15,588	2	-	-	-	-	15,590

RISK AND CAPITAL MANAGEMENT DISCLOSURES

BD 000's

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 as at 31 December 2010 was as follows:

2010	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	12,290	-	-	12,290
Placement with financial institutions	74,959	-	-	74,959
Financing assets (*)	8,332	121,064	73,814	203,210
Investment securities	20,986	59,113	20,180	100,279
Assets acquired for leasing (including lease rental receivable)	2,504	4,065	1,411	7,980
Investment in associates	-	4,113	-	4,113
Investment property	-	3,943	-	3,943
Other assets	673	936	867	2,476
Property and equipment	-	-	9,966	9,966
Total funded exposure	119,744	193,234	106,238	419,216
Undrawn financing facilities	4,000	5,217	4,706	13,923
Guarantees	-	32	1,635	1,667
Total unfunded exposures	4,000	5,249	6,341	15,590

* Financing asset exposures have been classified based on the purpose of financing.

4.3.3. Transactions with related counterparties

Related counterparties are those entities which are related 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 related counterparties the Bank strictly follows the guidelines issued by Central Bank of Bahrain for the purpose. Detailed break up is presented in note no 24 in the notes to the consolidated financial statements for the year ended 31 December 2010.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

BD 000's

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 2010

	Amount
Banks	
Bank A	23,623
Total	23,623

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 by type of financing contract of the Bank's credit portfolio and investment in sukuk is given in the table below.

Maturity Scale	< 1 M	1 - 3 M	3 - 6 M	6M - 1 Y	1 - 3 Y	>3 Y	Total
Credit Portfolio*							
Murabaha	6,638	8,072	12,076	2,882	76,222	41,625	147,515
Musharaka	725	(398)	3,249	1,906	17,187	11,637	34,306
Wakala	3,538	5,230	2,673	-	140	8,810	20,391
Istisna	-	-	-	-	-	998	998
Ijarah	-	822	-	725	79	6,354	7,980
Total	10,901	13,726	17,998	5,513	93,628	69,424	211,190
Investments in sukuk	2,350	310	-	3,440	9,293	2,168	17,561
Total	2,350	310	-	3,440	9,293	2,168	17,561
Grand Total	13,251	14,036	17,998	8,953	102,921	71,592	228,751

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

RISK AND CAPITAL MANAGEMENT DISCLOSURES

BD 000's

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 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.

Information on equity investments

Privately held	82,444
Quoted in an active market	274
Realised gain / (loss) during the year	-
Unrealised gain / (loss) in equity (Tier 2)	53

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

Equity investments in banking book	Gross Exposure		Risk weighted exposure		Capital charge	
	Self financed	URIA	Self financed	URIA	Self financed	URIA
Quoted equity investment	274	-	274	-	33	-
Unquoted equity investment	8,568	-	12,852	-	1,542	-
Investments in managed funds	-	-	-	-	-	-
Real estate investments	73,876	-	147,752	-	17,730	-
Total	82,718	-	160,878	-	19,305	-

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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 department 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 has been 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-	
Moody's	>=aa3	>=A3	>=Baa3	>=B3	C & D	
CI	>= AA-	>=A-	>=BBB-	>=B-	C & D	Unrated
Fitch	>= AA-	>=A-	>=BBB-	>=B-	Below B-	

Please refer to note 32 in the notes to the consolidated financial statements for the year ended 31 December 2010, 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 income statement 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 Income statement.

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For a detailed policy on impairment of financial assets, refer note 2 (n) in the notes to the consolidated financial statements for the year ended 31 December 2010.

For the quantitative disclosures relating to exposures which were past due or impaired as of 31 December 2010, please refer to note 32 in the notes to the consolidated financial statement for the year ended 31 December 2010.

During the year 2010, 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 % of its 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.

For movement in provisions on financing assets and investment securities refer to notes 5 and 6 respectively in the notes to the consolidated financial statement for the year ended 31 December 2010.

4.6.1. Geographical and sector-wise break up of impairment allowances and impaired/past due accounts

	GCC countries	Europe	USA	Asia	Australia	Africa	Total
Impaired	21,950	-	6,598	-	-	-	28,548
Allowance for impairment	(8,243)	-	(5,946)	-	-	-	(14,189)
Carrying amount	13,707	-	652	-	-	-	14,359
Past due but not impaired	18,733	-	-	-	-	-	18,733
Collective impairment	(2,206)	(129)	-	(11)	-	(5)	(2,351)

	Banks and financial institutions	Real estate	Others	Total
Impaired	-	21,019	7,529	28,548
Allowance for impairment	-	(9,786)	(4,403)	(14,189)
Carrying amount	-	11,233	3,126	14,359
Past due but not impaired:		3,786	11,111	18,733
0-30 days	-	1,143	710	1,853
30-60 days	1,880	-	952	2,832
60-90 days	1,906	-	1,882	3,788
90-180 days	-	1,653	292	1,945
180 days +	-	8,315	-	8,315
Collective impairment		(151)	(1,336)	(2,351)

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4.7. Renegotiated facilities

For disclosure of renegotiated loans refer note 32 in the notes to the consolidated financial statements for the year ended 31 December 2010.

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. As of date, there is one pending legal action against the Bank of BD 5,653 thousand. The case is still under discussion and evaluation. The legal claims from cases filed by the Bank amounted to BD 20,704 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.

The Bank has a policy of creating a contribution for Zakah and Charity fund for any non-Islamic income earned. During the year ended 31 December 2010 BD 36 thousand of non-Islamic income was transferred to Zakah & Charity fund.

For quantitative disclosures refer to consolidated statement of sources and uses of charity and Zakah fund in the consolidated financial statements for the year ended 31 December 2010.

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

The position of collateral cover for all credit exposures categorised on the basis of the type of security as on 31 December 2010 is given in the table below.

Collateral Type	Murabaha	Musharaka	Wakala	Istisna'a	Ijara	Value of Collateral ^[1]	Total Gross Exposure ^[2]	% of cover	% of Total
Real estate	172,778	41,786	2,553	2,680	10,726	230,523	127,430	181%	80%
Listed Securities	7,237	1,579	-	-	-	8,816	8,437	104%	3%
Unlisted Securities	1,474	-	-	-	-	1,474	4,330	34%	1%
Bank Guarantee	21,505	-	-	-	-	21,505	14,862	145%	8%
Cash Collateral	2,212	-	302	-	-	2,514	11,902	21%	1%
Unsecured	-	-	-	-	-	-	51,059	0%	0%
Others	2,510	2,743	5,639	-	10,188	21,080	9,658	218%	7%
Total	207,716	46,108	8,494	2,680	20,914	285,912	227,678	126%	100%

^[1] (Represents the last valuation carried out based on the Bank's valuation policy)

^[2] (The amounts are gross of collective impairment allowances of BD 2,299 thousand and specific impairment allowances of BD 14,189 thousand)

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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 ended 31 December 2010 there has been no such instance.

4.11. Regulatory Capital Requirements by type of financing contracts

Financing contracts	Exposure		Credit Risk Weighted Assets		Capital requirement @ 12%	
	Self	URIA	Self	URIA	Self	URIA
Murabaha	72,090	76,011	72,090	22,803	8,651	2,736
Ijarah assets (including lease rental receivables)	7,980	-	7,980	-	958	-
Mudaraba	-	-	-	-	-	-
Musharaka	33,945	-	33,945	-	4,073	-
Wakala	-	20,177	-	6,054	-	727
Istisna'a	-	987	-	296	-	36
Total	114,015	97,175	114,015	29,153	13,682	3,499

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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 32 in the notes to the consolidated financial statements for the year ended 31 December 2010.

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:

	As at 31 December	Max	Min
Equity position risk	-	-	-
Market risk on trading positions in sukuk	-	-	-
Foreign exchange risk	1,060	1,060	877
Commodity risk	-	-	-
Total (A)	1,060	1,060	877
Risk weighted assets (A x 12.5)	13,250	13,250	10,963
Capital requirement @ 12%	1,590	1,590	1,316

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 32 in the notes to the consolidated financial statements for the year ended 31 December 2010.

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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.

The risk weighted assets and capital requirement for operational risk as at 31 December 2010 is as given below:

Average gross income for 3 years (A)	28,045
Operational Risk Weighted Assets B = (A * 15%*12.5)	52,584
Capital requirement (B * 12%)	6,310

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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 sukuks 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 & 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 29 in the notes to the consolidated financial statements for the year ended 31 December 2010.

The following are the key liquidity ratios which reflect the liquidity position of the Bank:

	2010	2009	2008	2007	2006
Interbank assets to interbank liabilities	113.72	137.02	436.50	190.24	157.01
Liquid assets to total assets	20.81	30.02	37.04	31.63	37.53
Liquid assets to total deposits	41.72	59.56	60.39	98.22	119.68
Net liquid assets to total deposits	10.50	22.00	49.79	50.33	50.39

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 points (bps) parallel fall or rise across all yield curves and a 50 bps rise or fall of all yield curves. An analysis of the Bank's sensitivity to an increase or decrease in market profit rates has been disclosed in note 32 in the notes to the consolidated financial statements for the year ended 31 December 2010.

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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 Banks Risk Management Department. As at 31 December 2010, 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 geography and industry/sector wise refer points 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 the section on URIA 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.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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 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 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 18 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 2009, 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.

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.

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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 allocated impairment losses on its credit portfolio to the investors; (i.e. assets financed by URIA funds). During the year, such allocation was absorbed by utilisation of the Investment Risk Reserve.

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.

	2010	2009	2008	2007	2006
Allocated Income to URIA	8,254	11,103	8,953	3,012	917
Distributed Profit ^[1]	5,785	9,331	7,050	2,446	628
Mudarib Fees	2,469	1,772	1,903	566	289
As at 31 Dec					
URIA ^[2]	192,439	184,394	128,814	38,405	12,803
Profit Equalisation Reserve (PER)	169	1,209	649	206	60
Investment Risk Reserve (IRR)	-	925	473	134	43
Profit Equalisation Reserve-to-URIA	0.09%	0.66%	0.50%	0.54%	0.50%
Investment Risk Reserve-to-URIA	-	0.50%	0.37%	0.35%	0.36%

^[1] Includes PER and IRR expense

^[2] Represents average balance

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

Tenor	Profit distribution amount in BD					Ratio of profit paid as a percentage of total				
	2010	2009	2008	2007	2006	2010	2009	2008	2007	2006
1 Month Mudaraba ^[1]	3,107	4,271	3,346	1,576	335	53.7	45.8	47.5	64.4	53.4
3 Months Mudaraba	1,843	1,443	1,314	148	78	31.9	15.5	18.6	6.1	12.4
6 Months Mudaraba	641	736	373	71	26	11.1	7.9	5.3	2.9	4.1
12 Months Mudaraba	1,452	1,196	690	106	45	25.1	12.8	9.8	4.3	7.1
VIP Mudaraba	729	673	545	309	64	12.6	7.2	7.7	12.6	10.2
PER and IRR expenses	22	1,012	782	236	80	0.4	10.8	11.1	9.7	12.8
Utilisation of IRR	(2,009)	-	-	-	-	(34.8)	-	-	-	-
Total	5,785	9,331	7,050	2,446	628	100.0	100.0	100.0	100.0	100.0

^[1] 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
2010	4.03	(0.54)	(0.49)	1.28	4.04
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

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.

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

	2010	2009	2008
1 Month Mudaraba ^[1]	3.66%	4.00%	4.80%
3 Months Mudaraba	4.13%	4.94%	5.25%
6 Months Mudaraba	3.38%	5.30%	5.13%
12 Months Mudaraba	4.94%	5.79%	5.40%
VIP Mudaraba	4.35%	4.20%	4.52%

^[1] Includes saving account products.

URIA account by type of assets

The following table summarises the movement in type of assets in which the URIA funds are invested and allocation among various type of assets for the year ended 31 December 2010:

Particulars	Opening allocation	Movement	Closing allocation	Proportion of total asset
CBB balances	-	8,356	8,356	68%
Placements with Financial Institutions	-	74,959	74,959	100%
Financing assets				
Murabaha	124,937	(48,757)	76,180	51%
Musharaka	24,389	(24,389)	-	0%
Wakala	23,505	(3,328)	20,177	100%
Istisna'a	1,514	(527)	987	100%
Investment securities				
Sukuk	29,243	(11,682)	17,561	100%
Total	203,588	(5,368)	198,220	

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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.

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.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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RIA Name	Details	Launch Date	Projected Returns	Return Frequency	Returns annualised				
					2010	2009	2008	2007	2006
Al Hareth French Property Fund	An investment product designed to deliver attractive return from income producing properties in France. Approximate capital redemption of 30% was completed in April 2007 with a capital gain of 6% on the redeemed portion.	2005	9%	Annual	-	1.75%	9.5%	9.5%	9.5%
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.	2007	61.78% over product tenor	Bullet payment on maturity	-	-	-	-	-
RIA-2 Hajer Tower	An investment structure designed to participate in a product with the principal purpose of acquiring the 21st floor of Al-Hajer Tower in the Holy City of Mecca. The exit of this product was completed June 2008 as per the expected return on investment of 14.9%.	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 investment product designed to invest in growth and income generating real estate assets in the GCC and MENA regions. It should be noted that the distribution percentage made to date exceeds the forecasted yield outlined under the original Janayen Offering Documents and the revised distribution calendar provided in the first Investment Update.	2007	44.33%	Quarterly	0.27%	9.62%	10.65%	-	-
RIA-5 North Gate	A restricted investment product which owns a 6.0% stake in Shaden Real Estate Investment WLL which in turn (through its subsidiaries), holds a parcel of reclaimed land measuring approximately 3.875 million sq. meters (located in Al Hidd, Muharraq). The mixed-use plot will be sold to end-users subsequent to the completion of infrastructure works.	2008	90.66% over product tenor	Bullet return at maturity	-	-	-	-	-
RIA-6 Locata	A Restricted Mudharabah product which entitles the investors beneficial ownership of 21% 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 product tenor	Bullet return at maturity	-	-	-	-	-

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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 in compliance with the Corporate Governance Code (CGC), the Public Disclosure Module and the Stock Exchange Disclosure Standards set by the CBB. Corporate Governance Framework has been adopted in its pursuits of excellence in Corporate Governance.

The corporate governance philosophy of the Bank has been further strengthened with the adoption of the Bank's Corporate Governance Framework, Director's Conflict of Interest Policy, Insiders' Trading Policy, and the Bank Key Persons > Dealing Policy have been established. The Bank, through its Board and Committees, endeavours to strike and deliver the highest governing standards for the benefit of its stakeholders.

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 practice.

9.2. Board of Directors

The Board of Directors currently comprises of nine 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 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

Rashad Yousif Abdulla Janahi

Director

Director Since February 2008 (Non-Executive)

Over 18 years of experience in financial sector

Nominated by Esam Yousif Janahi

Managing Director, Board Member and founder of Abu Dhabi Investment House (ADIH)

Chairman- British School Bahrain Board of Trustees

Board Member – Vision3

Board Member - Balexco

RISK AND CAPITAL MANAGEMENT DISCLOSURES

Abdulla Abdulkarim Showaiter

Vice Chairman

Director Since February 2008 (Independent & Non-Executive)

Over 32 years of experience in the banking industry

Nominated by Emirates Islamic Bank

Deputy Chief Executive Officer – Emirates Islamic Bank

Board Member – First Energy Bank, Bahrain

Board Member – Ethmar Real Estate Company, Dubai

Board Member – Al Salam Bank, Sudan

Board Member – Al Mahraab Real Estate Company, Kuwait

Board Member – Waqf Trust Service, Government of Dubai, Dubai

Board Member, Madaares, Dubai

Ebrahim Hussain Ebrahim

Board Member & CEO

Director Since February 2008 (Executive)

Over 26 years of experience in financial sector

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 – First Energy Bank

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

Mohammed Barrak Al-Mutair

Board Member

Director Since August 2010 (Non-Executive)

Over 12 years of experience in Government and Business Sector.

Nominated by Al Imtiaz Investment Company K.S.C.

Member of the Kuwaiti Parliament

Chairman – Kuwait Real Estate Holding Company, Kuwait

Board Member – Gulf Real Estate Development Co. , KSA

Board Member – Al Imtiaz Investment Company K.S.C. , Kuwait

Yousif Saleh Khalaf

Board Member

Director Since February 2010 (Independent and Non-Executive)

Over 30 years of experience in financial and commercial sectors.

Managing Director – Vision Line Consulting, Bahrain

Board Member – First Leasing Bank, Bahrain

Board Member – ProCapital Associates, Bahrain

Abdul Latif Abdulla Al-Meer

Board Member

Director Since 2004 (Non-Executive)

Over 34 years of 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

RISK AND CAPITAL MANAGEMENT DISCLOSURES

Hisham Abdul Latif H. Al-Jabr

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

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

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 23,472,808 shares in the Bank as of the year ended 31 December 2010 (2009: 107,859,801 shares).

9.4. Code of conduct

The Board has approved a code of conduct for all staff of the Bank and the Board members. The Code, which includes how to deal with areas of conflict of interest, binds the Directors, Executive Management and staff to highest standard of professionalism and due diligence on discharging their duties. All Board members and senior management of the Bank have affirmed compliance with the Code of Conduct. A declaration is made by the Board members prior to each Board meeting confirming that they have disclosed all external appointments and notified the Chairman if there have been any changes to their external appointments since the previous meeting. Board members are excluded from dealing with all matters with an external entity where they hold external appointments with that entity.

9.5. Compliance with Regulators

The Bank's commitment to comply with the Regulations has been addressed through the adoption and maintenance by the Bank of a Corporate Governance Framework, a Director's Conflict of Interest Policy, an Insiders' Trading Policy and Procedures, and a Key Persons' Dealing Policy. The Bank, through its Board and Board Committees, endeavours to deliver the highest standards of governance for the benefit of its stakeholders. The Bank will dedicate an area on its new website www.khcbonline.com, wherein all Corporate Governance regulations and policies will be made available.

The Bank is committed to continuously reviewing and developing its corporate governance policies to ensure compliance with the changing requirements of the Regulations and to ensure compliance with international corporate governance best practice.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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)	Mr. Abdulla Abdulkarim Showaiter Mr. Yousif Saleh Khalaf Mr. Mohammed Barrak Al-Mutair	Human Resources, Compensation and incentives, Administration, Corporate Governance
Board Audit Committee (BAC)	Mr. Yousif Saleh Khalaf Mr. Rashad Yousif Janahi Mr. Khalid Rashid Al Thani	Internal Audit, External Audit, Compliance, Anti Money Laundering
Board Investment & Credit Committee (BICC)	Dr. Fuad Abdulla Al-Omar Mr. Abdulla Abdulkarim Showaiter Mr. Ebrahim Hussain Ebrahim Mr. Mohammed Barrak Al-Mutair	Investment & credit approval, Setting limits, Investment policies, Asset Liability Management, Banking relationship, Oversight of Off Balance Sheet Vehicles
Board Risk Management Committee (BRMC)	Mr. Abdul Latif Abdulla Al-Meer Mr. Hisham Abdul Latif Al-Jabr Mr. Khalid Rashid Al Thani	Risk management, Policies related to risk management

During 2010, The Board of Directors held 7 meetings, The Board Audit Committee (BAC) held 4 meetings, the Board Investment and Credit Committee (BICC) held 4 meetings, The Board Nominations, Remunerations and Governance Committee (BNRGC) held 4 meetings and the Board Risk Management Committee (BRMC) held 4 meetings.

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.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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

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 Shamil Bank
Board Member of the Dow Jones Islamic index
Member of Shari'a Supervisory Boards of a number of Islamic banks & insurance companies.

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

RISK AND CAPITAL MANAGEMENT DISCLOSURES

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 28 years of experience in both Islamic and conventional banks and financial institutions. Joined the Bank in 2004.

Qualification – BSc in Economics, Master of Business Administration with a concentration in Finance, Advanced Diploma in Islamic Banking.

Mr. Silvan Varghese

Deputy General Manager & COO

Experience - 20 years' experience in the banking industry in India and Middle East in several areas like Risk and Credit Management, compliance, Project Finance and Corporate Banking. Joined the Bank in 2007.

Qualification - BS in Chemical Engineering from BITS, Pilani, India and is an MBA from the Indian Institute of Management (IIM), Lucknow. He completed the General Management Program (GMP) at the Harvard Business School and is also certified by Global Association of Risk Professionals (GARP) as a Financial Risk Manager (FRM).

Fuad Ali Taqi

Deputy General Manager- Commercial Banking

Experience – Over 29 years of banking experience in Islamic and conventional banks. Joined the Bank in 2006.

Qualification - Business Studies Diploma, MBA from the University of Glamorgan, U.K.

Dimitry Blasi

Deputy General Manager- Investment Banking

Experience – Over 14 years experience Islamic and conventional banking including in a number of prominent international jurisdictions. Joined the Bank in 2005.

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

Hussam Saif

Head of Treasury

Experience – Over 21 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 – Over 31 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 – 13 years extensive experience in the Islamic banking industry and Audit. Joined the Bank in 2006.

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

Fetoo Al Mannai

Head of Human Resources

Experience – 15 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)

RISK AND CAPITAL MANAGEMENT DISCLOSURES

Mahdi A. Nabi Mohammed

Assistant General Manager – Operations & Administration

Experience - Over 30 years of banking experience. Joined the Bank in 2005. Prior to joining 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 26 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 – 22 years of experience in both internal and external audit, mainly in banks. Joined the Bank in 2007.

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

Christopher Ware

Head of Legal- Legal Department

Experience – over 12 years' experience, including more than 7 years as a qualified lawyer, gained through roles with various institutions in the UK, Japan, Australia and Bahrain. Experience extends to capital markets, structured finance, banking, Islamic finance, acquisitions, private equity and real estate work. Has been with the Bank since December 2010.

Qualification – LLB degree from King's College, University of London (1996) and a Post-Graduate Diploma in Law (2001) from the College of Law, London. Admitted to practise law as solicitor of the Supreme Court of England & Wales since 2003.

Abdulnasser Al Mahmood

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

Experience – Over 20 years of experience in Shari'a Audit and Islamic banking. Joined the Bank in 2008.

Qualification – BS in Shari'a and Islamic studies, Master's in Business Administration with thesis in Shari'a Control and Review in Islamic Banks, Associate Diploma in Shari'a Control, currently enrolled in MBA Program.

Mohammed Abdulla Ebrahim,

Corporate Secretary

Experience – Over 8 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.

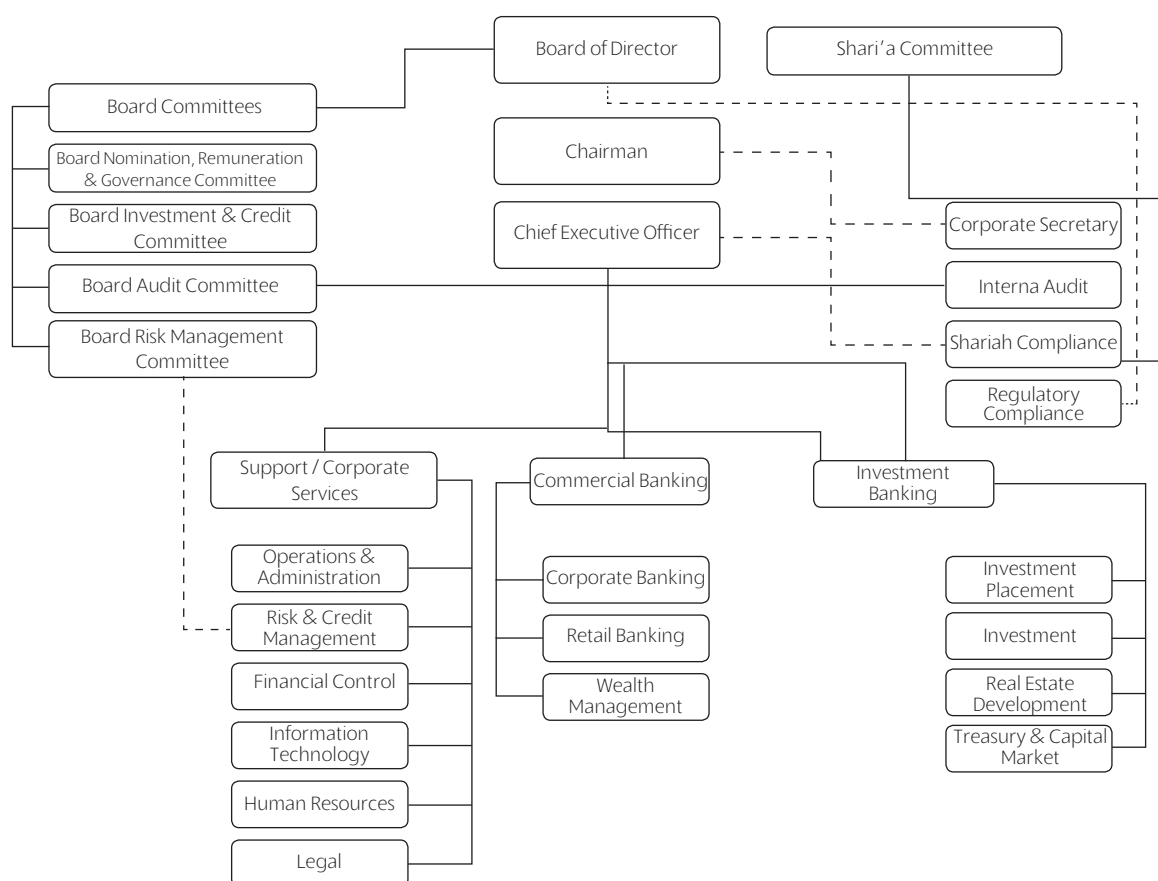
9.9. Executive and Senior Management interests

The members of the executive and senior management team held 21,573,997 shares as at 31 December 2010 (2009: 14,343,069 shares).

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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 eligible employees are awarded a combination of shares and cash incentives on achievement of pre-determined performance targets. For further details please refer note 21 in the notes to the consolidated financial statements for the year ended 31 December 2010. 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.

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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:

	2010	2009	2008	2007	2006
Return on average equity	(5.18)%	2.47%	20.00%	23.50%	20.89%
Return on average assets	(1.59)%	0.65%	7.40%	11.50%	9.54%
Financing income to financing expense ratio	240.21%	155.66%	154.11%	187.97%	144.59%
Cost-to-Income Ratio*	83.79%	48.30%	30.59%	30.46%	38.67%

* Cost has been considered excluding impairment allowances.

For detailed discussion on the performance for the year, kindly refer Chairman's report on the consolidated financial statement for the year ended 31 December 2010.