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

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

Executive summary

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

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

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

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

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

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

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

1 Group structure

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

2 Introduction to Basel II & risk management

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

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

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

Pillar I

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

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

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

Pillar II

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

Pillar II comprises two processes:

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

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

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

Pillar III

Pillar III complements the other two pillars and focuses on enhanced transparency in disclosure of information by the Banks to promote better market discipline. The information to be disclosed covers all areas including business performance, capital adequacy, risk management etc. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all banks, via market pressures, to move toward more advanced forms of risk management.
In April 2008, the Central Bank of Bahrain published a paper covering the detailed disclosure requirements to be followed by licensed banks in Bahrain to be in compliance with Pillar III under the Basel II framework. This document is prepared in accordance with these directives.

2.1 The risk management function

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

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

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

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

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

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

3 Capital management and capital adequacy ratio

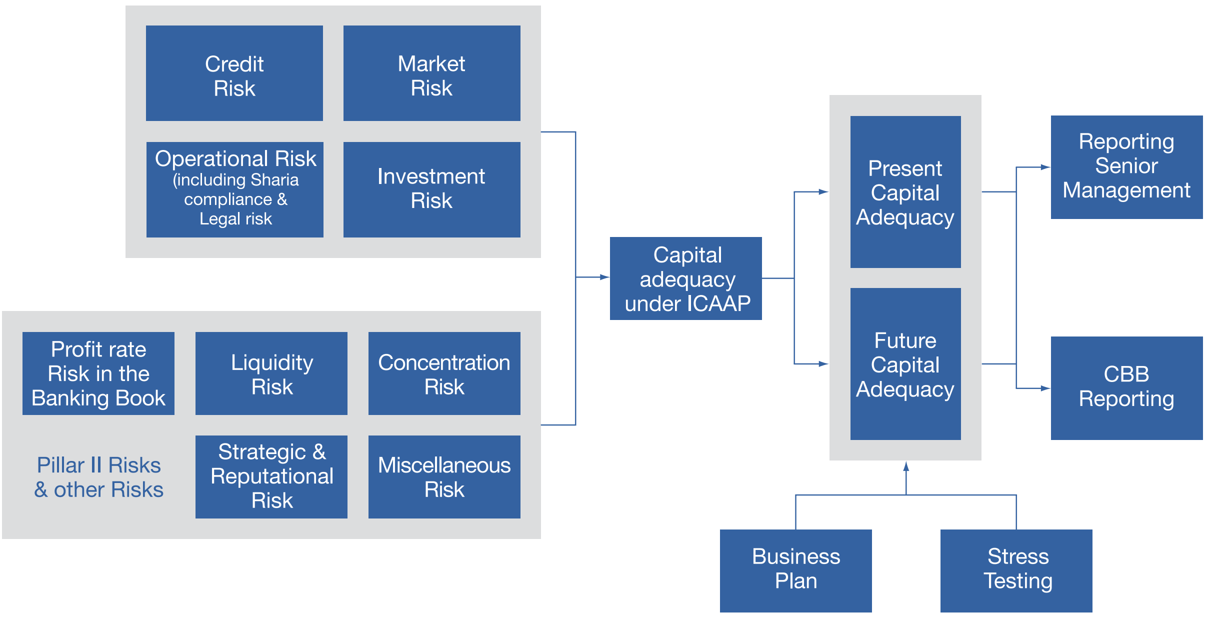
3.1 Capital management

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

3.2 Internal capital adequacy assessment process ("ICAAP")

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

ICAAP framework at the Bank



3.2.1 Risk addressed by the ICAAP

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

3.3 Capital structure, minimum capital requirements and capital adequacy

Net available capital	**31 December 2009**
Issued and fully paid ordinary shares	104,924
Less: Treasury shares	(5,216)
Less: ESOP shares	(1,648)
Statutory reserve	6,298
Share premium	958
Others reserves	367
Retained earning	20,861
Tier 1 capital	**126,544**
Unrealised gains arising from fair valuing equities	14
Profit equalisation reserve	1,209
Investment risk reserve	925
Tier 2 capital	2,148
Net available capital	**128,692**

Risk weighted assets	**31 December 2009**
Credit risk weight exposures	306,493
Market risk weight exposures	12,863
Operational risk weight exposures	57,088
Total risk weighted assets	**376,444**
Capital adequacy ratio (Tier 1)	**33.62%**
Capital adequacy ratio (Total capital)	**34.19%**

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

Regulatory capital components

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

Risk weighted assets

Credit risk

For regulatory reporting purposes, the Bank calculates the capital requirements for credit risk based on the standardised approach. Under this approach, the on and off-balance sheet credit exposures are assigned risk weights based on the type of counterparty, type of the exposure, and source of funding – URIA or own funds. The risk weights for types of counterparties and exposures are prescribed by CBB. Further for capital adequacy computations 100% of the RWA's is reckoned for self financed assets while only 30 % is considered for assets funded through URIA.

Market risk

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

Operational risk

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

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

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

4 Credit Risk

4.1 Credit risk management

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

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

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

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

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

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

4.2 Growth in exposure levels

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

Gross / Average Credit Exposures

BD’000

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

[1]Represents quarterly average balances for the year 2009.
[2]Includes cash balance of BD 793 thousand

4.3 Concentration of credit risk

4.3.1 Geographic distribution

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

BD 000's

2009	GCC countries	Europe	USA	Asia	Australia	Africa	Total
Assets							
Cash and Bank balances[1]	12,615	468	6,846	46	-	-	**19,975**
Placements with financial institutions	109,308	12,885	-	-	-	-	**122,193**
Islamic financing assets	190,524	1,561	-	-	-	-	**192,085**
Investment securities	63,304	2,216	-	24,944	-	1,890	**92,354**
Assets acquired for leasing	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**
Total Funded Exposures	**402,862**	**17,130**	**6,846**	**27,005**	**4,852**	**10,561**	**469,256**
Commitments to finance	7,474	-	-	-	-	-	**7,474**
Commitments to invest	1,727	-	-	1,885	-	-	**3,612**
Guarantees	5,258	-	-	-	-	-	**5,258**
Total Unfunded Exposures	**14,459**	**-**	**-**	**1,885**	**-**	**-**	**16,344**

[1]Includes cash balance of BD 793 thousand

4.3.2 Industry/ sector wise distribution of exposure

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

BD 000's

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

[1]Includes cash balance of BD 793 thousand

4.3.3 Transactions with connected counterparties

Connected counterparties are those entities which are connected to the Bank through significant shareholding or control or both. Wherever the Bank has entered into business transactions with such counterparties, such transactions have been done at an arm's length basis and on commercial terms that bring no disadvantage to the Bank. For the purpose of identification of connected counterparties the Bank strictly follows the guidelines issued by Central Bank of Bahrain for the purpose.
Detailed break up is presented in note no 22 in the notes to the consolidated financial statements for the year ended 31 December 2009.

4.3.4 Exposures in excess of 15% of capital base

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

BD 000's

	Amount
Bank A	26,151
Bank B	22,686
Total	**48,837**

4.3.5 Exposures in highly leveraged counterparties

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

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

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

BD 000's

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

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

4.4 Equity risk in banking book

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

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

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

The Bank's equity investments are predominantly in its own projects, which include private equity and infrastructure development products. The intent of such investments is a later stage exit along with the investors, by means of strategic sell outs at the project level or through initial public offerings. The Bank also has a strategic investment portfolio which is aligned with the long term investment objectives of the Bank.

BD 000's

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

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

BD 000's

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

*Includes commitments to Invest of BD 722 thousands

4.5 Risk grading of exposures

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

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

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

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

4.6 Past dues, impaired accounts, provisions

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

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

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

For a detailed policy on impairment of financial assets, refer note 2 (m) in the notes to the consolidated financial statements for the year ended 31 December 2009.
For the quantitative disclosures relating to exposure which were past due or impaired as of 31 December 2009, please refer to note 30 in the notes to the consolidated financial statement for the year ended 31 December 2009.

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

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

BD 000’s

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

BD 000's

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

4.7 Restructured/renegotiated credit facilities

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

4.8 Legal action and write off of exposures

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

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

4.9 Penalties for delayed payments

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

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

4.10 Credit risk mitigation

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

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

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

BD 000's

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

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

[2] (Excludes collective provisions of BD 2,491 thousand)

Real Estate properties are reckoned at values certified by qualified valuators. 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 valuators for real estate property. Valuation exercise is supervised by the Risk Management Department of the Bank, independent of the business units.

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

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

The declared value of exposures in all cases is the gross exposure net of specific provision. The Bank does not carry out any on balance sheet or off balance sheet netting for the securities held. The Bank has not claimed any capital relief for Credit Risk Mitigation under Section CA 4 of the Capital Adequacy module of CBB rule book and hence all exposures are risk weighted at their gross values.
The Bank has a policy of disposal of asset held as collateral not readily convertible into cash, after completion of necessary legal formalities. During the year there has been no such instance.

4.11 Regulatory Capital Requirements by type of Islamic financing contracts

BD 000's

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

5 Market Risk

5.1 Market risk management

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

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

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

5.2 Regulatory Capital Allocation against Market Rate Risk

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

BD 000's

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

6 Operational Risk

6.1 Operational risk management

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

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

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

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

6.2 Litigation

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

6.3 Shari'a compliance

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

6.4 Regulatory capital allocation against operational risk

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

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

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

7 Other risks

7.1 Liquidity Risk

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

The Bank has a liquidity risk policy in place, which describes the roles and responsibilities of the Asset Liability Management Committee (ALCO), Treasury and other concerned departments in management of liquidity. It also stipulates various liquidity ratios to be maintained by the bank, as well as gap limits under each time bucket of the maturity ladder. It is the Bank's policy to keep adequate level of high quality liquid assets such as inter-bank placements, CBB 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 and Financial Control Department (FCD) monitors the liquidity position and any violations are reported to ALCO, ERMC and the Board of Directors.

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

Figures in %

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

7.2 Profit rate risk in the banking book

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

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis point (bps) parallel fall or rise across all yield curves and a 50 bps rise or fall of all yield curves. An analysis of the Bank's sensitivity to an increase or decrease in market profit rates has been disclosed in note 30 in the notes to the consolidated financial statements for the year ended 31 December 2009.

7.3 Counterparty credit risk

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

7.4 Concentration risk

Concentration risks arises when a number of obligors, counterparties or investees are engaged in similar business activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Accordingly, such concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or region. The Bank has established exposure limits to various geographic regions and industry sectors. For break-up of exposure industry/sector wise refer point 4.3.1 and 4.3.2 above.

7.5 Reputational risk

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

7.6 Displaced commercial risk

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

7.7 Other risks

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

8 Product disclosures

8.1 Product descriptions & consumer awareness

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

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

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

8.2 Complaint handling

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

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

8.3 Unrestricted Investment Accounts (URIAs)

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

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

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

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

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

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

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

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

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

BD 000's

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

[1] Represents average balance

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

BD 000's

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

[2] Includes saving account products.

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

Market benchmark rates:

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

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

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

[2] Includes saving account products.

8.4 Restricted Investment Accounts (RIAs)

The Bank offers Restricted Investment Accounts ("RIAs") to both small investors and high net worth individuals in the GCC. The Bank structures it's 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.

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

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

9 Corporate Governance & Other Disclosures

9.1 Corporate governance structure

The Bank's corporate governance framework focuses on Board responsibility, oversight and management accountability vis-à-vis governing regulations and better practices. The framework is in line with global best practices and regulatory requirements which seek to balance entrepreneurship, control and transparency, while creating value for all stakeholders.
Corporate governance, the way the Board and Management is organised and how they operate in practice ultimately aims at leading the Bank towards successfully meeting its strategic objectives. The Board of Directors is accountable to the Bank's shareholders for the creation and delivery of strong sustainable financial performance and long-term shareholder value. To achieve this, the Board approves and monitors the Bank's strategy and financial performance, within a framework of sound corporate governance and effective risk management.

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

9.2 Board of Directors

The Board of Directors currently comprises of ten members. During the year 2008, the shareholders during the Annual General Meeting (AGM), elected a new Board which represents the new and changed shareholding of the Bank. The Chairman of the Board of Directors is charged with regular supervision and assessment of executive management and is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the Chief Executive Officer (CEO), and maintaining a dialogue with the Bank's stakeholders. The Board has constituted certain committees with specific delegated authorities to oversee and guide the management in specific areas of the Bank's operations and decision-making. The Board, either directly or through its various committees will oversee the management of the Bank.

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

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

Essam Yousif Janahi
Vice Chairman (Resigned in Feb 2010)
Director Since 2004 (Non-Executive)
Over 21 years of experience in the financial Industry
Nominated by Gulf Finance House BSC
Chairman - Gulf Finance House
Member -Shura Council of the Kingdom of Bahrain
Chairman - Bahrain Financial Harbour Holding Company
Chairman - Bayan Holding Company
Vice Chairman - Al Areen Holding Company
Board Member - Arab Finance House
Board Member - Abu Dhabi Investment House

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

Hesham Abdullatif H. Al Jaber
Director
Director Since February 2008 (Non-Executive)
Over 12 years of experience in commercial sector
Nominated by Gulf Finance House BSC
Board Member - Al-Jabr Trading Company, KSA
Board Member - United Gas Transmission Co, UAE
Board Member - Advanced Electronics Equipment, KSA
Board Member - Golden Chip Company, KSA
Board Member - Nattily Company, KSA

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

Talal Hazim R. Al Ghalib
Director (Resigned in November 2009)
Nominated by Gulf Finance House BSC
Director Since February 2008 (Non-Executive)
Executive Director - Gulf Finance House

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

Abdulla A. Karim Showaiter
Director
Director Since February 2008 (Independent & Non-Executive)
Over 32 years experience in the banking industry
Nominated by Emirates Islamic Bank
General Manager – Corporate & Investment, Emirates Islamic Bank
Board Member - Bahrain Islamic Investment Co, Bahrain
Board member - Saba Islamic Bank, Yemen

Abdullateef Moosa Al Abdul Razzaq
Director
Director Since February 2008 (Non-Executive)
Over 30 years of experience in financial and commercial sector
Nominated by Al Imtiaz Investment Company
CEO Consultant - Al Imtiaz Investment Company

Ebrahim Hussain Ebrahim
Director
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 – 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

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 107,859,801 shares in the Bank as of the year ended 31 December 2009 (2008: 102,005,556 shares).

9.4 Code of conduct

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

9.5 Insider trading

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

9.6 Board committees

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

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

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

9.7 Shari'a Supervisory Board

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

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

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

Shaikh Nizam Mohammed Saleh Yaqoobi
Member
Executive Member of the Shari'a Supervisory Board of Abu Dhabi Islamic Bank
Executive Member of the Shari'a Supervisory Board of Bahrain Islamic Bank
Executive Member of the Shari'a Supervisory Board of and Shamil Bank
Member of Shari'a Supervisory Boards of a number of Islamic banks
Board Member of the Dow Jones Islamic index

Abdulnasser Al Mahmood
Head of Shari'a Compliance - Regulatory Shari'a & Compliance

9.8 Executive / Management committee

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

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

Executive Management & Other Senior Management

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

Mr. Ebrahim Hussain Ebrahim
Chief Executive Officer & Board Member
Experience - Over 26 years of experience in both Islamic and conventional banks and financial institutions. Joined the Bank in 2004.
Qualification - Master of Business Administration with a concentration in Finance.

Mr. Silvan Varghese
Deputy General Manager & COO
Experience - Over 17 years experience in banking and financial services industry in the areas of risk and credit management, project finance and corporate banking. Joined the Bank in 2007.
Qualification - BS in Chemical Engineering from BITS, Pilani,India, MBA from the Indian Institute of Management (IIM), Lucknow, India, certified by Global Association of Risk Professionals (GARP) as a Financial Risk Manager (FRM).

Fuad Ali Taqi
Deputy General Manager- Commercial Banking
Experience - Over 28 years of banking experience in Islamic and conventional banks. Joined the Bank in 2006.
Qualification - Business Studies Diploma, currently enrolled in an MBA program.

Dimitry Blasi
Deputy General Manager- Investment Banking
Experience - Over 13 years of experience in Islamic and conventional banking including a number of prominent

international jurisdictions. Joined the Bank in 2005.
Qualification - ACA (United Kingdom), qualified lawyer (NSW, Australia)

Mahdi A. Nabi Mohammed
Assistant General Manager – Operations & Administration
Experience - Over 29 years of banking experience. Joined the Bank in 2005.
Qualification - Certified Diploma in Accounting & Finance from The Chartered Association of Certified Accountants (ACCA), MBA from the University of Strathclyde, United Kingdom.

Khalil Zaabi
Head of Investment Placement- Investment Banking
Experience - Over 25 years of banking experience in Islamic, conventional bank and financial institutions. Joined the Bank in 2006.
Qualification - Diploma in Mathematics from Arthur King Collage, Canada, Diploma in Computer Programming from Computer Institute of Canada.

Ahmed Ali Bucheery
Head of Internal Audit
Experience - 16 years of internal audit experience with banks. Joined the Bank in 2007.
Qualification - Certified Internal Auditor (from the Institute of Internal Audit, USA), BS Accounting from King Fahad University of Petroleum and Minerals.

Hussam Saif
Head of Treasury
Experience - 20 years of experience in treasury and Islamic banking. Joined the Bank in 2007.
Qualification - Graduate of Western International University - London with a degree in Business Administration & Management.

T N Ramesan
Head of Risk & Credit Management
Experience - 30 years of banking experience. Joined the Bank in 2007.
Qualification - MSc in Physics from the Indian Institute of Technology, Madras, India, Diploma in International Finance & Investment from Hong Kong Management Association, Certified Associate of the Indian Institute of Bankers.

Yaser Mudhafar
Head of Financial Control
Experience - 12 years extensive experience in the Islamic banking industry. Joined the Bank in 2005.
Qualification - CPA, CIPA, Executive MBA and a Bachelor of Science in accounting from University of Bahrain.

Fetooh Al Mannai
Head of Human Resources
Experience - 14 years of experience in human resources, training and administration Joined the Bank in 2007.
Qualification - MBA and a BA (Hons) in Human Resource Management, Member of Bahrain Society for Training and Development (BSTD), Member of Bahrain Management Society (BMS), Fellow of the Chartered Institute of Personnel & Development (Chartered FCIPD), Member of Society of Human Resource Management (SHRM).

Ramnath Narayanan
Head of Legal- Legal Department
Experience - Over 12 years experience in Legal and Banking industry. Joined the Bank in 2008.
Qualification - Master of Laws from the University of Virginia School of Law, USA, Bachelor of Laws from the University of Madras, India, and a Certified associate of the New York Attorney and Solicitors Regulation Authority.

Abdulnasser Al Mahmood
Head of Shari'a Compliance - Regulatory Shari'a & Compliance
Experience - Over 19 years of experience in Shari'a Audit and Islamic banking. Joined the Bank in 2008.
Qualification - BS in Shari'a and Islamic studies, Associate Diploma in Shari'a Control, MBA from Gulf University, Kingdom of Bahrain.

Mohammed Abdulla Ebrahim
Corporate Secretary

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

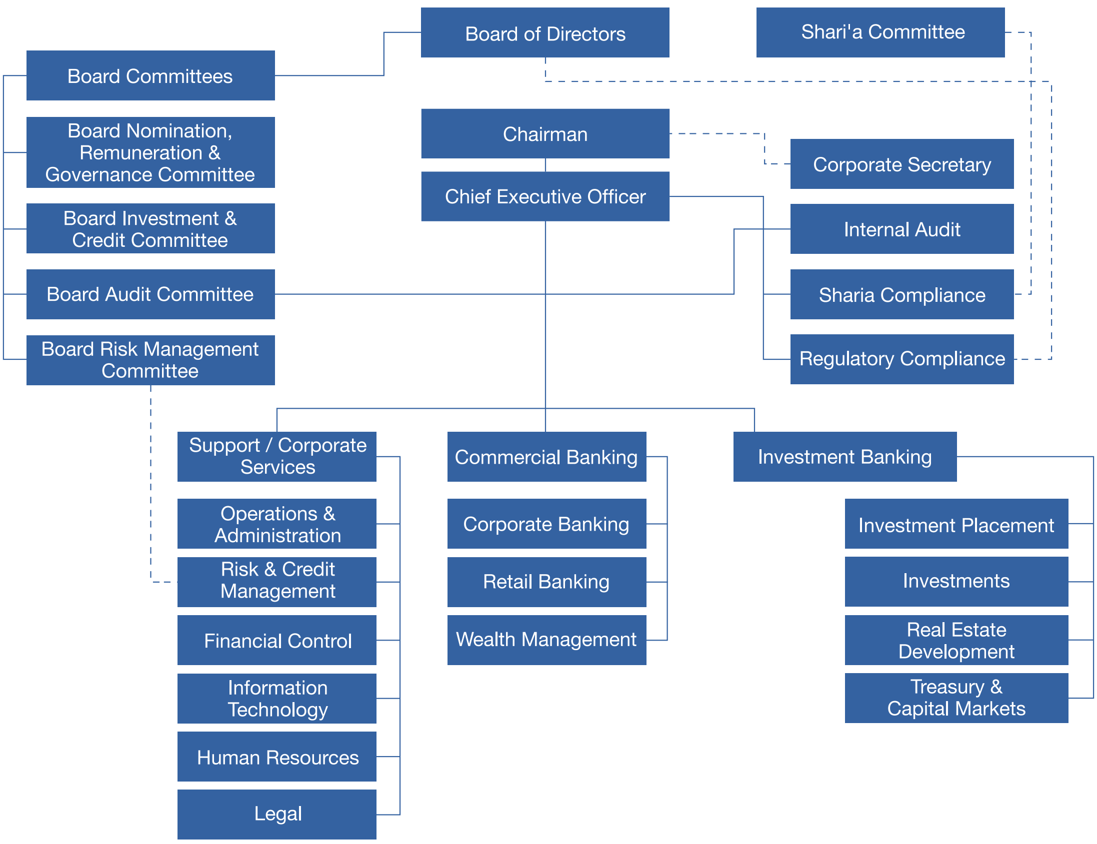
Qualification - Masters in IT, Media and E-Commerce Law from the University of Essex, UK, an Advanced Diploma in Islamic Finance by the Bahrain Institute of Banking and Finance (BIBF), a Diploma in Business Management from the University of Bahrain and a B.Sc. in Law from Dubai Police Academy.

9.9 Executive and Senior Management interests

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

9.10 Organisation chart

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



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

9.11 Executive compensation

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

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

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

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

10 Financial performance

Following are basic quantitative indicators of the financial performance:

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

* Cost has been considered excluding impairment allowances.

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