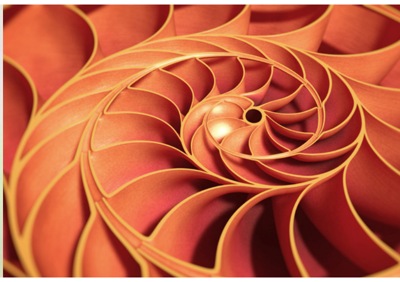
BBK

بنك البحرين والكويت

Annual Report 2010

# Numbers in nature
# Beauty in banking

Harnessing people, passion
and expertise for flourishing
financial results.

# Our vision

BBK will be the premier regional financial services enterprise in providing superior products and services of high quality through innovation, technology and life-long client relationships.

The Bank will expand its overseas presence in more locations in which it chooses to operate in order to satisfy the diversified needs of clients. We believe clients are the driving force in everything we do. We will not compromise on our absolute commitment to providing the very best in client service.

We believe our people are our number one asset with the highest degree of competence, integrity and professionalism. We instil in our people the principles of entrepreneurship, decision-making and ownership through our commitment to training, development, delegation and performance based reward systems.

We are determined to utilise cutting-edge technology which we recognise as most critical in supporting our short, medium and long-term business objectives.

Our shareholders are the source of our financial strength and can expect continued growth and profitability. They are supportive and are confident of our vision of the future.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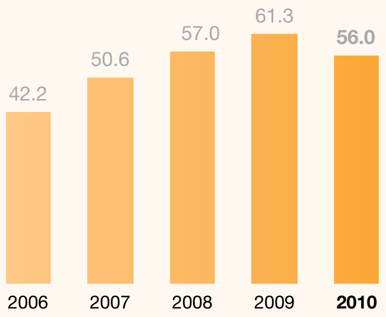
# Financial highlights

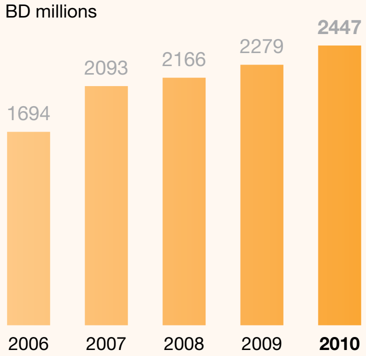
**Net interest income**

BD millions



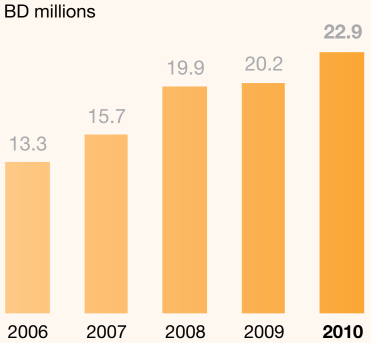

**Total assets**

BD millions



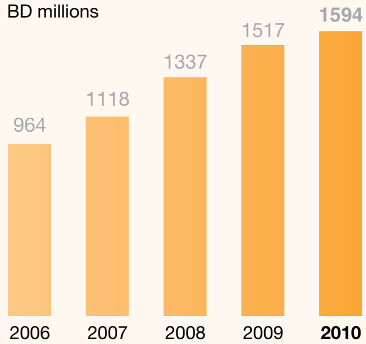

**Fees and commission income**

BD millions



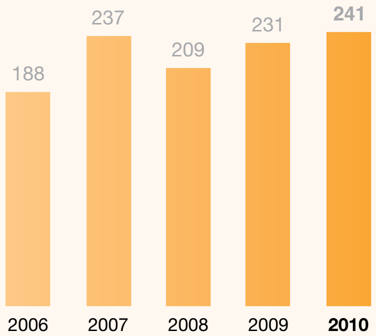

**Customer deposits**

BD millions



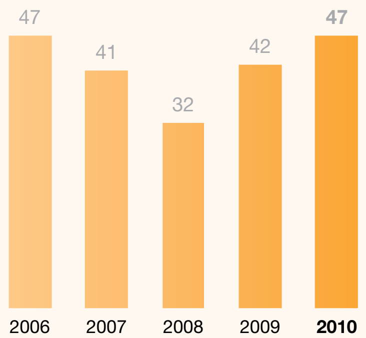

**Equity**

BD millions




**Earnings per share**

fils



| | 2006 | 2007 | 2008 | 2009 | **2010** |
|---|---|---|---|---|---|
| **Income statement highlights** (BD millions) | | | | | |
| Net interest income | 42.2 | 50.6 | 57.0 | 61.3 | **56.0** |
| Other income | 22.2 | 37.0 | 57.7 | 31.3 | **53.1** |
| Operating expenses | 26.7 | 30.6 | 35.1 | 42.9 | **45.6** |
| Net profit for the year | 32.8 | 30.0 | 27.1 | 35.0 | **39.1** |
| Dividend | 40% | 27% | 20% | 25% | **25%** |
| **Financial position highlights** (BD millions) | | | | | |
| Total assets | 1,694 | 2,093 | 2,166 | 2,279 | **2,447** |
| Net loans | 938 | 1,128 | 1,352 | 1,269 | **1,276** |
| Investments | 495 | 499 | 318 | 446 | **591** |
| Deposits | 1,018 | 1,269 | 1,372 | 1,599 | **1,672** |
| Term borrowings | 236 | 339 | 329 | 257 | **370** |
| Equity | 188 | 237 | 209 | 231 | **241** |
| **Profitability** | | | | | |
| Earnings per share (fils) | 47 | 41 | 32 | 42 | **47** |
| Cost / income | 41.41% | 34.97% | 30.62% | 46.39% | **41.82%** |
| Return on average assets | 1.86% | 1.51% | 1.22% | 1.66% | **1.63%** |
| Return on average equity | 19.13% | 16.02% | 12.14% | 16.38% | **16.90%** |
| Profit per employee (BD) | 43,115 | 34,405 | 27,919 | 32,661 | **36,344** |
| **Capital** | | | | | |
| Capital adequacy | 16.20% | 23.29% | 20.06% | 17.51% | **18.57%** |
| Equity / total assets | 11.08% | 11.33% | 9.66% | 10.14% | **9.82%** |
| Debt / equity | 125.54% | 143.09% | 157.53% | 111.39% | **154.12%** |
| **Liquidity & business indicators** | | | | | |
| Loans & advances / total assets | 55.38% | 53.89% | 62.44% | 55.67% | **52.15%** |
| Investments excluding treasury bills / total assets | 26.87% | 22.62% | 14.51% | 16.88% | **18.82%** |
| Liquid assets / total assets | 35.96% | 34.43% | 25.16% | 31.10% | **32.39%** |
| Non inter-bank deposits / loans & investments | 86.69% | 98.85% | 101.83% | 108.23% | **109.36%** |
| Net yield ratio | 2.58% | 2.60% | 2.74% | 2.94% | **2.48%** |
| Number of employees | 761 | 873 | 970 | 1,072 | **1,077** |

# Message from the Chairman

**I am delighted to inform you that it has proved to be another truly exceptional year for BBK. It was difficult to predict at the start of 2010 how the year would turn out considering the prevailing uncertainties in the global economy, but as a result of the great efforts of the management team and all employees, BBK continues to go from strength to strength.**

**"BBK is a successful, innovative bank that's growing in size and importance."**

The year 2010 marked the first year of BBK's 2010-2012 Strategic Plan. This plan was prepared to ensure that BBK's objectives are fully aligned with those of Bahrain's "Economic Vision 2030". It also builds on the good work that commenced in 2009 to refocus our business mainly on the GCC region, further improve the quality of our products, keep constant focus on customer satisfaction as well as broadening BBK's reach by expanding our physical network and making maximum use of technology.

Although the Bank has delivered improved margins and impressive cost control, growth remains a major priority. The Strategic Plan calls for strong focus on a number of key initiatives aimed at developing both our retail and corporate businesses and improving the overall quality of our assets. By the end of the Strategic Plan period we anticipate that the regional economy will have recovered and we are positioning the Bank to take full advantage of new business opportunities.

I am very pleased to report that BBK achieved a record net profit of BD 39.14 million in 2010 with return on equity of 16.90 per cent compared to 16.38 per cent in 2009. Total assets at the end of the year were BD 2,447 million compared to BD 2,279 million in 2009. The Board has recommended a dividend of 25 fils per share.

BBK is a successful, innovative bank that's growing in size and importance. The Bank is well capitalised, has a strong deposit base and a well-diversified client base, all of which we believe makes us well-positioned to take advantage of future business growth opportunities.

A number of expansion initiatives were progressed during 2010 including the opening of our 6th and 7th Financial Malls, one on Exhibition Road and another in Isa Town. Also measures were taken to further enhance the Bank's liquidity position, which have proved extremely effective, and a refocusing of our corporate banking business has helped BBK to successfully gain market share. Considerable attention was also given to our risk management, credit and investment policies.

BBK's commitment to corporate governance best practices was recognised for the second consecutive year by Hawkamah in conjunction with Union of Arab Banks.




There were many other notable successes too. CrediMax and our other locally-based subsidiaries and associates all continue to perform well. Outside Bahrain our businesses in India and Kuwait are growing and we continue to build on our pursuits in the UAE through our representative office in Dubai. In the wider GCC region we are expanding our client base with quality institutions and individuals.

BBK applies the highest ethical standards to the management of its business. Our principles are shaped by a series of codes and charters which form the ethical backbone of its management practices. Our achievements were acknowledged by Hawkamah, the regional institute for corporate governance, who ranked our corporate governance practices first among participating institutions in the MENA region in 2009. Since then we have continued our efforts to strengthen this area even further and I am delighted to report that we have been recognised again by Hawkamah who awarded BBK the 2010 "Distinguished Corporate Governance Award". These are all hallmarks of a successful organisation with strong and effective leadership.

BBK strives to be a good corporate citizen through our support of the Bahrain Government in all its endeavours. Helping to build thriving communities wherever we operate is a vital part of the way we work. We believe in developing the local economy by providing assistance to the less fortunate through a wide range of charitable undertakings and support initiatives which aim to improve the educational opportunities for Bahrain's young people and protect and preserve Bahrain's rich cultural heritage.

BBK's achievements would of course not have been possible without the ongoing hard work, diligence and commitment of our excellent employees. We remain wholeheartedly committed to ongoing investment in training and developing our people so we ensure that they are clear in their roles, have structured career progression, and enjoy their work, offering industry-leading employment.

Following World Finance magazine's selection of our Chief Executive, Mr. Abdulkarim Bucheery, as Banker of the Year in 2009, I am pleased to note that Mr. Bucheery was appointed to the position of Chairman of the Bahrain Association of Banks during 2010. This is another great honour both for Mr. Bucheery personally and for BBK. I take this opportunity to congratulate him on another distinguished achievement.

The year ahead will have its challenges as the world economy continues to recover from financial crisis, however I am fully confident that BBK will continue to rise to these challenges by driving efficiency, providing even better products and customer service and delivering an altogether better future, meeting the expectations of our shareholders.

I take this opportunity to thank the outgoing Directors Mr. Jamal Ali Al Hazeem and Mr. Khalid Abdulla Janahi for their valued contributions during their tenures and wish them well in their future endeavours. I also thank our current Board of Directors for providing the vision and guidance that our organisation needs to ensure continued success in our highly competitive industry.

Finally, I extend my appreciation and gratitude to His Majesty King Hamad bin Isa Al Khalifa, the King of the Kingdom of Bahrain, and His Highness Sheikh Sabah Al Ahmed Al Jaber Al Sabah, the Amir of the State of Kuwait. I thank their respective governments and regulatory authorities for their guidance and support during 2010. I would also like to thank BBK's management team and all employees for their considerable efforts and dedication. Last, but not least, I thank our loyal shareholders and customers for their support and ongoing partnership with BBK.

**Murad Ali Murad**
Chairman

# Board of Directors

**Murad Ali Murad**
Chairman

**Sh. Mohammed bin Isa Al Khalifa**
Deputy Chairman

**Ali Hasan Mushari Al Bader**

**Sh. Abdulla bin Khalifa bin Salman Al Khalifa**

**Sh. Khalifa bin Daij Al Khalifa**

**Dr. Abdulmohsen Medej Mohammed Al Medej**

**Mohamed Abdulrahman Hussain**

**Aref Saleh Khamis**

**Hassan Mohammed Mahmood**

**Ziad Hasan Rawashdeh**

**Jassem Hasan Ali Zainal**

# Board of Directors' report



## The Board of Directors is honoured to present BBK's 39th annual report, covering the year ended 31 December 2010.

### Economic and market background

The impact of the global economic crisis continued to be felt throughout 2010. While there are still concerns about the possibility of a double-dip recession in the United States and in parts of Europe, overall the outlook appears to be somewhat brighter in the MENA region, helped by an increase in oil prices and oil production, as well as generally supportive fiscal policies.

Stock markets in the region began to recover in 2010 as the economic outlook has brightened. While the real estate sector has not yet recovered the construction sector is becoming more active and there have been signs the worst may soon be over for banks in the region.

A recent IMF report estimates that the MENA region's output grew by 4.2 per cent in 2010, nearly double the rate recorded in 2009. Growth in 2011 is projected to be 4.8 per cent. Economic activity is picking up across the GCC and with the rebound in worldwide demand, crude oil production was projected to grow to 25 million barrels per day (bpd) in 2010 and 26 million bpd in 2011. The combined current account surplus of GCC countries is projected to rise by an estimated USD 50 billion in 2011.

The IMF report expects that activity in the non-oil sector across the MENA region will be somewhat less robust, picking up by only 1 percentage point between 2009 and 2011. Growth in this sector continues to rely on supportive fiscal policy, as the availability of private financing and credit remains limited.

The IMF recommends that governments in the region strengthen their focus on the medium-term objective of achieving greater economic diversification and reducing dependence on hydrocarbons. In Bahrain, which has one of the most diversified economies in the GCC, this has long been a key government objective. Bahrain's "Economic Vision 2030" sets out a road map for the Kingdom to achieve further diversification.

### Business review

BBK turned in an excellent financial performance once again, despite the backdrop of somewhat mixed economic and market conditions during 2010. This was in large part due to the implementation of a comprehensive Strategic Plan and then galvanising employees right across the organisation to work together to ensure that Year 1 plan objectives were achieved.

The Bank's USD 500 million five year bond issue in October was well received by the market. The success of this issue means that BBK is well set for the duration of the Strategic Plan and is unlikely to need to access the capital markets for some time. The Bank's strong liquidity position will allow the previous USD 500 million senior bond maturing in March 2011 to be repaid without the need for additional external finance.

Although BBK has been very careful to limit its exposure to the domestic and regional real estate sector, thereby largely avoiding the problems which have affected a number of other banks in the region, there remains no room for complacency. Consequently, a considerable amount of work was undertaken during the year to improve further the quality of the Bank's corporate assets and to "de-risk" the portfolio.

The corporate client calling programme was stepped up, some re-pricing of facilities was undertaken to ensure a more equitable balance between risk and return, and in the Bahrain market, where the value of corporate assets as a whole declined over the year, BBK was able to increase its market share without having to pursue riskier assets. Going forward, the recent launch of BBK's new cash management service will be an important business acquisition tool. The Bank will also compete strongly for trade finance business and in the local SME sector.

With a total of seven Financial Malls now operational in Bahrain and some significant enhancements made to the Bank's internet banking services, BBK is very strongly positioned in the retail banking market. These investments are already paying off, as evidenced by the very strong growth in retail deposits during 2010.

CrediMax has maintained its dominant market position in the Bahrain cards services business. Even in a market with limited further potential for growth, much can be achieved through the continued focus on product innovation. Opportunities for CrediMax to expand in the MENA region continue to be considered on their merits.

Our businesses outside Bahrain are well-positioned for growth. Our Kuwait branch continues to serve the needs of our clients effectively and our Dubai Representative Office is pursuing potential business opportunities in the UAE. Active client calling programmes are ongoing in other GCC countries as we seek to deepen relationships with selected clients. Additional licences will be sought where it is felt that these will be the most effective option for driving BBK's business expansion plans.

Taking all these factors into account, BBK was able to achieve record profits of BD 39.14 million in 2010, up 11.80 per cent on the previous year's profit of BD 35.01 million. Net interest income reached BD 55.96 compared to BD 61.30 million in 2009 which includes the gain on a partial redemption of the Bank's subordinated debt of BD 2.22 million (2009: BD 7.69 million). Fees and commissions stood at a healthy level of BD 22.85 million reporting a growth of more than 13 per cent over last year mainly due to higher fees and commissions generated from the corporate and retail banking. FX and investment income was at BD 27.85 million, compared to BD 9.20 million.

Total assets grew by BD 168 million to BD 2,447 million. This increase resulted from strong business growth, particularly in consumer assets. Customer deposits increased by 5.05 per cent to reach BD 1,594 million, a reflection of customer confidence in BBK. Non-trading investments also increased, by 19.12 per cent, with the Bank continuing to invest in high quality investments.

This strong financial performance was achieved despite the Bank making higher general provisions for possible impairments. We have adopted a conservative provisioning policy to ensure that BBK is well-cushioned to cope in the event of any future dislocation of the markets. Net provisions for the year amounted to BD 23.72 million, while our general provisioning level now stands at 1.08 per cent of the net loan portfolio.

At the close of business on 31 December 2010, the Bank's market capitalisation stood at BD 361 million (or 430 fils per share).

## Corporate governance

In its continuous endeavours to improve further the Corporate governance practices at the Bank, the Board undertook some major initiatives in this area during the year. These included the running of a seminar entitled "Board Performance Evaluation Techniques", which paves the way for a full-fledged evaluation of the Board, its members and its sub-committees to be undertaken in the near future. The Board also adopted a formal induction programme for newly appointed Directors. This was duly implemented during the year. In addition, approval was given by the Board for a new section to be added to the Bank's website entitled "Corporate governance". This includes a full report on the Bank's corporate governance practices and all relevant supporting documentation. This section also has a shareholders' communications page which allows shareholders to submit enquiries and to share their views with the Board through the Board Secretary.

## Appropriations

The Board of Directors recommends the below-listed appropriations of the Bank's net profit for approval by shareholders.

## Directors' remuneration

The Directors' remuneration, allowances and expenses for attendance at Board meetings and Board level Committee meetings for 2010 were BD 910,565 (2009: BD 731,602). For the current year the Bank has charged Directors' remuneration of BD 525 thousand to statement of income which is included in operating expenses.

## Ratings

Fitch Ratings has assessed the Long Term IDR at A-, with stable outlook, and the Short Term IDR at F2. Moody's has rated the Bank Deposit Obligation (FC & LC) at A3/P-2, with a Bank Financial Strength of C-, which translates to Baa2 Baseline Credit Assessment (BCA), a Long Term Senior rating of A3, and subordinated debt of Baa1.

## Appointment of auditors

At the Annual General Meeting of shareholders held on 7 March 2010, Ernst & Young were reappointed as external auditors to the Bank for the financial year ending 31 December 2010.

## Appreciation

The Board extends its appreciation and gratitude to His Majesty King Hamad bin Isa Al Khalifa, the King of the Kingdom of Bahrain, and His Highness Sheikh Sabah Al Ahmed Al Jaber Al Sabah, the Amir of the State of Kuwait, and also thanks their respective governments and regulatory authorities for their guidance and continued support during 2010.

Finally, the Board expresses sincere thanks to the Bank's shareholders for their continued confidence, to our loyal customers for their patronage, and to BBK's management and employees for their outstanding achievements in 2010.

On behalf of the Board of Directors

**Murad Ali Murad**
Chairman

| Appropriations | BD '000 |
|---|---|
| **Retained earnings as at 1 January 2010** | 18,853 |
| Profit for the year 2010 | 39,142 |
| Transfer to statutory reserve | (3,567) |
| Transfer to general reserve | (9,000) |
| Proposed appropriation for donations | (1,700) |
| Other transfer – share based payments | 501 |
| **Retained earnings at 31 December 2010 available for distribution (before proposed dividend)** | **44,229** |
| Proposed dividend (25% of paid-up capital, net of treasury stock) | (20,980) |
| **Retained earnings at 31 December 2010 (after proposed dividend)** | **23,249** |

Reflecting on the lessons provided by nature, we design products which offer maximum growth potential.

**Golden Ratio**

The fern illustrates the growth pattern of plants with both leaflets and veins branching out and following a natural symmetry as it grows. This pattern follows the Golden Ratio (1.618), also known as the Golden Number, Divine Proportion or mathematically as “phi”, and which permeates all structures in life, forms and proportions, whether organic, cosmic, acoustic or optical.

# Corporate governance report

## Corporate governance philosophy

High standards in corporate governance are fundamental in maintaining BBK's leading position within the local and regional banking sector and the community. Continuous review and adherence to strong corporate governance practices help enhance compliance levels according to international standards and best practice.

BBK shall continue its endeavour to enhance shareholder value, protect their interests and defend their rights by practicing pursuit of excellence in corporate life. The Bank shall not only comply with all statutory requirements but also formulate and adhere to strong corporate governance practices. BBK shall continuously strive to best serve the interests of its stakeholders including shareholders, customers, employees and the public at large.

The adoption and implementation of corporate governance is the direct responsibility of the Board of Directors, and this endeavour is in line with the policies of regulatory authorities and statutory requirements in the Kingdom of Bahrain and other countries where BBK operates.

## Shareholder information

BBK's shares are listed on the Bahrain Bourse Company. The Bank has issued 851,356,126 equity shares, each with a face value of 100 fils. All shares are fully paid.

### Annual General Meeting

The Annual General Ordinary and Extraordinary Meetings were held on 7th March 2010. The Extraordinary Meeting resolved to approve the changes in the Memorandum of Association and Articles of Association concerning amending article No.(4) Paragraph (12) by adding the phrase "and awarding shares to the Bank's employees" to appear in the Memorandum of Association and Articles of Association under both documents in full as "Buying the permitted number of the Bank's shares (treasury shares) according to the rules and conditions prescribed in the commercial companies law, Ministerial orders and official circulars and maintaining such shares, selling them and disposing thereof by all means of legal conveyances while allowing the use thereof in the Bank's employees' share option scheme and awarding shares to the Bank's employees".

### Shareholders

| Name | Country of origin | No. of shares | % holding |
|---|---|---|---|
| Citizens of the Kingdom of Bahrain & Others | – | 156,356,123 | 18.37 |
| Ithmaar Bank | Bahrain | 215,736,187 | 25.34 |
| Social Insurance Organization (Pension Fund) | Bahrain | 159,943,766 | 18.79 |
| Kuwait Investment Authority | Kuwait | 159,073,547 | 18.68 |
| Social Insurance Organization (GOSI) | Bahrain | 113,490,122 | 13.33 |
| Global Mena Macro Fund Company | Kuwait | 25,736,556 | 3.02 |
| Emerging Markets Middle East Fund | Ireland | 11,827,057 | 1.39 |
| Global Investment House | Kuwait | 9,192,768 | 1.08 |

### Distribution schedule of each class of equity

| Category | No. of shares | No. of shareholders | % of outstanding shares |
|---|---|---|---|
| Less than 1% | 156,356,123 | 2,369 | 18.37 |
| 1% to less than 5% | 46,756,381 | 3 | 5.49 |
| 5% to less than 10% | – | – | – |
| 10% to less than 20% | 432,507,435 | 3 | 50.80 |
| 20% to less than 50% | 215,736,187 | 1 | 25.34 |
| 50% and above | – | – | – |

## Board of Directors information

### Board composition

The Board composition is based on the Bank's Memorandum of Association and Articles of Association and comprises twelve Members. The Board represents a mix of high-level professional skills and expertise. Furthermore, in compliance with the corporate governance requirements, the Board Committees consist of Members with adequate professional background and experience. The Board periodically reviews its composition and the contribution of Directors and Committees.

The appointment of Directors is subject to prior Central Bank of Bahrain (CBB) approval. The classification of 'executive' Directors, 'non-executive' Directors and 'independent non-executive' Directors is as per definitions stipulated by the CBB.

During 2010, two Directors retired from the Board and one new Director representing Ithmaar Bank was inducted. The retiring members were: Mr. Khalid Abdulla Janahi and Mr. Jamal Ali Al Hazeem.

The Board is supported by the Board Secretary who provides professional and administrative support to the general assembly, the Board, its committees and members. The appointment of the Board Secretary is subject to the approval of the Board.

**Directors' roles and responsibilities**

The Board of Directors oversees the implementation of the Bank's strategic initiatives and its functioning within the agreed framework, in accordance with relevant statutory and regulatory structures. The Board ensures the adequacy of financial and operational systems and internal control, as well as the implementation of corporate ethics and the code of conduct.

The Board reserves a formal schedule of matters for its decision to ensure that the direction and control of the Bank rest with the Board. This includes strategic issues and planning, performance reviews, material acquisition and disposal of assets, capital expenditure, authority levels, appointment of auditors and review of the financial statements, financing and borrowing activities including annual operating plan and budget, ensuring regulatory compliance and reviewing the adequacy and integrity of internal controls.

The Board shall exercise judgment in establishing and revising the delegation of authority for Board committees and management. This delegation could be for authorisation of expenditures, approval of credit facilities and for other corporate actions. Such delegation may be approved and expressed under various policies of the Bank. The thresholds for the identified authorities will depend upon the operating requirements of the Bank.

The issues of major capital expenditure, divestitures, mergers and acquisitions, certain strategic investments would be within Board's authority.

Each Director holds the position for three years, after which he must present himself to the Annual General Meeting of shareholders for re-appointment. The majority of BBK Directors (including the Chairman and / or Deputy Chairman) are required to attend the Board meetings in order to ensure a quorum.

The Board and committees have a process of self-evaluation. Furthermore, the Bank has a formal induction programme for new Directors to familiarise them with the Bank's policies and procedures as well as the divisions of the Bank and its subsidiaries.

A continuous awareness program is in place to constantly update the Directors with various regulatory and market changes.

**Whistle blowing policy**

The Bank has a whistle blowing policy with designated officials to whom the employee can approach. The policy provides adequate protection to the employees for any reports in good faith. The Audit Committee oversees this policy.

**Insider Trading policy**

The Bank has established an Insider Trading policy to ensure that insiders are aware of the legal and administrative requirements regarding holding and trading of BBK shares, with the primary objective of preventing abuse of inside information. Insiders are defined to include the Directors, Executive Management, designated employees and any person or firm connected to the identified insiders. Responsibility for ensuring compliance with the Insider Trading policy is entrusted to the Board's Insider Committee.

The policy in due course would cover the new regulation of Bahrain Bourse Company relating to key persons.

**Code of Conduct**

The Board has approved a Code of Conduct for BBK Directors. The Board has also approved a Code of Ethics for the Executive Management and employees. These codes outline areas of conflict of interest, confidentiality, and the responsibilities of signatories to adhere to best practices.

**Corporate social responsibility**

BBK's contribution towards the well being of the community is an integral part of its corporate role. This corporate social responsibility is translated by the Bank through annual appropriation of a budget allocated for donations to finance community related projects and initiatives. The projects may vary in nature but ought to fall into any one of the following fields; charity, culture, research, education, philanthropy, environmental protection and sports.

BBK has an approved high-level donation policy for the distribution of the donation budget. The policy outlines guiding principles and sets criteria for the evaluation and selection of donation requests with the ultimate objective of maximising the return on both the Bank's social image and the benefit of the community.

## Disclosures relating to Board of Directors

### Directors' profiles

| | | |
|---|---|---|
| | **Murad Ali Murad**<br>Chairman<br>Chairman of Nomination and Remuneration Committee | *Director since 21 March 1999*<br>*(independent and non-executive)* |
| Deputy Chairman | Banader Hotels Co. | Kingdom of Bahrain |
| Board Member | Bahrain Telecommunications Co. (Batelco) | Kingdom of Bahrain |
| Board Member | Bahrain Kuwait Insurance Co. | Kingdom of Bahrain |
| Board Member | Bahrain Mumtalakat Holding Co. | Kingdom of Bahrain |
| Board Member | Umniah Mobile Telephones Limited Private Shareholding Company | Jordan |
| Board Member | BMIC | Mauritius |
| Chairman | Human Resources Development Fund in Banking Sector | Kingdom of Bahrain |
| Member | Council of Vocational Training in Banking Sector | Kingdom of Bahrain |

| | | |
|---|---|---|
| | **Sh. Mohammed bin Isa Al Khalifa**<br>Deputy Chairman<br>Chairman of the Executive Committee<br>*Nominated by Social Insurance Organization (GOSI)* | *Director since 4 December 2002*<br>*(non-independent and non-executive)* |
| CEO | Social Insurance Organization | Kingdom of Bahrain |
| Chairman | Securities and Investment Co. | Kingdom of Bahrain |
| Chairman | Oasis Capital Bank | Kingdom of Bahrain |
| First Deputy Chairman | Bahrain Telecommunication Co. (Batelco) | Kingdom of Bahrain |
| Deputy Chairman | National Motor Co. | Kingdom of Bahrain |
| Deputy Chairman | Bahrain International Golf Course Company | Kingdom of Bahrain |
| Deputy Chairman | Umniah Mobile Telephones Limited Private Shareholding Company | Jordan |
| Deputy Chairman | Riffa Views Development Company | Kingdom of Bahrain |
| Board Member | Bahrain Commercial Facilities Co. | Kingdom of Bahrain |
| Board Member | Etihad Atheeb Telecom Co. | Kingdom of Saudi Arabia |
| Board Member | Investcorp Bank | Kingdom of Bahrain |

| | | |
|---|---|---|
| | **Ali Hasan Mushari Al Bader**<br>Board Member | *Director since 9 June 2009*<br>*(independent and non-executive)* |
| Board member | Automated Systems Co. | State of Kuwait |

| | | |
|---|---|---|
| | **Sh. Abdulla bin Khalifa bin Salman Al Khalifa**<br>Board Member | *Director since 2 March 2008*<br>*(non-independent and non-executive)* |
| Chairman | Seef Properties B.S.C | Kingdom of Bahrain |
| Vice Chairman | Naseej B.S.C. (c) | Kingdom of Bahrain |
| Board Member | Bahrain International Golf Course Co. B.S.C. (c) | Kingdom of Bahrain |
| Board Member | BFC Group | Kingdom of Bahrain |
| Assistant Director, Investment | Social Insurance Organization | Kingdom of Bahrain |

| | | |
|---|---|---|
| | **Sh. Khalifa bin Daij Al Khalifa**<br>Board Member | *Director since 27 February 2005*<br>*(independent and non-executive)* |
| President | Court of the Crown Prince | Kingdom of Bahrain |
| Board Member and Chairman of Investment Committee | EDAMA | Kingdom of Bahrain |
| Board Member | Crown Prince's International Scholarship Program | Kingdom of Bahrain |

| | | |
|---|---|---|
| | **Dr. Abdulmohsen Medej Mohammed Al Medej**<br>Board Member<br>*Nominated by Kuwait Investment Authority* | *Director since 11 May 2009*<br>*(non-independent and non-executive)* |
| Chairman | Zahra Group Holding | State of Kuwait |
| Board Member | Kuwait Investment Authority | State of Kuwait |
| Member | Supreme Council for Planning & Development | State of Kuwait |
| Member-Board of Trustee | Australian College in Kuwait | State of Kuwait |

| | | |
|---|---|---|
| | **Mohamed Abdulrahman Hussain**<br>Board Member | *Director since 2 March 2008*<br>*(non-independent and non-executive)* |
| Board Member | First Leasing Bank B.S.C. (c) | Kingdom of Bahrain |
| Board Member | Faysal Bank Limited | Pakistan |
| Board Member | Ithraa Capital | Kingdom of Saudi Arabia |
| Board Member | Solidarity Holding Group B.S.C. (c) | Kingdom of Bahrain |
| Board Member | Emerging Markets Partnership B.S.C. (c) | Kingdom of Bahrain |

| | | |
|---|---|---|
| | **Aref Saleh Khamis**<br>Board Member<br>*Nominated by Social Insurance Organization (Pension Fund)* | *Director since 1 April 2003*<br>*(non-independent and non-executive)* |
| Undersecretary | Ministry of Finance | Kingdom of Bahrain |
| Chairman | Gulf Aluminium Rolling Mills Co. (GARMCO) | Kingdom of Bahrain |
| Deputy Chairman | Qatar-Bahrain Causeway Foundation | Kingdom of Bahrain |
| Alternate Board Member | Arab Ship Building & Repair Yard Co. (ASRY) | Kingdom of Bahrain |
| Member | Sh. Mohd. bin Khalifa bin Salman Al Khalifa Cardiac Centre | Kingdom of Bahrain |
| Member | King Hamad Hospital Consultative Board | Kingdom of Bahrain |

| | | |
|---|---|---|
| | **Hassan Mohammed Mahmood**<br>Board Member<br>*Nominated by Ithmaar Bank* | *Director since 1 September 2010*<br>*(non-independent and non-executive)* |
| Board Member | Faisal Finance (Maroc) S.A. | Morocco |
| Board Member | Overland Capital Group, Inc. | USA |
| Board Member | RIMCO SA | Switzerland |
| Board Member | Tenth of Ramadan Company for Pharmaceuticals Industries & Diagnostic Reagents S.A.E. | Egypt |
| Board Member | Egyptian Investment Company | Egypt |
| Board Member | Faysal Bank Limited | Pakistan |
| Board Member | Islamic Investment Company of Gulf (Bahamas) Limited | Bahamas |

| | | |
|---|---|---|
| | **Ziad Hasan Rawashdeh**<br>Board Member<br>*Nominated by Ithmaar Bank* | *Director since 2 March 2008*<br>*(non-independent and non-executive)* |
| Board Member | Solidarity Holding Group B.S.C. (c) | Kingdom of Bahrain |
| Board Member | Faisal Private Bank (Switzerland) S.A. | Switzerland |
| Board Member | Faisal Islamic Bank of Egypt | Egypt |
| Board Member | Islamic Investment Company of the Gulf (Bahamas) Limited | Bahamas |
| Group Chief Operation Officer | Dar Al-Maal Al-Islami Trust (DMITrust) | Switzerland |

| | | |
|---|---|---|
| | **Jassem Hasan Ali Zainal**<br>Board Member | *Director since 22 November 1994*<br>*(independent and non-executive)* |
| Chairman & Managing Director | Automated Systems Co. | State of Kuwait |
| Deputy Chairman | Al Razi Holding Co. | State of Kuwait |
| Deputy Chairman | Addax Investment Bank | Kingdom of Bahrain |
| Board Member | Kuwait International Bank | State of Kuwait |
| Board Member | Kuwait Airways Co. | State of Kuwait |

### Directors' and related parties' interests

**The number of shares held by Directors as of 31 December 2010 was as follows:**

| Name of Director | Type of shares | 31 Dec 2010 | 31 Dec 2009 |
|---|---|---|---|
| Murad Ali Murad | Ordinary | 672,164 | 672,164 |
| GOSI / Sh. Mohammed bin Isa Al Khalifa | Ordinary | 133,133 | 133,133 |
| Ali Hasan Mushari Al Bader | Ordinary | 100,000 | Nil |
| Sh. Abdulla bin Khalifa bin Salman Al Khalifa | Ordinary | 100,000 | Nil |
| Sh. Khalifa bin Daij Al Khalifa | Ordinary | 500,000 | 130,000 |
| KIA / Dr. Abdulmohsen Medej Al Medej | Ordinary | 100,000 | Nil |
| Mohamed Abdulrahman Hussain | Ordinary | 105,000 | 105,000 |
| Pension Fund Commission / Aref Saleh Khamis * | Ordinary | 105,000 | 105,000 |
| Hassan Mohammed Mahmood | Ordinary | 50,000 | 50,000 |
| Ziad Hasan Rawashdeh | Ordinary | 105,000 | 105,000 |
| Jassem Hasan Ali Zainal | Ordinary | 149,773 | 149,773 |

* *Qualifying shares related to Aref Saleh Khamis are part of the whole shares of the Pension Fund Commission ownership.*

**Related parties:**

Al Janabeya Co. owns 198,998 shares and is related to the Chairman of the Board.

**Nature and extent of transactions with related parties during 2010:**

None.

**Approval process for related parties transactions:**

The Bank has a due process for dealing with transactions involving Directors and related parties. Any such transaction will require the approval of the Board of Directors.

### Directors trading of company shares during the year 2010

| Name of Director | Trading through Bahrain Bourse Company | Date of trading |
|---|---|---|
| Sh. Abdulla bin Khalifa bin Salman Al Khalifa | Buying 100,000 shares | 17/05/2010 |
| Dr. Abdulmohsen Medej Mohammed Al Medej | Transfer 100,000 shares from Kuwait Investment Authority | 01/07/2010 |
| Sh. Khalifa bin Daij Al Khalifa | Buying 370,000 shares | 04/08/2010 |
| Ali Hasan Mushari Al Bader | Buying 100,000 shares | 04/08/2010 |

## Board meetings and attendances

The Board of Directors meets at the summons of its Chairman or his deputy (in event of his absence or disability) or if requested to do so by at least two Directors. The Board meets at least four times a year. A meeting of the Board of Directors shall be valid if attended by not less than seven Directors in person. During 2010, eight Board meetings at the Bank were held in the Kingdom of Bahrain in the following manner:

**Quarterly Board meetings 2010**

| Members | 31 Jan | 18 Apr | 11 Jul | 17 Oct |
|---|---|---|---|---|
| Murad Ali Murad | ✔ | ✔ | ✔ | ✔ |
| Sh. Mohammed bin Isa Al Khalifa | ✔ | ✔ | | ✔ |
| Ali Hasan Mushari Al Bader | ✔ | ✔ | ✔ | ✔ |
| Sh. Abdulla bin Khalifa bin Salman Al Khalifa | ✔ | ✔ | | ✔ |
| Sh. Khalifa bin Daij Al Khalifa | | ✔ | | ✔ |
| Dr. Abdulmohsen Medej Al Medej | ✔ | ✔ | ✔ | ✔ |
| Mohamed Abdulrahman Hussain | ✔ | ✔ | ✔ | ✔ |
| Aref Saleh Khamis | ✔ | ✔ | ✔ | ✔ |
| Hassan Mohammed Mahmood | | | | ✔ |
| Ziad Hasan Rawashdeh | | ✔ | ✔ | ✔ |
| Jassem Hasan Ali Zainal | ✔ | ✔ | ✔ | ✔ |

**Other Board meetings 2010**

| Members | 10 Jan | 7 Mar | 7 Mar | 26 Dec |
|---|---|---|---|---|
| | | *1st Session* | *2nd Session* | |
| Murad Ali Murad | ✔ | ✔ | ✔ | ✔ |
| Sh. Mohammed bin Isa Al Khalifa | ✔ | ✔ | ✔ | ✔ |
| Ali Hasan Mushari Al Bader | ✔ | ✔ | ✔ | ✔ |
| Sh. Abdulla bin Khalifa bin Salman Al Khalifa | ✔ | ✔ | ✔ | ✔ |
| Sh. Khalifa bin Daij Al Khalifa | | ✔ | | ✔ |
| Dr. Abdulmohsen Medej Al Medej | ✔ | ✔ | ✔ | ✔ |
| Mohamed Abdulrahman Hussain | ✔ | ✔ | ✔ | ✔ |
| Aref Saleh Khamis | ✔ | ✔ | ✔ | ✔ |
| Hassan Mohammed Mahmood | | | | ✔ |
| Ziad Hasan Rawashdeh | ✔ | ✔ | ✔ | ✔ |
| Jassem Hasan Ali Zainal | | ✔ | ✔ | ✔ |

## Board Committees

The Board level committees are formed and their members are appointed by the Board of Directors at the beginning of each Board term. They are considered the high level link between the Board and the Executive Management. The objective of these committees is to assist the Board in supervising the actual operations of the Bank, by reviewing many issues that are submitted by the management to the Board and making recommendations to the Board for their final review.

The Board reserves the right to form temporary committees and discontinue them, from time to time and as it sees necessary. Further, the members of the Board are provided with copies of meeting minutes of the said committees as required by the regulators.

## Board Committees' composition, roles and responsibilities

| Executive Committee | |
|---|---|
| **Members:**<br>**Sh. Mohammed bin Isa Al Khalifa**<br>Chairman<br>**Mohamed Abdulrahman Hussain**<br>Deputy Chairman<br>**Abdulkarim Ahmed Bucheery**<br>**Aref Saleh Khamis**<br>**Jassem Hasan Ali Zainal** | **Summary terms of reference, roles and responsibilities:**<br>▸ At least five members are appointed for a 1 year term.<br>▸ Minimum number of meetings required each year: 10 (actual meetings in 2010: 13).<br>▸ Chairman and Deputy Chairman are elected from among its members for one year.<br>▸ At least four Directors (including the committee's Chairman and / or Deputy Chairman) are required to attend the meetings in person in order to ensure a quorum.<br>▸ The Chief Executive, General Managers, AGM treasury and investment and Chief Financial Officer shall normally attend meetings.<br>**Summary of responsibilities:** reviews, approves and directs the Executive Management on matters raised to the Board of Directors such as various policies, business plans and the periodical review of the Bank's achievements. |

| Audit Committee | |
|---|---|
| **Members:**<br>**Sh. Khalifa bin Daij Al Khalifa**<br>(Independent)<br>**Ali Hasan Mushari Al Bader**<br>(Independent)<br>**Hassan Mohammed Mahmood**<br>(Non-independent) | **Summary terms of reference, roles and responsibilities:**<br>▸ The Board appoints not less than three members for a 1 year term and appoints the Chairman thereto.<br>▸ Minimum number of meetings required each year: 4 (actual meetings in 2010: 4).<br>▸ Meetings shall be valid only if attended by two members including the committee's Chairman.<br>▸ The Chief Executive, GM Shared Services Group, Head of internal audit, and a representative of the external auditors shall normally attend meetings.<br>**Summary of responsibilities:** reviews the internal audit program and internal control system, considers major findings of internal audit reviews, investigations and management's response. Ensures coordination among internal and external auditors. |

| Insider Committee | |
|---|---|
| **Members:**<br>**Sh. Khalifa bin Daij Al Khalifa**<br>(Independent)<br>**Ali Hasan Mushari Al Bader**<br>(Independent)<br>**Hassan Mohammed Mahmood**<br>(Non-independent) | **Summary terms of reference, roles and responsibilities:**<br>▸ At present, the Audit Committee is assigned to hold the role of Insider Committee. Meetings of the Insider Committee were held through audit meetings and with the same formation.<br>**Summary of responsibilities:** tracks, monitors and reports trading activities of insiders to ensure compliance with the CBB's guidelines on insiders. Ensures prohibition of the abuse of inside information and disclosure requirements. |

| Nomination and Remuneration Committee | |
|---|---|
| **Members:**<br>**Murad Ali Murad**<br>Chairman<br>**Dr. Abdulmohsen Medej Al Medej**<br>Deputy Chairman<br>**Sh. Abdulla bin Khalifa bin Salman Al Khalifa**<br>**Ziad Hasan Rawashdeh** | **Summary terms of reference, roles and responsibilities:**<br>▸ The Board appoints not less than three members for a 1 year term and appoints the Chairman thereto.<br>▸ The committee shall meet at least twice a year and at such other times as the Chairman of the committee requires (actual meetings in 2010:4).<br>▸ Meetings shall be valid only if attended by two members including the committee's Chairman or Deputy Chairman.<br>▸ The Chairman of the committee shall attend the Annual General Meeting and be prepared to respond to any shareholder questions on the committee's activities.<br>**Summary of responsibilities:** establishes a Board compensation policy for the Directors and Executive Management. |

| Corporate Governance Committee | |
|---|---|
| **Members:**<br>**Murad Ali Murad**<br>(Independent)<br>**Sh. Khalifa bin Daij Al Khalifa**<br>(Independent)<br>**Ali Hasan Mushari Al Bader**<br>(Independent)<br>**Hassan Mohammed Mahmood**<br>(Non-independent) | **Summary terms of reference, roles and responsibilities:**<br>▸ The committee was established during the year 2010.<br>▸ The main responsibility of the committee is to ensure that the Bank adopts and enhances sound corporate governance practices which are consistent with the corporate governance code of the Kingdom of Bahrain, regulatory requirements and also reflects the best market practices in corporate governance. |

### Board Committee meetings and record of attendance

#### Executive Committee meetings 2010

| Members | 09 Jan | 30 Jan | 20 Feb | 06 Mar | 17 Apr | 30 Apr | 29 May | 10 Jul | 09 Aug | 25 Sep | 16 Oct | 27 Nov | 25 Dec |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Sh. Mohammed bin Isa Al Khalifa | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ☎ | ✔ | ✔ | ✔ | ✔ | ✔ |
| Mohamed Abdulrahman Hussain | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ |
| Abdulkarim Ahmed Bucheery | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ |
| Aref Saleh Khamis | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ |
| Jassem Hasan Ali Zainal | | ✔ | ✔ | ✔ | ✔ | ☎ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ | ✔ |

☎ *Attended by telephone conference.*

#### Audit Committee meetings 2010

| Members | 30 Jan | 17 Apr | 10 Jul | 16 Oct |
|---|---|---|---|---|
| Sh. Khalifa bin Daij Al Khalifa | | ✔ | ☎ | ✔ |
| Ali Hasan Mushari Al Bader | ✔ | ✔ | ✔ | ✔ |

☎ *Attended by telephone conference.*

#### Insider Committee meetings 2010

| Members | 30 Jan | 17 Apr | 10 Jul | 16 Oct |
|---|---|---|---|---|
| Sh. Khalifa bin Daij Al Khalifa | | ✔ | ☎ | ✔ |
| Ali Hasan Mushari Al Bader | ✔ | ✔ | ✔ | ✔ |

☎ *Attended by telephone conference.*

*Note:* The Audit Committee is assigned to hold the role of Insider Committee, with the same formation.

#### Nomination and Remuneration Committee meetings 2010

| Members | 31 Jan | 06 Mar | 11 Jul | 17 Oct |
|---|---|---|---|---|
| Murad Ali Murad | ✔ | ✔ | ✔ | ✔ |
| Dr. Abdulmohsen Medej Al Medej | ✔ | ✔ | ✔ | ✔ |
| Sh. Abdulla bin Khalifa bin Salman Al Khalifa | ✔ | ✔ | | ✔ |
| Ziad Hasan Rawashdeh | | ✔ | ✔ | ✔ |

## Compliance and anti-money laundering

Compliance with regulatory and statutory requirements is an ongoing process. The Bank is conscious of its responsibilities in observing all regulatory provisions and best international practices in its functioning. The Bank has established independent Compliance Function in keeping with Basel and CBB guidelines. The unit acts as a focal point for all regulatory compliance and for adapting other best practice compliance principles. The Bank continuously strives to improve the level of compliance in all its activities. The Bank's adopted corporate philosophy is 'BBK shall continue its endeavour to enhance shareholders' value, protect their interests and defend their rights by practicing pursuit of excellence in corporate life.'

Anti-money laundering measures form an important area of the Compliance Function, in addition to areas of corporate governance, disclosure standards, insiders' trading, conflict of interest and adherence to best practices. The Bank has documented an Anti-Money Laundering and Combating Terrorist Financing Policy and Procedure, which contains sound Customer Due Diligence measures, procedure for identifying and reporting suspicious transactions, a programme for periodic awareness training to employees, record-keeping and a designated Money Laundering Reporting Officer (MLRO). The Bank has deployed a risk based automated transaction monitoring system in keeping with the anti-money laundering regulations of the CBB.

The Bank's anti-money laundering measures are regularly audited by the internal auditors who report to the Audit Committee of the Board. The Central Bank performs periodic inspections of the Bank's compliance with anti-money laundering regulations. Additionally, the Bank's anti-money laundering measures are audited by independent external auditors every year and their report is submitted to the CBB. The overseas branches in India and Kuwait and subsidiaries (CrediMax and Capinnova) have designated compliance and MLRO functions to ensure implementation of local regulations and also to meet CBB requirements as applicable.

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. These regulations and guidelines are consistent with the revised FATF 49 recommendations, 'Customer Due Diligence for Banks' paper, and best international practices.

## Communication strategy

The Bank has an open policy on communication with its stakeholders and has adopted a communication disclosure policy consistent with Basel II requirements. Shareholders are invited by the Chairman to attend the Annual General Meeting. The Chairman and other Directors attend the Annual General Meeting and are available to answer any questions. The Bank is at all times mindful and conscious of its regulatory and statutory obligations regarding dissemination of information to its stakeholders.

The Bank provides information on all events that merit announcement, either on its website – www.bbkonline.com – or through other forms of publication. The Bank's annual report and three years financial statements are also published on the website, as well as the Bank's corporate governance report, the corporate governance framework manual, whistle blowing policy and Insiders Trading policy. Shareholders can complete an online form which can be found on the website to forward any queries they may have.

The Bank uses a bulletin board for communicating with its employees on general matters, and sharing information of common interest and concern.

We grow, year by year, increasing and building on our proven structure, illustrated in our people, our services and our customers.

**Fibonacci Spiral**

Pictured is a cross-section of a Nautilus seashell. It shows the spiral curve of the shell and the internal chambers it adds on as it grows. In nature, spiral formations such as these provide the perfect arrangement for expansion and renewal.

# Management review

## During 2010 we began implementing the various actions that had been agreed in our Corporate Strategic Plan for 2010-2012. We have been able to get off to a strong start and the fact that BBK achieved a new record net profit gives us considerable satisfaction.

It also provides support for our view that the Bank is following the right path during a continuing period of economic volatility locally, regionally and globally.

We have re-focussed our efforts squarely on local and regional business. A number of initiatives which started in 2009 were completed during 2010 and the benefits of these are now being realised. There has been strong growth in our customer deposit base, particularly on the retail and local corporate sides of the business. On the corporate side we have been able to increase market share, helped by the launch of our new cash management platform. Our loan-to-deposit ratio at the end of the year was 71.34% which is at a very comfortable level and well within the Central Bank of Bahrain's regulatory level.

In October 2010 we successfully sold USD 500 million of bonds to support the Bank's growth plans over the next three years. This deal was originally scheduled for earlier in the year but we decided to wait until market conditions improved. By doing so we were able to achieve a considerably more attractive borrowing yield on the issue.

### Our people

Having introduced a number of new employee benefits and enhanced the overall employment proposition at BBK in 2008/2009 we focussed our attention in 2010 on the development of our people.

In line with one of the key objectives of both our Strategic Plan and Bahrain's "Economic Vision 2030" a new Employees Certification Programme was introduced. This involves all staff going through a structured, modular training programme which covers all of the key areas of banking. The programme has commenced for employees in our retail business and it will eventually be rolled out right across the Bank.

A new Leadership Development Programme is also in the final stages of development and this will be launched in 2011. This is an internally-developed programme which aims to develop a future generation of leaders at BBK and to drive a performance-driven culture right across the Bank.

During the year we also took the opportunity to review the pay and benefits structure of BBK employees employed at our branches in India.

### Our clients

**Retail Banking** had a particularly busy year with a number of planned initiatives coming to fruition in line with the Bank's 2010-2012 Strategic Plan. The retail business made a strong contribution to the 2010 results with growth in both customer deposits and consumer loans.

During the year the number of Financial Malls grew from five to seven, a new direct sales unit was created and the Bank's internet banking service, "bbkonline.com" was significantly upgraded allowing a number of new and market-leading services to be introduced. In addition, the Priority Banking unit was re-tailored to provide more personalised services to high net-worth individuals. Several important partnership agreements were also signed which will enable BBK to offer an ever broader range of retail products and services to our clients.

The growth in BBK's network and reach, combined with the efforts of our customer-facing employees meant that BBK's retail business was able to step up a gear in 2010. Employee costs were, however, carefully controlled - there was no increase in head count in the retail business despite the opening of the two new Financial Malls and the launch of the direct sales unit.

As well as seven Financial Malls, BBK has 8 branches and a Cash Management Centre in the Kingdom of Bahrain, a branch in the State of Kuwait, a representative office in Dubai and two branches in the Republic of India. The ATM network now numbers 42, including 14 off site ATMs and 6 which accept cash and cheque deposits.

With the initiatives which have been launched in 2010, as well as others currently in the pipeline, BBK's retail banking business looks to the future with considerable confidence.

> "Not only did we achieve the objectives which we had set ourselves, but we also laid the foundations for even higher levels of achievement in the future."

**Transactional Banking** implemented a number of important product and service enhancements including the launch of "BBK CashLink" our new Cash Management system for corporate clients. This has a number of powerful new features and capabilities which will allow BBK both to offer a wider range of services to existing corporate clients and to help the Bank win new ones.

A new Export Finance product was introduced and we are confident that this product will allow BBK to deepen existing relationships with major Bahrain-based corporates. In phase 2, commencing in 2011, opportunities to market this product to corporates based in other GCC countries will be explored.

In line with Bahrain's "Economic Vision 2030" renewed focus was placed on developing business in the domestic SME sector. Transactional Banking commenced the segmentation of the SME market in order to identify the segments where the best business opportunities lie. Serious discussions are also underway to partnership with TAMKEEN over this segment of the market.

**Corporate Banking** faced a challenging year as growth in Bahrain's economy was limited during 2010. At a national level corporate assets declined but some momentum was maintained as the government continued the important work of developing the Kingdom's infrastructure. BBK has a strong team of Relationship Managers and the Bank constantly seeks to play a role in financing aspects of major government infrastructure-related projects.

Following completion of the Strategic Plan much focus was placed on ensuring that there was no deterioration in asset quality. Considerable effort was devoted to enhancing controls, improving the quality of management information, reviewing security documentation and ensuring that facilities were closely monitored. The opportunity was also taken to re-price a number of facilities to ensure that the Bank is adequately compensated for the risk exposure that it carries.

Another of Corporate Banking's objectives in 2010 was to target clients to make additional deposits. They set about this objective in a co-ordinated manner, boosted the client calling programme to ensure more frequent client contact and were able to exceed their liability target for the year comfortably.

**International Banking** had another profitable year. The operation in India (2 branches) is performing well and licenses to open 2 additional branches in India are currently being sought. Our India business is supported by the provision of a range of products and services for Non Residents Indians (NRIs). These include our internet banking service which enables NRIs to make fast, low-cost remittances to anywhere in India, and for our clients to withdraw cash at ATMs throughout the country. BBK clients based in Bahrain also benefit from our joint venture with Geojit BNP Paribas which offers online stock trading on the Mumbai Stock Exchange.

Our branch in Kuwait continues to perform satisfactorily and we remain interested in expanding our presence there if the opportunity to do so should arise in the future. Work is also underway to set up a new joint venture in Kuwait to serve the NRIs in the Kuwaiti market to transact on the Indian stock exchanges and do their banking facilities through this joint venture in India.

On the corporate side in India we leverage our GCC presence to capitalise on trade flows between India and the GCC. Through our representative office in Dubai we are enhancing our presence through carefully structured transactions. In Saudi Arabia, Qatar and Oman we have established a number of important relationships and are seeking to deepen these, particularly in the areas of trade finance, contractor finance and specific-purpose financing.

**Treasury & Investment** continued with the re-structuring and diversification of our investment portfolio with greater bias towards the GCC region in line with the Bank's overall strategy. Investment portfolio growth was in line with the Strategic Plan and made a solid contribution to the Bank's 2010 net income.

We have benefited from a flight to quality and were able to attract strong deposits from the region, particularly from Saudi Arabia and Kuwait. This has resulted in a satisfactory build up in our liquidity.

Market conditions were generally better in 2010 than in the previous year and we were able to capitalise on this. We have seen good growth in our forex business and overall 2010 was a better trading year for the Bank than 2009.

BBK launched a GCC equity fund during the year and we are seeing a growing level of interest in this. In early 2011 we intend to launch a new GCC brokerage service.

## Our subsidiaries

**CrediMax**, BBK's wholly-owned subsidiary specialising in credit card issuing and acquiring, continues to perform well despite the limited opportunities for growth in the Bahrain market. CrediMax is evaluating opportunities to expand in the region on a product line basis. It has acquired new premises in the Seef district of Manama and will relocate its operations there during the early part of 2011.

**Capinnova** is BBK's Sharia'a-compliant investment banking subsidiary which offers corporate finance services, asset management services and participates in private equity deals. It continues to explore business and growth opportunities in the market.

**Invita**, BBK's wholly-owned call centre subsidiary continues to be profitable. In view of the limited growth potential in the domestic market Invita is exploring opportunities to expand in the MENA region.

**Sakana** is the 50-50 joint venture with Ithmaar Bank of Bahrain, providing Islamic finance to the real estate sector. During 2010, BBK's stake was transferred to Capinnova.

**Global Payment Services - GPS** is a joint venture through CrediMax subsidiary, specialised in the outsourcing of electronic payment services that support processing services such as issuing of credit, debit and Islamic cards; acquiring and driving point of sales and ATMs; and back office services such as EMV card personalisation and statement printing and dispatch. GPS is accredited by Visa, MasterCard and JCB to serve banks and financial institutions in the Middle East with initial focus on Bahrain market and now expanding into untapped regional markets.

## Internal processes

**Information Technology** developed a five year IT Strategic Plan (2011-2016) which will govern all aspects of IT's strategic direction. Key initiatives progressed during 2010 and included further enhancements to the Bank's Business Continuity Planning (with support for CrediMax and our international businesses), implementation of the new Cash Management platform and an upgrade of the Treasury Front Office system. Mobile banking is also in the final testing stages.

Work has already commenced in IT on a number of 2011 initiatives which will include an upgrade of the core banking system, cheque truncation and the adoption in the Bahrain market of International Bank Account Numbers (IBAN).

During 2010 **Risk, Compliance and Legal Affairs** developed a new Group Risk Management framework covering our wholly-owned subsidiaries CrediMax and Capinnova. Other achievements included the introduction of a formal dividend policy, a whistle blowing policy, enhancements to the ICAAP process (Internal Capital Adequacy Assessment Process) and the stress-testing framework as well as ongoing work related to Basel II. Market risk monitoring was also upgraded.

With BBK placing additional emphasis on developing the SME segment, a new policy was developed to address the business needs of this important segment.

Regulatory compliance is a key area of focus for the Bank. BBK's Compliance unit plays an important role in ensuring that we operate in full compliance with all Central Bank of Bahrain directives. The Compliance unit was also involved in a number of new CBB initiatives during 2010 including the proposed corporate credit bureau and the development of an enhanced Deposit Protection Scheme.

**Credit Management** continued to play a key risk management role in respect of the Bank's credit and investment portfolio. Credit Management is divided into two sections, Credit Review and Credit Administration. Credit Review fulfils an independent credit risk assessment and review role within BBK which is vital in ensuring that the Bank maintains a balanced approach to risk both in the Bank's corporate lending activities and in its investments. Credit Administration worked hard in 2010 to enhance reporting and information systems and derive efficiency gains from the automation of manual processes.

**Operations** were heavily involved in supporting the development and launch of BBK's new cash management platform and migrating clients onto it. Work on increasing transactional straight-through processing (STP) rates to boost efficiency and productivity is ongoing. In 2011 cheque truncation will be introduced in the Bahrain market; this will be a significant project for all banks and Operations has begun work to ensure that BBK is fully prepared.

## Our community

At BBK we are justifiably proud of our long tradition of providing support to a wide range of humanitarian, educational, cultural, as well as social and health initiatives in the communities in which we operate. In 2010, a considerable number of non-profit organisations received extensive support from the Bank.

One of the substantial commitments is the health centre donated to the Ministry of Health, which has been built in Hidd at a cost of BD 3.3 million, excluding the cost of furniture and equipment which is the next phase of the project that the Bank is considering. With the construction work now complete, we expect it to open in 2011.

We have also upgraded our commitment to support the Crown Prince's International Scholarship Programme (CPISP), recently announcing a BD 1 million contribution to the programme and becoming a Platinum sponsor.

## Conclusion

2010 was another memorable year for BBK, not least because of the Bank's excellent level of profitability in market conditions which remained challenging. Not only did we achieve the objectives which we had set ourselves in respect of the first year of our Corporate Strategic Plan 2010-12 but we also laid the foundations for even higher levels of achievement in the future.

We look to the future with considerable optimism and are hopeful that 2011 will herald the start of a broad-based recovery in the region which will bring new business opportunities for BBK.

In closing, it is my pleasure to extend sincere appreciation to our Board of Directors for their ongoing support and valuable guidance, to the Central Bank of Bahrain, the Central Bank of Kuwait, the Reserve Bank of India, Bahrain Bourse Company, our loyal customers and finally to all our dedicated employees who worked so hard, individually and collectively, to deliver another record performance in 2010.

**Abdulkarim Ahmed Bucheery**
Chief Executive

We invest in our employees, offering them opportunities to enhance their expertise and stay at the forefront of their fields with optimal career growth.

**The Fibonacci Sequence**

In the Fibonacci Sequence (0, 1, 2, 3, 5, 8,...), each number is the sum of the two previous numbers. Pictured is a sunflower heart which utilises the Fibonacci Sequence creating spirals curving both to the left and to the right. This provides the perfect arrangement for optimum growth potential for each individual seed.

# Executive Management

**Abdulkarim Ahmed Bucheery**
Chief Executive
BSc, University of Aleppo, Syria (1976)
33 years banking experience
Joined BBK in 2002

**Rashed Salman Al Khalifa**
General Manager,
Business Group
MBA, Arizona State University, USA (1982)
28 years banking experience
Joined BBK in 2008

**Reyadh Yousif Sater**
General Manager,
Shared Services Group
MBA, University of Glamorgan, UK (2001)
33 years banking experience
Joined BBK in 1978

**Mahmood Abdul Aziz**
Assistant General Manager,
Operations
Executive Management Diploma, University of Bahrain. Gulf Executive Management Program, University of Virginia, USA
39 years banking experience
Joined BBK in 1976

**Adnan A. Wahab Al Arayyed**
Head of Credit Management
BSc, Beirut Arab University, Lebanon (1984)
29 years banking experience
Joined BBK in 1983

**Rashad Akbari**
Assistant General Manager,
Transactional Banking
MSc, Marketing, University of Stirling, UK (1997)
24 years work experience, of which 10 years in banking
Joined BBK in 2000

**Axel Hofmann**
Assistant General Manager,
Retail Banking
MBA, University of Texas, USA (1991)
20 years banking experience
Joined BBK in 2007

**Mohammed Abdulla Isa**
Assistant General Manager,
Financial Planning and Control
Certified Public Accountant, American Institute of Certified Public Accountants – Delaware State Board of Accountancy (2001)
19 years finance experience
Joined BBK in 2001

**Amit Kumar**
Assistant General Manager,
Risk, Compliance and Legal Affairs
MBA, India Institute of Management (1983)
27 years banking experience
Joined BBK in 1994

**Khalil Al Meer**
Assistant General Manager,
Corporate Banking
BSc, Business Administration,
University of Bahrain (1985)
25 years banking experience
Joined BBK in 1989

**Jamal Al Sabbagh**
Assistant General Manager,
Information Technology
MBA, University of Glamorgan, UK (2001)
30 years banking experience
Joined BBK in 1980

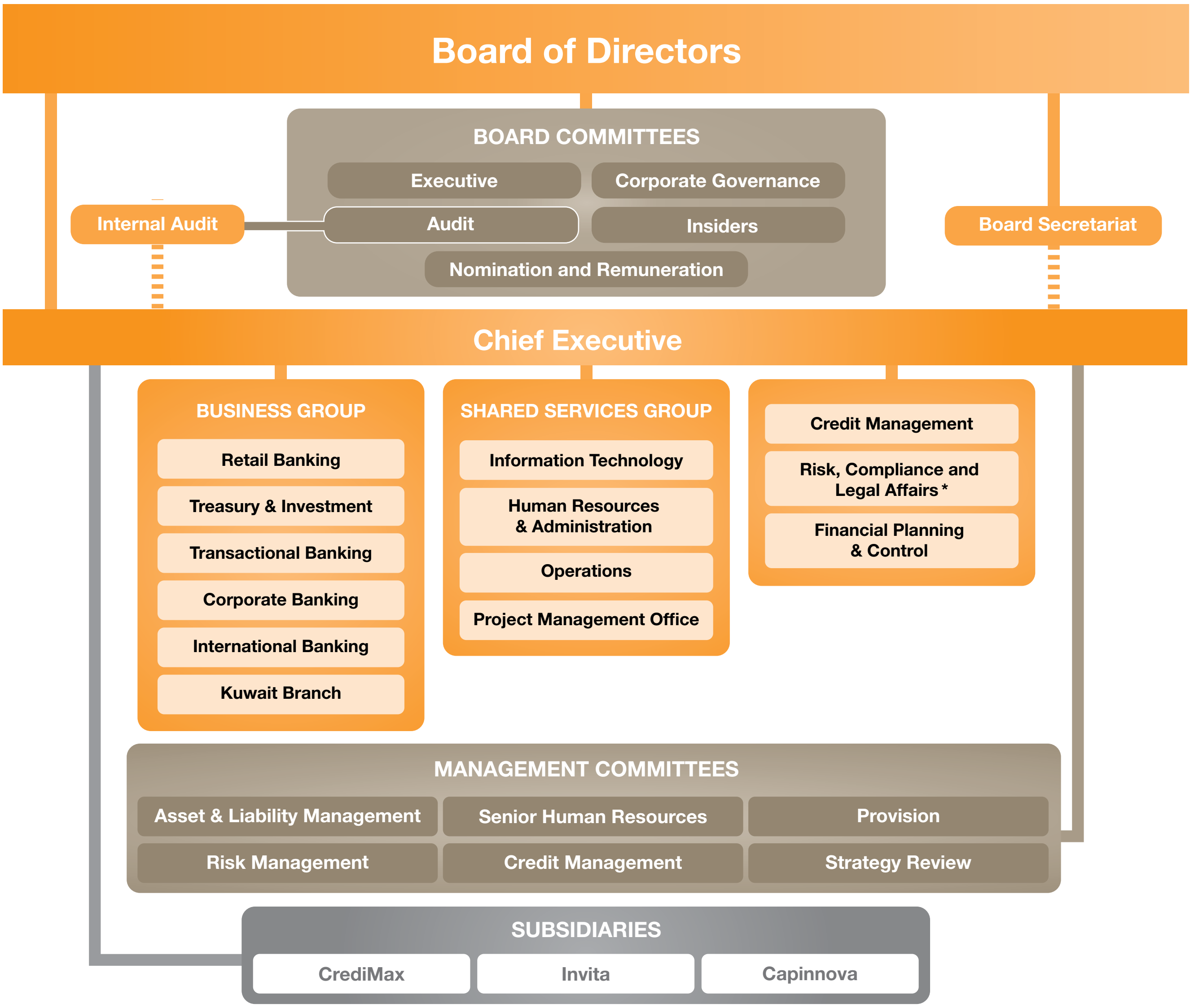
**Abdul Hussain Bustani**
Assistant General Manager,
Human Resources and Administration
Higher National Diploma, Civil Engineering,
Trent University, UK (1978)
35 years work experience, of which
21 years in banking
Joined BBK in 1988

**Abdulrahman Saif**
Assistant General Manager,
Treasury and Investment
PhD, Economics, University of Leicester UK (1992)
28 years banking experience
Joined BBK in 2008

**Ashish Sarkar**
Assistant General Manager,
International Banking
MBA, Indian Institute of Management (1990)
20 years banking experience
Joined BBK in 1997

# Organisation information

## Organisational structure




** AGM Risk, Compliance and Legal Affairs (RCLA) Division participates in the Board and / or Executive Committee meetings whenever risk issues are discussed. The Head of Compliance and Money Laundering Reporting Officer (MLRO) reports to the AGM - RCLA, and has access to the Management and presents quarterly compliance reports to the Audit Committee.*

## Executive Management interests

The number of shares held by Members of the Executive Management team as of 31 December 2010 was as follows:

| | Type of shares | 31 Dec 2010 | 31 Dec 2009 |
|---|---|---|---|
| Mahmood Abdul Aziz | Ordinary | 7,976 | 7,976 |
| Jamal Al Sabbagh | Ordinary | 6,208 | 6,208 |

## Management Committees

Management Committees are chaired by the Chief Executive. Committee Members are heads of the relevant divisions appointed by the committee Chairman. Each committee meets at least once a month, except the Senior Human Resources Committee and the Risk Management Committee that meet once every other month and the Credit Management Committee that meets once a week.

| Committee | Summary terms and reference |
|---|---|
| **Asset & Liability Management Committee** | Establishes policies and guidelines for the overall management of the statement of financial position and its associated risks. |
| **Senior Human Resources Committee** | Establishes appropriate policies, procedures and guidelines for the management of human resources. |
| **Provision Committee** | Reviews and establishes provisioning requirements for loans, advances and investments. |
| **Risk Management Committee** | Identifies, measures, monitors and controls risk by establishing risk policies and procedures. |

| Committee | Summary terms and reference |
|---|---|
| **Strategy Review Committee** | ‣ Reviews and monitors progress on strategic initiatives. |
| **Credit Management Committee** | ‣ Approves credit and investment proposals of a certain limit. Also reviews and recommends any proposal requiring Executive Committee or Board approval. |

## Long Term Incentive Plans

The BBK Long Term Incentives Plans are share based reward schemes, under which the Bank allocates certain numbers of shares every year to executive and senior management employees based on performance, potential, and job criticality level. The grant price is determined according to the share price at the closing of the market on the fourteenth day after the Annual General Meeting. There are two forms of the Employee Long Term Incentive Plans:

**Employee Stock Options Plan**

This plan was introduced in 1999 and options were granted on a yearly basis until 2009. The plan will end once all options granted till 2009 expire or vest. In 2010 the Bank has opted to introduce a new performance shares plan approved by the shareholders.

**Employee Performance Shares Plan**

The scheme was introduced effective 2010. The plan operates on a yearly basis of shares being allocated and held in a trust in the name of the individual employee over the vesting period. Following the assessment of the performance of the Bank against the target performance conditions stipulated for the period, the ownership of the vested shares is transferred to the individual employee.

## Major BBK shareholdings as of 31 December 2010

| | | | | | Number of shares | |
|---|---|---|---|---|---|---|
| Name / Entity | Nationality / Head Quarter | Legal status | Ownership date | % | Previous | Current |
| Companies listed on the Bahrain Bourse Company *(5% and above)* | | | | | | |
| Bahrain Kuwait Insurance (BKIC) | Bahrain | B.S.C. | 2006 | 6.82% | 4,436,215 | 4,436,215 |
| Securities Investment Company | Bahrain | B.S.C. (c) | 2006 | 9.89% | 41,250,000 | 41,250,000 |
| Bahrain Commercial Facilities Company | Bahrain | B.S.C. (c) | 1994 | 23.00% | 37,618,691 | 37,618,691 |
| Major shareholders of the company's outstanding shares *(5% and above)* | | | | | | |
| Ithmaar Bank | Bahrain | Investment Bank | 2008 | 25.34% | 215,736,187 | 215,736,187 |
| Pension Fund Commission (PFA) | Bahrain | Governmental Institution | 1986 | 18.79% | 159,943,766 | 159,943,766 |
| Kuwait Investment Authority (KIA) | Kuwait | Investment Company | 1990 | 18.68% | 159,073,547 | 159,073,547 |
| Social Insurance Organization (GOSI) | Bahrain | Governmental Institution | 1986 | 13.33% | 113,490,122 | 113,490,122 |
| The Bank's holdings in other companies (Quoted / unquoted in / out Kingdom of Bahrain) *(10% and above)* | | | | | | |
| CrediMax | Bahrain | B.S.C. (c) | 1999 | 100.00% | 5,000,000 | 5,000,000 |
| Invita | Bahrain | B.S.C. (c) | 2006 | 100.00% | 500,000 | 500,000 |
| BBK Investment Fund Company | Bahrain | B.S.C. | 1997 | 100.00% | 53,000 | 53,000 |
| Global Payment Services* | Bahrain | W.L.L. | 2005 | 55.00% | 10,000 | 10,000 |
| Sakana Holistic Housing Solutions** | Bahrain | B.S.C. (c) | 2006 | 50.00% | 10,000,000 | 10,000,000 |
| Capinnova Investment Bank | Bahrain | B.S.C. (c) | 1999 | 100.00% | 125,000,000 | 125,000,000 |
| The Benefit Company | Bahrain | B.S.C. (c) | 1997 | 22.00% | 3,960 | 3,960 |
| EBLA Computer Consultancy** | Kuwait | K.S.C.C. | 2010 | 36.36% | 13,333,334 | 13,333,334 |
| Naseej Company | Bahrain | B.S.C. | 2009 | 13.89% | 250,000,000 | 250,000,000 |
| Alosra Bank | Bahrain | B.S.C. | 2009 | 10.00% | 5,000,000 | 5,000,000 |
| Kuwait Net Project Company | Kuwait | K.S.C. | 1990 | 10.00% | 900,000 | 900,000 |

** Shareholding of Global Payment Services through CrediMax subsidiary*

*** Shareholding of Sakana Holistic Housing Solutions and EBLA Computing Consultancy through Capinnova Investment Bank*

## Offices and international branches

**BBK – Headquarters**
43 Government Avenue
P.O. Box 597
Manama
Kingdom of Bahrain
**Tel:** +973 17 22 33 88
**Fax:** +973 17 22 98 22
**Cable:** BAHKUBANK
**Telex:** 8919
**SWIFT:** BBKUBHBM

**BBK – Kuwait**
Ahmed Al Jaber Avenue
P.O. Box 24396
13104 Safat
State of Kuwait
**Tel:** +965 2241 7140
**Fax:** +965 2244 0937

**BBK – Mumbai**
P.O. Box 11692
Jolly Maker Chambers II
225 Nariman Point
Mumbai 400021
Republic of India
**Tel:** +912 22 282 3698
**Fax:** +912 22 204 4458
+912 22 284 1416

**BBK – Hyderabad**
6-3-550 L B Bhavan
Somajiguda
Hyderabad 500482
Republic of India
**Tel:** +914 02 339 8219
**Fax:** +914 02 337 5977

**BBK – Dubai Representative Office**
Creek Tower
Office No. 18A
P.O. Box 31115
Dubai, UAE
**Tel:** +971 4 221 0560
+971 4 223 7156
**Fax:** +971 4 221 0570

*For further information please refer to* **www.bbkonline.com**

# Financial review

## This review incorporates the consolidated operating results and the consolidated statement of financial position of BBK including its overseas branches, its subsidiaries; CrediMax, Capinnova, Invita and Global Payment Services (GPS); the joint venture Sakana Holistic Housing Solutions, and associated companies; Bahrain Commercial Facilities Company, Benefits Company and EBLA.

The consolidated financial statements have been prepared and presented in accordance with International Financial Reporting Standards, and are in conformity with Bahrain Commercial Companies Law and Central Bank of Bahrain (CBB) and Financial Institutions law.

### Operating results

The Bank made a net profit, attributable to the shareholders of the Bank, of BD 39.142 million for the year ended 31 December 2010; being 11.8 per cent increase over last year. The net result for the year was positively impacted mainly by the increase in fees and commissions income by 13.1 per cent to reach BD 22.85 million and the increase in investment income from BD 9.20 million to BD 27.85 million.

On the other hand, operating expenses have increased by 6.3 per cent, over 2009, while net provisions have increased from BD 14.2 million to BD 23.7 million to account for expected and unexpected asset losses.

#### Operating income

Total operating income for the year stood at BD 109.1 million, compared to BD 92.6 million in 2009. Net interest income stood at BD 56.0 million, while other income witnessed a significant growth by 70 per cent and stood at BD 53.1 million at the end of 2010.

#### Net interest income

Net interest income for the year declined by 8.7 per cent, and stood at BD 56.0 million largely on account of reported gain on partial buy back of the Bank subordinated debt of BD 7.7 million in 2009 (2010: BD 2.2 million).

#### Other income

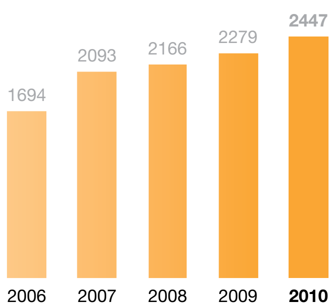
Other operating income consists of non-interest income, which is earned from business activities such as dealing in foreign currencies, investment in funds (other than fixed-income funds), the sale of corporate banking and retail banking services, investment trading and share of profit/loss in associated companies and joint ventures. The total income generated

**Summary income statement**

| BD millions | 2010 | 2009 | Variance BD millions | Change per cent |
|---|---|---|---|---|
| Net interest income | **56.0** | 61.3 | **(5.3)** | **-8.65%** |
| Other income | **53.1** | 31.3 | **21.8** | **69.97%** |
| **Total income** | **109.1** | 92.6 | **16.5** | **17.82%** |
| Operating expenses | **45.6** | 42.9 | **2.8** | **6.53%** |
| Provisions | **23.7** | 14.2 | **9.5** | **66.90%** |
| Profit before taxation | **39.7** | 35.4 | **4.3** | **12.15%** |
| Taxation | **(0.6)** | (0.4) | **(0.2)** | **50.00%** |
| Net profit for the year | **39.1** | 35.0 | **4.1** | **11.77%** |

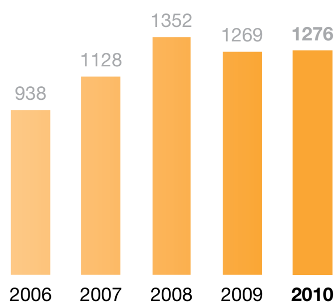
**Total assets**

BD millions



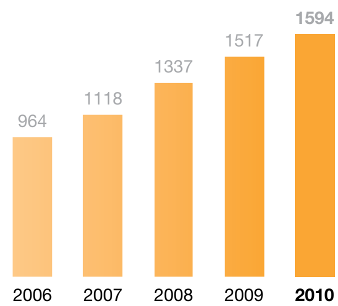

**Loans and advances**

BD millions




**Customer deposits**

BD millions



during the year from these activities reached BD 53.1 million (2009: BD 31.3 million).

Fees and commission income has increased by 13.1 per cent to reach BD 22.85 million (2009: BD 20.2 million), mainly due to higher retail loan fees, corporate loan fees, and credit card fee income.

Investment income increased from BD 9.20 million in 2009, to BD 27.85 million in 2010, due to healthy increase in gain on foreign exchange by 7%, and to the increase in investment trading activity during the year, which included a non-recurring gain resulting from the sale of non-trading investment in Kuwait.

### Operating expenses

Operating expenses which include staff, premises, equipment depreciation and other administrative costs, increased by 6.3 per cent and stood at BD 45.6 million to accommodate the expense growth on account of the investment in the two new financial malls opened in Isa Town and Exhibition Road during the year, investment in Cash Management Platform, investment in staff training and development, and further strategic expansion of core business activities as well as development of the IT and premises infrastructure of the Bank. Despite those investments, the underlying cost to income ratio, improved from 46.4 per cent in 2009 to 41.8 per cent in 2010.

### Net provisions

The Bank follows the International Accounting Standard (IAS 39) with regard to accounting for impairment of financial assets. The provisions for impairment of the Bank's loans and advances and assets carried at cost or amortised cost is arrived at after calculating the net present value of the anticipated future cash flows from these financial assets, discounted at original effective interest rates. For assets carried at fair value, impairment is the difference between the carrying cost and the fair value. This approach of provisioning for impairment of the Bank's financial assets is aimed at providing more realistic estimates of the impairment in the values of the assets.

The net provision for the year for impairment on loans and advances to customers increased from BD 11.3 million in 2009 to BD 17.7 million in 2010, including enhancement of general provision. Likewise the net provision charge for impairment of non-trading investment securities increased, by BD 3.0 million, and stood at around BD 6.0 million as part of the Bank prompt application of prudent policies on credit, interest and liquidity risks.

## Financial position

The statement of financial position of the Bank at the year-end grew to BD 2,447 million, an increase of BD 168 million when compared to December 2009. This growth was mainly driven by strong underlying business growth led by the increased investment in securities and bonds, funded through the increase in customer deposits and term borrowing.

### Consolidated Statement of Financial Position

Investment in associated companies and joint venture represents the Bank's interest of 23 per cent stake of Bahrain Commercial Facilities Company, a public shareholding company, 22 per cent stake in The Benefit Company, 36.36 per cent stake Ebla Kuwait and 50 per cent stake in Sakana Holistic Housing Solutions. Both investments in Ebla Kuwait and Sakana Holistic Housing Solutions owned by the Bank's fully owned, Sharia'a - compliant subsidiary "Capinnova". The carrying value of these investments represents the Bank's share of the net assets of those companies.

Treasury bills and inter-bank deposits are money market instruments held essentially for managing liquidity. The Bank's liquid assets (including cash and balances with central banks, treasury bills, trading investments, and placements with banks) to total assets ratio improved from 25.7 per cent in 2009 to 27.0 per cent in 2010. Other assets mainly include accrued interest receivable, fixed assets net of accumulated depreciation, and prepaid expenses.

### Assets

At the year-end, net loans and advances to customers stood at BD 1,276 million, reporting a marginal growth over 2009 balance of BD 1,269 million reflecting better quality lending opportunities available in the market, than those which were available in 2009.

The investment portfolio of the Bank is classified into "Available for sale" and "Investments stated at amortised costs". Those investments consist of quoted bonds and equities and unquoted securities that are mainly acquired with the intention of being retained for the long and medium term. At the end of 2010, the quoted bonds and equities constitute 58.7 per cent of the gross investments (45.3 per cent at the end of 2009).

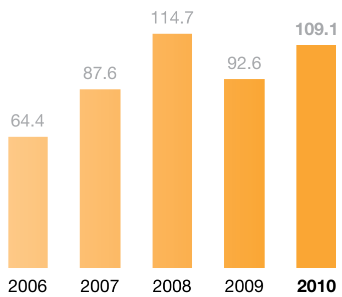
Non-trading investments has grown by 19.1 per cent to reach BD 425.4 million, which was in line with the strategic plan of the Bank, making a solid contribution to the Bank income in 2010.

### Liabilities

Current, saving and other deposits include the balances of interest-bearing and non-interest-bearing accounts due to customers on demand, and term deposits taken with different maturity dates, in various currencies and at varying rates of interest. As at the year-

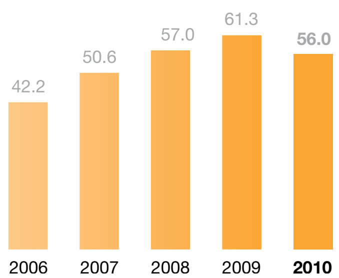
**Total income**

BD millions



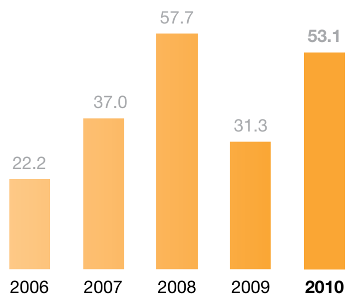

**Net interest income**

BD millions




**Other income**

BD millions



end, customer deposits increased to BD 1,594 million, from BD 1,517 million at the end of 2009, a growth of 5.1 per cent reflecting the confidence of customers in the Bank.

During the year, the Bank partially redeemed USD 24.3 million (USD 62.8 million in 2009) out of its USD 275 million subordinated debt. It also partially redeemed USD 175.1 million (USD 4.1 million in 2009) out of its USD 500 million senior notes that is maturing on March 2011.

It is worth mentioning that during the fourth quarter of 2010, the Bank has successfully issued a new five years-senior notes amounting to USD 500 million, under the current EMTN Euro note programme. The notes were issued at fixed rate, and were later partially hedged against interest rate risk.

Interest payable and other liabilities consist of accrued interest payable on interest-bearing deposits and accrued expenses.

## Capital adequacy

The Bank has implemented the Basel II framework for the calculation of capital adequacy since 1January 2008, in accordance with CBB guidelines.

Equity before appropriations stands at BD 241 million at the end of 2010 (BD 231 million at the end of 2009). Despite the fact that BBK total statement of financial position has increased by BD 168 million, and the banks total off statement of financial position items has increased by BD 259 million compared to last year, the total risk weighted assets has decreased by BD 68 million, reflecting better risk management practices. The decrease in the risk weighted assets, along with the increase in the Bank capital base from BD 304 million to BD 310 million resulted in improving the capital adequacy ratio from 17.51 per cent in December 2009, to 18.57 per cent as of December 2010.

To further strengthen the Bank's capital base, the Board of Directors approved the appropriation of BD 9 million from the current year's profit to the general reserve. This represents a 33.3 per cent increase over the 2009 general reserve of BD 27 million.

**Consolidated statement of financial position**

| BD millions | 2010 | 2009 | Variance BD millions | Change per cent |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and balances with central banks | **358.9** | 162.4 | 196.5 | 121.00% |
| Treasury bills | **130.2** | 61.6 | 68.6 | 111.36% |
| Deposits and due from banks and other financial institutions | **171.0** | 362.4 | (191.4) | -52.81% |
| Loans and advances to customers | **1,276.3** | 1,268.6 | 7.7 | 0.61% |
| Non-trading investment securities | **425.4** | 357.2 | 68.2 | 19.09% |
| Investment in associated company and joint venture | **35.1** | 27.5 | 7.6 | 27.64% |
| Interest receivable and other assets | **21.2** | 11.2 | 10.0 | 89.29% |
| Premises and equipment | **29.1** | 28.0 | 1.1 | 3.93% |
| **Total assets** | **2,447.2** | 2,278.9 | **168.3** | **7.39%** |
| **Liabilities and equity** | | | | |
| **Liabilities** | | | | |
| Deposits and due to banks and other financial institutions | **195.5** | 239.6 | (44.1) | -18.41% |
| Borrowings under repurchase agreements | **1.7** | - | 1.7 | - |
| Term borrowings | **370.3** | 257.2 | 113.1 | 43.97% |
| Customers' current, savings and other deposits | **1,593.6** | 1,516.9 | 76.7 | 5.06% |
| Interest payable and other liabilities | **45.6** | 34.2 | 11.4 | 33.33% |
| **Total liabilities** | **2,206.7** | 2,047.9 | **158.8** | **7.75%** |
| Equity attributable to shareholders of the Bank | **240.2** | 230.9 | 9.3 | 4.03% |
| Non-controlling interest | **0.3** | 0.1 | 0.2 | 200.00% |
| Total equity | **240.5** | 231.0 | 9.5 | 4.11% |
| **Total liabilities and equity** | **2,447.2** | 2,278.9 | **168.3** | **7.39%** |

We are leveraging our leadership, award-winning prowess and customer understanding to grow in both variety and scope to deliver ever increasing value banking.

**Fractal**

A snowflake is nature's example of a fractal. This is any pattern that reveals greater complexity and diversity as it is enlarged.

# Financial information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# Independent Auditors' report
## to the shareholders of BBK B.S.C.

**Report on the financial statements**

We have audited the accompanying consolidated financial statements of BBK 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 statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Board of Directors' responsibility for the financial statements*

The Board of Directors is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

*Auditors' responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2010, its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

**Report on other regulatory requirements**

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements, and the contents of the Chairman's statement relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank, have occurred during the year ended 31 December 2010 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position, and that the Bank has complied with the terms of its banking license.

Ernst + Young

**30 January 2011**

*Manama, Kingdom of Bahrain*

# Consolidated statement of financial position

31 December 2010

| | Note | 2010 BD '000 | 2009 BD '000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with central banks | 4 | **358,926** | 162,408 |
| Treasury bills | 5 | **130,172** | 61,655 |
| Deposits and due from banks and other financial institutions | 6 | **171,037** | 362,407 |
| Loans and advances to customers | 7 | **1,276,316** | 1,268,561 |
| Non-trading investment securities | 8 | **425,428** | 357,151 |
| Investments in associated companies and joint venture | 9 | **35,120** | 27,472 |
| Interest receivable and other assets | 10 | **21,096** | 11,235 |
| Premises and equipment | 11 | **29,082** | 28,003 |
| **TOTAL ASSETS** | | **2,447,177** | 2,278,892 |
| **LIABILITIES AND EQUITY** | | | |
| **Liabilities** | | | |
| Deposits and due to banks and other financial institutions | | **195,501** | 239,579 |
| Borrowings under repurchase agreement | | **1,678** | - |
| Term borrowings | 12 | **370,279** | 257,173 |
| Customers' current, savings and other deposits | 13 | **1,593,576** | 1,516,909 |
| Interest payable and other liabilities | 14 | **45,601** | 34,237 |
| Total liabilities | | **2,206,635** | 2,047,898 |
| **Equity** | | | |
| Share capital | 15 | **85,135** | 85,135 |
| Treasury stock | 15 | **(3,742)** | (2,845) |
| Share premium | 15 | **39,919** | 39,919 |
| Statutory reserve | 16 | **42,568** | 39,001 |
| General reserve | 16 | **27,000** | 20,000 |
| Cumulative changes in fair values | 17 | **(6,465)** | 924 |
| Foreign currency translation adjustments | | **917** | (462) |
| Retained earnings | | **23,249** | 18,853 |
| Proposed appropriations | 18 | **31,680** | 30,358 |
| EQUITY ATTRIBUTABLE TO THE SHAREHOLDERS OF THE BANK | | **240,261** | 230,883 |
| Non-controlling interest | | **281** | 111 |
| **Total equity** | | **240,542** | 230,994 |
| **TOTAL LIABILITIES AND EQUITY** | | **2,447,177** | 2,278,892 |

**Murad Ali Murad**
Chairman

**Sh. Mohammed Bin Isa Al Khalifa**
Deputy Chairman

**Abdulkarim Ahmed Bucheery**
Chief Executive

The attached notes 1 to 44 form part of these consolidated financial statements.

# Consolidated statement of income

Year ended 31 December 2010

| | Note | 2010 BD '000 | 2009 BD '000 |
|---|---|---|---|
| Interest and similar income | 19 | 84,923 | 82,422 |
| Interest and similar expense | | 28,968 | 21,125 |
| **Net interest income** | | 55,955 | 61,297 |
| Share of profit in associated companies and joint venture | 9 | 2,328 | 2,663 |
| Other income | 20 | 50,795 | 28,602 |
| **Total operating income** | | 109,078 | 92,562 |
| Staff costs | | 29,388 | 27,873 |
| Other expenses | | 12,972 | 12,303 |
| Depreciation | 11 | 3,261 | 2,762 |
| Net provision for impairment on loans and advances to customers | 7 | 17,718 | 11,291 |
| Net provision for impairment of non-trading investment securities | 8 | 6,001 | 2,952 |
| **Total operating expenses** | | 69,340 | 57,181 |
| PROFIT BEFORE TAXATION | | 39,738 | 35,381 |
| Net tax provision | | (589) | (364) |
| PROFIT FOR THE YEAR | | 39,149 | 35,017 |
| **Attributable to:** | | | |
| Shareholders of the Bank | | 39,142 | 35,013 |
| Non-controlling interest | | 7 | 4 |
| | | 39,149 | 35,017 |
| **Basic earnings per share (BD)** | 21 | 0.047 | 0.042 |
| **Diluted earnings per share (BD)** | 21 | 0.047 | 0.042 |



The attached notes 1 to 44 form part of these consolidated financial statements.

# Consolidated statement of comprehensive income

Year ended 31 December 2010

| | Note | 2010 BD '000 | 2009 BD '000 |
|---|---|---|---|
| **Profit for the year** | | **39,149** | 35,017 |
| Foreign exchange translation adjustments | | **1,379** | (4,154) |
| Net movement in cumulative changes in fair values | 17 | **(7,226)** | 10,842 |
| Cash flow hedges | 17 | **(163)** | (1,016) |
| Directors' remuneration and donations | 18 | **(2,325)** | (1,455) |
| **Other comprehensive (loss) income for the year** | | **(8,335)** | 4,217 |
| **Total comprehensive (loss) income for the year** | | **30,814** | 39,234 |
| **Attributable to:** | | | |
| Shareholders of the Bank | | **30,807** | 39,230 |
| Non-controlling interest | | **7** | 4 |
| | | **30,814** | 39,234 |

The attached notes 1 to 44 form part of these consolidated financial statements.

# Consolidated statement of changes in equity

Year ended 31 December 2010

| | | *Attributable to shareholders of the Bank* | | | | | | | | | | | *Total equity* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Note | Share capital BD '000 | Treasury stock BD '000 | Share Premium BD '000 | Statutory reserve BD '000 | General reserve BD '000 | Cumulative changes in fair values BD '000 | Foreign currency translation adjustments BD '000 | Retained earnings BD '000 | Proposed appropriations BD '000 | Total BD '000 | Non-controlling interest BD '000 | BD '000 |
| Balance at 31 December 2008 | | 81,081 | (1,357) | 39,919 | 35,500 | 20,000 | (8,902) | 3,692 | 17,626 | 21,605 | 209,164 | 107 | 209,271 |
| Profit for the year | | - | - | - | - | - | - | - | 35,013 | - | 35,013 | 4 | 35,017 |
| Other comprehensive income | | - | - | - | - | - | 9,826 | (4,154) | - | (1,455) | 4,217 | - | 4,217 |
| Total comprehensive income | | - | - | - | - | - | 9,826 | (4,154) | 35,013 | (1,455) | 39,230 | 4 | 39,234 |
| Share-based payments | 40 | - | - | - | - | - | - | - | 73 | - | 73 | - | 73 |
| Approval of dividend | 18 | - | - | - | - | - | - | - | - | (16,096) | (16,096) | - | (16,096) |
| Purchase of treasury stock | 15 | - | (1,488) | - | - | - | - | - | - | - | (1,488) | - | (1,488) |
| Issue of bonus shares | 18 | 4,054 | - | - | - | - | - | - | - | (4,054) | - | - | - |
| Transfer to statutory reserve | 16 | - | - | - | 3,501 | - | - | - | (3,501) | - | - | - | - |
| Proposed appropriations | 18 | - | - | - | - | - | - | - | (23,358) | 23,358 | - | - | - |
| Transfer to general reserve 2009 | | - | - | - | - | 7,000 | - | - | (7,000) | - | - | - | - |
| Balance at 31 December 2009 | | 85,135 | (2,845) | 39,919 | 39,001 | 27,000 | 924 | (462) | 18,853 | 23,358 | 230,883 | 111 | 230,994 |
| Profit for the year | | - | - | - | - | - | - | - | 39,142 | - | 39,142 | 7 | 39,149 |
| Other comprehensive loss | | - | - | - | - | - | (7,389) | 1,379 | - | (2,325) | (8,335) | - | (8,335) |
| Total comprehensive income | | - | - | - | - | - | (7,389) | 1,379 | 39,142 | (2,325) | 30,807 | 7 | 30,814 |
| Share-based payments | 40 | - | - | - | - | - | - | - | 501 | - | 501 | - | 501 |
| Approval of dividend | 18 | - | - | - | - | - | - | - | - | (21,033) | (21,033) | - | (21,033) |
| Purchase of treasury stock | 15 | - | (897) | - | - | - | - | - | - | - | (897) | - | (897) |
| Transfer to statutory reserve | 16 | - | - | - | 3,567 | - | - | - | (3,567) | - | - | - | - |
| Proposed appropriations | 18 | - | - | - | - | - | - | - | (31,680) | 31,680 | - | - | - |
| Additional capital in subsidiaries - non-controlling interest | | - | - | - | - | - | - | - | - | - | - | 163 | 163 |
| **Balance at 31 December 2010** | | **85,135** | **(3,742)** | **39,919** | **42,568** | **27,000** | **(6,465)** | **917** | **23,249** | **31,680** | **240,261** | **281** | **240,542** |

*Retained earnings include BD 16,306 thousand (2009: BD 14,799 thousand) of non-distributable reserves.*

The attached notes 1 to 44 form part of these consolidated financial statements.

# Consolidated statement of cash flows

Year ended 31 December 2010

| | Note | 2010 BD '000 | 2009 BD '000 |
|---|---|---|---|
| OPERATING ACTIVITIES | | | |
| Profit before taxation | | 39,738 | 35,381 |
| Adjustments for: | | | |
| Net provisions relating to: | | | |
| Loans and advances to customers | 7 | 17,718 | 11,291 |
| Non-trading investment securities | 8 | 6,001 | 2,952 |
| Share of profit in associated companies and joint venture | 9 | (2,328) | (2,663) |
| Depreciation | 11 | 3,261 | 2,762 |
| (Gain)/loss on sale of non-trading investment securities | 20 | (19,128) | 249 |
| **Operating profit before working capital changes** | | 45,262 | 49,972 |
| **(Increase) decrease in operating assets** | | | |
| Mandatory reserve deposits with central banks | | (16,441) | 2,792 |
| Treasury bills maturing after 91 days | | (37,825) | (15,989) |
| Financial assets at fair value through statement of income | | - | 861 |
| Deposits and due from banks and other financial institutions | | 13,274 | (35,269) |
| Loans and advances to customers | | (25,473) | 72,423 |
| Interest receivable and other assets | | (9,861) | 4,616 |
| **Increase (decrease) in operating liabilities** | | | |
| Deposits and due to banks and other financial institutions | | (44,078) | (11,005) |
| Borrowings under repurchase agreements | | 1,678 | - |
| Customers' current, savings and other deposits | | 76,667 | 180,348 |
| Interest payable and other liabilities | | 11,364 | (5,634) |
| Net cash from operating activities | | 14,567 | 243,115 |
| INVESTING ACTIVITIES | | | |
| Purchase of non-trading investment securities | | (346,494) | (239,873) |
| Disposal and maturities of non-trading investment securities | | 283,841 | 176,124 |
| Dividends received from associated company | 9 | 1,383 | 1,357 |
| Rights issue | 9 | - | (175) |
| Investments in associated companies and joint venture | 9 | (6,866) | - |
| Purchase of premises and equipment | | (4,340) | (9,668) |
| **Net cash used in investing activities** | | (72,476) | (72,235) |
| FINANCING ACTIVITIES | | | |
| (Redemption)/buy back of term borrowings | | (75,205) | (72,325) |
| Term borrowings received | | 188,500 | - |
| Payment of dividend, Directors' remuneration and donations | 18 | (23,358) | (17,551) |
| Treasury stock | | (897) | (1,488) |
| Additional capital in subsidiaries - non-controlling interest | | 163 | - |
| Net cash from (used in) financing activities | | 89,203 | (91,364) |
| Foreign exchange translation adjustments | | 1,379 | (4,154) |
| **NET CHANGE IN CASH AND CASH EQUIVALENTS** | | 32,673 | 75,362 |
| Cash and cash equivalents at beginning of the year | | 475,190 | 399,828 |
| **CASH AND CASH EQUIVALENTS AT END OF THE YEAR** | 23 | 507,863 | 475,190 |

The attached notes 1 to 44 form part of these consolidated financial statements.

# Notes to the consolidated financial statements

31 December 2010

## 1. Activities

BBK B.S.C. (the "Bank"), a public shareholding company, was incorporated in the Kingdom of Bahrain by an Amiri Decree in March 1971 and registered with the Ministry of Industry and Commerce under Commercial Registration number 1234 dated 16 March 1971. The Bank operates in Bahrain under a commercial banking license issued by the Central Bank of Bahrain and its shares are listed on the Bahrain Bourse Company.

The Bank is engaged in commercial banking activities through its branches in Bahrain, Kuwait and India and credit card operations and business process outsourcing services through its subsidiaries. The Bank's registered office is at 43 Government Avenue, P.O. Box 597, Manama, Kingdom of Bahrain.

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 30 January 2011.

## 2. Basis of consolidation *(Revised)*

The consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries (the "Group"), all of which have 31 December as their year end. The Bank has the following principal subsidiaries:

| Name | Ownership | Country of incorporation | Activity |
|---|---|---|---|
| CrediMax B.S.C. (c) | 100% | Kingdom of Bahrain | Credit card operations |
| Invita B.S.C. (c) | 100% | Kingdom of Bahrain | Business process outsourcing services |
| Capinnova Investment Bank B.S.C. (c) | 100% | Kingdom of Bahrain | Islamic investment banking |

CrediMax B.S.C. (c) owns 55% (2009: 66.67%) of the share capital of Global Payment Services W.L.L., which is engaged in processing and backup services relating to credit cards, debit cards and charge cards.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. Control is achieved where the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, using consistent accounting policies. All intra-group balances, transactions, unrealised gains and losses resulting from intra-group transactions and dividends are eliminated in full.

Non-controlling interests represent the portion of profit or loss and net assets not owned, directly or indirectly, by the Group and are presented separately in the consolidated statement of income and within equity in the consolidated statement of financial position, separately from parent shareholders' equity. Losses within a subsidiary are attributed to the non-controlling interest even if that results in a deficit balance. A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

- Derecognises the assets (including goodwill) and liabilities of the subsidiary
- Derecognises the carrying amount of any non-controlling interest
- Derecognises the cumulative translation differences, recorded in equity
- Recognises the fair value of the consideration received
- Recognises the fair value of any investment retained
- Recognises any surplus or deficit in profit or loss
- Reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss or retained earnings, as appropriate.

The change in accounting policy was applied prospectively and had no impact on earnings per share.

## 3. Basis of preparation and significant accounting policies

### Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and the applicable provisions of with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law.

### Basis of presentation

The consolidated financial statements are prepared on a historical cost basis, except for derivative financial instruments, available-for-sale investment securities, trading investments and financial assets held at fair value through statement of income, that have been measured at fair value. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and are otherwise carried at cost, are adjusted to record changes in fair values attributable to risks that are being hedged.

The consolidated financial statements are prepared in Bahraini Dinars which is the functional currency of the Bank.

### Changes in accounting policy and disclosures

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in the previous year except that the Group has adopted the following new and amended IASB Standards and International Financial Reporting Interpretations Committee (IFRIC) Interpretations during the year.

### IFRS 2 Share-based Payment *(Revised)*

The IASB issued an amendment to IFRS 2 that clarified the scope and the accounting for group cash-settled share-based payment transactions. The Group adopted this amendment as of 1 January 2010. It did not have an impact on the financial position or performance of the Group.

### 3. Basis of preparation and significant accounting policies continued

#### IFRS 3 Business Combinations *(Revised)* and IAS 27 Consolidated and Separate Financial Statements *(Amended)*

IFRS 3 (Revised) introduces significant changes in the accounting for business combinations occurring after becoming effective. Changes affect the valuation of non-controlling interest, the accounting for transaction costs, the initial recognition and subsequent measurement of a contingent consideration and business combinations achieved in stages. These changes will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs and future reported results.

IAS 27 (Amended) requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as a transaction with owners in their capacity as owners. Therefore, such transactions will no longer give rise to goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes by IFRS 3 (Revised) and IAS 27 (Amended) affect acquisitions or loss of control of subsidiaries and transactions with non-controlling interests after 1 January 2010.

The change in accounting policy was applied prospectively and had no impact on earnings per share.

#### IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items

The amendment clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as a hedged item. This also covers the designation of inflation as a hedged risk or portion in particular situations. The Group has concluded that the amendment will have no impact on the financial position or performance of the Group, as the Group has not entered into any such hedges.

#### IFRIC 17 Distribution of Non-cash Assets to Owners

This interpretation provides guidance on accounting for arrangements whereby an entity distributes non-cash assets to shareholders either as a distribution of reserves or as dividends. The interpretation has no effect on either the financial position nor performance of the Group.

#### Trading investments

Trading investments are held for a short-term period and are initially recognised at cost being the fair value of the consideration given and subsequently measured at fair value with any gain or loss arising from a change in fair value being included in the consolidated statement of income in the period in which it arises. Interest earned or dividends received are included in net trading income.

#### Financial assets designated at fair value through statement of income

Financial assets classified in this category are designated by management on initial recognition when the following criteria are met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis; or
- the assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows, that would not be separately recorded.

Financial assets at fair value through statement of income are recorded in the consolidated statement of financial position at fair value. Changes in fair value are recorded in 'Net gain or loss on financial assets designated at fair value through statement of income'. Interest earned is accrued in interest income, while dividend income is recorded in other income.

#### Deposits and due from banks and other financial institutions

These are stated at cost, adjusted for effective fair value hedges, less any amounts written off and provision for impairment.

#### Loans and advances to customers

Loans and advances to customers are stated at amortised cost, adjusted for effective fair value hedges, net of interest suspended, provision for impairment and any amounts written off.

#### Non-trading investment securities

These include bonds, equities, managed funds and other investments. Investments in managed funds comprise investments in mutual funds, private equity, real estate and credit structured products.

These are classified as follows:

- Available-for-sale
- Investments carried at amortised cost

All non-trading investments are initially recognised at cost, being the fair value of the consideration given, including incremental transaction costs.

***Investments carried at amortised cost***

Debt instruments which could be classified as loans and advances and which have fixed or determinable payments but are not quoted in an active market are treated as investments and carried at amortised cost, adjusted for effective fair value hedges, less provision for impairment. Premiums and discounts on non-trading investments with fixed or determinable repayments are amortised, using the effective interest rate method, and taken to interest income.

***Available-for-sale***

All other investments are classified as "available-for-sale". After initial recognition, available-for-sale investments are subsequently measured at fair value, unless fair value cannot be reliably measured in which case they are measured at cost less impairment. Fair value changes which are not part of an effective hedging relationship, are reported as a separate component of equity as cumulative changes in fair value until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as "cumulative changes in fair value" within equity, is included in the consolidated statement of income for the year.

That portion of any fair value changes relating to an effective hedging relationship is recognised directly in the consolidated statement of income.

#### Impairment and uncollectability of financial assets

The Group assesses at each statement of financial position date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of the financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, the probability that they will enter bankruptcy or other financial reorganisation, default or delinquency in interest or principal payments and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

*(i) Financial assets carried at amortised cost*

For financial assets carried at amortised cost (such as amounts due from banks, loans and advances to customers), the Group first assess individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the consolidated statement of income. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of 'interest income'. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group.

If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to provision for impairment.

The present value of estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal credit grading system, that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics such as asset type, industry, geographical location, collateral type, past due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

*(ii) Available-for-sale financial assets*

For available-for-sale investments, the Group assess at each statement of financial position date whether there is objective evidence that an investment is impaired.

In the case of debt instruments classified as available-for-sale, the Group assesses individually whether there is objective evidence of impairment based on the same criteria as financial assets carried at amortised cost. However, the amount recorded for impairment is the cumulative loss on the investment previously recognised in the consolidated statement of income. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of interest. If in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to a credit event occurring after the impairment loss was recognised in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

In the case of equity investments classified as available-for-sale, objective evidence would also include a 'significant' or 'prolonged' decline in the fair value of the investment below its cost. Where there is evidence of impairment 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 the consolidated statement of income is removed from equity and recognised in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income. Increases in fair value after impairment are recognised directly in equity.

*(iii) Renegotiated loans*

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

### Term borrowings

Financial instruments or their components issued by the Group, which are not designated at fair value through profit or loss, are classified as liabilities under 'term borrowings', where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

After initial measurement, term borrowings are subsequently measured at amortised cost using the effective interest rate. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.

## 3. Basis of preparation and significant accounting policies continued

### Derecognition of financial assets and financial liabilities

*Financial assets*

A financial asset (in whole or in part) is derecognised where:

- the rights to receive cash flow from the asset have expired;
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of ownership or (b) when it has neither transferred or retained substantially all the risks and rewards and when it no longer has control over the financial asset, but has transferred control of the asset.

*Financial liabilities*

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

### Fair values

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

Available-for-sale financial assets valued using a valuation technique or pricing models primarily consist of unquoted equities and debt securities.

These assets are valued using models which sometimes only incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

Other non-trading assets valued using a valuation technique consists of certain debt securities and asset-backed securities. The Group values the securities using valuation models which use discounted cash flow analysis which incorporates either only observable data or both observable and non-observable data. Observable inputs include assumptions regarding current rates of interest and real estate prices; unobservable inputs include assumptions regarding expected future default rates, prepayment rates and market liquidity discounts.

### Investment in associated companies and joint venture

An associate is a company in which the Group exerts significant influence, normally comprising an interest of 20% to 50% in the voting capital and is accounted for using the equity method of accounting. A joint venture is a contractual arrangement whereby the Group undertakes an economic activity with other entity (s) that is subject to joint control. The joint venture is also accounted for using the equity method of accounting. Under the equity method, the investments in the associates and joint venture are carried in the consolidated statement of financial position at cost plus post-acquisition changes in the Group's share of net assets of the associates and joint venture. The consolidated statement of income reflects the Group's share of the results of operations of the associates and joint venture. Where there has been a change recognised directly in the equity of the associate and joint venture, the Group recognises its share of any changes and discloses this, when applicable, in the consolidated statement of changes in equity.

### Premises and equipment

All items of premises and equipment are initially recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment, other than freehold land which is deemed to have an indefinite life.

### Collateral pending sale

The Group occasionally acquires real estate in settlement of certain loans and advances to customers. Such real estate is stated at the lower of the carrying value of the related facility and the current fair value of the collateral acquired, assessed on an individual basis. If the current fair value for any individual asset is lower, a provision is created. Gains or losses on disposal, and unrealised losses on revaluation, are recognised in the consolidated statement of income.

### Deposits

All money market and customer deposits are carried at the fair value of consideration received, adjusted for effective hedges, less amounts repaid.

### Repurchase and resale agreements

Securities sold under agreements to repurchase at a specified future date are not derecognised from the consolidated statement of financial position as the Group retains substantially all the risks and rewards of ownership. The corresponding cash received is recognised in the consolidated statement of financial position as an asset with a corresponding obligation to return it, including accrued interest as a liability, reflecting the transaction's economic substance as a loan to the Group. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of the agreement using the effective interest rate. When the counterparty has the right to sell or repledge the securities, the Group reclassifies those securities in its consolidated statement of financial position, as appropriate.

Conversely, securities purchased under agreements to resell at a specified future date are not recognised in the consolidated statement of financial position. The consideration paid, including accrued interest, is recorded in the consolidated statement of financial position, reflecting the transaction's economic substance as a loan by the Group. The difference between the purchase and resale prices is recorded in Interest income and is accrued over the life of the agreement using the effective interest rate. If securities purchased under agreement to resell are subsequently sold to third parties, the obligation to return the securities is recorded as a short sale within and measured at fair value with any gains or losses included in 'net interest income'.

### Taxation

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on foreign operations is provided in accordance with the fiscal regulations of the respective countries in which the Group operates.

### Employees' end of service benefits

Costs relating to employees' end of service benefits are accrued in accordance with actuarial and other valuations as required by regulations applicable in each location.

### Share-based payment transactions *(Revised)*

For equity-settled shared-based payment transaction the entity shall measure the services received, and the corresponding increase in equity at the fair value of the services received by reference to the fair value of the equity instruments granted. The fair value of those equity instruments shall be measured at grant date. The fair value so calculated at the grant date is recognised as an expense in the consolidated statement of income over the vesting period, with a corresponding credit to the retained earnings. When an employee leaves the Group during the vesting period the shares granted stand forfeited and any amount recognised in respect of these forfeited shares is reversed through the consolidated statement of income.

### Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) and the costs to settle the obligation are both probable and able to be reliably measured.

### Treasury stock
Treasury stock is deducted from equity and is stated at cost. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of own equity instruments.

### Proposed dividends
Proposed dividends are included as part of equity and only recognised as liabilities when approved by the shareholders. The payment of a dividend also requires the prior approval of the Central Bank of Bahrain.

### Financial guarantees
In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. All such guarantees are treated as memorandum liabilities and are disclosed as part of contingent liabilities. Financial guarantees are initially recognised in the consolidated financial statements at fair value, in 'other liabilities', being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee. Any increase in the liability relating to financial guarantees is taken to the consolidated statement of income in 'net provision for impairment'. The premium received is recognised in the consolidated statement of income in 'fee and commission income' on a straight line basis over the life of the guarantee.

### Derivatives
The Group enters into derivative instruments including futures, forwards, swaps, and options in the foreign exchange and capital markets. Derivatives are stated at fair value. Derivatives with positive market values are included in 'other assets' and derivatives with negative market values are included in 'other liabilities' in the consolidated statement of financial position.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through the consolidated statement of income. These embedded derivatives are measured at fair value with the changes in fair value recognised in the consolidated statement of income.

### Hedge accounting
The Group makes use of derivative instruments to manage exposures to interest rate and foreign currency risks. In order to manage particular risks, the Group applies hedge accounting for transactions which meet the specified criteria.

At inception of the hedge relationship, the Group formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship.

A formal assessment is also undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%. Hedges are formally assessed each quarter to reconfirm their effectiveness.

For the purposes of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (b) cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction.

#### *Fair value hedges*
In relation to fair value hedges, which meet the conditions for hedge accounting, any gain or loss from re-measuring the hedging instrument to fair value is recognised immediately in the consolidated statement of income. The hedged item is adjusted for fair value changes and the difference relating to the risk being hedged is recognised in the consolidated statement of income.

#### *Cash flow value hedges*
In relation to cash flow hedges which meet the conditions for hedge accounting the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised initially in equity and the ineffective portion is recognised in the consolidated statement of income. The gains or losses on effective cash flow hedges recognised initially in equity are either transferred to the consolidated statement of income in the period in which the hedged transaction impacts the consolidated statement of income or included in the initial measurement of the cost of the related asset or liability.

For hedges which do not qualify for hedge accounting, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated statement of income for the year.

#### *Discontinuation of hedges*
Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. For effective fair value hedges of financial instruments with fixed maturities any adjustment arising from hedge accounting is amortised over the remaining term to maturity. For effective cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of income.

### Fiduciary assets
Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and are, accordingly, not included in the consolidated statement of financial position.

### Offsetting
Financial assets and financial liabilities are only offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognised amounts and the Group intends to settle on a net basis.

### Recognition of income and expenses
Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

Interest income and loan commitment fees, which are considered an integral part of the effective yield of a financial asset, are recognised using the effective yield method unless collectability is in doubt. The recognition of interest income is suspended when loans become impaired, such as when overdue by more than ninety days. Notional interest is recognised on impaired loans and other financial assets based on the rate used to discount future cash flows to their net present value based on the original effective interest rate.

Interest expense is recognised using the effective yield method.

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees.

Other fees receivable are recognised when earned. Dividend income is recognised when the right to receive payment is established.

Where the Group enters into an interest rate swap to change interest from fixed to floating (or vice versa) the amount of interest income or expense is adjusted by the net interest on the swap.

### 3. Basis of preparation and significant accounting policies continued

#### Foreign currencies

*(i) Transactions and balances*

Transactions in foreign currencies are initially recorded at the functional currency rate of exchange ruling at the date of transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange at the statement of financial position date. All differences arising on non-trading activities are taken to 'other income' in the consolidated statement of income, with the exception of differences on foreign currency borrowings that provide an effective hedge against a net investment in foreign entity. These differences are taken directly to equity until the disposal of the net investment, at which time they are recognised in the consolidated statement of income.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations and translated at closing rate.

*(ii) Group companies*

As at the reporting date, the assets and liabilities of subsidiaries and overseas branches are translated into the Group's presentation currency at the rate of exchange as at the statement of financial position date, and their statements of income are translated at the weighted average exchange rates for the year. Exchange differences arising on translation are taken directly to a separate component of equity through the consolidated statement of comprehensive income. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the consolidated statement of income.

#### Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with central banks (excluding mandatory reserve deposits), treasury bills, deposits and due from banks and other financial institutions with original maturities of ninety days or less.

#### Trade date accounting and settlement date accounting

All "regular way" purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

#### Significant accounting judgments and estimates

In the process of applying the Group's accounting policies, management has exercised judgment and estimates in determining the amounts recognised in the consolidated financial statements. The most significant uses of judgment and estimates are as follows:

*Going concern*

The Group's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future. Furthermore, the management is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

*Fair value of financial instruments*

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgment is required to establish fair values. The judgments include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities.

*Classification of investments*

Management decides on acquisition of an investment whether it should be classified as held for trading, held to maturity, available-for-sale, fair value through statement of income or investments carried at amortised cost.

The Group classifies investments as trading if they are acquired primarily for the purpose of making a short term profit.

The Group classifies debt instruments as carried at amortised cost if the debt instruments are not quoted in an active market.

The Group classifies investments which it intends and has the ability to hold to maturity as held-to-maturity.

The Group classifies financial instruments which contain embedded derivatives which cannot be separated from the host instrument as carried at fair value through statement of income.

All other investments are classified as available-for-sale.

*Impairment losses on loans and advances and investments*

The Group reviews its individually significant loans and advances at each statement of financial position date to assess whether an impairment loss should be recorded in the consolidated statement of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Group makes judgments about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio, concentrations of risks and economic data.

*Collective impairment provisions on loans and advances*

In addition to specific provisions against individually significant loans and advances, the Group also makes a collective impairment provision against groups of loans and advances which have not been identified for allocating specific provision but carry higher risk of default than originally perceived when the assets were booked.

*Impairment of non-trading investment securities*

The Group reviews its debt securities classified as available-for-sale investments at each statement of financial position date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and advances. The Group also records impairment charges on available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is 'significant' or 'prolonged' requires judgment. In making this judgment, the Group evaluates, among other factors, historical share price movements and duration and the extent to which the fair value of an investment is less than its cost.

### New standards and interpretations issued but not yet effective

*IFRS 9 Financial instruments*

IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets. The standard is effective for the annual period beginning on or after 1 January 2013. The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

## 4. Cash and balances with central banks

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Cash | 10,385 | 12,303 |
| Current account and placements with central banks | 287,954 | 105,959 |
| Mandatory reserve deposits with central banks | 60,587 | 44,146 |
| | 358,926 | 162,408 |

Mandatory reserve deposits are not available for use in the Group's day to day operations.

## 5. Treasury bills

These are short term treasury bills issued by the Government of the Kingdom of Bahrain and Republic of India, carried at amortised cost.

## 6. Deposits and due from banks and other financial institutions

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Deposits with banks and other financial institutions | 141,172 | 294,422 |
| Other amounts due from banks | 29,865 | 67,985 |
| | 171,037 | 362,407 |

## 7. Loans and advances to customers

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Commercial loans and overdrafts | 1,156,898 | 1,163,473 |
| Consumer loans | 202,105 | 169,458 |
| | 1,359,003 | 1,332,931 |
| Less: Allowance for impairment and interest in suspense | (82,687) | (64,370) |
| | 1,276,316 | 1,268,561 |

Movements in allowance for impairment and interest in suspense are as follows:

| 2010 | Commercial loans and overdrafts BD '000 | Consumer loans BD '000 | Total BD '000 |
|---|---|---|---|
| Balance at 1 January | 57,826 | 6,544 | 64,370 |
| Charge for the year | 19,049 | 3,972 | 23,021 |
| Recoveries/write-backs | (4,050) | (1,253) | (5,303) |
| Interest suspended during the year | 2,431 | 7 | 2,438 |
| Amounts written off during the year | (836) | (908) | (1,744) |
| Interest recognised on impaired loans | (744) | - | (744) |
| Exchange and other movements | 683 | (34) | 649 |
| Balance at 31 December | 74,359 | 8,328 | 82,687 |
| Individual impairment | 60,643 | 8,311 | 68,954 |
| Collective impairment | 13,716 | 17 | 13,733 |
| **Gross amount of loans, individually determined to be impaired** | 93,785 | 29,978 | 123,763 |

| 2009 | Commercial loans and overdrafts BD '000 | Consumer loans BD '000 | Total BD '000 |
|---|---|---|---|
| Balance at 1 January | 51,443 | 4,452 | 55,895 |
| Charge for the year | 9,093 | 3,462 | 12,555 |
| Recoveries/write-backs | (611) | (653) | (1,264) |
| Interest suspended during the year | 3,923 | 9 | 3,932 |
| Amounts written off during the year | (4,872) | (742) | (5,614) |
| Interest recognised on impaired loans | (699) | - | (699) |
| Exchange and other movements | (451) | 16 | (435) |
| Balance at 31 December | 57,826 | 6,544 | 64,370 |
| Individual impairment | 51,593 | 6,529 | 58,122 |
| Collective impairment | 6,233 | 15 | 6,248 |
| **Gross amount of loans, individually determined to be impaired** | 124,730 | 15,152 | 139,882 |

The fair value of the collateral consisting of cash, securities, letters of guarantee and properties that the Group holds relating to loans individually determined to be impaired at 31 December 2010 amounts to BD 56,330 thousand (2009: BD 72,182 thousand).

The gross amount of loans determined to be impaired in 2010, relate to non-Bahrain loans for which restructuring has commenced in 2010. Management expects that the restructuring process for these loans will be completed in 2011.

### 8. Non-trading investment securities

| | Available-for-sale BD '000 | Carried at amortised cost BD '000 | Total 2010 BD '000 | Total 2009 BD '000 |
|---|---|---|---|---|
| **Quoted investments** | | | | |
| Government bonds | 89,403 | - | 89,403 | 32,222 |
| Other bonds | 158,367 | 7,581 | 165,948 | 130,220 |
| Equities | 28,421 | - | 28,421 | 27,091 |
| Managed funds | 2,855 | - | 2,855 | 1,782 |
| | 279,046 | 7,581 | 286,627 | 191,315 |
| **Unquoted investments** | | | | |
| Government bonds | 45,186 | 51,395 | 96,581 | 97,570 |
| Other bonds | 61,699 | 755 | 62,454 | 81,060 |
| Equities | 33,873 | - | 33,873 | 43,726 |
| Managed funds | 8,551 | - | 8,551 | 8,705 |
| | 149,309 | 52,150 | 201,459 | 231,061 |
| | 428,355 | 59,731 | 488,086 | 422,376 |
| Allowance for impairment | (62,658) | - | (62,658) | (65,225) |
| **Balance at 31 December 2010** | 365,697 | 59,731 | 425,428 | |
| Balance at 31 December 2009 | 306,578 | 50,573 | | 357,151 |

Included under available-for-sale investments are unquoted investments amounting to BD 83,564 thousand (2009: BD 108,420 thousand), which are recorded at cost since their fair value cannot be reliably estimated. There is no market for these investments and the Group intends to hold them for the long term.

#### Impaired investments

Gross amount of investments, determined to be impaired, before deducting any assessed impairment allowance:

| | Available-for-sale 2010 BD '000 | Available-for-sale 2009 BD '000 |
|---|---|---|
| Unquoted investments | 59,107 | 64,392 |

#### Allowance for impairment

The movements in allowance for impairment of non-trading investment securities are as follows:

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Balance at 1 January | 65,225 | 70,205 |
| Charge for the year | 6,001 | 3,228 |
| Recoveries | - | (276) |
| Amounts written off | (7,959) | (7,991) |
| Exchange and other movements | (609) | 59 |
| **Balance at 31 December** | **62,658** | **65,225** |

### 9. Investments in associated companies and joint venture

The Group has a 23% (2009: 23%) shareholding in Bahrain Commercial Facilities Company B.S.C. (BCFC), incorporated in the Kingdom of Bahrain, which is engaged in consumer financing, insurance, dealing in real estate and automobiles.

The Group has a 50% (2009: 50%) stake in Sakana Holistic Housing Solutions B.S.C. (c) ("Sakana"), a jointly controlled company incorporated in the Kingdom of Bahrain which is engaged in Islamic real estate financing.

The Group has a 22% (2009: 22%) shareholding in The Benefit Company B.S.C. (c) incorporated in the Kingdom of Bahrain which is engaged in ancillary services to provide payment systems and other related financial services for the benefit of the commercial banks and their customers in the Kingdom of Bahrain.

During the year the Group acquired a 36.36% stake in EBLA Computer Consultancy K.S.C.C. (2009: nil). EBLA Computer Consultancy K.S.C.C. (EBLA) was incorporated in Kuwait and engaged in the provision of IT solutions and IT consultancy services in the Middle East.

The following tables illustrate summarised financial information of the Group's interest in these entities:

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| *Carrying amount of investment in associate companies and joint venture* | | |
| At 1 January | 27,472 | 27,007 |
| Rights issue | - | 175 |
| Acquisitions during the year | 6,866 | - |
| Share of profit | 2,328 | 2,663 |
| Dividends received from associated company | (1,383) | (1,357) |
| Change in unrealised fair values - associated companies *(note 17)* | (163) | (1,016) |
| At 31 December | 35,120 | 27,472 |

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| *Share of associates and joint venture statements of financial position* | | |
| Current and non-current assets | 73,487 | 62,357 |
| Current and non-current liabilities | (38,367) | (34,885) |
| **Net assets** | **35,120** | **27,472** |
| *Share of associated companies and joint venture revenues* | | |
| Revenue | 3,387 | 3,092 |

The results and statement of financial positions of BCFC and The Benefit Company accounted for in these consolidated financial statements are based on the twelve month period ended 30 September 2010, being the latest available information. There have been no significant transactions or events between 30 September 2010 and the statement of financial position date.

The results and statement of financial position of Sakana and EBLA are for the year ended 31 December 2010.

### 10. Interest receivable and other assets

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Interest receivable | 6,367 | 4,856 |
| Accounts receivable | 8,305 | 2,545 |
| Positive fair value of derivatives *(note 26)* | 1,292 | 1,093 |
| Prepaid expenses | 627 | 699 |
| Deferred tax | - | 344 |
| Advance tax | 231 | 207 |
| Collateral pending sale | 50 | 50 |
| Other | 4,224 | 1,441 |
| | 21,096 | 11,235 |

## 11. Premises and equipment

| | Freehold land BD '000 | Leasehold properties & buildings BD '000 | Furniture & equipment BD '000 | Capital work in progress BD '000 | Total BD '000 |
|---|---|---|---|---|---|
| **Net book value at 31 December 2010** | **12,819** | **5,183** | **10,776** | **304** | **29,082** |
| Net book value at 31 December 2009 | 12,279 | 3,567 | 10,685 | 1,472 | 28,003 |

The depreciation charge for the year amounted to BD 3,261 thousand (2009: BD 2,762 thousand).

## 12. Term borrowings

The term borrowings were obtained for general financing purposes and comprise:

| Amount of facility USD '000 | Rate of interest | Maturity year | 2010 BD '000 | 2009 BD '000 |
|---|---|---|---|---|
| 500,000 | Libor + 0.45% | 2011 | **120,939** | 186,966 |
| 275,000 | Libor + 0.75% | 2017 | **61,029** | 70,207 |
| 500,000 | 4.50% | 2015 | **188,311** | - |
| | | | **370,279** | 257,173 |

The Bank redeemed BD 75,205 thousand of its own subordinated debt and senior notes (2009: BD 25,200 thousand) resulting in a profit of BD 2,227 thousand (2009: BD 7,687 thousand) which is included in interest and similar expense.

During the year, the Group issued notes of USD 500,000 thousand (BD 188,500 thousand) @ 4.5% fixed per annum. The Group entered into an interest rate swap for USD 275,000 thousand (BD 103,675 thousand) which has been designated as fair value hedge in the Group's financial statements. Please refer to note 39 for further details. No ineffectiveness from the hedge of subordinated debt was recognised in the consolidated statement of income during the year.

## 13. Customers' current, savings and other deposits

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Term deposits | **1,005,987** | 995,688 |
| Current accounts | **309,954** | 289,049 |
| Savings accounts | **209,871** | 185,169 |
| Other accounts | **67,764** | 47,003 |
| | **1,593,576** | 1,516,909 |

## 14. Interest payable and other liabilities

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Accrued expenses | **20,158** | 18,694 |
| Interest payable | **7,292** | 4,787 |
| Accounts payable | **9,986** | 5,386 |
| Negative fair value of derivatives *(note 26)* | **5,580** | 1,888 |
| Other | **2,585** | 3,482 |
| | **45,601** | 34,237 |

## 15. Equity

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| **Share Capital** | | |
| *Authorised* | | |
| **1,000,000,000 shares of BD 0.100 each** | **100,000** | 100,000 |
| *Issued and fully paid* | | |
| 851,356,126 shares (2009: 851,356,126 shares) of BD 0.100 each | **85,135** | 85,135 |
| **Treasury stock** | **(3,742)** | (2,845) |

Treasury stock represents the purchase by the Bank of its own shares. At the end of the year, the Bank held 12,156,806 (2009: 10,043,350) of its own shares, inclusive of bonus shares issued during 2010. Treasury stock does not carry the right to vote or to receive dividends.

### Share premium

The share premium arising on issue of ordinary shares is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

### Employee Performance Share Plan

The Group has an Employee Performance Share Plan under which shares are granted to certain eligible employees *(note 40)*.

## 16. Reserves

### Statutory reserve

The statutory reserve has been created in accordance with the Bahrain Commercial Companies Law. The Bank transfers 10% of its annual profit to its statutory reserve till such time as the reserve equals 50% of the paid up share capital of the Bank. The reserve is not available for distribution, except in circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

### General reserve

The general reserve has been built up in accordance with the provisions of the Bank's Articles of Association and underlines the shareholders' commitment to enhance the strong equity base of the Bank. The general reserve is distributable subject to the approval of the Central Bank of Bahrain.

## 17. Cumulative changes in fair values

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| ***Available-for-sale investments*** | | |
| At 1 January | **2,512** | (8,330) |
| Realised on sale during the year | **(11,295)** | 3,983 |
| Transferred to statement of income on impairment | **(1,296)** | - |
| Change in unrealised fair values during the year | **5,365** | 6,859 |
| At 31 December | **(4,714)** | 2,512 |
| ***Cash flow hedges*** | | |
| At 1 January | **(1,588)** | (572) |
| Change in unrealised fair values - associated companies *(note 9)* | **(163)** | (1,016) |
| At 31 December | **(1,751)** | (1,588) |
| | **(6,465)** | 924 |

## 18. Proposed appropriations

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Dividend | **20,980** | 21,033 |
| Transfer to general reserve | **9,000** | 7,000 |
| Donations | **1,700** | 1,800 |
| Directors' remuneration* | **-** | 525 |
| | **31,680** | 30,358 |

** For the current year the Bank has charged Director's remuneration of BD 525 thousand to statement of income which is included in operating expenses.*

The Board of Directors have proposed a cash dividend of BD 0.025 per share (2009: BD 0.025 per share), net of treasury stock.

The above appropriations will be submitted for formal approval at the Annual General Assembly of the shareholders to be held on 6 March 2011. The payment of dividend is also subject to the approval of the Central Bank of Bahrain.

## 19. Interest and similar income

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Loans and advances to customers | **68,741** | 70,417 |
| Non-trading investment securities - available-for-sale | **9,262** | 6,704 |
| Deposits and due from banks and other financial institutions | **3,418** | 3,204 |
| Non-trading investment securities - amortised cost | **1,513** | 1,264 |
| Notional interest on impaired financial assets - loans and advances to customers *(note 7)* | **744** | 699 |
| Treasury bills | **1,245** | 134 |
| | **84,923** | 82,422 |

## 20. Other income

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Fee and commission income | **27,322** | 24,224 |
| Dividend income | **2,905** | 3,420 |
| Gain (loss) on non-trading investment securities | **19,128** | (249) |
| Income from managed funds | **84** | 133 |
| Trading income | **75** | (3) |
| Gain on foreign exchange | **3,331** | 3,112 |
| Other | **2,419** | 1,987 |
| | **55,264** | 32,624 |
| Fee and commission expense | **(4,469)** | (4,022) |
| | **50,795** | 28,602 |

Included in fee and commission income is BD 69 thousand (2009: BD 132 thousand) relating to trust and other fiduciary activities.

Other income for the year ended 31 December 2010 includes BD 17,135 thousand (2009: nil) relating to gain on sale of a non-trading investment security.

## 21. Basic and diluted earnings per share

### Basic earnings per share

Basic earnings per share for the year are calculated by dividing the profit for the year by the weighted average number of shares outstanding during the year as follows:

| | 2010 | 2009 |
|---|---|---|
| Profit for the year attributable to the shareholders of the Bank (BD '000) | **39,142** | 35,013 |
| Weighted average number of shares, net of treasury stock, outstanding during the year | **839,199,320** | 841,312,774 |
| **Basic earnings per share (BD)** | **0.047** | **0.042** |

### Diluted earnings per share

Diluted earnings per share is calculated by dividing the net profit attributable to ordinary equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive shares into ordinary shares.

| | 2010 | 2009 |
|---|---|---|
| Profit for the year attributable to the shareholders of the Bank (BD '000) | **39,142** | 35,013 |
| Weighted average number of shares, net of treasury stock, outstanding during the year | **839,199,320** | 841,312,774 |
| Share Options | **88,222** | - |
| Employee performance share plan | **2,003,046** | - |
| Weighted average number of ordinary shares adjusted for the effect of dilution | **841,290,588** | 841,312,774 |
| **Diluted earnings per share (BD)** | **0.047** | **0.042** |

There have been no transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of the completion of these financial statements which would require the restatement of earnings per share.

## 22. Operating segments

### Segment information

For management purposes the Group is organised into four major business segments:

| | |
|---|---|
| **Retail banking** | Principally handling individual customers' deposits and providing consumer finance type loans, overdrafts, credit facilities and funds transfer facilities, credit cards and foreign exchange. |
| **Corporate banking** | Principally handling loans and other credit facilities, deposit and current accounts for corporate and institutional customers in Bahrain. |
| **International banking** | Principally handling loans and other credit facilities, deposit and current accounts for international corporate and institutional customers. This also covers the operations of the overseas units. |
| **Investment, treasury and other activities** | Principally providing money market, trading and treasury services as well as the management of the Group's funding operations. Investment activities involve handling investments in local and international markets, investment advisory services and funds management. Other activities also include business process outsourcing services. |

These segments are the basis on which the Group reports its information to the chief operating decision maker. Transactions between segments are generally recorded at estimated market rates on an arm's length basis. Interest is charged/credited to business segments based on a transfer pricing rate which approximates the marginal cost of funds on a matched funded basis.

Segment information for the year ended 31 December 2010 was as follows:

| 2010 | Retail banking BD '000 | Corporate banking BD '000 | International banking BD '000 | Investment, treasury and other activities BD '000 | Total BD '000 |
|---|---|---|---|---|---|
| Operating income before provisions | 30,943 | 19,187 | 34,167 | 22,453 | 106,750 |
| Net provision for impairment on loans and advances to customers | (3,129) | (2,447) | (12,142) | - | (17,718) |
| Net provision for impairment of non-trading investment securities | - | - | - | (6,001) | (6,001) |
| Segment result | 10,577 | 3,094 | 11,161 | 11,983 | 36,814 |
| Income from associated companies and joint venture | - | - | - | - | 2,328 |
| Profit for the year attributable to the shareholders of the Bank | | | | | 39,142 |
| Segment assets | 312,595 | 502,979 | 897,679 | 675,626 | 2,388,879 |
| Investment in associated companies and joint venture | - | - | - | - | 35,120 |
| Common assets | - | - | - | - | 23,178 |
| **Total assets** | | | | | 2,447,177 |
| Segment liabilities | 447,029 | 769,008 | 619,063 | 343,131 | 2,178,231 |
| Common liabilities | - | - | - | - | 28,404 |
| **Total liabilities** | | | | | 2,206,635 |

Segment information for the year ended 31 December 2009 was as follows:

| 2009 | Retail banking BD '000 | Corporate banking BD '000 | International banking BD '000 | Investment, treasury and other activities BD '000 | Total BD '000 |
|---|---|---|---|---|---|
| Operating income before provisions | 28,806 | 22,393 | 20,621 | 18,079 | 89,899 |
| Net provision for impairment on loans and advances to customers | (2,563) | (1,660) | (7,068) | - | (11,291) |
| Net provision for impairment of non-trading investment securities | - | - | - | (2,952) | (2,952) |
| Segment result | 10,192 | 7,974 | 5,070 | 9,114 | 32,350 |
| Income from associated companies and joint venture | - | - | - | - | 2,663 |
| Profit for the year attributable to the shareholders of the Bank | | | | | 35,013 |
| Segment assets | 269,772 | 537,750 | 1,079,769 | 342,104 | 2,229,395 |
| Investment in associated companies and joint venture | - | - | - | - | 27,472 |
| Common assets | - | - | - | - | 22,025 |
| Total assets | | | | | 2,278,892 |
| Segment liabilities | 380,489 | 701,165 | 824,672 | 118,690 | 2,025,016 |
| Common liabilities | - | - | - | - | 22,882 |
| Total liabilities | | | | | 2,047,898 |

## 22. Operating segments continued

### Geographic information

The Group operates in five geographic markets: Domestic (Bahrain), Others (Middle East/Africa, Europe, North America and Asia). The following tables show the distribution of the Group's revenue and non-current assets by geographical segment, allocated based on the location in which the assets and liabilities are located, for the years ended 31 December 2010 and 2009:

| | Domestic BD '000 | Others BD '000 | Total BD '000 |
|---|---|---|---|
| **31 December 2010** | | | |
| Net interest income | 47,394 | 8,561 | 55,955 |
| Share of profit in associated companies and joint venture | 1,370 | 958 | 2,328 |
| Other income | 35,665 | 15,130 | 50,795 |
| | 84,429 | 24,649 | 109,078 |
| **Non-current assets** | 23,837 | 5,245 | 29,082 |
| 31 December 2009 | | | |
| Net interest income | 54,053 | 7,244 | 61,297 |
| Share of profit in associated companies and joint venture | 2,663 | - | 2,663 |
| Other income | 25,579 | 3,023 | 28,602 |
| | 82,295 | 10,267 | 92,562 |
| Non-current assets | 22,704 | 5,299 | 28,003 |

Non-current assets represents premises and equipment.

## 23. Cash and cash equivalents

Cash and cash equivalents included in the consolidated statement of cash flows include the following statement of financial position amounts:

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Cash *(note 4)* | 10,385 | 12,303 |
| Current account and placements with central banks *(note 4)* | 287,954 | 105,959 |
| Treasury bills | 76,358 | 45,666 |
| Deposits and due from banks and other financial institutions with an original maturities of ninety days or less | 133,166 | 311,262 |
| | 507,863 | 475,190 |

## 24. Related party transactions

Related parties represent major shareholders, associates and the joint venture, directors and key management personnel of the Group and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Group's management.

Amounts outstanding as of the statement of financial position date in respect of transactions entered into with related parties were as follows:

| | Major shareholders BD '000 | Associated companies and joint venture BD '000 | Directors and key management BD '000 | Total BD '000 |
|---|---|---|---|---|
| **2010** | | | | |
| Loans and advances to customers | - | 8,672 | 1,244 | 9,916 |
| Customers' current, savings and other deposits | 205,590 | 470 | 1,985 | 208,045 |
| 2009 | | | | |
| Loans and advances to customers | - | 9,968 | 3,549 | 13,517 |
| Non-trading investment securities | - | 4,054 | - | 4,054 |
| Customers' current, savings and other deposits | 199,852 | 336 | 3,474 | 203,662 |

No provision is required in respect of loans given to related parties (2009: nil).

The income and expense in respect of related parties included in the consolidated statement of income are as follows:

| | Major shareholders BD '000 | Associated companies and joint venture BD '000 | Directors and key management BD '000 | Total BD '000 |
|---|---|---|---|---|
| **2010** | | | | |
| **Interest income** | 16 | 572 | 18 | 606 |
| **Interest expense** | 6,967 | - | 32 | 6,999 |
| 2009 | | | | |
| Interest income | 375 | 708 | 37 | 1,120 |
| Interest expense | 5,509 | 2 | 60 | 5,571 |

Compensation of the key management personnel is as follows:

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Short term employee benefits | 7,702 | 6,563 |
| Others | 617 | 196 |
| | 8,319 | 6,759 |

### Key management interest in an employee share incentive scheme

During the year the Bank has introduced a new share-based payment scheme refer (note 40) for details.

### 25. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled. However it does not reflect the rollover of deposits and borrowings. See note on liquidity risk for the Group's contractual undiscounted repayment obligations (note 38).

| 31 December 2010 | Within 1 month BD '000 | 1 to 3 months BD '000 | 3 to 6 months BD '000 | 6 to 12 months BD '000 | Subtotal BD '000 | 1 to 5 years BD '000 | 5 to 10 years BD '000 | 10 to 20 years BD '000 | More than 20 years BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | | | |
| Cash and balances with central banks | 298,158 | - | - | - | 298,158 | - | - | - | 60,768 | 358,926 |
| Treasury bills | 40,410 | 35,948 | 5,798 | 48,016 | 130,172 | - | - | - | - | 130,172 |
| Deposits and due from banks and other financial institutions | 138,701 | 30,717 | - | - | 169,418 | 1,619 | - | - | - | 171,037 |
| Loans and advances to customers | 108,549 | 97,126 | 62,007 | 99,749 | 367,431 | 445,210 | 289,896 | 48,019 | 125,760 | 1,276,316 |
| Non-trading investment securities | 181,172 | 18,636 | 34,756 | 13,487 | 248,051 | 68,844 | 50,576 | 3,940 | 54,017 | 425,428 |
| Investments in associated companies and joint venture | - | - | - | - | - | - | - | - | 35,120 | 35,120 |
| Interest receivable and other assets | 19,775 | 207 | 177 | 109 | 20,268 | 233 | - | - | 595 | 21,096 |
| Premises and equipment | - | - | - | - | - | - | - | - | 29,082 | 29,082 |
| **Total assets** | 786,765 | 182,634 | 102,738 | 161,361 | 1,233,498 | 515,906 | 340,472 | 51,959 | 305,342 | 2,447,177 |
| **Liabilities** | | | | | | | | | | |
| Deposits and due to banks and other financial institutions | 159,878 | 10,057 | 38 | 25,528 | 195,501 | - | - | - | - | 195,501 |
| Borrowings under repurchase agreement | 1,678 | - | - | - | 1,678 | - | - | - | - | 1,678 |
| Term borrowings | - | 120,939 | - | - | 120,939 | 188,311 | 61,029 | - | - | 370,279 |
| Customers' current, savings and other deposits | 184,692 | 101,326 | 70,628 | 27,665 | 384,311 | 12,634 | - | - | 1,196,631 | 1,593,576 |
| Interest payable and other liabilities | 44,607 | 311 | 218 | 152 | 45,288 | 119 | - | - | 194 | 45,601 |
| **Total liabilities** | 390,855 | 232,633 | 70,884 | 53,345 | 747,717 | 201,064 | 61,029 | - | 1,196,825 | 2,206,635 |
| Net | 395,910 | (49,999) | 31,854 | 108,016 | 485,781 | 314,842 | 279,443 | 51,959 | (891,483) | 240,542 |
| Cumulative | 395,910 | 345,911 | 377,765 | 485,781 | | 800,623 | 1,080,066 | 1,132,025 | 240,542 | |

| 31 December 2009 | Within 1 month BD '000 | 1 to 3 months BD '000 | 3 to 6 months BD '000 | 6 to 12 months BD '000 | Subtotal BD '000 | 1 to 5 years BD '000 | 5 to 10 years BD '000 | 10 to 20 years BD '000 | More than 20 years BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | | | |
| Cash and balances with central banks | 118,167 | 270 | 677 | 587 | 119,701 | 796 | - | - | 41,911 | 162,408 |
| Treasury bills | 20,707 | 24,960 | 5,635 | 10,353 | 61,655 | - | - | - | - | 61,655 |
| Deposits and due from banks and other financial institutions | 361,951 | 456 | - | - | 362,407 | - | - | - | - | 362,407 |
| Loans and advances to customers | 82,542 | 77,768 | 47,390 | 81,651 | 289,351 | 506,091 | 227,424 | 86,544 | 159,151 | 1,268,561 |
| Non-trading investment securities | 119,436 | 34,403 | 27,035 | 32,810 | 213,684 | 51,356 | 24,099 | - | 68,012 | 357,151 |
| Investments in associated companies and joint venture | - | - | - | - | - | - | - | - | 27,472 | 27,472 |
| Interest receivable and other assets | 9,727 | 282 | 94 | 26 | 10,129 | 550 | - | - | 556 | 11,235 |
| Premises and equipment | - | - | - | - | - | - | - | - | 28,003 | 28,003 |
| **Total assets** | 712,530 | 138,139 | 80,831 | 125,427 | 1,056,927 | 558,793 | 251,523 | 86,544 | 325,105 | 2,278,892 |
| **Liabilities** | | | | | | | | | | |
| Deposits and due to banks and other financial institutions | 219,784 | 12,202 | 7,540 | 53 | 239,579 | - | - | - | - | 239,579 |
| Term borrowings | - | - | - | - | - | 186,966 | 70,207 | - | - | 257,173 |
| Customers' current,savings and other deposits | 297,326 | 181,460 | 44,676 | 14,846 | 538,308 | 12,776 | 5 | - | 965,820 | 1,516,909 |
| Interest receivable and other liabilities | 33,137 | 294 | 165 | 153 | 33,749 | 330 | - | - | 158 | 34,237 |
| **Total liabilities** | 550,247 | 193,956 | 52,381 | 15,052 | 811,636 | 200,072 | 70,212 | - | 965,978 | 2,047,898 |
| Net | 162,283 | (55,817) | 28,450 | 110,375 | 245,291 | 358,721 | 181,311 | 86,544 | (640,873) | 230,994 |
| Cumulative | 162,283 | 106,466 | 134,916 | 245,291 | | 604,012 | 785,323 | 871,867 | 230,994 | |

## 26. Derivatives

A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in the price in one or more underlying financial instrument, reference rate or index. In the ordinary course of business, the Group enters into various types of transactions that involve derivative financial instruments. The use of derivatives is governed by the Group's policies approved by the Board of Directors. The Group enters into derivative contracts for the purpose of reducing risks from potential movements in foreign exchange rates and interest rates inherent in the Group's non-trading assets and liabilities. The Group also enters into derivative contracts for the purpose of trading.

The table below shows the positive and negative fair values of derivative financial instruments together with the notional amounts. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at year end but are neither indicative of the market risk nor credit risk.

| | Positive fair value BD '000 | Negative fair value BD '000 | Notional amount BD '000 |
|---|---|---|---|
| **31 December 2010** | | | |
| **Derivatives held for trading** | | | |
| Forward foreign exchange contracts | **298** | **262** | **20,211** |
| Options | **95** | **95** | **3,496** |
| **Derivatives held as fair value hedges** | | | |
| Interest rate swaps | **456** | **4,587** | **206,693** |
| Forward foreign exchange contracts | **443** | **636** | **161,206** |
| | **1,292** | **5,580** | **391,606** |
| 31 December 2009 | | | |
| Derivatives held for trading | | | |
| Interest rate swaps | 24 | 14 | 18,850 |
| Forward foreign exchange contracts | 442 | 296 | 15,102 |
| **Derivatives held as fair value hedges** | | | |
| Interest rate swaps | 354 | 1,509 | 62,184 |
| Forward foreign exchange contracts | 273 | 69 | 31,825 |
| | 1,093 | 1,888 | 127,961 |

### Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and interest rate futures are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. Forward rate agreements are effectively tailor-made interest rate futures which fix a forward rate of interest on a notional amount, for an agreed period of time starting on a specified future date.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency. For currency swaps, fixed or floating interest payments and notional amounts are exchanged in different currencies.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period. The Group does not engage in the writing of options.

### Derivatives held or issued for trading purposes

Most of the Group's derivative trading activities relate to back to back customer deals. In addition, the Group takes certain foreign exchange positions with the expectation of profiting from favourable movements in prices, rates or indices. Also included under this heading are derivatives which do not meet IAS 39 hedging requirements.

### Derivatives held or issued for hedging purposes

The Group has put in place systems for the measurement and management of risk. Part of the risk management process involves managing the Group's exposure to fluctuations in foreign exchange rates (currency risk) and interest rates through asset and liability management activities. It is the Group's policy to reduce its exposure to currency and interest rate risks to acceptable levels as determined by the Board of Directors. For strategies adopted to manage interest rate and currency risk, please refer notes 35 and 36 respectively.

As part of its asset and liability management the Group uses derivatives for hedging currency and interest rate movements. This is achieved by hedging specific financial instruments, forecasted transactions as well as strategic hedging against consolidated statement of financial position sheet exposures. In all such cases the objective of the hedging relationship, details of the hedged item and hedging instrument are documented and the transactions are accounted for as fair value or cash flow hedges, as the case may be.

### Fair value hedges

Fair value hedges are used by the Group to protect it against changes in the fair value of financial assets and financial liabilities due to movements in exchange rates and interest rates. The financial instruments hedged for interest rate risk include loans, available-for-sale debt securities, debt issued and other borrowed funds. The Group uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks, and interest rate swaps to hedge interest rate risk.

For the year ended 31 December 2010, the Group recognised a net loss of BD 353 thousand (2009: net gain of BD 221 thousand), representing the loss on the hedging instruments. The total gain on hedged items attributable to the hedged risk amounted to BD 354 thousand (2009: loss of BD 232 thousand).

## 27. Commitments and contingent liabilities

### Credit-related commitments

Credit-related commitments include commitments to extend credit, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Group's customers.

Commitments to extend credit represent the unused portions of contractual commitments to make loans and revolving credits, principally in the form of loans and advances, guarantees and letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of loss, which cannot readily be quantified, is expected to be considerably less than the total unused commitment as most of the commitments to extend credit are contingent upon the customer maintaining specific credit standards. Commitments generally have fixed expiration dates of less than one year or other termination clauses. Since commitments may expire without being drawn upon, the total contracted amounts do not necessarily represent future cash requirements.

Letters of credit, guarantees (including standby letters of credit) and acceptances commit the Group to make payments on behalf of customers contingent upon certain conditions. Standby letters of credit, which are included under guarantees, would have market risk if issued or extended at a fixed rate of interest. However, these contracts are primarily made at a floating rate.

The Group has the following credit related commitments:

| 31 December 2010 | On demand BD '000 | Less than 3 months BD '000 | 3 to 12 months BD '000 | 1 to 5 years BD '000 | Over 5 years BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|
| **Contingencies** | | | | | | |
| Letters of credit | 5,035 | 32,173 | 26,469 | - | - | 63,677 |
| Guarantees | 21,480 | 46,569 | 190,219 | 6,147 | 3,720 | 268,135 |
| Acceptances | 1,920 | 10,603 | 10,340 | - | - | 22,863 |
| | | | | | | 354,675 |
| **Commitments** | | | | | | |
| Undrawn loan commitments | 35,612 | 26,381 | 107,442 | 7,914 | 6,063 | 183,412 |
| Commitments in respect of investments | - | - | - | 452 | - | 452 |
| | | | | | | 183,864 |
| | | | | | | 538,539 |

| 31 December 2009 | On demand BD '000 | Less than 3 months BD '000 | 3 to 12 months BD '000 | 1 to 5 years BD '000 | Over 5 years BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|
| Contingencies | | | | | | |
| Letters of credit | 2,948 | 45,964 | 20,841 | - | - | 69,753 |
| Guarantees | 29,345 | 55,083 | 225,343 | 3,165 | 274 | 313,210 |
| Acceptances | 860 | 2,662 | 7,595 | - | - | 11,117 |
| | | | | | | 394,080 |
| Commitments | | | | | | |
| Undrawn loan commitments | 23,712 | 19,915 | 104,616 | 14 | 6 | 148,263 |
| Commitments in respect of investments | - | - | - | 509 | - | 509 |
| | | | | | | 148,772 |
| | | | | | | 542,852 |

The Group does not expect all its commitments to be drawn before the expiry of the commitment.

As at 31 December 2010, the Group had no capital commitments (2009: same).

### Lease commitments

*Operating lease commitments – Group as lessee*

The Group has entered into commercial leases on premises. Future minimum lease payments under non-cancellable operating leases as at 31 December are as follows:

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Within one year | 407 | 276 |
| After one year but not more than five years | 1,628 | 1,114 |
| More than five years | 2,778 | 876 |
| | 4,813 | 2,266 |

## 28. Risk management

Efficient and timely management of risks involved in the Group's activities is critical for the financial soundness and profitability of the Group. Risk management involves the identifying, measuring, monitoring and managing of risks on a regular basis. The objective of risk management is to increase shareholders' value and achieve a return on equity that is commensurate with the risks assumed. To achieve this objective, the Group employs leading risk management practices and recruits skilled and experienced people.

As with other financial institutions, the Group faces a range of risks in its business and operations including (i) credit risk; (ii) market risk (comprising of interest rate risk, currency risk and equity price risk); (iii) liquidity risk, (iv) legal risk and (v) operational risk, as detailed below.

The Board of Directors of the Bank has overall responsibility for managing risks. Whilst the Board approves and periodically reviews risk management policies and strategies of the Group, the management establishes procedures to implement the policies and strategies. The Risk Management Committee (RMC) and Asset and Liability Management Committee (ALMC), comprising Executive and Senior Management, are high level management committees responsible for the overall management of the risk profile of the Group. RMC discusses important risk related issues, policies, procedures and reviews implementation of its decisions. ALMC reviews issues relating to the statement of financial position at a micro level.

The Risk Management Department (RMD) is responsible for identifying risk characteristics inherent in new and existing products, activities, countries, regions, industries as well as establishing or developing relevant policies, procedures and exposure limits to mitigate these risks. The RMD also establishes systems and processes for monitoring market and operational risks.

The Credit Management Department (CMD) processes credit applications and ensures that the provisions of credit risk policies are complied with. The CMD generates regular reports on credit risk exposures, performs credit rating reviews and monitors credit limits. The Heads of RMD and CMD report directly to the Chief Executive of the Bank, thereby ensuring the independence of the risk management process.

The internal audit department assess whether the policies and procedures are complied with and, if necessary, suggest ways of further improving internal procedures.

The various risks to which the Group is exposed to and how the Group manages them is discussed in the following paragraphs.

## 29. Credit risk and concentration of credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and thereby cause the other party to incur a financial loss. Concentration of credit risk arises when a number of counterparties engaged in similar business activities, or activities in the same geographical region, or have similar economic features, fail to meet contractual obligations, due to them being affected by the changes in economic, political or other conditions.

Credit risk in derivative financial instruments arises from potential counterparty default on contractual obligations and it is limited to the positive fair value in favour of the Group.

The Group attempts to control credit risk by monitoring credit exposures continuously, limiting transactions with specific counterparties, assessing the creditworthiness of counterparties, diversifying lending activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses, and by obtaining security wherever necessary and appropriate. In addition to monitoring credit limits, the Group manages credit exposures by entering into netting agreements and collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposure.

The Group has well defined policies and procedures for identifying, measuring, monitoring and controlling credit risk in all of the Group's activities, at the level of individual credit and at portfolio level. Credit limits are approved after thorough assessment of the creditworthiness of the borrower or counterparty, including the purpose and structure of the credit, and its source of repayment.

Credit proposals are reviewed by the Credit Management Department (CMD) before approval by the appropriate approving authority is obtained. Such reviews are conducted independently of business units. CMD reports directly to the Chief Executive of the Bank. All policies relating to credit are reviewed and approved by the Board of Directors. An Executive Committee, consisting of six senior members of the Board of Directors, reviews and approves larger credits. In addition, all larger credits in excess of the approval authority of the Executive Committee are approved by the Board of Directors.

### 29. Credit risk and concentration of credit risk continued

The Group devises specific business and risk strategies relating to corporate, retail, investments and treasury areas, within the ambit of the Group risk policies and procedures. Any additional risks associated with such strategies are discussed in the RMC meetings and necessary risk control measures are applied through amendments to policies, procedures and circulars. The Group also draws up a comprehensive Risk Management Strategy every year and monitors the progress of that strategy.

Day-to-day monitoring of individual borrower or counterparty exposure is the responsibility of the respective business unit. The Group's Credit Administration Unit, a part of the CMD, ensures that credit facilities are released after appropriate approval and against proper documentation. It also monitors excesses over limits, past dues, expired credits and escalates exceptions if any, for corrective action.

Counterparty credit limits are established for all customers after careful assessment of their creditworthiness and approval as per the levels of authority (approved by the Executive Committee and the Board of Directors). These are also subject to large credit exposure limit criteria of the Central Bank of Bahrain and the local regulators in overseas locations. Standard procedures, outlined in the Group's Credit Procedures Manual, require that all credit proposals be subjected to a detailed screening by a designated Credit Officer who is part of a three signature approval process and functions independent of the business units.

The credit growth, quality and portfolio composition are monitored continuously to maximize the risk adjusted return and reduce the level of incidence of impairment and accretion of marginal credits. The Group monitors concentration risk by establishing limits for maximum exposure to individual borrower or counterparty, country, bank and industry. Such limits are also stipulated for each product. These limits are approved after detailed analysis and are reviewed and monitored regularly.

The Group has a risk asset rating policy which defines criteria for rating risk assets. All credits are assigned a rating in accordance with the defined criteria. All lending relationships are reviewed at least once in a year and more frequently in case of non-performing assets (NPAs). The Internal Audit Department conducts an independent review of risk assets periodically and submits its report to Senior Management/Audit Committee. The Group endeavours continuously to improve upon the internal credit risk rating methodologies and credit risk management policies and practices, to reflect the true credit risk of the portfolio and the credit culture in the Group.

It is the Group's policy to ensure that provisions for credit loss are maintained at an adequate level. For loans and advances considered by the management as individually significant, specific provision is made for the impairment loss calculated on the basis of estimated discounted value of future cash flows in line with IAS 39 guidelines. For the remaining accounts, which are individually not significant, specific provision is made based on historic trends and the current economic environment. All provisions are approved by the Provision Committee, which comprises members of senior management.

Details of the composition of the loans, advances and overdraft portfolio are set out in note 7 to the consolidated financial statements.

The portfolio of non-performing assets is managed by skilled and experienced staff, under separate recovery/loan remedial units.

Details of the industry sector analysis and the geographical distribution of assets, liabilities and off statement of financial position items are set out in note 31.

### 30. Maximum exposure to credit risk without taking into account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the statement of financial position and for derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Balances with central banks | **348,541** | 150,105 |
| Treasury bills | **130,172** | 61,655 |
| Deposits and due from banks and other financial institutions | **171,037** | 362,407 |
| Loans and advances to customers | **1,276,316** | 1,268,561 |
| Non-trading investment securities | **357,119** | 278,660 |
| Interest receivable and other assets | **20,238** | 9,985 |
| | **2,303,423** | 2,131,373 |
| Contingent liabilities | **354,675** | 394,080 |
| Commitments | **183,864** | 148,772 |
| | **538,539** | 542,852 |
| | **2,841,962** | 2,674,225 |

### 31. Concentration of assets, liabilities and off statement of financial position items

The distribution of assets, liabilities and off statement of financial position items by geographic region and industry sector was as follows:

| 2010 | Assets BD '000 | Liabilities BD '000 | Credit commitments & contingencies BD '000 |
|---|---|---|---|
| Gulf Co-operation Council countries | **2,216,671** | **1,700,584** | **422,054** |
| North America | **30,729** | **4,888** | **2,730** |
| European Union countries | **65,235** | **405,246** | **36,697** |
| Asia | **116,305** | **84,327** | **75,975** |
| Others | **18,237** | **11,590** | **1,083** |
| | **2,447,177** | **2,206,635** | **538,539** |
| Trading and manufacturing | **405,252** | **265,600** | **171,580** |
| Banks and other financial institutions | **911,444** | **602,943** | **179,810** |
| Construction and real estate | **333,423** | **54,259** | **121,782** |
| Government and public sector | **417,684** | **362,843** | **544** |
| Individuals | **195,059** | **454,601** | **6,687** |
| Others | **184,315** | **466,389** | **58,136** |
| | **2,447,177** | **2,206,635** | **538,539** |

| 2009 | Assets BD '000 | Liabilities BD '000 | Credit commitments & contingencies BD '000 |
|---|---|---|---|
| Gulf Co-operation Council countries | 1,990,344 | 1,662,959 | 372,727 |
| North America | 92,188 | 4,631 | 3,021 |
| European Union countries | 96,177 | 311,715 | 61,558 |
| Asia | 76,756 | 45,022 | 104,182 |
| Others | 23,427 | 23,571 | 1,364 |
| | 2,278,892 | 2,047,898 | 542,852 |
| Trading and manufacturing | 355,338 | 111,277 | 127,301 |
| Banks and other financial institutions | 885,013 | 672,057 | 244,611 |
| Construction and real estate | 341,095 | 49,864 | 117,557 |
| Government and public sector | 329,421 | 343,355 | 7,527 |
| Individuals | 184,876 | 390,998 | 8,773 |
| Others | 183,149 | 480,347 | 37,083 |
| | 2,278,892 | 2,047,898 | 542,852 |

### Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For commercial lending, charges over real estate properties, inventory and trade receivables, and bank guarantees
- For retail lending, mortgages over residential properties
- Cash collaterals such as bank deposits
- Marketable securities

The Group also obtains guarantees from parent companies for loans to their subsidiaries.

The Group monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for business use.

## 32. Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group using internal and external credit risk ratings.

The table below shows the credit quality by class of asset for loan-related statement of financial position lines, based on the Group's credit rating system.

| 31 December 2010 | Neither past due nor impaired High grade BD '000 | Neither past due nor impaired Standard grade BD '000 | Neither past due nor impaired Watch list grade BD '000 | Past due or individually impaired BD '000 | Total BD '000 |
|---|---|---|---|---|---|
| **Loans and advances to customers** | | | | | |
| Commercial loans | 265,252 | 548,302 | 197,598 | 114,370 | 1,125,522 |
| Consumer loans | 207,028 | 11,681 | 5,379 | 9,393 | 233,481 |
| **Total** | **472,280** | **559,983** | **202,977** | **123,763** | **1,359,003** |

The gross amount of loans determined to be impaired in 2010, relate to non-Bahrain loans for which restructuring has commenced in 2010. Management expects that the restructuring process for these loans will be completed in 2011.

| 31 December 2009 | Neither past due nor impaired High grade BD '000 | Neither past due nor impaired Standard grade BD '000 | Neither past due nor impaired Watch list grade BD '000 | Past due or individually impaired BD '000 | Total BD '000 |
|---|---|---|---|---|---|
| Loans and advances to customers | | | | | |
| Commercial loans | 274,552 | 611,723 | 117,260 | 133,063 | 1,136,598 |
| Consumer loans | 177,392 | 7,496 | 4,626 | 6,819 | 196,333 |
| Total | 451,944 | 619,219 | 121,886 | 139,882 | 1,332,931 |

### Internal credit risk ratings

The Group follows an internal rating mechanism for grading relationships under loans and advances.

The Group utilises a scale ranging from 1 to 10 for credit relationships, with 1 to 8 denoting performing grades, 9 and 10 non-performing, in line with Basel II guidelines. Grades 1 to 3 represents high grade, 4 to 5 represents standard grade and 6 to 8 represents watch-list grade.

All credits are assigned a rating in accordance with the defined criteria.

The Group endeavours continuously to improve upon the internal credit risk rating methodologies and credit risk management policies and practices to reflect the true underlying credit risk of the portfolio and the credit culture in the Group.

All lending relationships are reviewed at least once in a year and more frequently in the case of non-performing assets.

Past due loans and advances include those that are only past due by a few days. An analysis of past due loans, by age, is provided below.

**Ageing analysis of past due but not impaired loans**

| 31 December 2010 | Less than 30 days BD '000 | 31 to 60 days BD '000 | 61 to 90 days BD '000 | Total BD '000 |
|---|---|---|---|---|
| **Loans and advances to customers** | | | | |
| Commercial loans | 13,704 | 993 | 8,041 | 22,738 |
| Consumer loans | 177 | 111 | 86 | 374 |
| **Total** | **13,881** | **1,104** | **8,127** | **23,112** |

| 31 December 2009 | Less than 30 days BD '000 | 31 to 60 days BD '000 | 61 to 90 days BD '000 | Total BD '000 |
|---|---|---|---|---|
| Loans and advances to customers | | | | |
| Commercial loans | 9,983 | 17,244 | 22,773 | 50,000 |
| Consumer loans | 191 | 236 | 119 | 546 |
| Total | 10,174 | 17,480 | 22,892 | 50,546 |

The credit quality of other financial assets is managed by the Group using external credit ratings. The table below shows the credit quality by class of the financial assets.

| 31 December 2010 | Neither past due nor impaired High grade BD '000 | Neither past due nor impaired Standard grade BD '000 | Neither past due nor impaired Sub-standard grade BD '000 | Past due or individually impaired BD '000 | Total BD '000 |
|---|---|---|---|---|---|
| Deposits and due from banks and other financial institutions | 130,955 | 40,082 | - | - | 171,037 |
| **Non-trading investment securities** | | | | | |
| Bonds | 294,045 | 62,739 | 714 | 56,888 | 414,386 |
| Equities | 57,535 | 3,118 | 176 | 1,465 | 62,294 |
| Managed funds | 8,886 | 1,766 | - | 754 | 11,406 |
| | 360,466 | 67,623 | 890 | 59,107 | 488,086 |
| **Total** | **491,421** | **107,705** | **890** | **59,107** | **659,123** |

| 31 December 2009 | Neither past due nor impaired High grade BD '000 | Neither past due nor impaired Standard grade BD '000 | Neither past due nor impaired Sub-standard grade BD '000 | Past due or individually impaired BD '000 | Total BD '000 |
|---|---|---|---|---|---|
| Deposits and due from banks and other financial institutions | 133,443 | 228,964 | - | - | 362,407 |
| Non-trading investment securities | | | | | |
| Bonds | 248,334 | 27,132 | 1,259 | 64,347 | 341,072 |
| Equities | 67,454 | 3,318 | - | 45 | 70,817 |
| Managed funds | 9,266 | 1,221 | - | - | 10,487 |
| | 325,054 | 31,671 | 1,259 | 64,392 | 422,376 |
| Total | 458,497 | 260,635 | 1,259 | 64,392 | 784,783 |

Deposits and due from banks and other financial institutions under standard grade are unrated deposits which are rated based on the Group's internal ratings.

### 32. Credit quality per class of financial assets continued

#### Internal credit risk ratings continued

The following table shows the parameters used for classification of investments:

| | S&P/Fitch | | | Moody's | | |
|---|---|---|---|---|---|---|
| **High grade** | Range from | AAA to | A- | Range from | Aaa to | A3 |
| **Standard grade** | Range from | BBB+ to | B- | Range from | Baa1 to | B3 |
| **Sub-standard grade** | Range from | CCC+ to | CCC- | Range from | Caa1 to | Caa3 |

High grade includes unrated investments amounting to BD 69,676 thousand (2009: BD 20,872 thousand). These mainly comprise of Sukuks issued by GCC governments and corporates.

### 33. Carrying amount of financial assets whose terms have been renegotiated

The table below shows the carrying amount for renegotiated financial assets, by class.

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| **Loans and advances to customers** | | |
| Commercial loans | **104,333** | 56,637 |
| Consumer loans | **2,888** | 2,365 |
| | **107,221** | 59,002 |

### 34. Market risk

Market risk is defined as the risk of losses in the Group's on or off statement of financial position or changes in fair values of financial instruments arising from movements in the interest rates, foreign exchange rates and equity prices.

The Group has clearly defined policies for conducting investment (including trading investments) and foreign exchange business which stipulates limits for these activities. Investments are made strictly in accordance with investment acceptance criteria. The Group does not undertake any commodity trading activities. For management of market risk arising from movement in interest rates (refer to note 35).

The Group uses an internal Value-at-Risk (VaR) model for measuring general market risk in the trading book of the Group and all foreign exchange positions. The internal model was approved by the Central Bank of Bahrain. VaR is calculated using a 99% confidence level for a 10 day holding period. This implies a 1% possibility of the loss exceeding the VaR amount calculated by the model. As at 31 December, VaR calculated based on the above parameters was as follows:

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Foreign exchange | **93** | 224 |
| Interest rate | **2** | 47 |
| | **95** | 271 |

The Bank's Risk Management Department conducts backtesting in accordance with the Market Risk Capital Adequacy Regulations issued by the Central Bank of Bahrain to ensure that the VaR model and assumptions used for computing VaR numbers are reliable. Backtesting of 1 day VaR as per actual profit and loss (comparing 1 day VaR with the average actual daily profit and loss) and also hypothetical back testing (comparing 1 day VaR with derived profit and loss of static positions) is carried out on a daily basis as stipulated in the CBB Rule book. The objective is to ensure that the assumptions used for computing VaR are reasonable and provide a VaR number that is a good indicator of possible losses in trading positions. During the year, the backtesting produced satisfactory results.

The Group also conducts stress testing to identify events or influences that could greatly impact material trading positions taken by the Group. As per the Central Bank of Bahrain requirements, validation of the internal model is conducted by the Internal Audit Department of the Bank as well as by the external auditors.

### 35. Interest rate risk management

Interest rate risk is the exposure of the Group's financial condition to adverse movements of interest rates. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off statement of financial position instruments that mature or re-price in a given period. Excessive interest rate risk can pose a significant threat to the Group's earnings and capital base. Accordingly, an effective risk management process that maintains interest rate risk within prudent levels is essential to the safety and soundness of the Group.

It is the Group's policy to keep its assets and liabilities mismatches at stable and acceptable levels to maintain steady net interest income. The Group monitors interest rate risk based on gap/duration limits. The Group also uses 'what if' scenarios for projecting the net interest income and the economic value of equity of the Group. The Group uses derivative instruments such as interest rate swaps, floating rate agreements and bond futures to manage interest rate risk. Whilst day to day management of interest rate risk is the responsibility of the Global Treasurer, ALMC also reviews the interest rate risk reports periodically.

Based on the statement of financial position as at 31 December 2010 an increase of 100 basis point in interest rates, with all variables held constant, will result in an increase in the net interest income, for the following next 12 months, by approximately BD 2,609 thousand (2009: decrease by BD 384 thousand). Similarly a decrease of 100 basis point in interest rates will result in a decrease in the net interest income by BD 2,609 thousand (2009: increase by BD 384 thousand).

An increase of 100 basis point in interest rates, with all other variables held constant, will result in a negative impact on equity of approximate 3.7% (2009: 3.2%). Similarly a decrease of 100 basis point in interest rates, with all other variables held constant, will result in a positive impact on equity of approximately 3.7% (2009: 3.2% ).

### 36. Currency risk

The functional currency of the Group is the Bahraini Dinar.

The Group had the following significant non-strategic net exposures de-nominated in foreign currencies as of the statement of financial position date:

| | 2010 BD '000 equivalent long (short) | 2009 BD '000 equivalent long (short) |
|---|---|---|
| US Dollar | **(54,795)** | 12,898 |
| Euro | **85** | 64 |
| GCC currencies (excluding Kuwaiti Dinar) | **44,897** | 13,858 |
| Kuwaiti Dinar | **203** | 338 |
| Others | **489** | 312 |

As the Bahraini Dinar and other GCC currencies (except the Kuwaiti Dinar) are pegged to the US dollar (USD), positions in USD and other GCC currencies are not considered to represent a significant currency risk. For currency sensitivity impact refer to VaR (note 34).

The Board of Directors has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on a daily basis to ensure that they are maintained within established limits. The Group uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks.

## 37. Equity price risk

Equity price risk is the risk that the fair values of equities or managed funds decrease as a result of changes in the corresponding value of equity indices or the value of individual equity stocks. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

The effect on equity (as a result of a change in the fair value of equity instruments held as available-for-sale) due to a reasonably possible change in equity indices, with all other variables held constant, is as follows:

| 2010 | | Effect on equity | | |
|---|---|---|---|---|
| Change in index | | Strategic BD '000 | Managed funds BD '000 | Total BD '000 |
| **Bahrain Bourse Company** | **+25%** | **4,812** | **558** | **5,370** |
| **GCC and other stock exchanges** | **+25%** | **-** | **1,637** | **1,637** |
| | | **4,812** | **2,195** | **7,007** |
| **Bahrain Bourse Company** | **-25%** | **(4,812)** | **(558)** | **(5,370)** |
| **GCC and other stock exchanges** | **-25%** | **-** | **(1,637)** | **(1,637)** |
| | | **(4,812)** | **(2,195)** | **(7,007)** |

| 2009 | | Effect on equity | | |
|---|---|---|---|---|
| Change in index | | Strategic BD '000 | Managed funds BD '000 | Total BD '000 |
| Bahrain Bourse Company | +25% | 5,283 | 639 | 5,922 |
| GCC and other stock exchanges | +25% | - | 910 | 910 |
| | | 5,283 | 1,549 | 6,832 |
| Bahrain Bourse Company | -25% | (5,283) | (639) | (5,922) |
| GCC and other stock exchanges | -25% | - | (910) | (910) |
| | | (5,283) | (1,549) | (6,832) |

## 38. Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. To guard against this risk, management have diversified funding sources, assets are managed with liquidity in mind and liquidity positions are monitored, maintaining a healthy balance of cash, cash equivalents, and readily marketable securities. In addition, the Group maintains various statutory deposits with central banks and has taken lines of credit from various banks and financial institutions.

The Bank has in place a liquidity risk policy, which describes the roles and responsibilities of ALMC and Treasury, and stipulates the broad guidelines with regard to minimum liquid assets to be maintained by the Bank, gap limits under each time bucket of the maturity ladder, cumulative outflow of cash limits for each time bucket and various liquidity ratios to be maintained which are approved by the ALMC based on the Annual Liquidity Strategy.

It is the Bank's policy to keep its assets in high-quality liquid assets such as inter-bank placements, Treasury Bills and Government Bonds, to ensure that funds are available to meet maturing liabilities, undrawn facilities and deposit withdrawals as they fall due for payment. A substantial proportion of the Bank's deposits is made up of retail current, savings and fixed deposit accounts which, though payable on demand or at short notice, have traditionally formed part of a stable deposit base and a source of core funding.

The day to day management of liquidity risk is the responsibility of the Global Treasurer, who monitors the sources and maturities of assets and liabilities closely and ensures that limits stipulated by the ALMC are complied with, and that funding is not concentrated from any one source.

The Bank also draws up contingency plans to deal with extraordinary conditions of liquidity risk after comprehensive scenario analysis.

The table below summarises the maturity profile of the Group's liabilities based on contractual undiscounted repayment arrangements, and does not take into account the effective maturities as indicated by the Group's deposit retention history. The Group expects that many customers will not request repayment on the earliest date the Group could be required to pay. Refer to note 25 for the expected maturities of these liabilities.

| 31 December 2010 | | | | | BD '000 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Within 1 month | 1 to 3 months | 3 to 6 months | 6 to 12 months | 1 to 5 years | 5 to 10 years | 10 to 20 years | More than 20 years | Total |
| **Deposits and due to banks and other financial institutions** | **183,716** | **10,237** | **939** | **25,471** | **-** | **-** | **-** | **-** | **220,363** |
| **Borrowings under repurchase agreement** | **1,678** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **1,678** |
| **Term borrowings** | **-** | **121,325** | **4,447** | **4,660** | **225,286** | **62,005** | **-** | **-** | **417,723** |
| **Customers' current, savings and other deposits** | **1,286,257** | **147,281** | **105,904** | **48,033** | **16,335** | **9** | **-** | **-** | **1,603,819** |
| **Total undiscounted financial liabilities** | **1,471,651** | **278,843** | **111,290** | **78,164** | **241,621** | **62,014** | **-** | **-** | **2,243,583** |
| **Derivative financial instruments** | | | | | | | | | |
| **Contractual amounts payable** | **(94,538)** | **(51,594)** | **(4,939)** | **(6,661)** | **(903)** | **(360)** | **(27)** | **-** | **(159,022)** |
| **Contractual amounts receivable** | **94,747** | **51,265** | **4,938** | **6,620** | **395** | **69** | **-** | **-** | **158,034** |
| | **209** | **(329)** | **(1)** | **(41)** | **(508)** | **(291)** | **(27)** | **-** | **(988)** |

| 31 December 2009 | | | | | BD '000 | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Within 1 month | 1 to 3 months | 3 to 6 months | 6 to 12 months | 1 to 5 years | 5 to 10 years | 10 to 20 years | More than 20 years | Total |
| Deposits and due to banks and other financial institutions | 257,974 | 46,009 | 7,597 | 2,017 | - | - | 4 | 32 | 313,669 |
| Term borrowings | - | 506 | 510 | 1,031 | 190,145 | 71,983 | 93 | - | 264,361 |
| Customers' current, savings and other deposits | 1,264,554 | 183,950 | 47,535 | 16,374 | 12,967 | 5 | 9 | - | 1,525,403 |
| Total undiscounted financial liabilities | 1,522,528 | 230,465 | 55,642 | 19,422 | 203,112 | 71,988 | 106 | 32 | 2,103,433 |
| Derivative financial instruments | | | | | | | | | |
| Contractual amounts payable | (26,829) | (5,457) | (1,633) | (1,376) | (445) | (44) | - | - | (35,784) |
| Contractual amounts receivable | 27,082 | 5,388 | 1,585 | 1,346 | 129 | 18 | - | - | 35,549 |
| | 253 | (69) | (48) | (30) | (316) | (26) | - | - | (235) |

### 39. Fair values of financial instruments

The table below sets out the estimated carrying values and fair values of those on and off statement of financial position financial instruments carried at amortised cost where fair values are materially different from the carrying amounts shown in the consolidated financial statements:

| 2010 | Carrying value BD '000 | Fair value BD '000 | Difference BD '000 |
|---|---|---|---|
| **Financial liabilities** | | | |
| Term borrowings * | **266,793** | **254,864** | **(11,929)** |
| **Financial assets** | | | |
| Non-trading investment securities | **59,731** | **59,596** | **(135)** |

| 2009 | Carrying value BD '000 | Fair value BD '000 | Difference BD '000 |
|---|---|---|---|
| Financial liabilities | | | |
| Term borrowings * | 257,173 | 205,310 | (51,863) |
| Financial assets | | | |
| Non-trading investment securities | 104,247 | 103,252 | (995) |

** The portion of term borrowing hedged under interest rate swap is carried at fair value refer (note 12).*

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

**Level 1 :** quoted (unadjusted) prices in active markets for identical assets or liabilities;

**Level 2 :** other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

**Level 3 :** techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market date.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy at 31 December 2010:

| 31 December 2010 | Level 1 BD '000 | Level 2 BD '000 | Total BD '000 |
|---|---|---|---|
| **On statement of financial position** | | | |
| **Financial assets** | | | |
| Bonds | **230,450** | **15,604** | **246,054** |
| Equities | **28,027** | **2,162** | **30,189** |
| Managed funds | **1,824** | **4,066** | **5,890** |
| | **260,301** | **21,832** | **282,133** |
| Financial liabilities<br>Term borrowings *(Note 12)* | **-** | **103,486** | **103,486** |
| **Off statement of financial position** | | | |
| **Financial assets** | | | |
| Derivatives held for trading | **-** | **393** | **393** |
| Derivatives held as fair value hedges | **-** | **899** | **899** |
| **Financial liabilities** | | | |
| Derivatives held for trading | **-** | **358** | **358** |
| Derivatives held as fair value hedges | **-** | **5,223** | **5,223** |

| 31 December 2009 | Level 1 BD '000 | Level 2 BD '000 | Total BD '000 |
|---|---|---|---|
| On statement of financial position | | | |
| Financial assets | | | |
| Bonds | 137,029 | 16,413 | 153,442 |
| Equities | 25,358 | 12,853 | 38,211 |
| Managed funds | 1,782 | 4,722 | 6,504 |
| | 164,169 | 33,988 | 198,157 |
| Off statement of financial position | | | |
| Financial assets | | | |
| Derivatives held for trading | - | 466 | 466 |
| Derivatives held as fair value hedges | - | 627 | 627 |
| Financial liabilities | | | |
| Derivatives held for trading | - | 310 | 310 |
| Derivatives held as fair value hedges | - | 1,578 | 1,578 |

The Group had no level 3 investments during either the current or prior year.

Included under available-for-sale investments are unquoted investments amounting to BD 83,564 thousand (2009: BD 108,420 thousand ) which are carried at cost.

#### Transfers between Level 1, Level 2 and Level 3

During the reporting year ended 31 December 2010, an amount of BD 563 thousand has been transferred from Level 2 to Level 1 fair value measurements. There were no transfers into and out of Level 3 fair value measurements.

### 40. Share-based payments

The expense recognised for employee services received during the year is shown in the following table:

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Expense arising from equity-settled share-based payment transactions | **397** | - |
| Expense arising from modification to stock option plan | **36** | - |
| Expense arising from stock option transactions | **68** | 73 |
| **Total expense arising from share-based payment transactions** | **501** | 73 |

During the year, the Nomination & Remuneration committee of the Bank modified the employees stock option plans for the previously granted stock options. The existing plan was discontinued with effect from 31 March 2010. The Bank moved to a new long-term incentive plan, which is referred to as the Employee Performance Share Plan (EPSP), which will award shares (rather than options) to executives. The details of the modifications to stock option plan and EPSP are described below.

#### Stock option plan

The modifications to stock options issued until 31 March 2010 are as follows:

*2005-2008 Options*

Options awarded between 2005 and 2008 ("the exercise price") was re-set to BD 0.400 and the term of each option has been extended by two years subject to the share price reaching certain threshold levels.

*2009 Options*

The 2009 award was granted at a share price of BD 0.450. This price was not adjusted and two-year vesting period remains the same. However, the term of these options was also extended by two years.

The following table illustrates the number and exercisable prices (EP) of, and movements in, share options during the year:

| | Number of shares 2009 | EP BD 2009 |
|---|---|---|
| Outstanding at the beginning of the year | 1,622,274 | 0.400 |
| Granted during the year | 1,468,176 | 0.450 |
| Forfeited during the year | (32,402) | - |
| Outstanding at the end of the year | 3,058,048 | |

*Employee Performance Share Plan (EPSP)*

Shares are granted to Senior Managers and above, with more than 12 months service at the date of grant and meeting certain performance criteria. The shares granted are subject to the satisfaction of conditions relating to the Bank's net profit over a three year period.

The Bank intends to utilise their existing treasury shares for the EPSP and may also choose to issue new shares to settle the EPSP in the future. The price of the shares granted was equal to the market price of the Bank's shares on the grant date.

The following table illustrates the number and cost per share of the shares granted during the year under the new scheme.

| | Number of shares 2010 | Cost per share 2010 BD |
|---|---|---|
| Equity shares granted during the year | **2,003,046** | **0.426** |

The market price of BBK B.S.C. shares at 31 December 2010 was BD 0.430 (2009: BD 0.408).

## 41. Capital adequacy

The risk asset ratio calculated in accordance with the capital adequacy guidelines approved by the Central Bank of Bahrain, for the Group is as follows:

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| **Capital base:** | | |
| Tier 1 capital | **234,267** | 225,131 |
| Tier 2 capital | **75,470** | 78,739 |
| **Total capital base (a)** | **309,737** | 303,870 |
| Credit risk weighted exposure | **1,506,892** | 1,579,382 |
| Operational risk weighted exposure | **156,152** | 142,073 |
| Market risk weighted exposure: | **4,982** | 14,372 |
| **Total risk weighted exposure (b)** | **1,668,026** | 1,735,827 |
| **Capital adequacy (a/b * 100)** | **18.57%** | 17.51% |
| **Minimum requirement** | **12.00%** | 12.00% |

### Capital management

The primary objectives of the Group's capital management policies are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

### Basel II and Capital management

The Bank has adopted the new Basel II Capital Adequacy Framework (Basel II) with effect from 1 January 2008 as per the guidelines issued by the Central Bank of Bahrain which is enhancing the Bank's risk management process, supervisory review, disclosure standards and capital management.

The Bank has adopted the Standardized Approach in case of credit risk, the Internal Model Approach for market risk and the Basic Indicator Approach for operational risk.

The Bank has established its Internal Capital Adequacy Assessment Process (ICAAP) to provide policy guidance in Capital Planning and Capital Management. The Bank also uses Risk Adjusted Return on Capital (RAROC) model in its decision making process.

## 42. Legal and operational risk

### Legal risk

Legal risk is the risk relating to losses due to legal or regulatory action that invalidates or otherwise precludes performance by the end user or its counterparty under the terms of the contract or related netting agreements.

The Group has developed preventive controls and formalised procedures to identify legal risks so that potential losses arising from non-adherence to laws and regulations, negative publicity, etc. are significantly reduced. The Group also has well established legal procedures to scrutinise product offerings and manage risks arising out of its transactions.

As at 31 December 2010, there were legal cases pending against the Group aggregating BD 0.872 thousand (2009: BD 1,315 thousand). Based on the opinion of the Group's legal advisors, the management believes that no liability is likely to arise from these cases.

### Operational risk

Operational risk is the exposure to loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Bank has clearly defined operations procedures for each of its products and services. It also has advanced computer systems that enable it to run operations with speed and accuracy.

This department operates independently from other units of the Bank and reports directly to the Audit Committee, which consists of members of the Board. It conducts regular reviews of all business areas of the Bank and reports control deficiencies and exceptions to the Bank's policies and procedures. It also recommends measures to mitigate operational risk, which are implemented by management immediately.

The Bank also has a contingency plan to take care of any failure of its computer systems. Regular back-ups are made for all important datasets, and stored outside the Bank's premises. This ensures that in case of any system failure, the Bank will be able to continue its operations without losing critical data or business transactions. As part of its disaster recovery plan, the Bank has established a back-up site which would and operate during an emergency.

The Bank has a specific Business Continuity Plan (BCP) unit. The main objective of the BCP is to ensure that in the event of full or partial disaster, the Bank should be able to continue providing essential services to customers, minimizing any adverse effects on the Bank's business, through business impact analysis, business restoration plans and procedures, for the identified critical functions.

The Bank is using an operational risk management solution for monitoring operational risk, conducting risk and control self assessments and capturing operational loss data in accordance with Basel II/Central Bank of Bahrain guidelines.

### 43. Deposit protection scheme

Certain customers' deposits of the Group are covered by deposit protection scheme established by the Central Bank of Bahrain. The scheme applies to all non-bank private sector deposits subject to specific exclusions mainly relating to maximum deposit amounts. Eligible depositors are covered by the CBB to the extent of lower of 75% of the combined total of eligible deposits held by the depositor and BD 15,000.

### 44. Staff saving scheme

The scheme is a contribution saving fund between the Bank and the employee of the Bank. It was introduced in January 1996 with the objective of providing the employees with cash benefit upon resignation, retirement or death. Participation in the scheme is discretionary; the employee may contribute any amount; the Bank guarantees a corresponding contribution of an amount that is 3% higher provided that total Bank contribution is not in excess of 10% of the employees' salary. The employee becomes eligible for the full amount of the Bank's contribution provided the employee completes 5 years of service; otherwise the entitlement is proportionately calculated. The scheme is managed by a committee, consisting of members from management and representatives nominated and selected by staff.

As at 31 December 2010 the total contribution fund including the earned income stands at BD 8,585 thousand (2009: BD 6,724 thousand). Out of the total fund amount, payment of the principal amount equal to BD 7,511 thousand (2009: BD 5,699 thousand) consisting of the respective staff and Bank's contribution is guaranteed by the Bank to employees participating in the scheme.

# Basel II Pillar III disclosures

For the year ended 31 December 2010

## 1. Executive summary

This reports has been prepared in accordance with Pillar III disclosure requirements prescribed by the Central Bank of Bahrain, herein referred to as (CBB).

CBB Basel II guidelines became effective on 1st January 2008 as the common framework for the implementation of the Basel Committee on Banking Supervision's (Basel Committee) Basel II capital adequacy framework for banks incorporated in the Kingdom of Bahrain.

The disclosures in this report are in addition to the disclosures set out in the consolidated financial statements for the year ended 31 December 2010 presented in accordance with the International Financial Reporting Standards (IFRS).

## 2. Introduction to the Basel II framework

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

- Pillar I: calculation of the Risk Weighted Assets (RWAs) and capital requirement. The capital requirement has to be covered by own regulartory framework.
- Pillar II: the supervisory review process, including the Internal Capital Adequacy Assessment Process (ICAAP).
- Pillar III: rules for the disclosure of risk management and capital adequacy information.

### Pillar I

Pillar I prescribes the basis for the calculation of the regulatory capital adequacy ratio. Pillar I sets out the definition and calculations of the RWAs, and the derivation of the regulatory capital base. The capital adequacy ratio is calculated by dividing the regulatory capital base by the total RWAs.

The resultant ratio is to be maintained above a predetermined and communicated level. Under the previously applied Basel I Capital Accord, the minimum capital adequacy ratio for banks incorporated in Bahrain was 12 per cent compared to the Basel Committee's minimum ratio of 8 per cent.

The CBB also requires banks incorporated in Bahrain to maintain a buffer of 0.5 per cent above the minimum capital adequacy ratio. In the event that the capital adequacy ratio falls below 12.5 per cent additional prudential reporting requirements apply, and a formal action plan setting out the measures to be taken to restore the ratio above the target level is to be formulated and submitted to the CBB. Consequently, the CBB requires BBK to maintain an effective minimum capital adequacy ratio of 12.5 per cent. No separate minimum tier 1 ratio is required to be maintained under the CBB's Basel II capital adequacy framework.

Under the CBB's Basel II capital adequacy framework, the RWAs are calculated using more sophisticated and risk sensitive methods than under the previous Basel I regulations. Credit risk and market risk are two essential risk types that were included under Basel I, while operational risk has been introduced as a new risk type in the CBB's Basel II capital adequacy framework. The table below summarises the approaches available for calculating RWAs for each risk type in accordance with the CBB's Basel II capital adequacy framework:

*Approaches for determining regulatory capital requirements as per CBB guidelines*

| Credit risk | Market risk | Operational risk |
|---|---|---|
| Standardised Approach | Standardised Approach | Basic Indicator Approach |
| Foundation Internal Ratings Based Approach (FIRB) | Internal Models Approach | Standardised Approach |

The approach applied by BBK for each risk type is as follows:

*i) Credit risk*

For regulatory reporting purposes, BBK is using the Standardised Approach for credit risk. The standardised approach is similar to the basis under the previous Basel I capital adequacy regulations, except for the use of external ratings to derive RWAs and the ability to use a wider range of financial collaterals. The RWAs are determined by multiplying the credit exposure by a risk weight factor dependent on the type of counterparty and the counterparty's external rating, where available.

*ii) Market risk*

For the regulatory market risk capital requirement, BBK is using the Internal Model Approach based on Value-at-Risk (VaR) model. The use of the Internal Model Approach for the calculation of regulatory market risk capital has been approved by the CBB.

*iii) Operational risk*

Under the CBB's Basel II capital adequacy framework, all banks incorporated in Bahrain are required to apply the Basic Indicator Approach for operational risk unless approval is granted by the CBB to use the Standardised Approach. The CBB's Basel II guidelines do not currently permit the use of the Advanced Measurement Approach (AMA) for operational risk. For regulatory reporting purposes, BBK is currently using the Basic Indicator Approach. Under the Basic Indicator Approach, the regulatory capital requirement is calculated by applying an alpha co-efficient of 15 per cent to the average gross income for the preceding three financial years.

### Pillar II

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

Under the CBB's Pillar II guidelines all banks incorporated in Bahrain are required to maintain a 12 per cent minimum capital adequacy ratio.

Pillar II comprises of two processes:

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

The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the Bank is exposed. BBK has developed its ICAAP and it addresses all components of BBK's risk management, from the daily management of more material risks to the strategic capital management of the Group.

### 2. Introduction to the Basel II framework continued

#### Pillar II continued

The supervisory review and evaluation process represents the CBB's review of the Group's capital management and an assessment of internal controls and corporate governance. The supervisory review and evaluation process is designed to ensure that institutions identify their material risks and allocate adequate capital, and employ sufficient management processes to support such risks.

The supervisory review and evaluation process also encourages institutions to develop and apply enhanced risk management techniques for the measurement and monitoring of risks in addition to the credit, market and operational risks addressed in the core Pillar I framework. Other risk types which are not covered by the minimum capital requirements in Pillar I include liquidity risk, interest rate risk in the banking book, business risk and concentration risk. These are covered either by capital, or risk management and mitigation processes under Pillar II.

#### Pillar III

In the CBB's Basel II framework, the third pillar prescribes how, when, and at what level information should be disclosed about an institution's risk management and capital adequacy practices.

The disclosures comprise detailed qualitative and quantitative information. The purpose of the Pillar III disclosure requirements is to complement the first two pillars and the associated supervisory review process. 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.

Under the current regulations, partial disclosure consisting mainly of quantitative analysis is required during half year reporting, whereas full disclosure is required to coincide with the financial year end reporting.

### 3. Group structure

The Group's financial statements are prepared and published on a full consolidation basis, with all subsidiaries being consolidated in accordance with IFRS. For capital adequacy purposes, all subsidiaries are included within the Group structure. However, the CBB's capital adequacy methodology accommodates both normal and aggregation forms of consolidation.

The principal subsidiaries, Associates and Joint Ventures and basis of consolidation for capital adequacy purposes are as follows:

| | Domicile | Ownership | Consolidation basis |
|---|---|---|---|
| **Subsidiaries** | | | |
| CrediMax B.S.C. (c) | Kingdom of Bahrain | 100% | Full Consolidation |
| Invita B.S.C. (c) | Kingdom of Bahrain | 100% | Full Consolidation |
| Capinnova Investment Bank B.S.C. (c) | Kingdom of Bahrain | 100% | Aggregation |
| Global Payment Services W.L.L. (GPS) | United States of America | 55% | Full Consolidation |
| **Associate** | | | |
| EBLA Computer Consultancy K.S.C.C. | Kuwait | 36% | Aggregation |
| Bahrain Commercial Facilities Company B.S.C. (c) | Kingdom of Bahrain | 23% | Aggregation |
| The Benefit Company B.S.C. (c) | Kingdom of Bahrain | 22% | Aggregation |
| **Joint venture** | | | |
| Sakana Holistic Housing Solutions B.S.C. (c) | Kingdom of Bahrain | 50% | Aggregation |

There are no investments in subsidiaries that are treated as a deduction from the Group's regulatory capital. There are no restrictions on the transfer of funds or regulatory capital within the Group.

### 4. Capital components - consolidated

Tier one capital is defined as capital of the same or close to the character of paid-up capital and comprises share capital, share premium, retained earnings and eligible reserves. Eligible reserves include general reserve, statutory reserve, and unrealised losses arising from revaluation of equities classified as available-for-sale, and excludes unrealised losses arising from revaluation of debt securities classified as available-for-sale.

Tier two capital comprises interim profits, qualifying subordinated term finance, collective impairment provisions, and unrealised gains arising from revaluation of equities classified as available-for-sale, though limited to 45 per cent. It excludes unrealised gains arising from valuing debt securities classified as available-for-sale.

The subordinated term financing facilities, amounting to USD 182 million (initial amount raised USD 275 million), are part of its USD 1 billion Euro Medium Term Deposits Notes Programme. These are issued for 10 years with a call option which can only be exercised starting 2012. The subordinated financing facilities have been approved for inclusion in tier two capital for regulatory capital adequacy purposes by the CBB.

The CBB applies various limits to elements of the regulatory capital base. The amount of innovative tier one securities cannot exceed 15 per cent of total tier one capital; qualifying tier two capital cannot exceed tier one capital; and qualifying subordinated term finance cannot exceed 50 per cent of tier one capital. There are also restrictions on the amount of collective impairment provisions that may be included as part of tier two capital.

In accordance with the CBB's Basel II capital adequacy framework, certain assets are required to be deducted from regulatory capital rather than included in RWAs. At 31st December 2010, BD 8.79 million (2009: BD 4.21 million) was deducted from regulatory capital in relation to securitisation exposures that were rated below BB- or were unrated. In accordance with the CBB's Basel II capital adequacy framework, the deductions are applied 50 per cent from tier one and 50 per cent from tier two capital.

There are no impediments on the transfer of funds or regulatory capital within the Group other than restrictions over transfers to ensure minimum regulatory capital requirements are met for subsidiary companies.

| | December 2010 BD '000 | December 2009 BD '000 |
|---|---|---|
| **Tier 1 capital** | | |
| Share capital | **81,393** | 82,290 |
| General reserves | **27,000** | 20,000 |
| Statutory reserves | **39,001** | 35,500 |
| Share premium | **39,919** | 39,919 |
| Retained earnings and others | **20,554** | 17,349 |
| Unrealised gross losses arising from fair valuing equities | **(4,872)** | (2,790) |
| Deductions from tier 1 capital | **(40,304)** | (38,933) |
| Total tier 1 capital | **162,691** | 153,335 |
| **Tier 2 capital** | | |
| Current year profit | **39,142** | 35,013 |
| 45% of unrealised gains arising from fair valuing equities | **1,870** | 6,203 |
| Collective impairment provisions | **13,733** | 6,248 |
| Subordinated term debt | **61,029** | 70,207 |
| Deductions from Tier 2 capital | **(40,304)** | (38,933) |
| Total tier 2 capital | **75,470** | 78,738 |
| Total available capital (tier 1 + tier 2) | **238,161** | 232,073 |
| Aggregation | **71,576** | 71,796 |
| **Total eligible capital** | **309,737** | 303,869 |

## 5. Capital adequacy

The Group's policy is to maintain a strong capital base so as to preserve investor, creditor and market confidence and to sustain the future development of the business. The impact of the level of capital on shareholders' return is also recognised as well as 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 Group manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans. The capital structure may be adjusted through the dividend payout, and the issue of new shares, and subordinated term finance.

BBK aims to maintain a minimum total capital adequacy ratio in excess of 15 per cent. The CBB's current minimum total capital adequacy ratio for banks incorporated in Bahrain is set at 12 per cent. The Capital Adequacy ratio of the Group at 31 December 2010 was 18.57 per cent (2009: 17.51 per cent).

### Strategies and methods for maintaining a strong capital adequacy ratio

BBK prepares multi-year strategic projections on a rolling annual basis which include an evaluation of short term capital requirements and a forecast of longer-term capital resources.

The evaluation of the strategic planning projections have historically given rise to capital injections. The capital planning process triggered the raising of additional tier two capital through a USD 275 million subordinated debt issue in 2007 to enhance the total regulatory capital adequacy ratio, and a BD 50 million capital increase in October 2007 to provide additional tier 1 capital to support planned medium term asset growth.

*Capital ratios - consolidated & subsidiaries above 5% of Group capital*

| | December 2010 | | December 2009 | |
|---|---|---|---|---|
| | Total capital ratio | Tier 1 capital ratio | Total capital ratio | Tier 1 capital ratio |
| BBK - Group | **18.57%** | **14.04%** | 17.51% | 12.97% |
| CrediMax | **82.85%** | **55.14%** | 72.86% | 53.18% |
| Capinnova Investment Bank | **110.03%** | **110.03%** | 269.50% | 269.50% |

## 6. Credit risk – Pillar III disclosures

This section describes the BBK's exposure to credit risk and provides detailed disclosures on credit risk in accordance with the CBB's Basel II framework in relation to Pillar III disclosure requirements.

### Definition of exposure classes

BBK has a diversified on and off statement of financial position credit portfolio, the exposures of which are divided into the counterparty exposure classes defined by the CBB's Basel II capital adequacy framework for the standardised approach for credit risk. A high-level description of the counterparty exposure classes, referred to as standard portfolios in the CBB's Basel II capital adequacy framework, and the generic treatments, i.e. the risk weights to be used to derive the RWAs, are as follows:

*Sovereigns portfolio*

The sovereigns portfolio comprises exposures to governments and their respective central banks. The risk weights are zero per cent for exposures in the relevant domestic currency, or in any currency for exposures to GCC sovereigns. Foreign currency claims on other sovereigns are risk weighted based on their external credit ratings.

Certain multilateral development banks as determined by the CBB may be included in the sovereigns portfolio and treated as exposures with a zero per cent risk weighting.

*Public Sector Entities (PSE) portfolio*

Claims on Bahraini PSEs, and claims on PSEs on domestic currency - which are assigned a zero per cent risk weight by their respective country regulator, can be assigned a zero per cent risk weight. All other PSEs are risk weighted according to their external ratings.

*Banks portfolio*

Claims on banks are risk weighted based on their external credit ratings. A preferential risk weight treatment is available for qualifying short term exposures. Short term exposures are defined as exposures with an original tenor of three months or less. The Bank's portfolio also includes claims on investment firms, which are risk weighted based on their external credit ratings, though without any option for preferential treatment for short term exposures.

*Corporates portfolio*

Claims on corporates are risk weighted based on their external credit ratings. A 100 per cent risk weight is assigned to exposures to unrated corporates. A preferential risk weight treatment is available for certain corporates owned by the Government of Bahrain, as determined by the CBB, which are assigned a zero per cent risk weight.

*Regulatory retail portfolio*

Claims on retail portfolio are risk weighted at 75 per cent, except for past due portfolio.

*Mortgage portfolio*

Claims which are fully secured by first mortgages on residential property that is or will be occupied by the borrower, or that is leased, must carry a risk weighting of 75 per cent. Claims secured mortgages on commercial real estate are subject to a minimum of 100 per cent risk weight. If the borrower is rated below BB-, the risk weight corresponding to the rating of the borrower must be applied.

*Equities portfolio*

The equities portfolio comprises equity investments in the banking book, i.e. the available-for-sale securities portfolio. A 100 per cent risk weight is assigned to listed equities while unlisted equities are weighted at 150 per cent.

In addition to the standard portfolios, other exposures are assigned to the following exposure classes.

*Investments in funds portfolio*

The risk weight for claims on corporate will be used to determine the risk weight for investments in rated funds. Unrated funds will be assigned a risk weight of 100 per cent if listed, and 150 per cent if not listed.

*Past due exposures*

This includes claims, for which the repayment is overdue for more than ninety days. The risk weighting for such loans is either 100 per cent or 150 per cent which is applied depending on the level of provisions maintained against the loan.

*Holding of real estate*

All holding of real estate by banks (owned directly or by the way of investments in real estate companies, subsidiaries or associate companies or other arrangements such as trusts, funds or REITS) must be risk weighted at 200 per cent. Premises occupied by the Bank are weighted at 100 per cent.

*Other assets and holdings of securitisation tranches*

Other assets are risk weighted at 100 per cent. Securitisation tranches are risk weighted based on their external credit ratings. Risk weightings range from 20 per cent to 350 per cent. Exposures to securitisation tranches that are rated below BB- or are unrated are deducted from regulatory capital rather than subject to a risk weight.

All of BBK's holding of securitisations form part of the Bank's investment portfolio.

*External rating agencies*

BBK uses ratings issued by Standard & Poor's, Moody's and Fitch to derive the risk weightings under the CBB's Basel II capital adequacy framework. Where ratings vary between rating agencies, the highest rating from the lowest two ratings is used to represent the rating for regulatory capital adequacy purposes.

## 6. Credit risk – Pillar III disclosures continued

### Definition of exposure classes continued

*Credit risk presentation under Basel II*

The credit risk exposures presented in much of this report differ from the credit risk exposures reported in the consolidated financial statements. Differences arise due to the application of different methodologies, as illustrated below:

- Under the CBB's Basel II framework, off statement of financial position exposures are converted into credit exposure equivalents by applying a credit conversion factor (CCF). The off statement of financial position exposure is multiplied by the relevant CCF applicable to the off statement of financial position. Subsequently, the exposure is treated in accordance with the standard portfolios as referred to above in this report in the same manner as on statement of financial position exposures.
- Credit risk exposure reporting under Pillar III is frequently reported by standard portfolios based on the type of counterparty. The financial statement presentation is based on asset class rather than the relevant counterparty. For example, a loan to a bank would be classified in the Bank's standard portfolio under the capital adequacy framework although is classified in loans and advances in the consolidated financial statements.
- Certain eligible collateral is applied to reduce exposure under the Basel II capital adequacy framework, whereas no such collateral netting is applicable in the consolidated financial statements.
- Based on the CBB's Basel II guidelines, certain exposures are either included in, or deducted from, regulatory capital rather than treated as an asset as in the consolidated financial statements, e.g. unrated securitisation tranches.

## 7. Capital requirement for risk weighted exposure

| 31 December 2010 | Gross credit exposures (before risk mitigation) BD '000 | Eligible financial collateral BD '000 | Credit risk after risk mitigation BD '000 | Risk weighted asset BD '000 | Regulatory capital required 12% BD '000 |
|---|---|---|---|---|---|
| Sovereign | 739,638 | - | 53,567 | 26,298 | 3,156 |
| Public sector entities | 175,861 | - | 6,771 | 5,233 | 628 |
| Banks | 414,166 | 1,087 | 410,954 | 171,037 | 20,524 |
| Corporates | 1,056,193 | 53,272 | 960,305 | 942,571 | 113,109 |
| Regulatory retail | 163,014 | 19,510 | 143,504 | 107,628 | 12,915 |
| Mortgage | 66,694 | 2,904 | 63,789 | 48,295 | 5,795 |
| Equity | 44,224 | - | 0 | 45,857 | 5,503 |
| Investment in funds | 4,099 | - | 4,099 | 6,148 | 738 |
| Past due | 612 | - | 612 | 612 | 73 |
| Real estate | 33,354 | - | 0 | 54,663 | 6,560 |
| Securitisation | 3,436 | - | 3,436 | 3,436 | 412 |
| Other assets | 36,569 | - | 36,569 | 36,569 | 4,388 |
| Cash items | 11,164 | - | 0 | 156 | 19 |
| **Total** | **2,749,024** | **76,773** | **1,683,606** | **1,448,503** | **173,820** |
| Aggregation | 58,389 | - | 58,389 | 58,389 | 7,007 |
| **Total credit risk** | **2,807,413** | **76,773** | **1,741,995** | **1,506,892** | **180,827** |
| Market risk | - | - | - | 4,982 | 598 |
| Operational risk | - | - | - | 156,152 | 18,738 |
| **Total risk weighted exposure** | **2,807,413** | **76,773** | **1,741,995** | **1,668,026** | **200,163** |

| 31 December 2009 | Gross credit exposures (before risk mitigation) BD '000 | Eligible financial collateral BD '000 | Credit risk after risk mitigation BD '000 | Risk weighted ssset BD '000 | Regulatory capital required 12% BD '000 |
|---|---|---|---|---|---|
| Sovereign | 417,103 | - | 45,240 | 23,374 | 2,805 |
| Public sector entities | 197,338 | - | 11,586 | 3,209 | 385 |
| Banks | 601,830 | 1,630 | 543,551 | 282,642 | 33,917 |
| Corporates | 972,085 | 104,038 | 861,585 | 847,276 | 101,673 |
| Regulatory retail | 149,659 | 18,554 | 131,105 | 98,329 | 11,799 |
| Mortgage | 52,043 | 2,707 | 49,336 | 37,233 | 4,468 |
| Equity | 52,232 | - | - | 58,120 | 6,974 |
| Investment in funds | 4,532 | - | 4,532 | 6,798 | 816 |
| Past due | 226 | 3 | 223 | 223 | 27 |
| Real estate | 24,130 | - | - | 48,260 | 5,791 |
| Securitisation | 5,190 | - | 5,190 | 5,190 | 623 |
| Other assets | 118,907 | 7,123 | 111,785 | 111,785 | 13,414 |
| Cash items | 14,010 | - | - | 267 | 32 |
| Total | 2,609,285 | 134,055 | 1,764,133 | 1,522,706 | 182,725 |
| Aggregation | 56,677 | - | 56,677 | 56,677 | 6,801 |
| Total credit risk | 2,665,962 | 134,055 | 1,820,810 | 1,579,382 | 189,525 |
| Market risk | - | - | - | 14,372 | 1,725 |
| Operational risk | - | - | - | 142,073 | 17,049 |
| Total risk weighted exposure | 2,665,962 | 134,055 | 1,820,810 | 1,735,828 | 208,299 |

### Collateral valuation policy

The Bank has detailed policies and procedures for valuing collateral/securities offered for various credit facilities. The collateral is valued, at minimum, quarterly or annually based on the type of security.

More frequent valuations are also considered if warranted by market volatility and declining trend in valuations are observed. The basis of valuation for different types of securities such as equity, debt, and real estate is also clearly defined in the policies.

### 8. Funded and unfunded total credit exposure

| | 2010 | | 2009 | |
|---|---|---|---|---|
| Total gross credit exposures | Total funded credit exposure BD '000 | Total un-funded credit exposure BD '000 | Total funded credit exposure BD '000 | Total un-funded credit exposure BD '000 |
| Sovereign | 701,764 | 37,874 | 371,851 | 45,252 |
| Public sector entities | 147,235 | 28,626 | 174,885 | 22,453 |
| Banks | 288,787 | 125,379 | 430,604 | 171,226 |
| Corporates | 875,943 | 180,250 | 823,538 | 148,547 |
| Regulatory retail | 160,640 | 2,374 | 146,611 | 3,048 |
| Mortgage | 66,694 | - | 52,043 | - |
| Equity | 44,224 | - | 52,232 | - |
| Investment in funds | 3,873 | 226 | 4,278 | 254 |
| Past due | 612 | - | 226 | - |
| Real estate | 33,354 | - | 24,130 | - |
| Securitisation | 3,436 | - | 5,190 | - |
| Other assets | 36,569 | - | 105,952 | 12,955 |
| Cash Items | 11,164 | - | 14,010 | - |
| Total | 2,374,295 | 374,729 | 2,205,550 | 403,735 |
| Aggregation | 58,389 | - | 56,677 | - |
| **Total credit risk at 31 December 2010** | 2,432,684 | 374,729 | 2,262,227 | 403,735 |

### 9. Average credit exposure

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Sovereign | 688,483 | 343,001 |
| Public sector entities | 180,983 | 220,255 |
| Banks | 447,211 | 426,766 |
| Corporates | 1,019,022 | 989,614 |
| Regulatory retail | 154,886 | 146,782 |
| Mortgage | 58,360 | 48,495 |
| Equity | 45,803 | 46,123 |
| Investment in funds | 4,399 | 6,722 |
| Past due | 818 | 3,265 |
| Real estate | 31,464 | 24,839 |
| Securitisation | 3,793 | 5,968 |
| Other assets | 40,753 | 113,899 |
| Cash items | 11,510 | 11,558 |
| Total | 2,687,485 | 2,387,287 |
| Aggregation | 58,932 | 60,067 |
| **Total credit risk** | 2,746,417 | 2,447,354 |

## 10. Concentration of credit risk by region

| December 2010 | GCC BD '000 | North America BD '000 | Europe BD '000 | Asia BD '000 | Others BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|
| Cash and balances with central banks | 355,134 | - | - | 3,792 | - | **358,926** |
| Treasury bills | 128,538 | - | - | 1,634 | - | **130,172** |
| Deposits in banks & other financial institutions | 99,060 | 3,934 | 28,197 | 3,262 | 79 | **134,532** |
| Loans & advances to customers | 1,194,374 | 315 | 1,583 | 74,637 | 5,407 | **1,276,316** |
| Investment securities | 319,624 | 26,198 | 35,456 | 31,118 | 12,751 | **425,147** |
| Other assets | 47,339 | - | - | 1,863 | - | **49,202** |
| Total funded exposure | 2,144,069 | 30,447 | 65,236 | 116,306 | 18,237 | **2,374,295** |
| Unfunded commitments & contingents | 312,654 | 1,580 | 22,177 | 38,020 | 297 | **374,728** |
| Aggregation | 58,389 | - | - | - | - | **58,389** |
| **Total credit risk at 31 December 2010** | **2,515,112** | **32,027** | **87,413** | **154,326** | **18,534** | **2,807,412** |

| December 2009 | GCC BD '000 | North America BD '000 | Europe BD '000 | Asia BD '000 | Others BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|
| Cash and balances with central banks | 159,795 | - | - | 2,613 | - | 162,408 |
| Treasury bills | 61,655 | - | - | - | - | 61,655 |
| Deposits in banks & other financial institutions | 182,407 | 61,566 | 60,792 | 6,403 | 9,429 | 320,598 |
| Loans & advances to customers | 1,213,902 | 349 | 1,711 | 47,357 | 5,242 | 1,268,561 |
| Investment securities | 266,337 | 27,929 | 31,806 | 18,112 | 8,756 | 352,940 |
| Other assets | 36,501 | - | - | 2,271 | - | 38,772 |
| Total funded exposure | 1,920,596 | 89,843 | 94,310 | 76,756 | 23,427 | 2,204,933 |
| Unfunded commitments & contingents | 277,373 | 2,339 | 47,584 | 76,440 | - | 403,736 |
| Aggregation | 56,677 | - | - | - | - | 56,677 |
| Total credit risk at 31 December 2009 | 2,254,646 | 92,182 | 141,894 | 153,196 | 23,427 | 2,665,346 |

## 11. Concentration of credit risk by industry

| December 2010 | Trading and manufacturing BD '000 | Banks & other financial institutions BD '000 | Construction & real estate BD '000 | Government & public sector BD '000 | Individuals BD '000 | Others BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with central banks | - | 10,385 | - | 348,541 | - | - | **358,926** |
| Treasury bills | - | - | - | 130,172 | - | - | **130,172** |
| Deposits in banks & other financial institutions | - | 134,532 | - | - | - | - | **134,532** |
| Loans & advances to customers | 367,891 | 111,931 | 474,034 | 35,614 | 131,111 | 155,735 | **1,276,316** |
| Investment securities | 20,735 | 133,950 | 21,309 | 246,299 | - | 2,854 | **425,147** |
| Other assets | - | - | - | - | - | 49,202 | **49,202** |
| Total funded exposure | 388,626 | 390,798 | 495,343 | 760,626 | 131,111 | 207,791 | **2,374,295** |
| Unfunded commitments & contingents | 94,814 | 142,036 | 70,993 | 548 | 4,873 | 61,464 | **374,728** |
| Aggregation | - | 58,389 | - | - | - | - | **58,389** |
| **Total credit risk at 31 December 2010** | **483,440** | **591,223** | **566,336** | **761,174** | **135,984** | **269,255** | **2,807,412** |

| December 2009 | Trading and manufacturing BD '000 | Banks & other financial institutions BD '000 | Construction & real estate BD '000 | Government & public sector BD '000 | Individuals BD '000 | Others BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with central banks | - | 12,303 | - | 150,105 | - | - | 162,408 |
| Treasury bills | - | - | - | 61,655 | - | - | 61,655 |
| Deposits in banks & other financial institutions | - | 320,598 | - | - | - | - | 320,598 |
| Loans & advances to customers | 327,959 | 121,330 | 461,328 | 85,692 | 105,402 | 166,850 | 1,268,561 |
| Investment securities | 26,072 | 101,458 | 36,459 | 177,609 | - | 11,343 | 352,940 |
| Other assets | - | - | - | - | - | 38,772 | 38,772 |
| Total funded exposure | 354,030 | 555,688 | 497,787 | 475,061 | 105,402 | 216,966 | 2,204,934 |
| Unfunded commitments & contingents | 94,362 | 186,687 | 87,157 | 5,752 | 6,697 | 23,080 | 403,736 |
| Aggregation | - | 56,677 | - | - | - | - | 56,677 |
| Total credit risk at 31 December 2009 | 448,393 | 799,052 | 584,944 | 480,813 | 112,099 | 240,046 | 2,665,346 |

## 12. Concentration of credit risk by maturity

| December 2010 | Within 1 month BD '000 | 1 to 3 months BD '000 | 3 to 6 months BD '000 | 6 to 12 months BD '000 | 1 to 5 years BD '000 | 5 to 10 years BD '000 | 10 to 20 years BD '000 | Above 20 years BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|---|---|---|
| Cash and balances with central banks | 298,158 | - | - | - | - | - | - | 60,768 | **358,926** |
| Treasury bills | 40,410 | 35,948 | 5,797 | 48,017 | - | - | - | - | **130,172** |
| Deposits in banks & other financial institutions | 102,196 | 30,717 | - | - | 1,619 | - | - | - | **134,532** |
| Loans & advances to customers | 108,549 | 97,126 | 62,007 | 99,749 | 445,210 | 289,896 | 48,019 | 125,760 | **1,276,316** |
| Investment securities | 180,890 | 18,636 | 34,756 | 13,488 | 68,844 | 50,576 | 3,940 | 54,017 | **425,147** |
| Other assets | 19,204 | 207 | 177 | 109 | 233 | - | - | 29,272 | **49,202** |
| Total funded exposure | 749,407 | 182,634 | 102,737 | 161,363 | 515,906 | 340,472 | 51,959 | 269,817 | **2,374,295** |
| Unfunded commitments & contingents | 70,172 | 44,368 | 137,983 | 106,608 | 8,347 | 4,438 | 305 | 2,507 | **374,728** |
| Aggregation | | | | | | | | 58,389 | **58,389** |
| **Total credit risk at 31 December 2010** | **819,579** | **227,002** | **240,720** | **267,971** | **524,253** | **344,910** | **52,264** | **330,713** | **2,807,412** |

| December 2009 | Within 1 month BD '000 | 1 to 3 months BD '000 | 3 to 6 months BD '000 | 6 to 12 months BD '000 | 1 to 5 years BD '000 | 5 to 10 years BD '000 | 10 to 20 years BD '000 | Above 20 years BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|---|---|---|
| Cash and balances with central banks | 118,167 | 270 | 677 | 587 | 796 | - | - | 41,910 | 162,408 |
| Treasury bills | 20,707 | 24,960 | 5,635 | 10,353 | - | - | - | - | 61,655 |
| Deposits in banks & other financial institutions | 320,141 | 456 | - | - | - | - | - | - | 320,598 |
| Loans & advances to customers | 82,542 | 77,768 | 47,390 | 81,651 | 506,091 | 227,424 | 86,544 | 159,151 | 1,268,561 |
| Investment securities | 119,436 | 34,403 | 27,035 | 31,896 | 51,356 | 24,099 | - | 64,714 | 352,940 |
| Other assets | 9,818 | 282 | 94 | 26 | 550 | - | - | 28,001 | 38,772 |
| Total funded exposure | 670,811 | 138,140 | 80,832 | 124,513 | 558,794 | 251,523 | 86,544 | 293,776 | 2,204,933 |
| Unfunded commitments & contingents | 50,418 | 80,502 | 144,012 | 126,758 | 1,655 | 35 | 154 | 202 | 403,736 |
| Aggregation | | | | | | | | 56,677 | 56,677 |
| Total credit risk at 31 December 2009 | 721,229 | 218,642 | 224,844 | 251,271 | 560,448 | 251,558 | 86,698 | 350,655 | 2,665,346 |

## 13. Impaired loans and provisions

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | Principal & interest outstanding BD '000 | Impaired loans BD '000 | Specific provisions BD '000 | Principal & interest outstanding BD '000 | Impaired loans BD '000 | Specific provisions BD '000 |
| Manufacturing | **210,934** | **20,286** | **13,988** | 225,932 | 20,671 | 14,371 |
| Mining and quarrying | **9,921** | **-** | **-** | 2,064 | - | - |
| Agriculture, fishing and forestry | **4,867** | **26** | **26** | 692 | 149 | 150 |
| Construction | **191,484** | **15,774** | **5,007** | 145,851 | 17,373 | 3,833 |
| Financial | **142,240** | **38,713** | **27,887** | 139,615 | 45,984 | 17,687 |
| Trade | **164,353** | **9,426** | **3,747** | 118,367 | 7,544 | 2,959 |
| Personal/Consumer finance | **147,417** | **17,511** | **15,272** | 118,400 | 15,914 | 12,479 |
| Commercial real estate financing | **224,876** | **14,620** | **555** | 269,348 | 25,172 | 1,036 |
| Residential mortgage | **68,314** | **4,250** | **624** | 53,375 | 1,423 | 104 |
| Government | **35,873** | **-** | **-** | 86,114 | - | - |
| Technology, media and telecommunications | **51,806** | **370** | **274** | 60,513 | 509 | 357 |
| Transport | **42,818** | **1,417** | **1,416** | 42,043 | 4,894 | 4,893 |
| Other sectors | **64,100** | **1,370** | **158** | 70,619 | 249 | 253 |
| **Total at 31 December** | **1,359,003** | **123,763** | **68,954** | 1,332,933 | 139,882 | 58,122 |

## 14. Reconciliation of changes in impaired loans and Provision

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Specific impairment provisions BD '000 | Collective impairment provisions BD '000 | Specific impairment provisions BD '000 | Collective impairment provisions BD '000 |
| At beginning of the year | **58,122** | **6,248** | 52,185 | 3,710 |
| Amounts written off | **(1,744)** | **-** | (5,664) | - |
| Write backs/cancellation due to improvement | **(5,263)** | **(40)** | (1,655) | - |
| Additional provisions made | **16,790** | **8,669** | 12,368 | 2,446 |
| Exchange adjustment and other movements | **1,793** | **(1,144)** | 1,587 | 91 |
| Notional interest on impaired loans | **(744)** | **-** | (699) | - |
| **Balance at reporting date** | **68,954** | **13,733** | 58,122 | 6,247 |

## 15. Past due loans by region

| December 2010 | GCC BD '000 | North America BD '000 | Europe BD '000 | Asia BD '000 | Others BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|
| Past due loans | 122,643 | - | - | 1,120 | - | 123,763 |
| Specific impairment provisions including interest in suspense | 68,215 | - | - | 739 | - | 68,954 |
| Collective impairment provisions | 13,420 | - | - | 313 | - | 13,733 |

| December 2009 | GCC BD '000 | North America BD '000 | Europe BD '000 | Asia BD '000 | Others BD '000 | Total BD '000 |
|---|---|---|---|---|---|---|
| Past due loans | 139,008 | - | - | 874 | - | 139,882 |
| Specific impairment provisions including interest in suspense | 57,261 | - | - | 861 | - | 58,122 |
| Collective impairment provisions | 5,924 | - | - | 324 | - | 6,248 |

## 16. Aging of past due loans

| | 2010 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | 3 months up to 1 year BD '000 | 1 to 3 years BD '000 | Over 3 years BD '000 | Total BD '000 | 3 months up to 1 year BD '000 | 1 to 3 years BD '000 | Over 3 years BD '000 | Total BD '000 |
| Gross impaired loans | 31,166 | 44,731 | 47,866 | 123,763 | 73,219 | 13,544 | 53,120 | 139,883 |
| Less: specific provisions | 1,725 | 24,294 | 25,524 | 51,543 | 14,289 | 774 | 28,172 | 43,235 |
| Less: interest in suspense | 294 | 3,153 | 13,964 | 17,411 | 1,649 | 221 | 13,017 | 14,887 |
| **Net outstanding** | 29,147 | 17,284 | 8,378 | 54,809 | 57,281 | 12,548 | 11,931 | 81,761 |
| **Market value of collateral** | 26,686 | 12,232 | 17,414 | 56,332 | 34,550 | 6,788 | 30,844 | 72,182 |

## 17. Market risk disclosures for banks using the Internal Models Approach (IMA) for trading portfolios

| | VaR Results for the December 31, 2010 (10 day 99%) Global (BAHRAIN & KUWAIT) January 1, -December 31, 2010 | | | | | VaR Results for the December 31, 2010 (10 day 99%) Global (BAHRAIN & KUWAIT) January 1, -December 31, 2009 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Asset Class | Limit BD '000 | VaR 31/12/20010 BD '000 | High VaR BD '000 | Low VaR BD '000 | Average VaR BD '000 | Limit BD '000 | VaR 31/12/2009 BD '000 | High VaR BD '000 | Low VaR BD '000 | Average VaR BD '000 |
| Foreign exchange | 641 | 93 | 323 | 37 | 118 | 641 | 222 | 376 | 194 | 257 |
| Interest rate | 151 | 2 | 72 | - | 26 | 75 | 46 | 49 | - | 11 |
| **Total** | 792 | 95 | 339 | 37 | 144 | 716 | 268 | 422 | 198 | 268 |

## 18. Concentration risk to individuals where the total exposure is in excess of single obligor limit of 15%

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Sovereign | - | 59,420 |
| Corporate | - | - |
| **Total** | - | 59,420 |

## 19. Credit derivatives exposure

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| FTD | 7,540 | 11,310 |
| CDS and CDOS | 125,563 | 159,375 |
| **Total credit derivatives** | 133,103 | 170,685 |

## 20. Equity positions in the banking book

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Publicly traded equity shares | 40,957 | 27,632 |
| Privately held equity shares | 19,630 | 40,963 |
| **Total** | 60,587 | 68,595 |
| **Capital required** | 7,270 | 8,231 |

## 21. Gains on equity instruments

| | 2010 BD '000 | 2009 BD '000 |
|---|---|---|
| Realised gains/Losses in statement of income | 17,360 | - |
| Unrealised gains/Losses in tier 1 capital (eligible portion) | (717) | 10,995 |
| Unrealised gains/Losses in tier 2 capital (eligible portion) | 1,870 | 6,203 |