ANNUAL
REPORT

2010

بنك البحرين الإسلامي

BisB

His Royal Highness
Prince Khalifa bin Salman
Al Khalifa

The Prime Minister

His Royal Majesty
King Hamad bin Isa
Al Khalifa

The King of the
Kingdom of Bahrain

His Royal Highness
Prince Salman bin Hamad
Al Khalifa

The Crown Prince, Deputy
Supreme Commander

بسم اللّه الرحمن الرحيم

يَا أَيُّهَا الَّذِينَ آمَنُوا اتَّقُوا اللَّهَ وَذَرُوا مَا بَقِيَ مِنَ الرِّبَا إِن كُنتُم مُّؤْمِنِينَ

(سورة البقرة – الآية ٢٧٨ – الجزء ٢)

In the name of Allah, the Most Beneficent, the Most Merciful.

O ye who believe! Fear Allah, and give up what remains of your usury, if ye are indeed believers

(Chapter 2 Al Baqara - Verse 278)

CONTENTS

ABOUT BisB

Bahrain Islamic Bank (BisB) is the first Islamic bank in the Kingdom of Bahrain and the third in the world.

Since inception in 1979, BisB has recorded steady growth, with total assets of BD 936 million. By combining its tradition with modern banking practices, underscored by technology and innovation, BisB has maintained its status as the leading Islamic bank in Bahrain. This was reinforced when BisB became the first Islamic financial institution in Bahrain to be rated by Moody's Investor Service in 2008.

The Bank offers a range of high quality and innovative Sharia-compliant retail, corporate, institutional and investment banking services. These are delivered through a network of 13 branches and 51 ATMs, the largest of any Islamic bank in the Kingdom. As a pioneer of modern Islamic banking, BisB is committed to continuing its contribution to the development of the Islamic financial services sector in Bahrain, and to the growth of Islamic banking worldwide.

VISION & MISSION

Our vision

is to be the best Sharia'a Compliant financial solutions provider.

Our mission
is to leverage our core competencies of customer intimacy, service, leadership and product innovation, in order to achieve the expectations of our stakeholders.

CHAIRMAN'S STATEMENT

In the name of Allah, the Most Beneficent, the Most Merciful.Prayers and Peace be upon the Last Apostle and Messenger, Our Prophet Mohammed, His Comrades and Relatives.

On behalf of the Board of Directors, it is my privilege to present the annual report and the consolidated financial statements of Bahrain Islamic Bank (BisB) for the year ended 31 December 2010. As the world continues to experience the effects of the global financial crisis, the continuing economic slowdown, and its subsequent adverse effect on the GCC, the year proved to be one of the most challenging years for the banking and finance industry.

With a prudent management approach, our adherence to Islamic Sharia principles and a primary focus on the Bahrain's market, we were not directly affected by the declining global economy. However, BisB indirectly experienced serious effects of continuing fall in asset prices particularly in the real estate sector, the negative impact of some of the large regional corporates and the smaller retail credit market rigidity on business growth, which continued to characterise the region in 2010. For the second consecutive year, customers remained very cautious. The mortgage finance activity was the most affected and asset values continued to decline with the pressure on real estate prices.

Consequently, the Bank registered book losses amounting to BD 39.71 million incurred as a result of providing for both financing and investment portfolios. This resulted in lowering shareholders' equity to BD 100.06 million. However, in spite of the losses incurred in 2010, the financial and liquidity position of the Bank remains on solid ground. Total assets increased to BD 935.67 million – an increase of 2.6% over 2009. Similarly, customers' deposits have grown by 13.2% over 2009 to BD 681.7 million.

A key priority for 2011 is restoring trust in the region's business environment and the financial system. This can be achieved by applying greater regulatory control and adopting sound corporate governance and risk management practices. Furthermore, BisB is being more rigorous in selecting its transactions through a stricter credit rating system and methodology.

Having said that, it is important to mention that the economic outlook for Bahrain and the GCC region as a whole remains positive. The GCC states are sitting on substantial oil and natural gas reserves, their underlying macro-economic fundamentals remain sound and the

recovery and stabilisation of the oil prices should help future growth through greater government spending into the infrastructure and other strategic long term developments. Any recovery in the economy will have a strong positive effect on the banking and financial services industry. We are much more optimistic for 2011 compared to the last two years.

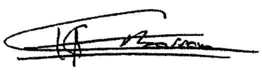
Although market conditions remained difficult, BisB managed to maintain its competitive edge in Bahrain's commercial banking sector. On the business side, we continued to enhance our low cost sustainable deposit accounts in 2010 and diversified our retail products in e-banking and the youth segment.

The year 2011 shall witness the Bank's capital increase, which would take place before the end of the first quarter. Capital increase will be utilized in satisfying the Bank's financing needs and to benefit from the opportunities arising in the investment sector and to diversify and improve the quality of its assets, so as to provide its shareholders with greater returns on their investments.

During 2010, the Bank received many awards announced for the banking sector. The last was the selection of BisB's website by the Pan Arab Web Academy in Lebanon for the Best Visual Award in the Kingdom under the Islamic Banks category.

While we reflect on our achievements, we realise that we need to remain prudent and alert and there is no room for complacency. Therefore, we continue to implement the three-year strategy approved by the Board for the Bank last year. Its key elements are achieving and maintaining sustainable recurring income, increasing fee income to protect the balance sheet, enhancing customer service, to have greater penetration in the local market in retail and corporate financing and to apply greater focus on small to medium enterprises (SMEs) where we already have the strength that we can build on. We also plan to actively support key Government infrastructure projects. Although 2010 was the most challenging year for the Bank, it is satisfying to know that we have the core fundamentals in place for a gradual recovery and a return to profitability.

Finally, I would like to take this opportunity to thank the political leadership for the wise vision, direction and support to the financial services industry in Bahrain in general and to the Islamic banking in particular. I would also like to thank our regulator, the Central Bank of Bahrain, the Ministry of Industry & Commerce and all the government agencies for their continued guidance and cooperation, to our Sharia Supervisory Board for their advice, guidance and supervision, to our shareholders and clients for their loyalty and continued support, and to the Bank's management and staff for their professionalism and unwavering dedication and hard work.



Khalid Abdulla Al Bassam
Chairman

BOARD OF DIRECTORS

KHALID ABDULLA AL BASSAM

Chairman

Holds a Bachelor degree in Business Administration. Currently Chairman of Al Bassam Investment Company and of Capital Management House. Also a Board Member of Gulf Investment Corporation, Kuwait and the Islamic Bank of Asia, Singapore. Previously was the Deputy Governor of Bahrain Monetary Agency (now Central Bank of Bahrain) and Vice Chairman of the Bahrain Stock Exchange.

KHALID MOHAMMED NAJEEBI

Board Member and Chairman of the Executive Committee

Holds a Bachelor Degree in Business Administration and is a member of the Certified Public Accountants of Washington State Board of Accountancy. A founding member and Executive Director of Najibi Investment Company W.L.L, Managing Director & CEO of Capital Management House. Also a Board Member of First Energy Bank and Arbah Capital.

SHAIKH HESHAM BIN ABDULRAHMAN AL KHALIFA

Vice Chairman and Head of the Audit Committee

Holds an MBA in Finance and a Bachelor of Science in Business & Management. Previously held prestigious positions namely Head of Central Strategy Office, Ministry of Finance & National Economy, Bahrain; Head of Commercial Enterprises at the Government Shareholdings Directorate of the Ministry of Finance & National Economy and Senior Financial Analyst - Industrial Enterprises at the Government Shareholdings Directorate, Ministry of Finance & National Economy.

ALI MOHAMMED ALI AL OLIMI

Board Member and Member of the Audit Committee

Holds a B.Sc. in Accounting and is currently the General Manager of Kuwait's Public Authority for Minors' Affairs. Currently a Board Member for Al Reem Real Estate Services and was a Board Member of National Real Estate Company, Kuwait.

NABIL AHMED MOHAMMED AMEEN

Board Member and Member of the Executive Committee

Holds a B.S. in International Business Administration. Currently Chairman & Managing Director of Almadar Finance and Investment Company, Kuwait. Also Vice Chairman of Al Wethaq Takaful Insurance Company, Kuwait. Has also held senior executive positions in Kuwait Finance House in Kuwait and Turkey and at The International Investor in Kuwait.

MOHAMMED ALZAROOQ RAJAB

Board Member and Member of the Audit Committee

Holds a B.S. in Accountancy and is a Fellow member of the Institute of Chartered Accountants in England & Wales. Has held senior posts in Libya including the Auditor General, the Minster of Treasury, Head of Libyan Peoples' Congress, the Prime Minister from 1983 to 1985, Convener of Libyan Central Bank, and has been with Libyan Foreign Investment since 2007.

YOUSIF MOHAMMED SALEH AL AWADHI

Board Member and Member of the Executive Committee

Holds a Bachelor Degree in Management. Was Undersecretary in the Ministry of Awqaf and Islamic Affairs of Kuwait. Has also held various important positions in the Finance Department of the Government of Kuwait including the Assistant Undersecretary for Financial, Administrative and Legal Affairs.

CHIEF EXECUTIVE'S REPORT

In the name of Allah, the Most Beneficent, the Most Merciful.

2010 was one of the most challenging years in the life of BisB. The global financial crisis and economic downturn in the GCC markets continued to lead to slow down in the real estate sector and caused cancellation or postponement of some major vital projects.

Under these conditions, BisB took various steps towards meeting its long term objectives and retain its position as the leading Islamic commercial bank in Bahrain.

The Bank has followed a conservative and prudent approach to business and remained focused to enhance its infrastructure and strengthen its organisation.

The following is a summary of our major developments and achievements during the year 2010.

Financial performance

Repercussions of the international financial crisis continued to impact our performance in 2010 when the situation was not better than the previous year. The Bank decided to take prudent provisions to the tune of BD38.3 million out of which BD20.3 million is for impairment in the finance and investment portfolios and the remaining BD18 million is for the drop in the fair value of the real estate portfolio. This has resulted in the non-cash losses equal to BD39.7 million. Hence, the Bank was in a position to adequately cover the nonperforming accounts and to look ahead for new, clean and a strong start. It is worth noting that the Bank still has a CAR of 14.10%, liquidity ratio of 27.2% and asset growth ratio of 3%.

Responding to challenges

Our local customers were adversely affected by the global and regional crisis. As an Islamic bank, BisB worked actively in helping its customers get through these difficult times by restructuring and rescheduling their obligations. The Bank also took action to protect its asset quality. During this process, BisB had to take additional provisions against the nonperforming facilities.

Focus on achievements

We have concentrated our efforts on enhancing and building up the core business of the bank in Retail and Commercial and Corporate banking. This was achieved through the continuous improvement of our service quality and expanding our net work by opening new branches. Our main effort was diverted towards introducing new innovative products and services. This has culminated in expanding our customer base as the growth in numbers of retail credit cards was 230%. We are also very proud of our website "www.bisb.com" winning the Best Visual Award in the Kingdom, under the Islamic Banks category by the Pan Arab Web Academy in Lebanon. We also focused on renovating our branches, shifting them to new strategic locations and expanding our network of ATMs around the country. Today, we provide the second largest ATM network in Bahrain.

In the last three to four years we were able to develop the right infrastructure needed to compete in the market. Therefore, we will now be more focused on business in the coming year rather than infrastructure development. This will keep operating costs under control.

We at Bahrain Islamic Bank believe that our main asset is our staff. We have recruited high calibre staff and we pay special attention in investing in their training and their welfare to create the right environment to deliver the best service to our customers.

Reputation

We are proud to say that BisB remains the leading Islamic commercial bank in the Kingdom of Bahrain. Established in 1979 as the first Islamic bank in the Kingdom, BisB is internationally recognised as a pioneer in the Islamic banking sector. The enduring loyalty of our staff and customers has been a major factor in establishing BisB's reputation which the Bank has earned for its continuous contribution to the economic and business prosperity of Bahrain.

Looking ahead

We have set up an ambitious strategic plan. We have set up plans to cope with the anticipated challenge to prepare ourselves for greater challenges that may lie ahead. We shall focus on the core business lines in the retail banking and on building up the corporate and financial institutions' business with a particular attention to diversify our revenue. We will also continue to maximise fee-based income to protect the balance sheet while maintaining strict control on our fixed costs. We will make every effort to show our understanding of the current conditions by reducing cost through customer deposits; term borrowing; establishing relationships for interbank short term transactions with other regional, local and international banks; booking good quality assets and retaining good customers in this highly competitive climate. Furthermore, we will introduce two new structured investment products in 2011.

Acknowledgments

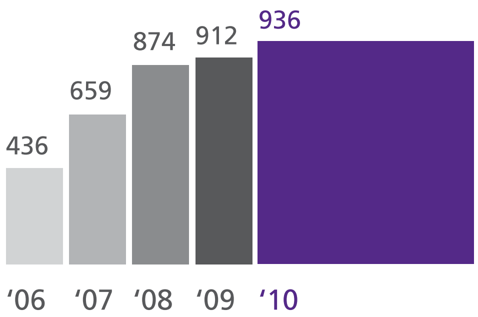
Our achievements during 2010 would not have been possible without the continued efforts of all our stakeholders. In particular, I would like to thank our Board of Directors for their financial support and encouragement; our Sharia'a Supervisory Board for their valuable guidance and supervision; our customers for their trust and loyalty and our business partners for their positive and constructive cooperation. I would also like to commend BisB's management and staff for their unwavering dedication, professionalism and innovative spirit. Together, they have ensured that BisB is well placed for 2011 with renewed confidence and strength.

Allah the Almighty is the Purveyor of all Success.

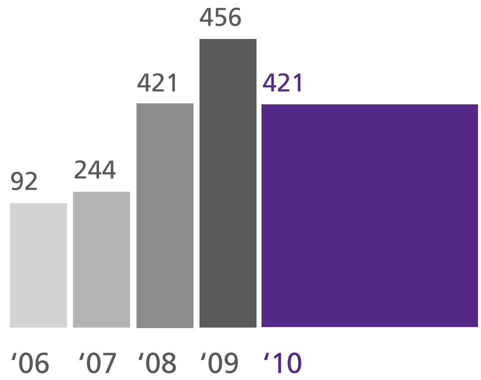
Mohammed Ebrahim Mohammed
Chief Executive

FINANCIAL HIGHLIGHTS

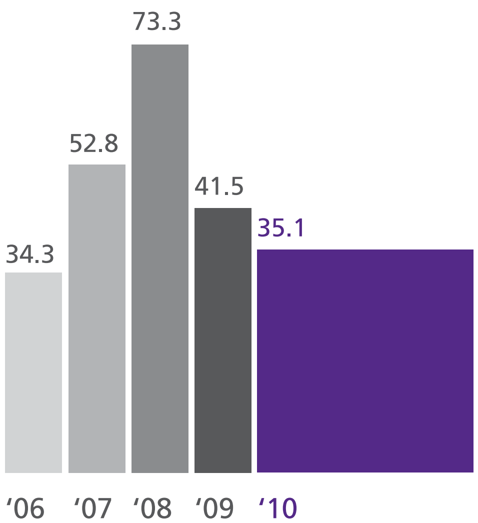
TOTAL ASSETS
BD MILLIONS



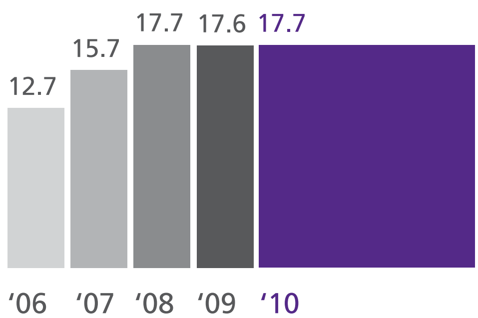
ISLAMIC FINANCING
BD MILLIONS

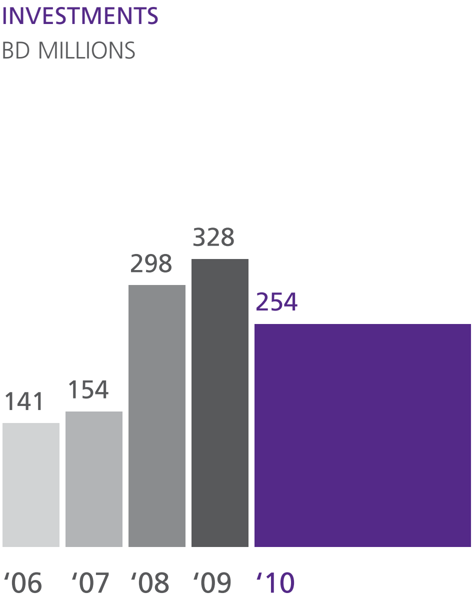


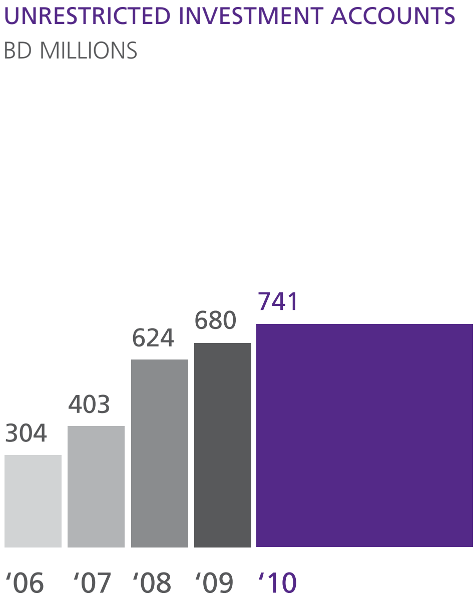
TOTAL OPERATING INCOME
BD MILLIONS



INVESTORS' SHARE IN INCOME
BD MILLIONS




INVESTMENTS
BD MILLIONS
141
154
298
328
254
'06
'07
'08
'09
'10


UNRESTRICTED INVESTMENT ACCOUNTS
BD MILLIONS
304
403
624
680
741
'06
'07
'08
'09
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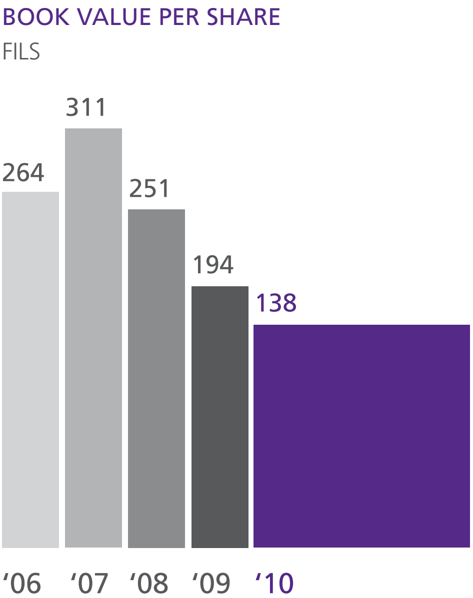
BOOK VALUE PER SHARE
FILS
264
311
251
194
138
'06
'07
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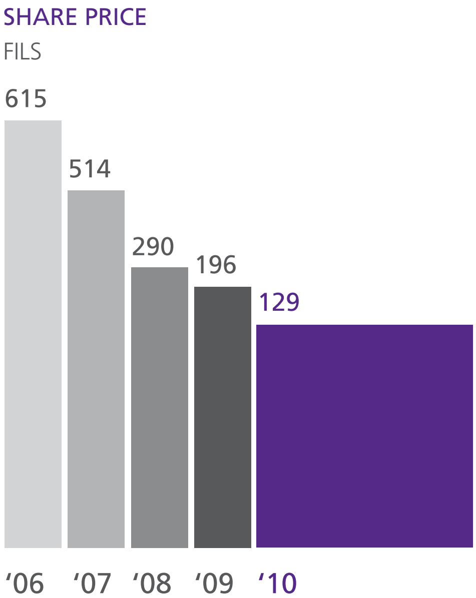
'09
'10


SHARE PRICE
FILS
615
514
290
196
129
'06
'07
'08
'09
'10

EXECUTIVE MANAGEMENT

(Left to right)

Mohammed Ahmed Hassan
General Manager Support Services

Dr. Salahudin A. Qader
General Manager Credit & Risk Management

Khalid Mahmoud Abdulla
Head of Internal Audit

Khalid Mohammed Al Dossari
Chief Financial Officer

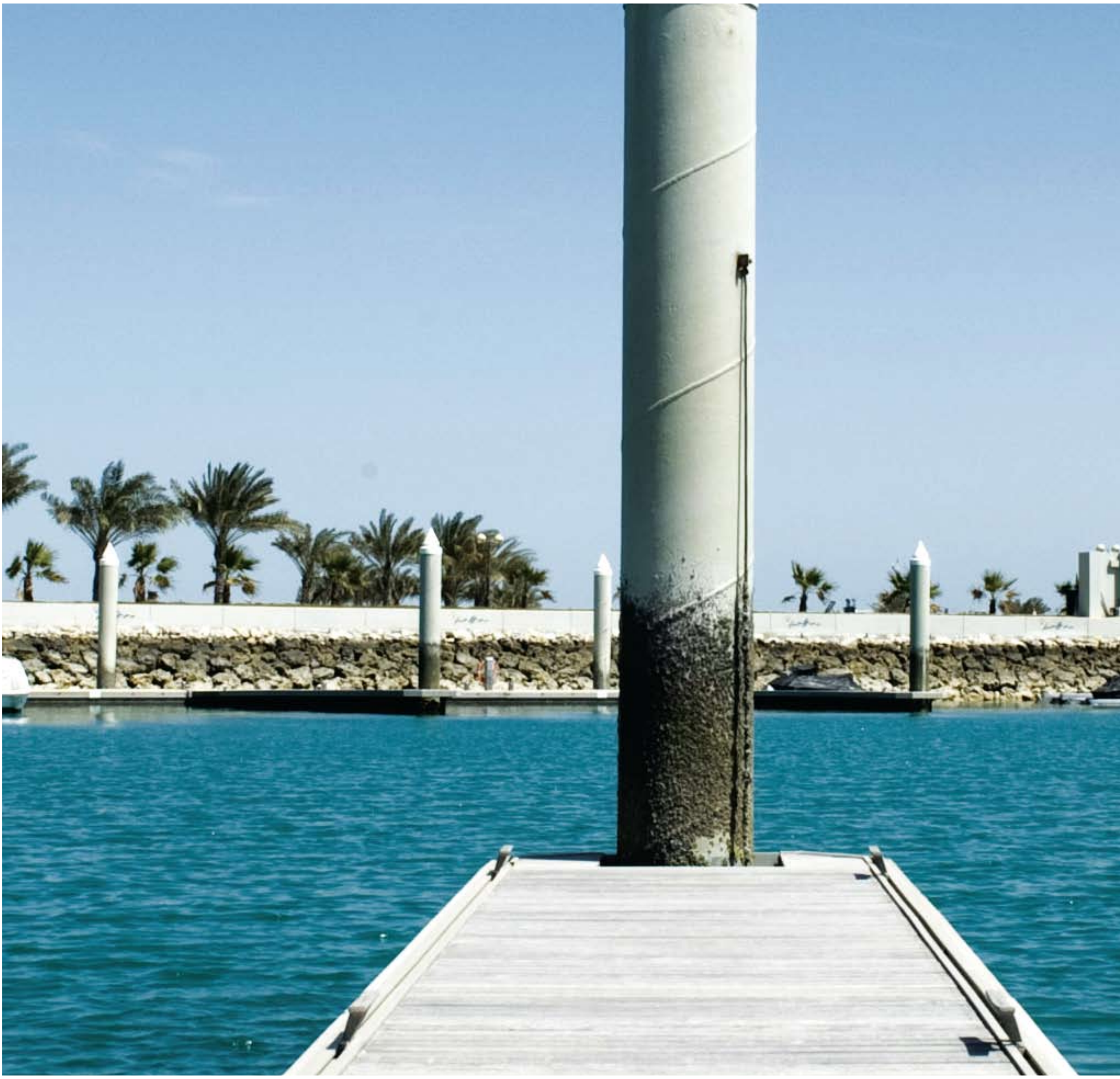
Mohammed Ebrahim Mohammed
Chief Executive

Abdulrahman Mohammed Turki
General Manager Retail

Mohammed Fikree
Head of Treasury & Investment

Nader Mohammed Ebrahim
General Manager Corporate & Institutional Banking

REVIEW OF OPERATIONS



Future plans for retail banking include the launch of a new Priority Banking service

REVIEW OF OPERATIONS

RETAIL BANKING

The retail banking business of BisB enjoyed a busy and successful year in 2010, despite the challenging market conditions and increasingly competitive commercial banking sector in Bahrain. We focused on retaining the loyalty of existing customers; attracting new clients; enhancing our services; launching new innovative products and expanding delivery channels.

Our major challenge in 2010 was to match the market's contentious rate cut on personal and mortgage offers. Most competitors significantly reduced their offered rates on all types of financing to individuals. Although it was difficult to match the rate reduction trend, we managed to reduce our cost of funds significantly. This enabled us to offer competitive rates on our personal financing and remain competitive.

The Bank focused on two major business segments in 2010, the youth customer segment and e-banking customers. For the youth segment, the Bank introduced the Vevo account and for the e-banking we launched the e-card. These two new products were accompanied by intensive advertising campaigns that highlighted the added value features for the target market.

The Bank continued to grow its low cost sustainable deposit accounts. Our credit card sales took off very strongly in 2010, reaching 9,000 accounts and an interim growth rate of 230%. The Vevo credit card and the e-Card exceeded the Bank's expectations in terms of fast growth. Our website - www.bisb.com - was selected for the Best Visual Award in the Kingdom in the Islamic banks category by the Pan Arab Web Academy, Lebanon.

Our main challenge and objective in 2011 is to affect the migration of conventional customers of the bank to e-banking services. We have set up a powerful awareness programme to help familiarise customers with e-banking. We are also planning to introduce an SMS alert system to inform customers of their debit or credit card transactions as well as any received funds in to their accounts.

In 2010, BisB renovated four branches, shifted two branches to new strategic locations and opened one new branch at the prestigious Bahrain City Centre. Also, BisB today is the second largest ATM service provider in the Kingdom of Bahrain with a network of 52 ATMs all around the Kingdom.

CORPORATE & INSTITUTIONAL BANKING

The effects of the global financial crisis, economic downturn and credit squeeze continued to adversely impact the corporate environment in Bahrain during 2010. It has heavily affected the real estate sector which takes up a decent portion of our financial book. The financial crisis has reflected on our clients and as we are driven by their business needs, the Bank experienced a very challenging year in 2010. A number of our clients rescheduled their commitments with us. We also experienced repayments and existing limits not being utilised due to low business as well as limited new requests at the terms acceptable to BisB.

However, the main focus of our division in 2010 was on preserving the balance sheet and enhancing the financial book. We achieved this through close monitoring of our financial portfolios, niche marketing, structured trade finance booking and arranging syndicated transactions.

We continued preserving the financing level of 2009 through a very conservative approach to new lending transactions, being very selective and booking new business form existing and new clients. We actively approached structured trade finance and quasi –sovereign club deals to manage risk and credit quality.

Looking ahead, we will employ additional capital being raised through rights issue, offer clients more competitive financial terms to remain competitive, actively market our clients and markets, introduce more automation of our

services to improve the quality and distinguish ourselves accordingly. In 2011, we will introduce new corporate internet banking services, structured trade finance packages and we will forge strategic alliances with local and regional banks to cover the market more effectively.

BisB is the leader in the corporate and syndication financing among Islamic banks in Bahrain. We have developed a well established and distinguished relationship with the Government through investment in Mumtalakat (Bahrain's sovereign wealth fund). BisB is well recognised and respected as a business partner of regional and local associations.

We are very much well regarded by international organisations interested in Islamic banking locally and regionally. BisB remains their preferred Islamic banking business partner.

TREASURY & INVESTMENT

Treasury

We had a good year in 2010 as Treasury continued to successfully manage the Bank's liquidity and grow and protect its balance sheet. The priority remained the need to preserve capital and to ensure recurring sustainable income. BisB also continued to adopt a cautious approach to proprietary trading, with a balanced portfolio primarily focused on public and very selective private equities, and capital market Sukuk issues. We took advantage of the declining profit rate by buying fixed rate Sukuk.

Also during the year, BisB continued to implement the state-of-the-art treasury system. Future plans include broadening the Bank's range of treasury products and services, and through our new Asset Management unit, we will cater to high net-worth individuals and retail clients.

Treasury aims to enhance the Bank's funding profile in 2010 by negotiating bilateral medium term Murabah facilities to better match maturities. In the medium term, the Bank plans to seek longer term funding from the syndicated finance market or the capital markets once the market conditions return to normality.

Investment

In accordance with its conservative approach, BisB maintained the primary exposure of its investment portfolio to GCC-focused blue chip entities. Due to the challenging and volatile market conditions that continued to prevail in 2010, the Bank focussed on stable cash flow yielding businesses to continue making a contribution to the Bank's bottom line. The Bank's major investment transactions in 2010 were focussed on the petrochemical sector boom and allied activities as we shifted our focus to sectors with an edge in the region such as petrochemicals, agriculture and services.

We took advantage of financial market volatility by using opportunistic tactics. A good example of this is when the Dubai restructuring episode occurred in late 2009, BisB took steps to investigate the knock on impacts on portfolios stemming through cascading impacts on regional financial markets. Thus, we managed to grow on the asset and equity sides.

Key initiatives in 2010 included BisB's underwriting of the Aluminium Bahrain (Alba) retail IPO offering and achieving fee-based income streams that continue into 2011.

Future plans include asset management with one or two new investment products in 2011 and taking more active and leading role in Sukuk issuance in the GCC and other capital markets activities. Focus will also be placed on infrastructure and industrial projects that can produce good sustainable recurring income for BisB and which will also support Bahrain's economic development and industrial diversification. In addition, the Bank will explore investing in Islamic structured products to gain exposure to various asset classes available to investors around the world.

REVIEW OF OPERATIONS

SUPPORT SERVICES

Human Capital

Our employees are the most valuable asset to BisB. They act as a key driver of the Bank's strategic and business growth. In 2010, competition remained very high between banks with an increasingly high demand on competent and experienced employees.

The challenge in 2010 was to cope with the fierce competition from other banks in the market. It was generally a good year for our division as we continued to review our services to improve them and meet new requirements while retaining highly qualified staff. We will continue to retain staff in a competitive market by providing incentives and an excellent work environment.

We also continued to implement our comprehensive succession system which covers not only the top level of management, but applies to the entire organisation. This is designed to identify and develop staff at junior levels for future management positions. We kept our focus on the Bank's strategy to instil a culture of performance and accountability throughout the organisation.

Training & Development

We continued our considerable investment in staff training and development in 2010. Training courses were conducted in Bahrain and abroad to enhance basic knowledge and skills, meeting regularity requirements for anti-money laundering and addressing critical areas such as risk management and credit control.

General Services

Our general services experienced a boost in 2010 as we continued to review procedures to ensure timely delivery of our products. We reduced cost by applying cost effective measures and carried out the renovation of eight out of 13 branches to provide the ideal business environment and atmosphere for our clients. In 2010, we particularly focused on corporate social responsibility as part of our Islamic ethos. Most notable of our CSR activities was the sole sponsorship of a week-long charity event with the Rekaz Society.

Information Technology

Information and Communications Technology (ICT) is a critical business enabler and strategic driver for the Bank. We are glad to say that our IT security management reached maturity in 2010 with the installation of state-of the art technology. Our data centre, disaster recovery centre and information security measures are all in line with BisB's prestigious ISO 27001 certification.

Our employees are the most valuable asset to BisB. They act as a key driver of the bank's strategic and business growth.

In addition, new ICT tools and systems were identified and developed for the ongoing automation of the following areas and activities of the Bank:

- A new treasury solution
- A new risk management solution
- A new corporate internet solution

Central Operations

We continued to take advantage of downturn in business activity in 2010 by devoting more time and resources to further enhance our overall support infrastructure. We significantly enhanced our institutional capability, operational efficiency and the scope and quality of support services.

We also focused on streamlining the Back Office operational procedures to enable front line staff to deliver greater customer satisfaction, while maintaining necessary due diligence to mitigate operational risk.

Several new specialist software applications for critical areas such as treasury, risk management and human resources were implemented to enhance automation, minimise human error and reduce overall cycle times and costs.

RISK
MANAGEMENT

All individuals within the Bank are personally accountable for the risk exposures relating to their responsibilities

RISK MANAGEMENT

As an inherent part of the Bank's activities, risk is managed through a process of ongoing identification, measurement, monitoring and reporting in line with the risk appetite of the Bank which is set and guided by the Board of Directors. This process of risk management is critical to the continued profitability of BisB, and all individuals within the institution are personally accountable for the risk exposures relating to their responsibilities.

The Bank is exposed primarily to credit risk, liquidity risk, market risk (including profit rate, equity price and currency risks), operational risk, reputational risk and Sharia-compliance risk.

Risk management philosophy

The risk management philosophy of BisB is to identify, capture, monitor and manage the various dimensions of risk. The objective is to protect asset values and income streams so that the interests of the Bank's stakeholders are safeguarded, while optimising shareholders' returns and maintaining risk exposure within the parameters set by the Board.

The Bank has defined its risk appetite within the broad framework of its Risk Strategy. BisB reviews and aligns its risk appetite in line with its evolving business plan, and changing economic and market scenarios. The Bank also assesses its tolerance for specific risk categories and its strategy to manage these risks.

Risk management framework

BisB has in place a comprehensive enterprise-wide integrated risk management framework (Risk Governance). This embraces all levels of authorities, organisational structure, people and systems required for the smooth functioning of risk management policies within the Bank.

The Board of Directors retains ultimate responsibility and authority for all risk matters, including establishing overall policies and procedures. The Board is assisted in fulfilling its responsibilities by the Chief Executive and by various board levels and management committees.

The Credit & Risk Management (C&RM) division, headed by a General Manager reporting directly to the Chief Executive, has day-to-day responsibility for managing the risks involved across all areas of the Bank. C&RM provides independent identification, measurement, monitoring and control of all risk parameters, while liaising with the business divisions that ultimately own the risks. C&RM comprises a number of specialist units, including Risk Management & Compliance, Credit Review & Analysis, Credit Administration, and Legal Affairs.

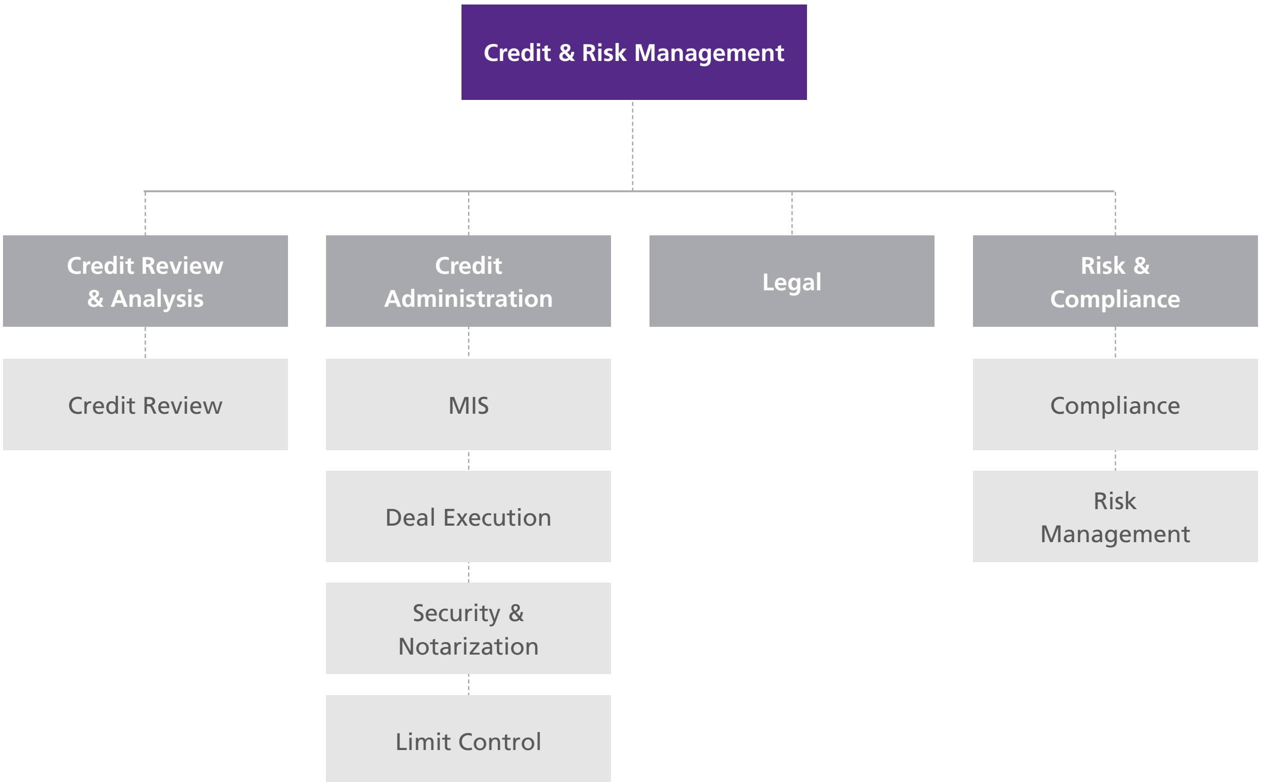
Key developments in 2010

In light of the prevailing global and regional challenging conditions, the Bank placed the highest priority on further strengthening its risk management infrastructure during 2010. Key developments and initiatives achieved include:

- Board approved Risk Governance Charter (Risk Management Framework)
- New policies required in compliance with Basel II (ICAAP, Credit Risk Mitigation, Liquidity & Public Disclosure Policies)
- Enterprise-wide Risk Management System (SunGard)
- Ensuring ongoing compliance with the rules and regulations of the Central Bank of Bahrain and Basel II requirements
- Monitoring Sharia-compliance risk as well as the other risks to which BisB is exposed
- Instilling a credit culture throughout the Bank
- Ensuring controlled growth through a balance of 'minimising risk and maximising yield'

Additional information on the Bank's risk management framework, policies, processes and procedures is included in the Notes to the Consolidated Financial Statements and the Basel II Pillar 3 Public Disclosure sections of this annual report.

The risk management philosophy of BisB is to identify, capture, monitor and manage the various dimensions of risk.



CORPORATE GOVERNANCE

As a responsible financial institution and a leading Islamic bank, BisB is committed to upholding the highest standards of corporate governance.

CORPORATE GOVERNANCE

BisB is committed to upholding the highest standards of corporate governance.

BisB is committed to upholding the highest standards of corporate governance. The Bank seeks to balance entrepreneurship, compliance, and industry best practices, while creating value for all stakeholders. This includes, but is not limited to, conducting the policy and affairs of BisB in compliance with regulatory requirements. It also involves having the right checks and balances in place throughout the organisation to ensure that the right things are always done in the right way.

Responsibilities

The Board of Directors is accountable to the shareholders for the creation and delivery of strong sustainable financial performance and long-term shareholder value through strategic initiatives. The Chairman is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the Executive Management, and maintaining a dialogue with the Bank's shareholders. The Board has appointed two Committees to assist it in carrying out its responsibilities. The Internal Audit function reports directly to the Board through the Audit Committee. The Board delegates the authority for management of the business to the Chief Executive.

BisB's seeks to balance entrepreneurship, compliance, and industry best practices, while creating value for all stakeholders.

Framework

BisB's corporate governance framework comprises a code of business conduct; operational policies and procedures; internal controls and risk management systems; internal and external audit and compliance procedures; effective communications and transparent disclosure; and measurement and accountability.

Code of Business Conduct

BisB conducts itself in accordance with the highest standards of ethical behaviour. A Code of Business Conduct has been developed to govern the personal and professional conduct of all stakeholders.

Compliance

BisB has in place comprehensive policies and procedures to ensure full compliance with the relevant rules and regulations of the Central Bank of Bahrain, including appropriate anti-money laundering procedures.

Communications

BisB conducts all communications with its stakeholders in a professional, honest, transparent, understandable, accurate and timely manner. Main communications channels include an annual report, corporate brochure and website, and regular announcements in the appropriate local media.

CORPORATE
SOCIAL
RESPONSIBILITY

Since inception, BisB has been committed to contributing to the economic and social well-being of the Kingdom of Bahrain.

CORPORATE SOCIAL RESPONSIBILITY

Since inception, BisB has been committed to supporting the social and economic development of the Kingdom of Bahrain.

Since inception, BisB has been committed to supporting the social and economic development of the Kingdom of Bahrain. As a concerned corporate citizen, we have put in place a comprehensive corporate social responsibility programme that provides financial assistance to various charitable, educational, medical, cultural and sporting organisations and events, and deserving causes; and also supports the development of Bahrain's financial services industry. In line with the Bank's business philosophy, we are particularly keen to support initiatives that foster entrepreneurship and that encourage the development of tomorrow's leaders.

SHARIA SUPERVISORY BOARD REPORT

Dr. Shaikh A.Latif Mahmood Al Mahmood
Chairman

Shaikh Mohammed Jaffar Al Juffairi
Vice Chairman

Shaikh Adnan Abdullah Al Qattan
Member

Shaikh Nedham M. Saleh Yacoubi
Member

Shaikh Dr. Essam Khalaf Al Onazi
Member

SHARIA SUPERVISORY BOARD REPORT

In The Name of Allah, most Gracious, most Merciful Peace and Blessings Be Upon His Messenger.

To the shareholders of Bahrain Islamic Bank B.S.C.

Assalam Alaykum Wa Rahmatu Allah Wa Barakatoh

Pursuant to the powers entrusted to the Sharia'a Supervisory Board to supervise the Bank's activities, we hereby submit the following report.

The Sharia'a Supervisory Board monitored the operations, related to the Bank throughout the year end 31 December 2010 to express opinion on the Bank's adherence to the provisions and principles of Islamic Sharia'a in its activities by following the guidelines and decisions issued by the Sharia'a Supervisory Board. The Sharia'a Supervisory Board believes that ensuring the conformity of its activities and investments with the provisions of Islamic Sharia'a is the sole responsibility of the Bank's Management while the Sharia'a Supervisory Board is only responsible for expressing an independent opinion and preparing a report thereabout.

The Sharia'a Supervisory Board's monitoring function included the checking of documents and procedures to scrutinize each operation carried out by the Bank, whether directly or through the Sharia'a Internal Audit department. We planned with the Sharia'a Internal Audit department to carry out monitoring functions by obtaining all the information and clarifications that were deemed necessary to confirm that the Bank did not violate the principles and provisions of Islamic Sharia'a. The Sharia'a Internal Audit department audited the Bank's transactions and submitted a report to the Sharia'a Supervisory Board. The report confirmed the Bank's commitment and conformity to the Sharia'a Supervisory Board's opinions.

The Sharia'a Supervisory Board obtained data and clarifications it deemed necessary to confirm that the Bank did not violate the principles and provisions of Islamic Sharia'a. It held several

meetings throughout the year ended 31 December 2010 and replied to the inquiries, in addition to approving a number of new products presented by the Management. The Sharia'a Supervisory Board discussed with the Bank's officials all transactions carried out by the Management throughout the year and reviewed the Bank's conformity with the provisions and principles of Islamic Sharia'a as well as the resolutions and guidelines of the Sharia'a Supervisory Board.

The Sharia'a Supervisory Board believes that:

1. Contracts, operations and transactions conducted by the Bank throughout the year ended 31 December 2010 were in accordance with the standard contracts pre-approved by the Sharia'a Supervisory Board.

2. The distribution of profit on investment accounts was in line with the basis and principles approved by the Sharia'a Supervisory Board.

3. Any gains resulted from sources or means prohibited by the provisions and principles of Islamic Sharia'a, have been directed to the Charity and Donations Account according to SSB's resolution.

4. Zakah was calculated according to the provisions and principles of Islamic Sharia'a. The Bank distributed Zakah on the statutory reserve, general reserve and retained earnings. The shareholders should pay their portion of Zakah on their shares as stated in the financial report.

5. The Bank was committed to the Sharia'a standards issued by the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI).

Dr. Shaikh A. Latif Mahmood Al Mahmood
Chairman

Shaikh Mohammed Jaffar Al Juffairi
Vice Chairman

Shaikh Adnan Abdullah Al Qattan
Member

Shaikh Nedham M. Saleh Yacoubi
Member

Shaikh Dr. Essam Khalaf Al Onazi
Member

FINANCIAL STATEMENTS

AUDITORS' REPORT

We have audited the accompanying consolidated statement of financial position of Bahrain Islamic Bank B.S.C. ["the Bank"] and its subsidiary ["the Group"] as of 31 December 2010, and the related consolidated statements of income, cash flows, changes in equity, sources and uses of good faith qard fund and sources and uses of zakah and charity fund for the year then ended. These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a Rules and Principles are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ["AAOIFI"]. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statements presentation. We believe that our audit provides a reasonable basis for our 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, the results of its operations, its cash flows, changes in equity, sources and uses of good faith qard fund and sources and uses of zakah and charity fund for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

OTHER MATTERS

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 Report of the Board of Directors 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 licence and has also complied with Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

Ernst + Young

18 January 2011
Manama, Kingdom of Bahrain

FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2010

	Notes	**2010 BD'000**	2009 BD'000
ASSETS			
Cash and balances with Central Bank of Bahrain and other banks	3	**45,831**	36,093
Murabaha receivables	4	**431,692**	332,519
Mudaraba investments	5	**37,360**	53,370
Musharaka investments	6	**80,246**	80,919
Investments	7	**94,667**	134,195
Investment in associates	8	**6,778**	7,448
Investment in Ijarah assets	9	**9,635**	9,771
Ijarah Muntahia Bittamleek	10	**105,386**	119,244
Investment in properties	11	**105,192**	123,030
Ijarah rental receivables		**7,569**	3,603
Other assets	12	**11,318**	11,758
TOTAL ASSETS		**935,674**	911,950
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY			
LIABILITIES			
Customers' current accounts		**81,660**	79,724
Other liabilities	13	**12,571**	11,432
Total Liabilities		**94,231**	91,156
UNRESTRICTED INVESTMENT ACCOUNTS			
Financial institutions' investment accounts	14	**141,358**	157,914
Customers' investment accounts	14	**600,024**	522,379
Total Unrestricted Investment Accounts		**741,382**	680,293
EQUITY	15		
Share capital		**72,859**	72,859
Treasury shares		**(307)**	(173)
Share premium		**43,936**	43,936
Reserves		**(16,594)**	23,132
Proposed appropriations		**167**	747
Total Equity		**100,061**	140,501
TOTAL LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY		**935,674**	911,950
COMMITMENTS AND CONTINGENT LIABILITIES	17	**13,230**	18,765

Khalid Abdulla Al Bassam
Chairman

Khalid Mohammed Najeebi
Board Member

Mohammed Ebrahim Mohammed
Chief Executive Officer

The attached notes 1 to 31 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME
For the year ended 31 December 2010

	Notes	2010 BD'000	2009 BD'000
INCOME			
Income from Islamic finances	18	**28,073**	30,300
Income from sukuk and commodities	18	**5,010**	5,394
		33,083	35,694
Gross return to unrestricted investment accounts		**28,188**	29,155
Group's share as a Mudarib		**(10,467)**	(11,517)
Return on unrestricted investment accounts		**17,721**	17,638
Group's share of income from joint financing and investment accounts		**15,362**	18,056
Net income from investments	19	**901**	3,164
Loss on sale of available for sale investments		**(1,429)**	(2,005)
Share of results of associates		**(717)**	(174)
Fee and commission income		**2,661**	4,418
Other income		**616**	433
Total income		**17,394**	23,892
EXPENSES			
Staff costs		**9,711**	9,812
Depreciation		**1,554**	1,320
Other expenses	20	**7,473**	5,750
Total expenses		**18,738**	16,882
Net (loss) income before fair value adjustment for investment in properties and provisions		**(1,344)**	7,010
Fair value adjustment for investment in properties	11	**(18,051)**	-
Provision for impairment	21	**(20,317)**	(26,407)
NET LOSS FOR THE YEAR		**(39,712)**	(19,397)
BASIC AND DILUTED EARNINGS PER SHARE (fils)	23	**(54.60)**	(26.67)

The attached notes 1 to 31 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOW

For the year ended 31 December 2010

	Notes	2010 BD'000	2009 BD'000
OPERATING ACTIVITIES			
Net loss for the year		**(39,712)**	(19,397)
Adjustments for non-cash items:			
Depreciation		**1,554**	1,320
Provision for impairment	21	**20,317**	26,407
Fair value adjustment for investment in properties		**18,051**	-
Loss on sale of available for sale investments		**1,429**	2,005
Share of results of associates	8	**717**	174
Operating profit before changes in operating assets and liabilities		**2,356**	10,509
Working capital adjustments:			
Mandatory reserve with Central Bank of Bahrain		**(3,460)**	7,838
Murabaha receivables		**(104,823)**	16,363
Mudaraba investments		**10,829**	1,986
Musharaka investments		**(3,594)**	(351)
Ijarah rental receivables		**(3,966)**	(2,134)
Other assets		**(2,674)**	(6,408)
Customers' current accounts		**1,936**	10,258
Other liabilities		**1,277**	(5,255)
Net cash (used in) from operating activities		**(102,119)**	32,806
INVESTING ACTIVITIES			
Purchase of investment in properties		**(213)**	(6,157)
Ijarah Muntahia Bittamleek		**13,858**	(51,284)
Purchase of investment in Ijarah assets		**-**	(5)
Purchase of investments		**(24,121)**	(60,275)
Proceeds from disposal of investments		**58,056**	28,013
Movement in investment in associates		**-**	(234)
Net cash from (used in) investing activities		**47,580**	(89,942)
FINANCING ACTIVITIES			
Purchase of treasury shares		**(134)**	(173)
Decrease in financial institutions' investment accounts		**(16,556)**	(37,968)
Increase in customers' investment accounts		**77,645**	94,142
Dividends paid		**(59)**	(3,801)
Zakah paid		**(79)**	(712)
Net cash from financing activities		**60,817**	51,488
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**6,278**	(5,648)
Cash and cash equivalents at 1 January		**12,683**	18,331
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	3	**18,961**	12,683
Cash and cash equivalents at year end comprise of:			
Cash in hand		**7,605**	5,927
Balances with CBB, excluding mandatory reserve deposits		**3,150**	1,044
Balances with banks and other financial institutions		**8,206**	5,712
		18,961	12,683

The attached notes 1 to 31 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2010

	Share capital BD'000	Treasury shares BD'000	Share premium BD'000	Statutory reserve BD'000	General reserve BD'000	Investment in properties fair value reserve BD'000	Cumulative changes in fair value of investments BD'000	Accumulated losses BD'000	Proposed appropriations BD'000	Total equity BD'000
At 1 January 2010	**72,859**	**(173)**	**43,936**	**10,268**	**1,000**	**18,093**	**(1,431)**	**(4,798)**	**747**	**140,501**
Purchase of treasury shares (note 15)	**-**	**(134)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(134)**
Zakah paid	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(747)**	**(747)**
Net loss for the year	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(39,712)**	**-**	**(39,712)**
Transfer to investment in properties fair value reserve	**-**	**-**	**-**	**-**	**-**	**(18,051)**	**-**	**18,051**	**-**	**-**
Net movement in cumulative changes in fair value of investments	**-**	**-**	**-**	**-**	**-**	**-**	**153**	**-**	**-**	**153**
Appropriations (note 15)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(167)**	**167**	**-**
At 31 December 2010	**72,859**	**(307)**	**43,936**	**10,268**	**1,000**	**42**	**(1,278)**	**(26,626)**	**167**	**100,061**
At 1 January 2009	66,235	-	43,936	10,268	1,000	18,093	(4,688)	17,714	13,889	166,447
Bonus shares issued (note 15)	6,624	-	-	-	-	-	-	-	(6,624)	-
Purchase of treasury shares (note 15)	-	(173)	-	-	-	-	-	-	-	(173)
Dividends paid	-	-	-	-	-	-	-	-	(6,624)	(6,624)
Zakah paid	-	-	-	-	-	-	-	-	(641)	(641)
Net loss for the year	-	-	-	-	-	-	-	(19,397)	-	(19,397)
Net movement in cumulative changes in fair value of investments	-	-	-	-	-	-	889	-	-	889
Transfer of changes in fair value reserve	-	-	-	-	-	-	2,368	(2,368)	-	-
Appropriations (note 15)	-	-	-	-	-	-	-	(747)	747	-
At 31 December 2009	72,859	(173)	43,936	10,268	1,000	18,093	(1,431)	(4,798)	747	140,501

The attached notes 1 to 31 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF SOURCES AND USES OF GOOD FAITH QARD FUND

For the year ended 31 December 2010

	Qard hasan receivables BD'000	Funds available for qard hasan BD'000	Total BD'000
Balance at 1 January 2010	**2**	**126**	**128**
Uses of qard fund			
Marriage	**27**	**(27)**	**-**
Refurbishment	**16**	**(16)**	**-**
Medical treatment	**14**	**(14)**	**-**
Others	**13**	**(13)**	**-**
Total uses during the year	**70**	**(70)**	**-**
Repayments	**(68)**	**68**	**-**
Balance at 31 December 2010	**4**	**124**	**128**
Balance at 1 January 2009	10	118	128
Uses of qard fund			
Marriage	18	(18)	-
Refurbishment	16	(16)	-
Medical treatment	14	(14)	-
Others	11	(11)	-
Total uses during the year	59	(59)	-
Repayments	(67)	67	-
Balance at 31 December 2009	2	126	128

	2010 BD'000	2009 BD'000
Sources of Qard fund		
Contribution by the Bank	**125**	125
Donation	**3**	3
Total of sources during the year	**128**	128

The attached notes 1 to 31 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF SOURCES AND USES OF ZAKAH AND CHARITY FUND

For the year ended 31 December 2010

	2010	2009
	BD'000	BD'000
Sources of zakah and charity funds		
Undistributed zakah and charity funds at the beginning of the year	**1,092**	1,049
Zakah due from the Bank for the year	**167**	747
Non-Islamic income / late fee	**398**	206
Total sources of Zakah and Charity funds during the year	**1,657**	2,002
Uses of zakah and charity funds		
Philanthropic societies	**696**	677
Aid to needy families	**420**	233
Total uses of funds during the year	**1,116**	910
Undistributed zakah and charity funds at the end of the year	**541**	1,092

The attached notes 1 to 31 form part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

1. INCORPORATION AND ACTIVITIES

Bahrain Islamic Bank B.S.C. (the "Bank") was incorporated in the Kingdom of Bahrain in the year 1979 by Amiri Decree No.2 of 1979, under Commercial Registration (CR) number 9900, to carry out banking and other financial trading activities in accordance with the teachings of Islam (Shari'a). The Bank operates under a retail banking license issued by the Central Bank of Bahrain (CBB). The Bank's Shari'a Supervisory Board is entrusted to ensure the Bank's adherence to Shari'a rules and principles in its transactions and activities. The Bank is listed on Bahrain Stock Exchange.

The Bank holds 100% of the share capital of Abaad Real Estate Company B.S.C. (c) ("Subsidiary"). The Subsidiary was incorporated in the Kingdom of Bahrain on 8 April 2003 with an authorized and fully paid-up share capital of BD 25 million. The Subsidiary has started operations during the year 2007. The main activities of the Subsidiary are the management and development of real estate in accordance with the Islamic Shari'a rules and principles.

The Bank's registered office is at Building 722, Road 1708, Block 317, Manama, Kingdom of Bahrain.

The Bank has thirteen branches (2009: twelve), all operating in the Kingdom of Bahrain.

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 18 January 2011.

2. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of the consolidated financial statements are set out below:

a. Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis, except for "investment in properties", "available for sale" and "trading securities" investments that have been measured at fair value.

The consolidated financial statements have been presented in Bahraini Dinars ("BD"), being the functional currency of the Group's operations. All the values are rounded to the nearest BD thousand except when otherwise indicated.

b. Statement of Compliance

The consolidated financial statements of the Group have been prepared in accordance with the Financial Accounting Standards ("FAS") issued by the Accounting and Auditing Organization for Financial Institutions ("AAOIFI"), the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank, the Bahrain Commercial Companies Law, Central Bank of Bahrain ("CBB") and the Financial Institutions Law. In accordance with the requirement of AAOIFI, for matters for which no AAOIFI standards exist, the Group uses the relevant International Financial Reporting Standards ("the IFRS").

c. Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary (together referred to as the "Group") as at 31 December each year. A subsidiary is an entity over which the Bank has power to control, which is other than fiduciary in nature.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

c. Basis of consolidation (continued)

The Subsidiary is fully consolidated from the date of acquisition, being the date on which the Group obtained control, and continues to be consolidated until the date that such control ceases. Control is achieved where the Group has direct ownership of more than 50% of the voting rights over the subsidiary.

The financial statements of the Subsidiary are prepared for the same reporting year as the Bank, using consistent accounting policies.

All intra-group balances, income and expenses and unrealised gains and losses resulting from intra-group transactions are eliminated in full.

The Bank has one fully owned subsidiary, Abaad Real Estate Company B.S.C. (c), which is consolidated in these financial statements.

d. Cash and cash equivalents

For the purpose of the consolidated cash flows statement, "cash and cash equivalents" consist of cash in hand, balances with the Central Bank of Bahrain, balances with banks and other financial institutions, with original maturities of 90 days or less.

e. Murabaha receivables

Murabaha receivables consist mainly of deferred sales transactions (Murabaha) and international commodities, which are stated net of deferred profits and provisions for impairment.

f. Mudaraba and Musharaka investments

These are stated at the fair value of consideration given less provision for impairment.

g. Investments

Investments comprise of held to maturity investment, available for sale investment and trading securities.

All investments, are initially recognised at cost, being the fair value of the consideration given including acquisition charges associated with the investment.

Held to maturity

Investments which have fixed or determinable payments and where the Group has both the intent and ability to hold to maturity are classified as held to maturity. Such investments are carried at amortised cost, less provision for impairment in value. Amortised cost is calculated by taking into account any premium or discount on acquisition. Any gain or loss on such investment is recognised in the consolidated statement of income, when the investment is de-recognised or impaired.

Available for sale

Subsequent to acquisition, available for sale investments are remeasured at fair value, with unrealised gains and losses recognised in a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment, the cumulative gain or loss previously recorded in equity is recognised in the consolidated statement of income for the year.

Impairment losses on equity investments are not reversed through the consolidated statement of income and increases in their fair value after impairment are recognised directly in equity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

g. Investments (continued)

Trading securities
These are initially recognised at cost, being the fair value of the consideration given excluding acquisition costs. These are subsequently re-measured at fair value. All related realised and unrealised gains or losses are included in the consolidated statement of income.

h. Fair value
For investments traded in organised financial markets, fair value is determined by reference to quoted market bid prices at the close of business on the consolidated statement of financial position date.

For investment where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument, which is substantially the same or is based on the assessment of future cash flows. The cash equivalent values are determined by the Group at current profit rates for contracts with similar term and risk characteristics.

For Murabaha receivables the fair value is determined at the Bank at the end of the financial period at their cash equivalent value.

i. Investment in associates
The Group's investment in associates are accounted for under the equity method of accounting. Associates are entities over which the Group exercises significant influence but not control and which are neither subsidiaries nor joint ventures. Under the equity method, the investment in associates 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 associate, less any impairment in value. The consolidated statement of income reflects the Group's share of the results of its associates. Where there has been a change recognised directly in the equity of the associates, the Group recognises its share of any changes and discloses this, when applicable, in the consolidated statement of changes in equity. Unrealised profits and losses resulting from transactions between the Group and its associate are eliminated to the extent of the Group's interest in the associate.

The Group determines at each consolidated statement of financial position date whether there is any objective evidence that the investment in associate is impaired. If this is the case the Group calculates the amount of impairment as being the difference between the fair value of the associate and the carrying value and recognises the amount in the consolidated statement of income.

The reporting dates of the associates and the Group are identical and the associates accounting policies conform to those used by the Group for like transaction and events in similar circumstances.

j. Ijarah assets, Ijarah Muntahia Bittamleek
These are initially recorded at cost. Ijarah assets and Ijarah Muntahia Bittamleek mainly comprise of land and buildings and certain other assets. Ijarah Muntahia Bittamleek is a lease whereby the legal title of the leased asset passes to the lessee at the end of the ijarah (lease term), provided that all ijarah installments are settled.

Depreciation is calculated using the straight-line method on all Ijarah Muntahia Bittamleek other than land (which is deemed to have indefinite life), at rates calculated to write off the cost of each asset over its useful life.

For Ijarah assets, the depreciation is calculated using the straight-line method, at rates calculated to write off the cost of the assets over its estimated useful life. The estimated useful lives of the assets for calculation of depreciation ranges between 10 to 35 years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

k. Investment in properties
Properties held for rental, or for capital appreciation purposes, or both, are classified as Investment in properties. Investment in properties are initially recorded at cost, being the fair value of the consideration given and acquisition charges associated with the property. Subsequent to initial recognition, Investment in properties are re-measured at fair value and changes in fair value are recognised in the consolidated statement of income.

In accordance with AAOIFI, such gains or losses are appropriated to investment in properties fair value reserve at year end. Upon realisation, these gain/losses are transferred to retained earnings from investment in properties fair value reserve.

l. Equipment
Equipment are initially recognised at cost. The cost of additions and major improvements are capitalised; maintenance and repairs are charged to the consolidated statement of income as incurred. Gains or losses on disposal are reflected in other income. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets.

The calculation of depreciation is on the following basis:

Office furniture and equipment	3 to 5 years
Vehicles	5 years
Others	1 to 3 years

m. Unrestricted investment account holders
All unrestricted investment accounts are carried at cost plus profit and related reserves less amounts settled.

Unrestricted investment account holders share of income is calculated based on the income generated from investment accounts after deducting Mudarib share. Operating expenses are charged to shareholders' funds and not included in the calculation.

The basis applied by the Group in arriving at the unrestricted investment account holders' share of income is (total income from jointly financed Islamic finances less shareholders' " Bank" income). Portion of the income generated from unrestricted investment account holders will be deducted as Mudarib share and the remaining will be distributed to the unrestricted investment account holders.

n. Investment risk reserve
Investment risk reserves are amounts appropriated out of the income of unrestricted investment account holders, after allocating the Mudarib share, in order to cater against future losses for unrestricted investment account holders.

o. Profit equalisation reserve
The Group appropriates a certain amount in excess of the profit to be distributed to unrestricted investment accounts after taking into consideration the Mudarib share of income. This is used to maintain a certain level of return on investment for unrestricted investment account holders.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

p. Zakah
Zakah is calculated on the Zakah base of the Group in accordance with the "FAS" issued by the "AAOIFI" using the net invested funds method. Zakah is paid by the Group based on the consolidated figures of statutory reserve, general reserve and retained earning balances at the beginning of the year. The remaining Zakah is payable by individual shareholders. Payment of Zakah on unrestricted investment and other accounts is the responsibility of investment account holders.

q. Provisions
Provisions are recognised when the Group has a present obligation (legal or constructive) arising from a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of obligation.

r. Dividends
Dividends to shareholders are recognised as liabilities in the year in which they are declared.

s. Derecognition of financial assets and liabilities

Financial assets
A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the right to receive cash flows from the asset have expired;
- the Group has transferred its rights to receive cash flows from and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the assets, but has transferred control of the asset; or
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset.

Financial liabilities
A financial liability is derecognized when the obligation specified in the contract is discharged, cancelled or expired.

t. Treasury shares
These are own equity instruments of the Group which are reacquired through its own broker. Treasury shares are deducted from equity and accounted for at weighted average cost. Consideration paid or received on the purchase, sale, issue or cancellation of the Group's own equity instruments is recognised directly in equity. No gain or loss is recognised in consolidated statement of income on the purchase, sale, issue or cancellation of own equity instruments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

u. Earnings prohibited by Shari'a
The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity fund where the Group uses these funds for social welfare activities.

v. Joint and self financed
Investments, financing and receivables that are jointly owned by the Group and the unrestricted investment accounts holders are classified under the caption "jointly financed" in the consolidated financial statements. Investments, financing and receivables that are financed solely by the Bank are classified under "self financed".

w. Offsetting
Financial assets and financial liabilities are only offsetted and the net amount reported in the consolidated statement of financial position when there is a legal or religious enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

x. Revenue recognition

Murabaha receivables
Where the income is quantifiable and contractually determined at the commencement of the contract, income is recognised on a time-apportioned basis over the period of the contract based on the principal amounts outstanding.

Where the income from a contract is not quantifiable, it is recognised when realised. Income related to non performing accounts is excluded from the consolidated statement of income.

Musharaka investments
Income is recognised when the right to receive payment is established or on distribution by the Musharek, whereas the losses are charged to income on their declaration by the Musharek. Income related to non performing accounts is excluded from the consolidated statement of income.

Mudaraba investments
Income is recognised when the right to receive payment is established or on distribution by the Mudarib, whereas the losses are charged to income on their declaration by the Mudarib

Ijarah and Ijarah Muntahia Bittamleek
Ijarah income and income from Ijarah Muntahia Bittamleek are recognised on a time-apportioned basis over the lease term. The Ijarah Muntahia Bittamleek Income is net of depreciation. Income related to non performing Ijarah Muntahia Bittamleek is excluded from the consolidated statement of income.

Dividends income
Dividends are recognised when the right to receive payment is established.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

x. Revenue recognition (continued)

Income from Ijarah assets
Rental income is accounted for on a straight-line basis over the Ijarah terms.

Fee and commission income
Fee and commission income is recognised when earned.

Group's share as a Mudarib
The Group's share as a Mudarib for managing unrestricted investment accounts is accrued based on the terms and conditions of the related mudaraba agreements.

Income allocation
Income is allocated proportionately between unrestricted investment accounts and shareholders on the basis of the average balances outstanding during the year.

y. Foreign currencies
Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into Bahraini Dinars at the rate of exchange ruling at the consolidated statement of financial position date. All differences are taken to the consolidated statement of income.

Translation gains or losses on non-monetary items carried at fair value are included in equity as part of the fair value adjustment.

z. Impairment of financial assets
An assessment is made at each financial position date to determine whether there is objective evidence that a specific financial asset or a group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the assessment by the Group of the estimated cash equivalent value, is recognised in the consolidated statement of income. Specific provisions are created to reduce all impaired financial contracts to their realisable cash equivalent value. Financial assets are written off only in circumstances where effectively all possible means of recovery have been exhausted. Impairment is determined as follows:

(a) For assets carried at fair value, impairment is the difference between cost and fair value, less any impairment loss previously recognised in the consolidated statement of income;

(b) For assets carried at cost, impairment is the difference between carrying value and the present value of future cash flows discounted at the current market rate of return for a similar financial asset; and

(c) For assets carried at amortised cost, impairment is the difference between carrying amount and the present value of future cash flows discounted at the original effective profit rate.

For available for sale equity investments impairment losses recognised in the statement of income for an investment equity instrument shall not be reversed through the statement of income and should be recorded as increases in cumulative changes in fair value through equity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

aa. Use of estimates in preparation of the consolidated financial statements
In the process of applying the Group's accounting policies, management has made estimates in determining the amounts recognised in the consolidated financial statements. The most significant use of judgments and estimates are as follows:

Impairment
The Group assesses at each consolidated statement of financial position date whether there is objective evidence that a specific asset or a group of assets may be impaired. An asset or a group of 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 have occurred after the initial recognition of the asset (an incurred "loss event") and that loss event(s) have an impact on the estimated future cash flows of the asset or the group of the assets that can be reliably estimated.

Collective impairment provision
Impairment is assessed collectively for losses on Islamic financing facilities that are not individually significant and for individually significant facilities where there is not yet objective evidence of individual impairment. Collective impairment is evaluated on each reporting date with each portfolio receiving a separate review.

Fair valuation of investments
The determination of fair values of unquoted investments requires management to make estimates and assumptions that may affect the reported amount of assets at the date of the consolidated financial statements. The valuation of such investments is based on the fair value criteria explained above.

Nonetheless, the actual amount that is realised in a future transaction may differ from the current estimate of fair value and may still be outside management estimates, given the inherent uncertainty surrounding valuation of unquoted investments.

bb. Judgments
In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which effects the amounts recognised in the financial statements:

Classification of investments
Management decides on acquisition of a financial asset whether it should be classified as "trading security", "available for sale" or "held to maturity".

cc. Trade 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.

dd. Employees' end of service benefits
Provision is made for amounts payable under the Bahrain Labour law applicable to non-Bahraini employees' accumulated periods of service at the date of the consolidated statement of financial position, subject to completion of a minimum period of employment.

Bahraini employees of the Group are covered by contributions made to the General Organisation of Social Insurance Scheme (GOSI) as a percentage of the employees' salaries. The Group's obligations are limited to these contributions, which are expensed when due.

ee. Shari'a supervisory board
The Group's business activities are subject to the supervision of a Shari'a Supervisory Board consisting of five members appointed by the general assembly.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

3. CASH AND BALANCES WITH CENTRAL BANK OF BAHRAIN AND OTHER BANKS

	2010		2009	
	Self financed BD'000	**Jointly financed BD'000**	Self financed BD'000	Jointly financed BD'000
Cash in hand	**7,605**	**-**	5,927	-
Balances with CBB, excluding mandatory reserve deposits	**3,150**	**-**	1,044	-
Balances with banks and other financial institutions	**8,206**	**-**	5,712	-
Cash and cash equivalents	**18,961**	**-**	12,683	-
Mandatory reserve with CBB	**-**	**26,870**	-	23,410
	18,961	**26,870**	12,683	23,410
Total		**45,831**		36,093

The mandatory reserve with CBB is not available for use in the day-to-day operations.

4. MURABAHA RECEIVABLES

	Jointly financed 2010 BD'000	Jointly financed 2009 BD'000
Murabaha with banks:		
International commodities	**195,875**	76,319
Other murabaha:		
Tawarooq	**131,134**	143,166
Letters of credit	**55,741**	60,343
Commodities murabaha with non-banks	**7,547**	18,743
Tasheel	**77,340**	58,843
Land	**594**	1,120
Building	**2,459**	5,803
Motor vehicles	**13,740**	14,983
Building materials	**784**	1,782
Furniture	**190**	253
Others	**4,133**	2,520
	293,662	307,556
Qard fund	**4**	2
	293,666	307,558
Gross receivables	**489,541**	383,877
Deferred profits	**(23,652)**	(22,810)
Provision for impairment (note 21) *	**(34,197)**	(28,548)
Total	**431,692**	332,519

* This includes collective impairment provision of BD 193 thousand (2009: BD 4,976 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

4. MURABAHA RECEIVABLES (continued)

Non-performing Murabaha receivables outstanding as of 31 December 2010 amounted to BD 97,882 thousand (2009: BD 43,593 thousand).

The Group considers the promise made in the Murabaha to the purchase orderer as obligatory.

The composition of the gross Murabaha receivables portfolio geographically and by sector is as follows:

		2010			2009	
		Middle			Middle	
	Europe	**East**	**Total**	Europe	East	Total
	BD'000	**BD'000**	**BD'000**	BD'000	BD'000	BD'000
Commercial	**12,542**	**111,501**	**124,043**	11,205	104,619	115,824
Financial institutions	**34,376**	**195,500**	**229,876**	7,676	125,017	132,693
Others including retail	**-**	**111,970**	**111,970**	-	112,550	112,550
At 31 December	**46,918**	**418,971**	**465,889**	18,881	342,186	361,067

5. MUDARABA INVESTMENTS

	Jointly financed 2010 BD'000	Jointly financed 2009 BD'000
Mudaraba investments	**44,669**	56,008
Provision for impairment (note 21)	**(7,309)**	(2,638)
Total	**37,360**	53,370

The Group's Mudaraba investments transactions consist of investment in funds operated by other banks and financial institutions and participation in the financing transactions through other banks and financial institutions.

Impaired Mudaraba investments as of 31 December 2010 amounted to BD12,887 thousand (2009: BD 5,749 thousand).

6. MUSHARAKA INVESTMENTS

	Jointly financed 2010 BD'000	Jointly financed 2009 BD'000
Musharaka investment in real estate	**84,522**	80,927
Provision for impairment (note 21)	**(4,276)**	(8)
Total	**80,246**	80,919

Non-performing Musharaka investments outstanding as of 31 December 2010 amounted to BD 31,676 thousand (2009: BD 4,157 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

7. INVESTMENTS

	2010 Self financed BD'000	2010 Jointly financed BD'000	2010 Total BD'000	2009 Self financed BD'000	2009 Jointly financed BD'000	2009 Total BD'000
i) Held to maturity						
Unquoted investments						
Sukuk						
At 1 January	-	93,075	93,075	-	75,492	75,492
Acquisitions	-	7,214	7,214	-	32,839	32,839
Disposals and redemptions	-	35,214	35,214	-	15,256	15,256
At 31 December	-	65,075	65,075	-	93,075	93,075
ii) Available for sale						
Quoted investments						
Equity shares						
At 1 January	37,307	-	37,307	20,074	-	20,074
Acquisitions	9,924	-	9,924	18,630	-	18,630
Disposals	26,922	-	26,922	1,397	-	1,397
At 31 December	20,309	-	20,309	37,307	-	37,307
Unquoted investments						
Equity shares						
At 1 January	14,030	-	14,030	37,451	-	37,451
Acquisitions	327	-	327	463	-	463
Disposals	37	-	37	23,884	-	23,884
At 31 December	14,320	-	14,320	14,030	-	14,030
iii) Trading securities						
Quoted investments						
Equity shares						
At 31 December	1,191	-	1,191	297	-	297
Total investment before provision for impairment at 31 December	35,820	65,075	100,895	51,634	93,075	144,709
Provision for impairment on						
Held to maturity (note 21)	-	(2,212)	(2,212)	-	(2,099)	(2,099)
Available for sale (note 21)	(4,016)	-	(4,016)	(8,415)	-	(8,415)
Total provision at 31 December	(4,016)	(2,212)	(6,228)	(8,415)	(2,099)	(10,514)
Total investments	**31,804**	**62,863**	**94,667**	43,219	90,976	134,195

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

8. INVESTMENT IN ASSOCIATES

Investments in associates comprise the following:

	Ownership %	Country of incorporation	2010 Self financed BD '000	2009 Self financed BD '000
Quoted				
Insurance				
Takaful International Company B.S.C.*	**22.75%**	**Kingdom of Bahrain**	**1,664**	1,591
Unquoted				
Financial Institution				
Liquidity Management Centre B.S.C. (c)	**25.00%**	**Kingdom of Bahrain**	**5,114**	5,857
			6,778	7,448

* Takaful International Company B.S.C. is a listed company in the Bahrain Stock Exchange. The latest available quoted price of BD 0.290 was as of 10 January 2010, no further trades have commenced on the company's shares since this date.

The following table summarizes the latest associates' financial information :

2010	**Total assets BD '000**	**Total liabilities BD '000**	**Total contingent liabilities BD '000**	**Total revenue BD '000**	**Profit (loss) BD '000**	**Surplus in participants fund BD '000**
Takaful International Comapny B.S.C	**27,721**	**20,406**	**-**	**3,044**	**181**	**387**
Liquidity Management Centre B.S.C. (c)	**88,336**	**67,881**	**9,167**	**2,750**	**(3,383)**	**-**
	116,057	**88,287**	**9,167**	**5,794**	**(3,202)**	**387**

2009	Total assets BD '000	Total liabilities BD '000	Total contingent liabilities BD '000	Total revenue BD '000	Profit (loss) BD '000	Surplus in participants fund BD '000
Takaful International Comapny B.S.C	27,505	20,508	-	2,323	80	163
Liquidity Management Centre B.S.C. (c)	100,611	77,186	10,000	3,945	(917)	-
	128,116	97,694	10,000	6,268	(837)	163

Takaful International Company B.S.C. was incorporated in 1989. It carries out takaful and retakaful activities in accordance with the teachings of Islamic Shari'a.

Liquidity Management Centre B.S.C. (c) was set up in 2002 to facilitate the creation of an Islamic inter-bank market that will allow Islamic financial services institutions to effectively manage their assets and liabilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

9. NVESTMENT IN IJARAH ASSETS

	2010			2009		
	Self financed			Self financed		
	Land	Buildings	Total	Land	Buildings	Total
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
Cost:						
At 1 January	6,600	5,640	12,240	6,600	5,640	12,240
Additions	-	-	-	-	-	-
Disposals	-	-	-	-	-	-
At 31 December	6,600	5,640	12,240	6,600	5,640	12,240
Depreciation:						
At 1 January	-	2,469	2,469	-	2,339	2,339
Provided during the year	-	136	136	-	130	130
At 31 December	-	2,605	2,605	-	2,469	2,469
Net book value:						
At 31 December	6,600	3,035	9,635	6,600	3,171	9,771

10. IJARAH MUNTAHIA BITTAMLEEK

	2010				2009			
	Self financed				Self financed			
	Land	Buildings	Aviation assets	Total	Land	Buildings	Aviation assets	Total
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
Cost:								
At 1 January	53,496	43,486	25,865	122,847	32,292	37,137	-	69,429
Additions	1,937	26,138	16,257	44,332	21,863	17,595	26,584	66,042
Disposals	(19,013)	(11,254)	(23,957)	(54,224)	(659)	(11,246)	(719)	(12,624)
At 31 December	36,420	58,370	18,165	112,955	53,496	43,486	25,865	122,847
Depreciation:								
At 1 January	-	3,459	144	3,603	-	1,469	-	1,469
Provided during the year	-	3,110	1,211	4,321	-	2,181	144	2,325
Relating to disposed assets	-	(254)	(101)	(355)	-	(191)	-	(191)
At 31 December	-	6,315	1,254	7,569	-	3,459	144	3,603
Net book value:								
As at 31 December	36,420	52,055	16,911	105,386	53,496	40,027	25,721	119,244

Impaired Ijarah Muntahia Bittamleek as of 31 December 2010 is BD 41,898 thousand (2009: 1,433 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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11. INVESTMENT IN PROPERTIES

	2010 Self financed BD '000	2009 Self financed BD '000
Cost:		
At 1 January	**104,937**	98,780
Additions	**213**	6,157
Disposals	**-**	-
At 31 December	**105,150**	104,937
Fair value reserve*	**42**	18,093
Fair value at 31 December	**105,192**	123,030

* During the year a net fair value adjustment of BD 18,051 thousand (2009: nil) was taken through the consolidated statement of income.

Investment in properties comprises of properties located in GCC countries.

Investment in properties are stated at fair value, which have been determined based on valuations performed by independent valuers and industry specialists in valuing these types of investment properties.

12. OTHER ASSETS

	2010 BD'000	2009 BD'000
Equipment	**4,723**	4,534
Receivables from related parties	**2,526**	2,945
Staff advances	**1,271**	1,340
Other Receivables	**756**	756
Income receivable	**311**	297
Receivables under letter of credit	**188**	188
Prepaid expenses	**160**	126
Others	**4,632**	3,125
	14,567	13,311
Provision for impairment (note 21)	**(3,249)**	(1,553)
Total	**11,318**	11,758

13. OTHER LIABILITIES

	2010 BD'000	2009 BD'000
Dividends payable	**3,477**	3,536
Payable to vendors	**2,178**	2,343
Unearned income	**1,281**	675
Managers' cheques	**1,273**	1,326
Accrued expenses	**1,215**	1,125
Provision for employees' end of service benefits and leave	**424**	333
Zakah and charity fund	**374**	345
Margin on letters of credit	**48**	201
Clearance cheques	**-**	204
Others	**2,301**	1,344
Total	**12,571**	11,432

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

14. UNRESTRICTED INVESTMENT ACCOUNTS

	2010 BD'000	2009 BD'000
Customers	**600,024**	522,379
Profit equalisation reserve (note 14.1)	**-**	-
Investment risk reserve (note 14.2)	**-**	-
Customers' investment accounts	**600,024**	522,379
Financial institutions' investment accounts	**141,358**	157,914

14.1 Movement in profit equalisation reserve

	2010 BD'000	2009 BD'000
Balance at 1 January	**-**	2,368
Transferred to income from jointly financed sales	**-**	(2,368)
Balance at 31 December	**-**	-

14.2 Movement in investment risk reserve

	2010 BD'000	2009 BD'000
Balance at 1 January	**-**	167
Amounts apportioned from income allocable to unrestricted investment account holders	**-**	(167)
Balance at 31 December	**-**	-

The profit equalisation reserve reverts to unrestricted investment accounts as per terms and conditions of the Mudaraba contract.

As unrestricted investment account holders' funds are commingled with the Group's funds for investment, no priority is granted to any party for the purpose of investments and distribution of profits.

The Group's share, as Mudarib, in the profits of unrestricted investment accounts is up to a maximum of 65% (2009: 65%).

The following table represents the distribution of profit by type of unrestricted investment accounts:

	2010		2009	
Account Type	**Percentage of funds invested**	**Distributed profit rate**	Percentage of funds invested	Distributed profit rate
Defined deposits	**87%**	**2.15%**	87%	2.90%
Specific investment deposits	**95%**	**3.87%**	95%	4.40%
Investment certificates	**90%**	**4.00%**	90%	4.00%
Savings accounts	**45%**	**0.70%**	45%	0.70%
Iqra	**85%**	**3.00%**	85%	3.00%
Tejoori	**45%**	**0.70%**	45%	0.70%
Vevo	**45%**	**0.70%**	45%	0.70%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

14. UNRESTRICTED INVESTMENT ACCOUNTS (continued)

14.3. Unrestricted Investment Account Balances

Type of Account	2010 BD'000	2009 BD'000
Saving accounts (including Vevo)	**75,052**	66,631
Defined accounts - 1 month	**12,007**	16,834
Defined accounts - 3 months	**3,970**	4,696
Defined accounts - 6 months	**3,792**	3,984
Defined accounts - 9 months	**87**	80
Defined accounts - 1 year	**18,088**	20,048
Investment certificates	**2,317**	3,094
Iqra Deposits	**1,203**	539
Tejoori Deposit	**62,773**	38,955
Customer's deposits	**417,388**	363,806
Bank's deposits	**141,358**	157,914
Profit payable to depositors	**3,347**	3,712
Total	**741,382**	680,293

All the Bank's sources of unrestricted investment accounts funds are from the Kingdom of Bahrain.

14.4 Unrestricted Investment Account Balances by Type of Demand

Type of demand	2010 BD'000	2009 BD'000
Balances on demand	**139,027**	106,125
Contractual basis*	**602,355**	574,168
Total	**741,382**	680,293

* Theses can be withdrawn subject to a monetary penalty.

15. EQUITY

	2010 BD'000	2009 BD'000
(i) Share capital		
a) Authorised		
1,000,000,000 shares of BD 0.100 each	**100,000**	100,000
b) Issued and fully paid up		
728,589,400 shares (2009: 728,589,400 shares) of BD 0.100 each	**72,859**	72,859

During the year 2009 the Group ssued 66,235 thousand bonus shares at one share for every ten shares held amounting to BD 6,624 thousand.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

15. EQUITY (continued)

(ii) Treasury Shares

	Number of Shares	2010 BD'000
At 1 January 2010	**601,332**	**(173)**
Purchase of treasury shares	**699,163**	**(134)**
At 31 December 2010	**1,300,495**	**(307)**

	2010 BD'000
Cost of treasury shares	**307**
Market value of treasury shares	**168**

The Treasury Shares as a percentage of total shares in issue is 0.18% only.

Own equity instruments which are reacquired are deducted from equity. No gain or loss is recognised in the consolidated statement of income on the purchase, sale, issue or cancellation of the Group's own equity instruments.

(iii) Share premium
Amounts collected in excess of the par value of the issued share capital during any new issue of shares, net of issue expenses, are treated as share premium. This amount is not available for distribution, but can be utilised as stipulated by the Bahrain Commercial Companies Law.

(iv) Reserves

Statutory reserve
As required by Bahrain Commercial Companies Law and the Group's articles of association, 10% of the net income for the year is transferred to the statutory reserve. The Group may resolve to discontinue such annual transfers when the reserve totals 50% of paid up share capital. No transfer has been made for the current year as there was a net loss for the year. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of CBB.

General reserve
The general reserve is established in accordance with the articles of association of the Group and is distributable following a resolution of shareholders at a general meeting and the approval of CBB. The Group may transfer any amount to the general reserve, as approved by the shareholders at a general meeting, out of the net income for the year after appropriating statutory reserve.

Investment in properties fair value reserve
This represents cumulative unrealised revaluation gains or losses on investment in properties. This reserve is transferred to the retained earnings upon sale of the investment properties.

Cumulative changes in fair value of investments
This represents the net unrealised gains or losses on available for sale investments relating to self financed investments.

15. EQUITY (continued)

(v) Appropriations

	2010 BD'000	2009 BD'000
Zakah	**167**	747
	167	747

The proposed appropriation for the year ended 2009 was approved at the Annual General Meeting held on 17 March 2010 and was effected in 2010 following that approval.

(vi) Additional information on shareholding pattern

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

		2010		2009	
Names	**Nationality**	**Number of shares**	**% holding**	Number of shares	% holding
Investment Dar	**Kuwait**	**290,591,510**	**39.88%**	290,591,510	39.88%
Islamic Development Bank	**Saudi**	**94,745,420**	**13.00%**	94,745,420	13.00%
General Council of Kuwaiti Awaqaf	**Kuwait**	**67,946,033**	**9.33%**	67,946,033	9.33%
Kuwait Investment Company S.A.K	**Kuwait**	**63,407,126**	**8.70%**	63,407,126	8.70%

ii) The Bank has only one class of shares and the holders of these shares have equal voting rights.

iii) Distribution schedule of shares, setting out the number and percentage of holders in the following categories;

	2010			2009		
	Number of shares	**Number of shareholders**	**% of total outstanding shares**	Number of shares	Number of shareholders	% of total outstanding shares
Less than 1%	**126,602,716**	**3,418**	**17.38%**	126,602,716	3,423	17.38%
1% up to less than 5%	**85,296,595**	**5**	**11.71%**	85,296,595	5	11.71%
5% up to less than 10%	**131,353,159**	**2**	**18.02%**	131,353,159	2	18.02%
10% up to less than 50%	**385,336,930**	**2**	**52.89%**	385,336,930	2	52.89%
	728,589,400	**3,427**	**100%**	728,589,400	3,432	100%

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15. EQUITY (continued)

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

Categories:

	2010		2009	
	No. of shares	**No. of directors**	No. of shares	No. of directors
Less than 1%	**3,307,383**	**9**	3,454,753	11

The following is the number of shares, and percentage of shareholding of Directors and Senior management (Assistant General Managers and above);

	2010		2009	
	No. of shares	**Percentage of Shareholding**	No. of shares	Percentage of Shareholding
Directors	**3,307,383**	**0.45%**	3,454,753	0.47%
Senior management	**65,872**	**0.01%**	75,872	0.01%
	3,373,255	**0.46%**	3,530,625	0.48%

16. CAPITAL ADEQUACY

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 Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issuing sukuk etc. No changes were made in the objectives, policies and processes from the previous years.

The Group's capital structure is primarily made of its paid-up capital, including share premium and reserves. From regulation's perspective, the significant amount of the Group's capital are in Tier 1 form as defined by the CBB, i.e., most of the capital are of permanent nature.

The Group's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of financing facilities growth expectations for each business group, expected growth in off-balance sheet facilities and future sources and uses of funds.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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16. CAPITAL ADEQUACY (continued)

The classification of the Group's capital in accordance with the regulatory requirements is as follows:

	2010 BD'000	2009 BD'000
Core capital - Tier 1:		
Issued and fully paid ordinary shares	**72,552**	72,686
General reserves	**1,000**	1,000
Legal / statutory reserves	**10,268**	9,840
Share premium	**43,936**	43,936
Retained earnings / losses (excluding current year net income/loss)	**(4,798)**	11,380
Less:		
Net losses for the year	**(21,661)**	(18,634)
Unrealized gross losses arising from fair valuing equity securities	**(2,412)**	(2,636)
Tier 1 Capital before deductions	**98,885**	117,572
Supplementary capital - Tier 2:		
Current year net income	**-**	-
Asset revaluation reserve (45% only)	**19**	6,302
Unrealized gains arising from fair valuing equities (45% only)	**348**	156
Tier 2 Capital before deductions	**367**	6,458
Total available capital	**99,252**	124,030
Deductions		
Significant minority interest in banking, securities and financial entities	**(5,114)**	(5,480)
Excess amount over materiality threshold	**-**	(7,452)
Investment in insurance entity greater than or equal to 20%	**(1,664)**	(1,593)
Excess amount over maximum permitted large exposure limit	**(16,138)**	(35,072)
Total eligible capital	**76,336**	74,433

To assess its capital adequacy requirements in accordance to the CBB requirements, the Group adopts the Standardized Approach for its Credit Risk, Basic Indicator Approach for its Operational Risk and Standardized Measurement Approach for its Market Risk. The Capital requirements for these risks are as follows:

	2010 BD'000	2009 BD'000
Total Credit Risk Weighted Assets	**465,798**	463,217
Total Market Risk Weighted Assets	**22,656**	24,255
Total Operational Risk Weighted Assets	**52,968**	54,095
Total Regulatory Risk Weighted Assets	**541,422**	541,567
Capital Adequacy Ratio	**14.10%**	13.74%
Minimum requirement	**12%**	12%

Starting from 2008, the Group has adopted the Basel II guidelines for calculation of the capital adequacy ratio.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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17. COMMITMENTS AND CONTINGENT LIABILITIES

Credit related commitments

These include commitments to enter into financing contracts which are designed to meet the requirements of the Group's customers.

Letters of credit and guarantees commit the Group to make payments on behalf of customers.

The Group has the following credit related commitments and contingent liabilities on behalf of customers:

	2010	2009
	BD'000	BD'000
Letters of credit and acceptances	**4,971**	9,096
Guarantees	**7,735**	9,255
Operating lease commitments *	**524**	414
Total	**13,230**	18,765

* The Group has entered into commercial leases for certain branches. These leases have an average life of between 3 months and 7 years with renewal terms included in the contracts. Renewals are at the option of the specific entity that holds the lease. There are no restrictions placed upon the lessee by entering into these leases.

Future minimum rentals payable under non-cancellable operating leases as at 31 December are as follows:

	2010	2009
	BD'000	BD'000
Within one year	**238**	170
After one year but not more than five years	**286**	230
More than five years	**-**	14
Total	**524**	414

Credit Lines Commitment

The Group during 2009 has provided credit line to its associate of BD 9,425 thousand for liquidity purposes which was fully utilised during 2009.

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18. INCOME FROM JOINTLY FINANCED SALES AND INVESTMENTS

	2010 BD'000	2009 BD'000
Income from Islamic finances:		
Income from Murabaha receivables	**16,088**	16,645
Income from Mudaraba investments	**368**	872
Income from Musharaka investments	**4,660**	5,315
Income from Ijarah Muntahia Bittamleek - net *	**6,957**	7,468
Total	**28,073**	30,300

	2010 BD'000	2009 BD'000
Income from sukuk and commodities:		
Income from Murabaha commodities	**946**	1,422
Income from investments in sukuk	**4,064**	3,972
	5,010	5,394

* The details of Income from Ijarah Muntahia Bittamleek are as follows:

	2010 BD'000	2009 BD'000
Income from Ijarah Muntahia Bittamleek – gross	**11,278**	9,793
Depreciation during the year (note 10)	**(4,321)**	(2,325)
Net income	**6,957**	7,468

19. NET INCOME FROM INVESTMENTS

	2010 BD'000	2009 BD'000
Dividend income	**868**	1,640
Gain on sale of investment in properties	**-**	1,176
Unrealised loss on trading securities	**(97)**	(40)
Other investment income	**130**	388
Total	**901**	3,164

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20. OTHER EXPENSES

	2010 BD'000	2009 BD'000
Marketing and advertisement expenses	**1,791**	1,047
Information technology related expenses	**1,128**	911
Communication expenses	**790**	776
Expenses on Ijarah assets	**662**	450
Professional services and consultancy fees	**395**	518
Stationery expenses	**409**	279
Travelling and transportation expenses	**159**	183
Brokerage fees and commission	**204**	290
Shari'a committee remuneration and board expenses	**216**	200
Premises Expenses	**607**	497
Other miscellaneous expenses	**1,112**	599
Total	**7,473**	5,750

21. PROVISIONS

2010	**Murabaha receivables BD'000**	**Mudaraba investments BD'000**	**Musharaka Investments BD'000**	**Investments BD'000**	**Other assets BD'000**	**Total BD'000**
At 1 January	**28,548**	**2,638**	**8**	**10,514**	**1,553**	**43,261**
Written (off) back	**(3,691)**	**(475)**	**1,963**	**(7,056)**	**940**	**(8,319)**
	24,857	**2,163**	**1,971**	**3,458**	**2,493**	**34,942**
Provided during the year	**9,340**	**5,146**	**2,305**	**2,770**	**756**	**20,317**
At 31 December	**34,197**	**7,309**	**4,276**	**6,228**	**3,249**	**55,259**
Notes	**4**	**5**	**6**	**7**	**12**	

2009	Murabaha receivables BD'000	Mudaraba investments BD'000	Musharaka Investments BD'000	Investments BD'000	Other assets BD'000	Total BD'000
At 1 January	8,867	3,421	50	5,824	-	18,162
Written off	(111)	(305)	(42)	(850)	-	(1,308)
	8,756	3,116	8	4,974	-	16,854
Provided (written back) during the year	19,792	(478)	-	5,540	1,553	26,407
At 31 December	28,548	2,638	8	10,514	1,553	43,261
Notes	4	5	6	7	12	

21. PROVISIONS (continued)

The fair value of collateral that the Group holds relating to non performing facilities at 31 December 2010 amounts to BD 171,069 thousand (31 December 2009: BD 9,828 thousand). The collateral consists of cash, securities and properties.

The Bank has taken all the provision allocated to the non performing assets to its own capital. Hence the Unrestricted Investment Account holders were not charged for any of the impairment.

22. ZAKAH

The total Zakah payable as of 31 December 2010 amounted to BD 1,601 thousand (2009: BD 2,692 thousand) of which BD 167 thousand (2009: BD 747 thousand) represent the Zakah on the statutory reserve, general reserve and retained earning as at 1 January 2010, is payable by the Bank. The remaining Zakah balance amounting to BD1,433 thousand or 2.0 fils per share (2009: BD 1,945 thousand or 2.7 fils per share) is due and payable by the shareholders.

23. EARNINGS PER SHARE

Basic and diluted earnings per share is calculated by dividing the net loss for the year by the weighted average number of shares during the year as follows:

	2010	2009
	BD'000	BD'000
Net loss for the year in BD'000'	**(39,712)**	(19,397)
Weighted average number of shares	**727,289**	727,289
Basic and diluted earnings per share (fils)	**(54.60)**	(26.67)

There have been no transactions during the year which caused dilution of the earnings per share.

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31 December 2010

24. RELATED PARTY TRANSACTIONS

Related parties represent associated companies, major shareholders, directors, key management personnel of the Group and Shari'a Supervisory Board members.

The balances and values of major transactions with the related parties are as follows:

Related party	Transaction	Income (expense) 2010 BD'000	Income (expense) 2009 BD'000	Balance at 31 December 2010 BD'000	Balance at 31 December 2009 BD'000
Shareholders*	Sukuk	**-**	-	**4,197**	4,197
Shareholders**	Tawarooq	**455**	902	**20,359**	19,665
Shareholders	Investment in properties	**-**	-	**15,693**	18,850
Shareholders*	Receivable	**-**	1,553	**2,526**	2,945
Associate	Sukuk	**-**	82	**-**	-
Associate	Mudaraba	**155**	138	**3,691**	13,136
Board of Directors	Ijarah Muntahia Bittamleek	**-**	9	**-**	-
Board of Directors	Musharaka	**-**	20	**-**	-
Board of Directors	Tawarooq	**113**	82	**1,115**	1,259
Board of Directors	Expenses	**(162)**	(124)	**-**	-
Shari'a Supervisory Board	Expenses	**(54)**	(76)	**-**	-
Shari'a Supervisory Board	Murabaha	**82**	59	**1,081**	809
Shari'a Supervisory Board	Musharaka	**17**	17	**192**	231
Shari'a Supervisory Board	Tawarooq	**5**	1	**-**	137
Key management personnel	Staff advances	**-**	-	**366**	454
		611	2,663	**49,220**	61,683

* An amount of BD5,750 thousand (2009: BD 5,750 thousand) is considered as impaired for which provision of BD3,652 thousand (2009: BD 3,652 thousand) has been made.

** An amount of BD7,817 thousand (2009: BD 7,817 thousand) is considered as impaired for which provision of BD1,634 thousand (2009: Nil) has been made.

Compensation of the key management personnel is as follows:
Key management personnel includes the staff in grade of assistant general manager and above.

	2010 BD'000	2009 BD'000
Short term employee benefits	**1,102**	1,046
Other long term benefits	**128**	133
Total	**1,230**	1,179

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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25. RISK MANAGEMENT

Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. These risks and the processes to mitigate these risks have not significantly altered from the previous year.

The Group is exposed mainly to credit, liquidity, market and operational risks.

Risk management objectives

The risk management philosophy of the Group is to identify, capture, monitor and manage the various dimensions of risk with the objective of protecting asset values and income streams such that the interest of the Group's shareholders (and others to whom the Group owes a liability) are safeguarded, while maximizing the returns intended to optimize the Group's shareholder return while maintaining it's risk exposure within self-imposed parameters.

The Group has defined its risk appetite within the parameters of its risk strategy. The Group reviews and realigns its risk appetite as per the evolving business plan of the Group with changing economic and market scenarios. The Group also assesses its tolerance for specific risk categories and its strategy to manage these risks.

Risk appetite of the Group is articulated in terms of the following dimensions:

1. Adequate capital level;
2. Stable profitability and growth;
3. Sufficient liquidity; and
4. Sound reputation.

Structure and Organization of Risk Management Function

Risk Management Structure includes all levels of authorities, organizational structure, people and systems required for the smooth functioning of risk management processes in the Group. The responsibilities associated with each level of risk management structure and authorities include the following:

The Board retains ultimate responsibility and authority for all risk matters, including:

a. Establishing overall policies and procedures; and
b. Delegating authority to Executive Committee, Credit Committee, Managing Director, Chief Executive Officer and further delegation to the management to approve and review.

The Executive Committee (EC) comprises three designated members of the Board of Directors. The EC is delegated authorities by the Board to manage the ongoing activities of the Group. Decisions are taken by the EC either at periodic meetings or if the need arises, by circulation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

25. RISK MANAGEMENT (continued)

Structure and Organisation of Risk Management Function (continued)

Credit and Investment Committee (CIC): As delegated by the Board of Directors and as per approved terms of reference, the Committee has been delegated with the authorities and responsibilities including, approving extension or renewal of credit facilities, granting temporary excesses to customers with credit facilities approved by the Board, approving early repayments of facilities, monitoring the performance and quality of the Group's credit portfolio and overseeing the administration and effectiveness of and compliance with, the Group's credit policies through the review of such processes, reports and other information as it deems appropriate.

Risk Measurement and Reporting Systems

Based on the risk appetite, the Group has put in place various limits. These limits have been approved by the Board. Any limit breach is reported by Risk Management Department (RMD) to the Credit Committee. The limits are reviewed and revised, if necessary at least annually (or earlier if required).

a) Credit Risk

Credit risk is the risk that one party to a financial contract will fail to discharge an obligation and cause the other party to incur a financial loss.

Type of credit risk

Financing contracts mainly comprise of Murabaha receivables, Mudaraba investments, Musharaka investments and Ijarah Muntahia Bittamleek.

Murabaha receivables

The Group finances these transactions through buying the commodity which represents the object of the Murabaha contract and then resells this commodity to the Murabeh (beneficiary) at a profit. The sale price (cost plus profit margin) is repaid in installments by the Murabeh over the agreed period. The transactions are secured at times by the object of the Murabaha contract (in case of real estate finance) and other times by a total collateral package securing the facilities given to the Murabeh.

Mudaraba investments

The Group enters into Mudaraba contracts by investing in funds operated by other banks and financial institutions for a definite period of time.

Musharaka investments

Musharaka is a form of partnership between the Group and its clients whereby each party contributes to the capital of partnership in equal or varying degrees to establish a new project or share in an existing one, whereby each of the parties becomes an owner of the capital on a permanent or declining basis. Profits are shared in an agreed ratio, but losses are shared in proportion to the amount of capital contributed.

Ijarah Muntahia Bittamleek

The legal title of the assets under Ijarah Muntahia Bittamleek only passes to the lessee at the end of the Ijarah term, through gift, consideration or gradual sale, provided that all Ijarah installments are settled.

Credit Risk Mitigation

Credit risk mitigation refers to the use of a number of techniques, like collaterals, guarantees and credit derivatives (Shari'a compliant protection) to mitigate the credit risks that the Group is exposed to. Credit risk mitigants reduce the credit risk by allowing the Group to protect against counterparty non-performance of credit contracts through collaterals, netting agreements, guarantees and credit derivatives (Shari'a compliant protection).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

25. RISK MANAGEMENT (continued)

a) Credit Risk (continued)

Credit Risk Mitigation (continued)

Generally, the Group extends credit facilities only where supported by adequate tangible collateral security and/or audited financial statements. Facilities may be considered without adequate tangible collateral security, when audited financial statements reveal satisfactory financial position/repayment ability and the facilities are properly structured supported by assignments, guarantees, etc. as appropriate. Name lending (i.e. lending without audited financial statements and tangible collateral security) is discouraged and is approved only on an exceptional basis after careful analysis of the quality of the customer, market reputation, approximate personal net worth etc.

In general, personal guarantees of the partners/promoters/directors of the borrowing entity are obtained in support of credit facilities. In all cases, a statement of net worth of the guarantor is to be compiled by the Account Officer, so that adequate information is available at a future date in case the guarantees need to be enforced.

Notwithstanding the above, when facilities are extended to family owned limited liability entities, the following is normally obtained;

a. Collateral security, fully covering the exposure; or
b. Joint and several guarantees of shareholders directly involved in managing the entity as well as of shareholders owing at least 80% of the shares of the entity.

Third party guarantees in support of credit facilities are accepted only after review and approval of appropriate guarantor lines.

(i) Gross maximum exposure to credit risk

The market value of tangible collateral security are properly evaluated by the Group approved valuers (for properties) or based on publicly available quotations. Only the Loan-able Value of such security are taken into account while considering credit facilities.

From time to time, the CIC reviews and approves the Loan-able Value of securities. It has also approved a list of acceptable securities.

The table below shows the gross maximum exposure to credit risk for the components of the consolidated statement of financial position, including credit related commitments. The figures represent gross exposure, without taking account of any collateral held or other credit enhancements.

	2010 **BD'000**	2009 BD'000
Balances with banks and other financial institutions	**8,206**	5,712
Murabaha receivables	**465,889**	361,067
Mudaraba investments	**44,669**	56,008
Musharaka investments	**84,522**	80,927
Investment in Sukuk	**65,075**	93,075
Ijarah muntahia bittamleek	**105,386**	119,244
Ijarah rental receivables	**7,569**	3,603
Other assets	**5,052**	5,526
	786,368	725,162
Letters of credit, guarantees and acceptances	**12,706**	18,351

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

25. RISK MANAGEMENT (continued)

a) Credit Risk (continued)

Credit Risk Mitigation (continued)

(ii) Risk concentrations of the maximum exposure to credit risk

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location. The Group seeks to manage its credit risk exposure through diversification of financing activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses.

The distribution of the Group's assets, liabilities, unrestricted investment accounts, commitments and contingent liabilities by geographic region and industry sector is as follows:

	Assets		Liabilities and unrestricted investment accounts		Commitments and contingent liabilities	
	31 December 2010 BD'000	31 December 2009 BD'000	**31 December 2010 BD'000**	31 December 2009 BD'000	**31 December 2010 BD'000**	31 December 2009 BD'000
Geographical region						
North America	**4,682**	4,776	**-**	-	**-**	-
Europe	**55,171**	26,121	**5,009**	7,026	**-**	-
Middle East	**873,768**	877,874	**830,600**	764,419	**13,230**	18,765
Rest of Asia	**2,053**	3,179	**4**	4	**-**	-
Total	**935,674**	911,950	**835,613**	771,449	**13,230**	18,765
Industry sector						
Trading and manufacturing	**82,011**	88,644	**47,455**	67,192	**6,821**	8,993
Aviation	**24,801**	27,950	**103,568**	11,924	**-**	-
Real Estate	**243,945**	304,355	**14,657**	27,767	**3,410**	1,498
Banks and financial institutions	**314,860**	226,822	**195,795**	247,677	**2,475**	7,860
Others	**270,057**	264,179	**474,138**	416,889	**524**	414
Total	**935,674**	911,950	**835,613**	771,449	**13,230**	18,765

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

25. RISK MANAGEMENT (continued)

a) Credit Risk (continued)

Credit Risk Mitigation (continued)

(iii) Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group using internal credit ratings. The table below shows the credit quality by class of asset, based on the Group's credit rating system.

	Neither past due nor impaired					
2010	**High grade BD'000**	**Standard grade BD'000**	**Restructured* BD'000**	**Past due but not impaired BD'000**	**Individually impaired BD'000**	**Total BD'000**
Murabaha receivables	**9,160**	**330,349**	**11,049**	**17,449**	**97,882**	**465,889**
Musharaka investments	**4,098**	**31,507**	**6,899**	**10,342**	**31,676**	**84,522**
Ijarah muntahia bittamleek	**-**	**59,023**	**-**	**4,465**	**41,898**	**105,386**
Ijarah rental receivables	**-**	**7,569**	**-**	**-**	**-**	**7,569**
	13,258	**428,448**	**17,948**	**32,256**	**171,456**	**663,366**

	Neither past due nor impaired					
2009	High grade BD'000	Standard grade BD'000	Restructured* BD'000	Past due but not impaired BD'000	Individually impaired BD'000	Total BD'000
Murabaha receivables	8,167	248,336	58,201	2,770	43,593	361,067
Musharaka investments	-	46,099	30,541	130	4,157	80,927
Ijarah muntahia bittamleek	-	111,342	-	6,469	1,433	119,244
Ijarah rental receivables	-	3,603	-	-	-	3,603
	8,167	409,380	88,742	9,369	49,183	564,841

* Restructured facilities represent the facilities which were restructured during the year. Moreover any restructured facilities which become non-performing are classified as individually impaired.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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25. RISK MANAGEMENT (continued)

a) Credit Risk (continued)

Credit Risk Mitigation (continued)

(iv) Aging analysis of past due but not impaired Islamic financing facilities per class of financial assets

2010	**Less than 30 days BD'000**	**31 to 60 days BD'000**	**61 to 90 days BD'000**	**Total BD'000**
Murabaha receivable	**8,583**	**2,642**	**6,224**	**17,449**
Musharaka investments	**4,408**	**3,013**	**2,921**	**10,342**
Ijarah muntahia bittamleek	**3,551**	**451**	**463**	**4,465**
	16,542	**6,106**	**9,608**	**32,256**

2009	Less than 30 days BD'000	31 to 60 days BD'000	61 to 90 days BD'000	Total BD'000
Murabaha receivable	462	2,264	44	2,770
Musharaka investments	108	22	-	130
Ijarah muntahia bittamleek	4,777	1,486	206	6,469
	5,347	3,772	250	9,369

b) Liquidity Risk

Liquidity risk is the risk that the Group will be unable to meet its net funding requirements when they fall due. Liquidity risk can be caused by market disruptions or credit downgrades which may cause certain sources of funding to cease immediately. To guard against this risk, the Group has a large customer base and assets are managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents, international commodity Murabaha, credit lines and quoted investments.

Maturity profile of Group's assets and liabilities

The table below summarises the maturity profile of the Group's assets and liabilities. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period at the consolidated statement of financial position date to the contractual maturity date and do not take account of the effective maturities as indicated by the Group's retention history of its unrestricted investment accounts.

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25. RISK MANAGEMENT (continued)

The maturity profile of assets, liabilities, unrestricted investment accounts and equity at 31 December 2010 was as follows:

	Up to 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 months to 1 year BD '000	1 to 3 years BD '000	Over 3 years BD '000	No fixed maturity BD '000	Total BD '000
ASSETS								
Cash and balances with CBB and other banks	18,961	-	-	-	-	-	26,870	45,831
Murabaha receivables	194,333	35,254	18,236	23,395	24,683	135,791	-	431,692
Mudaraba investments	4,274	-	747	-	-	32,339	-	37,360
Musharaka investments	3,336	4,579	5,264	402	3,224	63,441	-	80,246
Investments	4,836	18,672	12,721	645	14,477	30,184	13,132	94,667
Investment in associates	-	-	-	-	-	-	6,778	6,778
Investment in Ijarah assets	-	-	-	-	-	-	9,635	9,635
Ijarah Muntahia Bittamleek	1,125	108	135	25	11,639	92,354	-	105,386
Investment in properties	-	-	-	-	-	-	105,192	105,192
Ijarah rental receivables	-	-	7,569	-	-	-	-	7,569
Other assets	-	-	6,597	-	-	-	4,721	11,318
Total assets	226,865	58,613	51,269	24,467	54,023	354,109	166,328	935,674
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY								
Customers' current accounts	81,660	-	-	-	-	-	-	81,660
Other liabilities	12,571	-	-	-	-	-	-	12,571
Unrestricted investment accounts	243,682	228,086	68,063	191,433	8,799	-	1,319	741,382
Equity	-	-	-	-	-	-	100,061	100,061
Total liabilities, unrestricted investment accounts and equity	337,913	228,086	68,063	191,433	8,799	-	101,380	935,674
Liquidity gap	(111,048)	(169,473)	(16,794)	(166,966)	45,224	354,109	64,948	-
Cumulative liquidity gap	(111,048)	(280,521)	(297,315)	(464,281)	(419,057)	(64,948)	-	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

25. RISK MANAGEMENT (continued)

The maturity profile of assets, liabilities, unrestricted investment accounts and equity at 31 December 2009 was as follows:

	Up to 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 months to 1 year BD '000	1 to 3 years BD '000	Over 3 years BD '000	No fixed maturity BD '000	Total BD '000
ASSETS								
Cash and balances with CBB and and other banks	12,683	-	-	-	-	-	23,410	36,093
Murabaha receivables	145,302	24,434	30,468	36,492	38,698	57,125	-	332,519
Mudaraba investments	13,690	-	1,610	-	-	38,070	-	53,370
Musharaka investments	20,310	5,722	6,704	4,091	10,010	34,082	-	80,919
Investments	5,671	36,549	-	5,414	43,744	29,804	13,013	134,195
Investment in associates	-	-	-	-	-	-	7,448	7,448
Investment in Ijarah assets	-	-	-	-	-	-	9,771	9,771
Ijarah Muntahia Bittamleek	6,860	1,315	36,097	198	6,357	68,417	-	119,244
Investment in properties	-	-	-	-	-	-	123,030	123,030
Ijarah rental receivables	-	-	3,603	-	-	-	-	3,603
Other assets	-	-	7,224	-	-	-	4,534	11,758
Total assets	204,516	68,020	85,706	46,195	98,809	227,498	181,206	911,950
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY								
Customers' current accounts	79,724	-	-	-	-	-	-	79,724
Other liabilities	11,432	-	-	-	-	-	-	11,432
Unrestricted investment accounts	302,351	133,560	79,318	160,177	4,077	-	810	680,293
Equity	-	-	-	-	-	-	140,501	140,501
Total liabilities, unrestricted investment accounts and equity	393,507	133,560	79,318	160,177	4,077	-	141,311	911,950
Liquidity gap	(188,991)	(65,540)	6,388	(113,982)	94,732	227,498	39,895	-
Cumulative liquidity gap	(188,991)	(254,531)	(248,143)	(362,125)	(267,393)	(39,895)	-	-

c) Market Risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as profit rates, equity prices, and foreign exchange rates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

25. RISK MANAGEMENT (continued)

(i) Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and unrestricted investment accounts as the repricing of assets, liabilities and unrestricted investment accounts occur at similar intervals. The profit distribution to unrestricted investment accounts is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

However, the profit sharing agreements will result in displaced commercial risk when the Group's results do not allow the Group to distribute profits inline with the market rates.

(ii) Equity price risk

Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the investment portfolio. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

In order to measure the risk of equity on its financial positions, the Group adopts a sensitivity analysis on its quoted equity portfolio for 10% increase of the portfolio value with all other variables remain constant. The effect of a similar decrease in equity prices is expected to be equal and opposite to the effect of the increase shown.

Equity price risk variation as of 31 December is as follows;

2010	**Increase in equity price %**	**Sensitivity of profit or loss BD'000**	**Sensitivity of equity BD'000**
Bahrain Stock Exchange	**+10**	**49**	**969**
Saudi Stock Exchange (TADAWUL)	**+10**	**38**	**-**
Qatar Stock Exchange	**+10**	**10**	**438**
Abu Dhabi Stock Exchange	**+10**	**8**	**-**
Oman Stock Exchange	**+10**	**14**	**342**

2009	Increase in equity price %	Sensitivity of profit or loss BD'000	Sensitivity of equity BD'000
Bahrain Stock Exchange	+10	16	2,054
Saudi Stock Exchange (TADAWUL)	+10	-	957
Dubai International Financial Exchange	+10	-	36
Qatar Stock Exchange	+10	-	368
Abu Dhabi Stock Exchange	+10	9	-
Kuwait Stock Exchange	+10	5	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

25. RISK MANAGEMENT (continued)

As at consolidated statement of financial position date, the Group has unquoted (equities and sukuk) of BD 76 million (31 December 2009: BD 107 million). The impact of changes in the value of these unquoted equities and sukuk and the related impact on equity will only be reflected when the financial instrument is sold or deemed to be impaired.

iii) Currency risk
Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group views the Bahraini Dinar as its functional currency. The Board has set limits on positions by currency. Positions are monitored on a daily basis to ensure they are maintained within established limits.

The Group had the following significant net exposures denominated in foreign currencies as of 31 December:

	Equivalent Long (short) 2010 BD '000	Equivalent Long (short) 2009 BD '000
Currency		
Pound Sterling	**(9,714)**	(5,157)
Euro	**14,109**	23,880
Kuwaiti Dinars	**8,533**	(12,391)

As the Bahraini Dinar is pegged to the US Dollar, positions in US Dollars are not considered to represent significant currency risk.

Moreover, as the Group does not have significant exposure to other currencies, movement of the currency exchange risk against the BD with other variables held constant will have an immaterial impact on the consolidated statement of income and equity.

d) Operational Risk
Operational risk is the risk of loss arising from system failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2010

26. SEGMENTAL INFORMATION

The activities of the Group are performed on an integrated basis. Therefore, any segmentation of operating income, expenses, assets and liabilities is not relevant. As such, operating income, expenses, assets and liabilities are not segmented.

The Group operates solely in the Kingdom of Bahrain and, as such, no geographical segment information is presented.

27. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable and willing parties in an arm's length transaction. Consequently, differences can arise between carrying values and fair value estimates.

Included under investments are unquoted available for sale investments amounting to BD 13,132 (2009: BD 13,014) which are carried at cost due to lack of other reliable methods for arriving at a reliable fair value for these investments.

The estimated fair value of the Group's financial instruments are not significantly different from their book values as at the consolidated statement of financial position.

28. EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a qard fund account where the Group uses these funds for various social welfare activities. The movements in these funds is shown in statement of sources and uses of good faith qard fund. The non-Islamic income includes the penalties charged on late repayments for Islamic facilities.

29. SHARI'A SUPERVISORY BOARD

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

30. SOCIAL RESPONSIBILITY

The Group discharges its social responsibilities through zakah and charity fund's expenditures and donations to good faith qard fund for marriage, refurbishment, medical treatments, etc.

31. COMPARATIVE FIGURES

Certain of the prior year's figures have been reclassified to conform to the presentation adopted in the current year. Such reclassification did not affect previously reported net income or equity.

PUBLIC DISCLOSURES

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

1. BACKGROUND

The Public Disclosures under this section have been prepared in accordance with the Central Bank of Bahrain ("CBB") requirements outlined in its Public Disclosure Module ("PD"), Section PD-1: Annual Disclosure requirements, CBB Rule Book, Volume II for Islamic Banks. Rules concerning the disclosures under this section are applicable to Bahrain Islamic Bank B.S.C. (the "Bank") being a locally incorporated Bank with a retail banking license, and its subsidiary together known as (the "Group").

The Board of Directors seeks to optimize the Bank's performance by enabling the various Group business units to realize the Group's business strategy and meet agreed business performance targets by operating within the agreed capital and risk parameters and the Group risk policy framework.

2. CAPITAL STRUCTURE AND CAPITAL ADEQUACY

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and 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 Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issuing sukuk etc. No changes were made in the objectives, policies and processes from the previous years.

The Group's capital structure is primarily made up of its paid-up capital, including share premium and reserves. From a regulatory perspective, the significant amount of the Group's capital is in Tier 1 form as defined by the CBB, i.e., most of the capital is of permanent nature.

The Group's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of financing facilities growth expectations for each business group, expected growth in off-balance sheet facilities and future sources and uses of funds. To assess its capital adequacy requirements in accordance with CBB requirements, the Group adopts the Standardized Approach for its Credit Risk, Basic Indicator Approach for its Operational Risk and Standardized Measurement Approach for its Market Risk. All assets funded by unrestricted investment accounts are subject to Board approval.

All transfer of funds or regulatory capital within the Group is only carried out after proper approval process.

As part of the risk management practice, the Bank has already implemented Sunguard system to be Basel II compliant as prescribed by CBB.

For the purposes of guidance every table was cross referenced with the relevant para number of the Central Bank of Bahrain's Public Disclosures Module.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

2. CAPITAL ADEQUACY (continued)

Table – 1. Capital Structure (PD-1.3.12, 1.3.13, 1.3.14 and 1.3.15)

The following table summarizes the eligible capital as of 31 December 2010 after deductions for Capital Adequacy Ratio (CAR) calculation;

	Tier 1 BD'000	Tier 2 BD'000
Components of capital		
Issued and fully paid ordinary shares	72,552	-
General reserves	1,000	-
Legal / statutory reserves	10,268	-
Share premium	43,936	-
Retained earnings / losses (excluding current year net income/loss)	(4,798)	-
Less:		
Net losses for the year	(21,661)	-
Unrealized gross losses arising from fair valuing equity securities	(2,412)	-
Tier 1 Capital before PCD deductions	**98,885**	**-**
Asset revaluation reserve (45% only)		19
Unrealized gains arising from fair valuing equities (45% only)		348
Tier 2 Capital before PCD deductions		**367**
Total available capital		**99,252**
Deductions		
Significant minority investments in banking, securities and other financial entities unless pro-rata consolidated	(2,557)	(2,557)
Investment in insurance entity greater than or equal to 20%	(832)	(832)
Excess amount over maximum permitted large exposure limit	(8,069)	(8,069)
Total Deductions	**(11,458)**	**(11,458)**
Tier 1 and Tier 2 eligible capital before additional deduction	87,427	(11,091)
Additional deduction from Tier 1 to absorb deficiency in Tier 2	(11,091)	11,091
Tier 1 and Tier 2 eligible capital	**76,336**	**-**
TOTAL ELIGIBLE CAPITAL	**76,336**	**-**

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

2. CAPITAL ADEQUACY (continued)

Table – 1. Capital Structure (PD-1.3.12, 1.3.13, 1.3.14 and 1.3.15) (continued)

	Amount of exposures BD'000
Total Credit Risk Weighted Assets	465,798
Total Market Risk Weighted Assets	22,656
Total Operational Risk Weighted Assets	52,968
TOTAL REGULATORY RISK WEIGHTED ASSETS	**541,422**
CAPITAL ADEQUACY RATIO	**14.10%**
Minimum requirement	**12%**

Table – 2. Capital requirements by type of Islamic financing contracts (PD-1.3.17)

The following table summarises the amount of exposures as of 31 December 2010 subject to standardized approach of credit risk and related capital requirements by type of Islamic financing contracts;

	Risk Weighted Assets BD'000	Capital requirements BD'000
Type of Islamic Financing Contracts		
Murabaha receivables*	209,853	25,182
Ijarah Muntahia Bittamleek*	24,933	2,992
Musharaka investments*	18,985	2,278
Mudaraba investments	747	90
Investment in Sukuk	12,650	1,518
Ijarah rental receivable	2,464	296
Other credit exposures	196,166	23,540
	465,798	**55,896**

*The amounts have been allocated on pro-rata basis due to system limitation.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

2. CAPITAL ADEQUACY (continued)

Table – 3. Capital requirements for market risk (PD-1.3.18)

The following table summarises the amount of exposures as of 31 December 2010 subject to standardized approach of market risk and related capital requirements;

	BD'000
Market Risk - Standardised Approach	
Foreign exchange risk	**1,812**
Total of Market Risk -Standardised Approach	**1,812**
Multiplier	**12.5**
RWE to be used in CAR Calculation	**22,656**
Total Market Risk Exposures	**22,656**
Total Market Risk Exposures - Capital Requirement	**2,719**

Table – 4. Capital Requirements for operational risk (PD-1.3.30 (a & b) and PD-1.3.19)

The following table summarises the amount of exposures as of 31 December 2010 subject to basic indicator approach of operational risk and related capital requirements;

	Capital charge BD'000
Indicators of operational risk	
Average Gross income	28,249
Multiplier	12.5
	353,113
Eligible Portion for the purpose of the calculation	15%
Total Operational Risk Exposure	**52,968**
Total Operational Risk Exposures - Capital Requirement	**6,356**

Table – 5. Capital Adequacy Ratios (PD-1.3.20)

The following are Capital Adequacy Ratios as of 31 December 2010 for total capital and Tier 1 capital;

	Total capital ratio	Tier 1 capital ratio
Top consolidated level	14.10%	14.10%

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT

3.1 Bank-wide Risk Management Objectives

The risk management philosophy of the Group is to identify, capture, monitor and manage the various dimensions of risk with the objective of protecting asset values and income streams such that the interest of the Group's shareholders (and others to whom the Group owes a liability) are safeguarded, while maximizing the returns intended to optimize the Group's shareholder return while maintaining it's risk exposure within self-imposed parameters.

The Group has defined its risk appetite within the parameters of its Risk Strategy. The Group reviews and realigns its risk appetite as per the evolving business plan of the Group with changing economic and market scenarios. The Group also assesses its tolerance for specific risk categories and its strategy to manage these risks.

In addition to satisfying the minimum regulatory capital requirements of CBB, the Group seeks to constantly identify and quantify, to the extent possible, the various risks that are inherent in the normal course of its business and maintain appropriate internal capital levels as per the ICAAP framework. The main objective of the Group's ICAAP is to ensure that adequate capital is retained at all times to support the risks the Group undertakes in the course of its business.

The Bank has an established internal capital adequacy process (ICAAP) as per the requirements under Pillar of the Basell II. ICAAP prescribes and measure designed to ensure appropriate identification, measurement, aggregation and monitoring of the Bank risk. It also defines an appropriate level of internal capital in relation to the Bank overall risk profile and business plan.

3.2 Strategies, Processes and Internal Controls

3.2.1 Bank's risk strategy

Capital Management policies and Risk Charter define the Bank's risk strategy. Comprehensive Risk Management Policy Framework is approved by the Board. These are also supported by appropriate limit structures. These policies provide an enterprise-wide integrated risk management framework in the Bank.

The risk charter identifies risk objectives, policies, strategies and risk governance both at the Board and the management level. The capital management policy is aimed at ensuring financial stability by allocating enough capital to cover unexpected losses.

Limit structures serve as a key component in articulating risk strategy in quantifiable risk appetite. They are further supported by a comprehensive framework for various risk silos with its own policies and methodology documents. In addition, the Bank is in the process of implementing various risk systems to help quantify not just the regulatory capital but also the economic capital allocated to various portfolios.

The Bank is exposed to various types of risk, such as market, credit, profit rate, liquidity and operational, all of which require the comprehensive controls and ongoing oversight. The risk management framework summarises the spirit behind Basel II, which includes management oversight and control, risk culture and ownership, risk recognition and assessment, control activities and segregation of duties, adequate information and communication channels, monitoring risk management activities and correcting deficiencies.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.2 Strategies, Processes and Internal Controls (continued)

3.2.2 Credit risk
The Bank manages its credit risk exposure by evaluating each new product/activity with respect to the credit risk introduced by it. The Group has established a limit structure to avoid concentration of risks for counterparty, sector and geography.

3.2.3 Market risk
The Group proactively measures and monitors the market risk in its portfolio using appropriate measurement techniques such as limits on its foreign exchange open positions although they are insignificant. The Bank is in the process of developing techniques to carry out stress testing to assess the impact of adverse market conditions on its market risk sensitive portfolio.

The Bank has established a limit structure to monitor and control the market risk in its trading and available for sale equity portfolio. These limits include maximum Stop-loss limits, position limits, VaR limits and maturity limits.

3.2.4 Operational risk
The Bank has implemented SunGard's Operational Risk Management system 'SWORD' for recording the potential risks, controls and events on a continuous basis. As part of implementation, the Bank has carried out Risk Control Self Assessment ("RCSA") exercise on a regular basis. The system also measures the Operational risk appetite based on the predefined limits/thresholds.

The Group has established a clear segregation of duties, through documentation and implementation of policies and procedures. This ensures objectivity, security and avoids conflicts of interest. Maker checker concept and dual eye principles are applied across the Bank, where possible.

3.2.5 Equity price risk
Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the investment portfolio. The Bank manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

3.2.6 Profit rate risk
Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Group's management believes that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and unrestricted investment accounts. The profit distribution to unrestricted investment accounts is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

However, the profit sharing agreements will result in displaced commercial risk when the Group's results do not allow the Group to distribute profits inline with the market rates.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.2 Strategies, Processes and Internal Controls (continued)

3.2.7 Displaced Commercial Risk

Displaced commercial risk ("DCR") refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by the liabilities, when the return on assets is under performing as compared with competitor's rates.

The Group manages its displaced commercial risk by placing gap limits between the returns paid to investors and market returns.
The Group is currently in the process of developing detailed written policies and procedures for displaced commercial risk. The Group may forego its fee in case displaced commercial risk arises. The Group benchmarks its rates with other leading banks in the market.

All the above strategies used have been effective throughout the reporting year.

3.3 Structure and Organization of Risk Management Function

Risk Management Structure includes all levels of authorities (including Board level Risk committee), organizational structure, people and systems required for the smooth functioning of risk management processes in the Bank. The responsibilities associated with each level of risk management structure and authorities include the following:

The Board retains ultimate responsibility and authority for all risk matters, including:

a Establishing overall policies and procedures, and

b. Delegating authority to Executive Committee, Credit Committee, the Chief Executive Officer and further delegation to the management to approve and review.

3.4 Risk Measurement and Reporting Systems

Based on risk appetite of the Bank, the Bank has put in place various limits. These limits have been approved by the Board of Directors. Any limit breaches are reported to the respective senior management committees and the Board by the Credit and Risk Management Department ("CRMD"). The limits are reviewed and revised at least on an annual basis or when is deemed required.

The Bank has developed a risk measurement and reporting system that generates various types of reports which has enhanced the monitoring process of the Bank.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.5 Credit Risk

3.5.1 Introduction
Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from lending and investment activities. The Bank controls credit risk by monitoring credit exposures, and continually assessing the creditworthiness of counterparties. Financing contracts are mostly secured by collateral in the form of mortgage financed or other tangible securities.

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept in terms of counterparties, product types, geographical area and industry sector. The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision by the Credit Review and Analysis Department ("CR&AD"). Any changes to the Credit Risk Policy will be approved by the Board.

All credit proposals undergo a comprehensive risk assessment examinig the customer's financial condition, trading performance, nature of the business, quality of management, and market position, etc. In addition, the Bank's internal risk rating model scores these quantitative and qualitative factors. The credit approval decision is then made and terms and conditions are set.

Exposure limits are based on the aggregate exposure to counterparty and any connected entities across the Bank. Corporate contracts/ facilities are reviewed on an annual basis by CR&AD.

3.5.2 Types of credit risk
Financing contracts mainly comprise Murabaha receivables, Mudaraba investments, Musharaka investments and Ijarah Muntahia Bittamleek.

Murabaha receivables
The Group finances these transactions through buying the commodity which represents the object of the Murabaha contract and then resells this commodity to the Murabeh (beneficiary) at a profit. The sale price (cost plus profit margin) is repaid in installments by the Murabeh over the agreed period. The transactions are secured at times by the object of the Murabaha contract (in case of real estate finance) and other times by a total collateral package securing the facilities given to the Murabeh.

Mudaraba investments
The Group enters into Mudaraba contracts by investing in funds operated by other banks and financial institutions for a definite period of time.

3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

Musharaka investments

Musharaka is a form of partnership between the Group and its clients whereby each party contributes to the capital of partnership in equal or varying degrees to establish a new project or share in an existing one, whereby each of the parties becomes an owner of the capital on a permanent or declining basis. Profits are shared in an agreed ratio, but losses are shared in proportion to the amount of capital contributed.

Ijarah Muntahia Bittamleek

The legal title of the assets under Ijarah Muntahia Bittamleek only passes to the lessee at the end of the Ijarah term, through gift, consideration or gradual sale, provided that all Ijarah installments are settled.

3.5.3 Past Due and impaired Islamic financing

The Bank defines non-performing facilities as the facilities that are overdue for period of 90 days or more. These exposures are placed on a non-accrual status with income being recognized to the extent that it is actually received. It is the Bank's policy that when an exposure is overdue for a period of 90 days or more, the whole financing facility extended is considered as non performing, not only the overdue installments/payments.

As a policy the Group places on a non-accrual basis any facility where there is reasonable doubt about the collectability of the receivable irrespective of whether the customer concerned is currently in arrears or not.

3.5.4 External credit assessment institutions

The Bank relies on external ratings for rated corporate customers and counterparties. The Bank uses Standard & Poor's, Fitch, Moody's and Capital Intelligence to provide ratings for such counterparties. In case of unrated counterparties, the Bank will assess the credit risk on the basis of defined parameters. These ratings are used for risk assessment and calculation of risk weighted equivalents.

3.5.5 Definition of Geographical distribution

The geographic distribution of the credit exposures is monitored on an ongoing basis by Group's Risk Management Department and reported to the Board on a quarterly basis. The Group's classification of geographical area is according to its business needs and the distribution of its portfolios.

3.5.6 Concentration risk

Concentration risk is the credit risk stemming from not having a well diversified credit portfolio, i.e. being overexposed to a single customer, industry sector or geographic region. As per CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's prior approval for any planned exposure to a single counterparty, or group of connected counterparties, exceeding 15% of the regulatory capital base.

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

3.5.7 Credit risk mitigation
Credit risk mitigation refers to the use of a number of techniques, like collaterals and guarantees to mitigate the credit risks that the Group is exposed to. Credit risk mitigants reduce the credit risk by allowing the Group to protect against counterparty non-performance of credit contracts through collaterals, netting agreements and guarantees.

Generally, the Group extends credit facilities only where supported by adequate tangible collateral security and/or audited financial statements. Facilities may be considered without adequate tangible collateral security, when audited financial statements reveal satisfactory financial position/repayment ability and the facilities are properly structured and supported by assignments, guarantees, etc. as appropriate. Name lending (i.e. lending without audited financial statements and tangible collateral security) is discouraged and is approved only on an exceptional basis after careful analysis of the quality of the customer, market reputation, approximate personal net worth etc.

In general, personal guarantees of the partners/promoters/directors of the borrowing entity are obtained in support of credit facilities. In all cases, a statement of net worth of the guarantor is to be compiled by the Account Officer, so that adequate information is available at a future date in case the guarantees need to be enforced.

The market value of tangible collateral security are properly evaluated by the Bank approved valuers (for properties) or based on publicly available quotations. Only the Loan-able Value of such security is taken into account while considering credit facilities.

From time to time, the Credit Committee reviews and approves the loan-able value of securities. It has also approved a list of acceptable securities.

The majority of the Group's current credit portfolio is secured through mortgage of commercial real estate properties. The Group may dispose off the assets as a last resort after carrying out due legal process.

3.5.7.1 General policy guidelines of collateral management
Acceptable Collaterals: The Bank has developed guidelines for acceptable collaterals. Assets offered by customers must meet the following criteria to quantify as acceptable collateral:

a. Assets must be maintaining their value, at the level prevalent at inception, until maturity date of the facility granted;
b. Such assets should be easily convertible into cash, if required (liquidity);
c. There should be a reasonable market for the assets (marketability); and
d. The Group should be able to enforce its rights over the asset if necessary (enforceability).

Ownership: Prior to valuation or further follow up on the offered collateral, Credit Administration ensures satisfactory evidence of the borrower's ownership of the assets.

3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

Valuation: All assets offered as collateral are valued by an appropriate source either in-house (through another department in the Group) or by an external appraiser (real estate related collateral). The Group maintains a list of independent appraisers, approved by management.

a. **Valuation of shares and goods:** Where competent staff is available within the Group, the valuation is conducted in-house. The Group performs in-house valuation on the following types of securities:

- Pledge of shares of local companies;
- Pledge of international marketable shares and securities; and
- Pledge and hypothecation of goods.

International shares are valued at the quotes available from stock exchanges, periodicals, etc.

b. **Valuation of real estate and others:** Besides assets mentioned above the valuation of following securities are also conducted:

- Real Estate;
- Equipment and machinery; and
- Precious metals and jewelers.

The Credit Administration requests the concerned department to arrange for the valuation from approved valuators.

The following additional guidelines are also followed by the Group:

a. No facility should be disbursed until credit documentation is properly signed and security/guarantees required have been signed and registered, where required. Exceptional cases can be considered by sanctioning authorities; and

b. All documents received as security or support for credit facilities will be lodged in the safe custody through the Credit Administration and should be kept under dual control. Group must ascertain that collateral providers are authorized and acting within their capacity.

3.5.7.2 Guarantees
In cases where a letter of guarantee from parent company or a third party is accepted as credit risk mitigants, the Group ensures that all guarantees are irrevocable, legal opinion has been obtained from a legal counselor domiciled in the country of guarantor (overseas) regarding the enforceability of the guarantee, if the guarantor / prime obligor is domiciled outside Bahrain and all guarantees should be valid until full settlement of the facilities. Also no maturity (negative) mismatch is permissible between the guarantee and exposure.

3.5.7.3 Custody/ collateral management
The assets, or title to the asset, will be maintained in the Group's custody or with custodian approved by the Group. The Credit Administration will obtain confirmation of the assets held with each custodian on an annual basis.

The release of collateral without full repayment of all related financial obligations requires authorization of the same level that originally approved and sanctioned the facility. Substitution of collateral is permitted if the new collateral would further minimize the Group's risk exposure.

When collateral is released to the customer, the Head of Credit Administration obtains and maintains in his records acknowledgement of receipt from the customer or his/her authorized representative.

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3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

3.5.8 Counterparty credit risk
The Group has adopted the Standardized Approach to allocate capital for counterparty credit risk. The Group has put in place an internal counterparty limit structure which is based on internal/external ratings for different types of counterparties. The Group has also set concentration limits as a percentage of its capital based on internal and external grades. In case of a counterparty rating downgrade/ deterioration, the Group may require further collateral or advise the counterparty to reduce its exposure on a case by case basis.

3.5.8.1 Exposure
The measure of exposure reflects the maximum loss that the Group may suffer in case counterparty fails to fulfill its commitments. Exposure shall always be calculated on the basis of approved limits or actual outstanding exposure (Financing facilities, Investments or others), whichever is higher.

3.5.8.2 Counterparty
A counterparty is defined as an obligor (individual/company/other legal entity), a guarantor of an obligor, or a person receiving funds from the Group, the issuer of a security in case of a security held by the Group, or a party with whom a contract is made by the Group for financial transactions.

3.5.8.3 Group exposure
Group exposure is defined as the total exposure to all counterparties closely related or connected to each other. For this purpose, Group is two or more counterparties related in such a way that financial soundness of one may affect the financial soundness of the other(s) and one of them has a direct or indirect control over other(s).

3.5.8.4 Connected counterparties
Connected counterparties are companies or individuals connected with the Group or its subsidiaries and associated companies (whether such association is due to control or shareholding or otherwise), Directors and their associates (whether such association is due to control, family links or otherwise), members of the Shari'a Supervisory Board, management and other staff and shareholders holding more than 10% or more of the equity voting rights in the Group.

3.5.8.5 Large exposure
Large exposure is any exposure whether direct, indirect or funded by unrestricted investment accounts to a counterparty or a group of closely related counterparties which is greater than or equal to 10% of the Group's capital base.

Prior written approval from the CBB is required in the following cases:

a. If any counterparty (single/group) exposure exceeds 15% of Group's Capital Base; and
b. If any facility (new/extended) to an employee is equal or above BD100, 000 (or equivalent).

3.5.8.6 Maximum exposure
The Group has set an internal maximum exposure limit in the light of CBB guidelines.

3.5.8.7 Reporting
The Group reports large counterparty exposures (as defined above) to CBB on periodic basis. The Group reports the exposures on a gross basis without any set-off. However, debit balances on accounts may be offset against credit balances where both are related to the same counterparty, provided the Group has a legally enforceable right to do so.

3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

3.5.8.8 Other matters

As a Group's strategy exposure to connected counterparties may be undertaken only when negotiated and agreed on an arm's length basis.

The Group shall not assume any exposure to its external auditors.

3.5.9 Related party transactions

The disclosure relating to related party transactions has been made in the consolidated financial statements. All related party transactions have been made on arm's length basis.

Table – 6. Credit Risk Exposure (PD-1.3.23(a)

The following table summarises the amount of gross funded and unfunded credit exposure as of 31 December 2010 and average gross funded and unfunded exposures over the year ended 31 December 2010 allocated in own capital and current account and profit sharing investment account (PSIA);

	Own capital and current account		Profit Sharing Investment Account	
	Total gross credit exposure BD'000	*Average gross credit exposure over the Year BD'000	Total gross credit exposure BD'000	*Average gross credit exposure over the Year BD'000
Funded				
Cash and balances with Central Bank of Bahrain and other banks	18,961	18,165	26,870	26,144
Murabaha receivables	15,754	13,724	415,938	362,331
Mudaraba investments	32,522	37,041	4,838	11,098
Musharaka investments	2,929	2,818	77,317	74,388
Investments	34,098	35,040	60,569	73,908
Investment in associates	6,778	7,427	-	-
Investment in Ijarah assets	9,635	9,698	-	-
Ijarah Muntahia Bittamleek	3,845	4,096	101,541	108,143
Investment in properties	105,192	121,687	-	-
Ijarah rental receivables	276	143	7,293	3,790
Other assets	11,318	16,175	-	-
Unfunded				
Bank's liability under L/C and L/G	13,230	15,148	-	-
Total	**254,538**	**281,162**	**694,366**	**659,802**

* Average balances are computed based on month end balances.

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3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

Table – 7. Credit Risk – Geographic Breakdown (PD-1.3.23(b))

The following table summarises the geographic distribution of exposures as of 31 December 2010, broken down into significant areas by major types of credit exposure;

	Own capital and current account *Geographic area					Profit Sharing Investment Account *Geographic area				
	North America BD'000	Europe BD'000	Middle East BD'000	Rest of Asia BD'000	Total BD'000	North America BD'000	Europe BD'000	Middle East BD'000	Rest of Asia BD'000	Total BD'000
Cash and balances with Central Bank of Bahrain and other banks	3,826	310	14,733	92	18,961	-	-	26,870	-	**26,870**
Murabaha receivables	-	1,712	14,042	-	15,754	-	45,206	370,732	-	**415,938**
Mudaraba investments	856	7,943	21,762	1,961	32,522	-	-	4,838	-	**4,838**
Musharaka investments	-	-	2,929	-	2,929	-	-	77,317	-	**77,317**
Investments	-	-	34,098	-	34,098	-	-	60,569	-	**60,569**
Investment in associates	-	-	6,778	-	6,778	-	-	-	-	**-**
Investment in Ijarah assets	-	-	9,635	-	9,635	-	-	-	-	**-**
Ijarah Muntahia Bittamleek	-	-	3,845	-	3,845	-	-	101,541	-	**101,541**
Investment in properties	-	-	105,192	-	105,192	-	-	-	-	**-**
Ijarah rental receivables	-	-	276	-	276	-	-	7,293	-	**7,293**
Other assets	-	-	11,318	-	11,318	-	-	-	-	**-**
Total	**4,682**	**9,965**	**224,608**	**2,053**	**241,308**	**-**	**45,206**	**649,160**	**-**	**694,366**

* Geographical distribution of exposure into significant areas by major type of credit exposure is based on counterparty's country of incorporation.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

Table – 8. Credit Risk – Industry Sector Breakdown (PD-1.3.23(c))

The following table summarises the distribution of funded and unfunded exposures as of 31 December 2010 by industry, broken down into major types of credit exposure;

	Own capital and current account *Geographic area						Profit Sharing Investment Account *Geographic are					
	Trading and Manufacturing	Banks and Financial Institutions	Real Estate	Aviation	Others	Total	Trading and Manufacturing	Banks and Financial Institutions	Real Estate	Aviation	Others	Total
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
Funded												
Cash and balances with Central Bank of Bahrain and other banks	-	12,921	-	-	6,040	**18,961**	-	26,870	-	-	-	**26,870**
Murabaha receivables	2,126	8,389	1,293	94	3,852	**15,754**	56,133	221,488	34,133	2,490	101,694	**415,938**
Mudaraba investments	-	956	15,520	-	16,046	**32,522**	-	4,838	-	-	-	**4,838**
Musharaka investments	426	-	752	-	1,751	**2,929**	11,247	-	19,862	-	46,208	**77,317**
Investments	4,246	16,303	3,181	42	10,326	**34,098**	-	6,158	20,842	1,090	32,479	**60,569**
Investment in associates	-	6,778	-	-	-	**6,778**	-	-	-	-	-	**-**
Investment in Ijarah assets	-	-	9,635	-	-	**9,635**	-	-	-	-	-	**-**
Ijarah Muntahia Bittamleek	286	371	1,224	769	1,195	**3,845**	7,547	9,788	32,311	20,316	31,579	**101,541**
Investment in properties	-	-	105,192	-	-	**105,192**	-	-	-	-	-	**-**
Ijarah rental receivables	-	-	-	-	276	**276**	-	-	-	-	7,293	**7,293**
Other assets	-	-	-	-	11,318	**11,318**	-	-	-	-	-	**-**
Unfunded												
Bank's liability under L/C and L/G	6,621	2,475	3,410	-	724	**13,230**	-	-	-	-	-	**-**
Total	**13,705**	**48,193**	**140,207**	**905**	**51,528**	**254,538**	**74,927**	**269,142**	**107,148**	**23,896**	**219,253**	**694,366**

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3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

Table – 9. Credit Risk – Intra-group transactions (PD-1.3.23(d))

The balances of major transactions with the subsidiary are as follows:

	Own Capital and Current Account BD'000'	Profit Sharing Investment Account BD'000	**Total BD'000**
Customers' current accounts	83	-	**83**
Other liabilities	8,580	-	**8,580**
Other assets	47	-	**47**
Investment in associates	25,000	-	**25,000**

The income and expenses arising from dealing with the subsidiary eliminated in the consolidated statement of income are as follows:

	Own Capital and Current Account BD'000'	Profit Sharing Investment Account BD'000	**Total BD'00**
Net income from investments	34	-	**34**
Other expenses	15	-	**15**
Gross return to unrestricted investment accounts	-	9	**9**

3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

Table – 10. Credit Risk – Financing Facilities to Highly Leveraged or Other High Risk Counterparties (PD-1.3.23(e))

The balances of major transactions with the subsidiary are as follows:

	Own Capital and Current Account BD'000'	Profit Sharing Investment Account BD'000	**Total BD'000**
Counterparties			
Counterparty # 1	458	12,084	**12,542**
Counterparty # 2	294	7,775	**8,069**
Counterparty # 3	285	7,532	**7,817**
Counterparty # 4	282	7,443	**7,725**
Counterparty # 5	77	2,021	**2,098**
	1,396	**36,855**	**38,251**

Table – 11. Credit Risk – Concentration of Risk (PD-1.3.23(f))

Following balances representing the concentration of risk to individual counterparties as of 31 December 2010;

	Own Capital and Current Account BD'000'	Profit Sharing Investment Account BD'000	**Total BD'000**
Counterparties *			
Counterparty # 1	868	22,923	**23,791**
Counterparty # 2 **	1,733	20,063	**21,796**
Counterparty # 3	718	18,947	**19,665**
Counterparty # 4	633	16,714	**17,347**
	3,952	**78,647**	**82,599**

* The exposure is in excess of the 15% individual obligor limit.
** This is a group exposure

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3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

Table – 12. Credit Risk – Residual Contractual Maturity Breakdown (Own Capital and Current Account) (PD-1.3.23(g))

The following table summarises the residual contractual maturity of own capital and current account breakdown of the whole credit portfolio as of 31 December 2010, broken down by major types of credit exposure;

	Own capital and current account										
	Up to One month BD'000	1-3 month BD'000	3-6 month BD'000	6-12 month BD'000	1-3 years BD'000	3-5 years BD'000	5-10 years BD'000	10-20 years BD'000	Over 20 years BD'000	No fixed maturity BD'000	**Total BD'000**
Assets											
Cash & balances with Central Bank of Bahrain and other banks	18,961	-	-	-	-	-	-	-	-	-	**18,961**
Murabaha receivables *	7,092	1,287	666	854	901	1,091	1,540	-	2,323	-	**15,754**
Mudaraba investments	156	-	27	-	-	-	-	-	32,339	-	**32,522**
Musharaka Investments *	122	167	192	15	118	374	941	-	1,000	-	**2,929**
Investments *	176	18,672	464	24	528	990	35	-	77	13,132	**34,098**
Investment in associates	-	-	-	-	-	-	-	-	-	6,778	**6,778**
Investment in Ijarah assets	-	-	-	-	-	-	-	-	-	9,635	**9,635**
Ijarah Muntahia Bittamleek *	41	4	5	1	425	465	1,376	-	1,528	-	**3,845**
Investment in properties	-	-	-	-	-	-	-	-	-	105,192	**105,192**
Ijarah rental receivables	-	-	276	-	-	-	-	-	-	-	**276**
Other assets	-	-	6,597	-	-	-	-	-	-	4,721	**11,318**
Total Assets	**26,548**	**20,130**	**8,227**	**894**	**1,972**	**2,920**	**3,892**	**-**	**37,267**	**139,458**	**241,308**

* All non performing facilities have been classified as over 20 years.

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3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

Table – 13. Credit Risk – Residual Contractual Maturity Breakdown (Profit Sharing Investment Account) (PD-1.3.23(g))

The following table summarises the residual contractual maturity of profit sharing investment account breakdown of the whole credit portfolio as of 31 December 2010, broken down by major types of credit exposure;

	Profit Sharing Investment Account										
	Up to One month BD'000	1-3 month BD'000	3-6 month BD'000	6-12 month BD'000	1-3 years BD'000	3-5 years BD'000	5-10 years BD'000	10-20 years BD'000	Over 20 years BD'000	No fixed maturity BD'000	**Total BD'000**
Assets											
Cash & balances with Central Bank of Bahrain and other banks	-	-	-	-	-	-	-	-	-	26,870	**26,870**
Murabaha receivables*	187,241	33,967	17,570	22,541	23,782	28,816	40,660	-	61,361	-	**415,938**
Mudaraba investments	4,118	-	720	-	-	-	-	-	-	-	**4,838**
Musharaka Investments*	3,214	4,412	5,072	387	3,106	9,883	24,842	-	26,401	-	**77,317**
Investments *	4,660	-	12,257	621	13,949	26,147	915	-	2,020	-	**60,569**
Ijarah Muntahia Bittamleek*	1,084	104	130	24	11,214	12,275	36,339	-	40,371	-	**101,541**
Ijarah rental receivables	-	-	7,293	-	-	-	-	-	-	-	**7,293**
Total Assets	**200,317**	**38,483**	**43,042**	**23,573**	**52,051**	**77,121**	**102,756**	**-**	**130,153**	**26,870**	**694,366**

* All non performing facilities have been classified as over 20 years.

Table – 14. Credit Risk – Impaired Exposures, Past Due Exposures and Allowances (Own capital and current account by industry sector) (PD-1.3.23(h) PD-1.3.24(b) PD-1.3.24(d))

The following table summarises the impaired facilities, past due facilities and allowances financed by own capital and current account disclosed by major industry sector 31 December 2010;

	Own capital and current account										
		Aging of Past Due Facilities			Speccific Allowances				*General Allowances		
	Non- performing or past due or impaired Islamic financing contracts BD'000	3 months to 1 year BD'000	1 to 3 years BD'000	Over 3 years BD'000	Balance at the beginning of the year BD'000	Charges during the year BD'000	Charge-offs during the year BD'000	Balance at the end of the year BD'000	General allowances beginning balance BD'000	General allowances movement BD'000	General allowances ending balance BD'000
Trading and Manufacturing	2,434	1,212	719	30	781	339	-	1,016	-	-	-
Real Estate	2,809	1,453	325	-	-	-	-	-	-	-	-
Banks & Financial Institutions	54	50	1	-	-	140	-	140	-	-	-
Others	960	251	39	7	87	154	-	241	-	-	-
No specific sector	-	-	-	-	-	-	-	-	175	(167)	8
Total	**6,257**	**2,966**	**1,084**	**37**	**868**	**633**	**-**	**1,397**	**175**	**(167)**	**8**

** General allowance represents collective impairment provision against exposures which, although not specifically identified, have a greater risk of default than when originally granted.

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3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

Table – 15. Credit Risk – Impaired Exposures, Past Due Exposures and Allowances (profit sharing investment account by industry sector) (PD-1.3.23(h))

The following table summarises the impaired facilities, past due facilities and allowances financed by profit sharing investment account disclosed by major industry sector as of 31 December 2010;

	Profit Sharing Investment Account										
		Aging of Past Due Facilities			Speccific Allowances				*General Allowances		
	Non- performing or past due or impaired Islamic financing contracts	3 months to 1 year	1 to 3 years	Over 3 years	Balance at the beginning of the year	Charges during the year	Charge-offs during the year	Balance at the end of the year	General allowances beginning balance	General allowances movement	General allowances ending balance
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
Trading and Manufacturing	64,263	32,009	18,991	796	20,433	6,388	-	26,821	-	-	-
Real Estate	25,353	38,354	8,586	-	-	-	-	-	-	-	-
Banks & Financial Institutions	74,170	1,314	13	-	-	3,689	-	3,689	-	-	-
Others	1,413	6,618	1,036	178	2,279	4,093	-	6,372	-	-	-
No specific sector	-	-	-	-	-	-	-	-	4,618	(4,432)	186
Total	**165,199**	**78,295**	**28,626**	**974**	**22,712**	**14,170**	**-**	**36,882**	**4,618**	**(4,432)**	**186**

* General allowance represents collective impairment provision against exposures which, although not specifically identified, have a greater risk of default than when originally granted.

Although the above table shows the portion of impairment provision related to PSIA, the Bank has taken all the provision to their own capital. Hence the PSIA were not charged for any of the impairment provision.

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3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

Table – 16. Credit Risk – Impaired Exposures, Past Due Exposures and Allowances (own capital and current account and profit sharing investment account by geographic area) (PD-1.3.23(i) PD-1.3.24(c))

The following table summarises the past due facilities and allowances financed by own capital and current account and profit sharing investment account disclosed by geographical area as of 31 December 2010;

	Own capital and current account			Profit Sharing Investment Account		
	Past due Islamic financing contracts BD'000	Specific Impairment provision BD'000	Collective Impairment provision BD'000	Past due Islamic financing contracts BD'000	Specific Impairment provision BD'000	Collective Impairment provision BD'000
Middle East	6,257	1,397	8	165,199	36,882	186
Total	**6,257**	**1,397**	**8**	**165,199**	**36,882**	**186**

Table – 17. Credit Risk – Restructured Financing Facilities (PD-1.3.23(j))

The following table summarises the past due facilities and allowances financed by own capital and current account and profit sharing investment account disclosed by geographical area as of 31 December 2010;

	Own capital and current account	Profit Sharing Investment Account
	Aggregate amount BD'000	Aggregate amount BD'000
Restructured financing facilities	655	17,293
Total	**655**	**17,293**

The provision on restructured facilities is nil and the impact on present and future earnings is not significant.

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3. RISK MANAGEMENT (continued)

3.5 Credit Risk (continued)

Table – 18. Credit Risk Mitigation (PD-1.3.25 (b) and (c))

The following table summarises the exposure as of 31 December 2010 by type of Islamic financing contract covered by eligible collateral;

Although the above table shows the portion of impairment provision related to PSIA, the Bank has taken all the provision to their own capital. Hence the PSIA were not charged for any of the impairment provision.

	Total exposure covered by	
	Eligible collateral BD'000	Guarantees BD'000
Murabaha receivables	10,076	-
Musharaka investments	439	-
Ijarah Muntahia Bittamleek	4,656	-
Total	**15,171**	**-**

Table – 19. Counterparty Credit (PD-1.3.26 (b))

The following table summarises the counterparty credit risk exposure covered by collateral after the application of haircuts as of 31 December 2010;

	BD'000
Gross positive fair value of contracts	935,674
Netting Benefits	-
Netted current credit exposure	**935,674**
Collateral held:	
- Cash	15,171
- Shares	5,512
- Real Estate	210,832
Total	**231,515**

A haircut of 30% is applied on the Real Estate collateral.

3.6 Market Risk

3.6.1 Introduction

The Bank has accepted the definition of market risk as defined by CBB as "the risk of losses in on- and off-balance-sheet positions arising from movements in market prices.

3.6.2 Sources of market risk

For the Group, market risk may arise from movements in profit rates, foreign exchange markets, equity markets or commodity markets. A single transaction or financial product may be subject to any number of these risks.

Profit rate risk is the sensitivity of financial products to changes in the profit rates. Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and unrestricted investment accounts as the repricing of assets, liabilities and unrestricted investment accounts occur at similar intervals. The profit distribution to unrestricted investment accounts is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

Foreign exchange risk is the sensitivity of financial products to changes in spot foreign exchange rates. The value of the Group's portfolio which is denominated in a number of currencies may be exposed to these risks when converted back to the Group's base currency.

Equity price risk is the sensitivity of financial products to the changes in equity prices. Equity risk arises from holding open positions in equities or equity based instruments, thereby creating exposure to a change in the market price of the equity. In addition to Group performance expectations, equity prices are also susceptible to general economic data and sector performance expectations.

Commodity risk; products may have an inherent risk as a result of sensitivity to changes in commodity prices. Since prices in commodity markets are determined by fundamental factors (i.e. supply and demand of the underlying commodity) these markets may be strongly correlated within particular sector and less correlated across sectors.

3.6.3 Market risk strategy

The Group's Board is responsible for approving and reviewing (at least annually), the risk strategy and significant amendments to the risk policies. The Group's senior management is responsible for implementing the risk strategy approved by the Board, and continually enhancing the policies and procedures for identifying, measuring, monitoring and controlling risks.

In line with the Group's risk management objectives and risk tolerance levels, the specific strategies for market risk management include:

1. The Group will manage its market risk exposure by evaluating each new product/ activity with respect to the market risk introduced by it;
2. The Group will proactively measure and continually monitor the market risk in its portfolio;
3. The Group will at all time hold sufficient capital in line with the CBB Pillar 1 regulatory capital requirements;
4. The Group will establish a market risk appetite which will be quantified in terms of a market risk limit structure;
5. The Group will establish a limit structure to monitor and control the market risk in its portfolio. These limits will include position limits, maximum/stop loss limits, factor sensitivity limits, VaR limits and maturity limits;

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3. RISK MANAGEMENT (continued)

3.6 Market Risk (continued)

3.6.3 Market risk strategy (continued)
6. The Group will carry out stress testing periodically using the worst case scenarios to assess the effects of changes in the market value due to changing market conditions;
7. The Group will periodically carry out back testing of market risk assessment models in order to evaluate their accuracy and the inherent model risk;
8. The Group will match the amount of floating rate assets with floating rate liabilities; and
9. The Group will clearly identify the foreign currencies in which it wishes to deal in and actively manage its market risk in all foreign currencies in which it has significant exposure.

3.6.4 Market risk measurement methodology
Market risk measurement techniques includes the use of a number of techniques for market risk measurement. The risk measurement techniques mentioned in this section are used for measuring market risk in both trading book as well as banking book.

The various techniques which are used by the Group for the measurement, monitoring and control of market risk are as follows:

a. Overnight open positions;
b. Stop loss limits;
c. Factor sensitivity limits;
d. VaR limits; and
e. Profit rate risk gap analysis.

3.6.5 Market risk monitoring and limits structure
The Asset and Liability Committee (ALCO) proposes through the Executive Committee and Board the tolerance for market risk. Based on these tolerances, Risk and Compliance Department and Treasury have established appropriate risk limits that maintain the Group's exposure within the strategic risk tolerances over a range of possible changes in market prices and rates.

3.6.6 Limits monitoring
The Treasury Department and Risk and Compliance Unit monitor the risk limits for each transaction, ensure that the limits are well within set parameters and report periodically to top management.

3.6.7 Breach of limits
In case a limit is breached, an approval from the CEO is required to continue with the transaction. An immediate report is provided to the ALCO after every significant limit breach. This breach is also reported to the Executive Committee (EXCOM). The limits are revised at least bi-annually or when deemed required.

3.6.8 Portfolio review process
On a monthly basis, Risk and Compliance Unit reviews the Group's assets and liabilities portfolio to evaluate the overall corporate exposure to market risk. As part of the review, Risk and Compliance Department also monitors the Group's overall market exposure against the risk tolerance limits set by the Board. Risk and Compliance Unit also reviews the adherence to approved limits to control the market risk. Changes, if any, in market risk limits are communicated to business units after review by the GM-C&RM/CEO and approval by the ALCO or EXCOM, as per the delegated authorities approved by the Board. Balance sheet exposure is being reviewed on a quarterly basis by the Board level Audit and Risk committees.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.6 Market Risk (continued)

3.6.9 Reporting
Risk and Compliance Unit generates over regular periodic intervals market risk management reports. These reports aim to provide the Group's senior management with an up-to-date view of its market risk exposure.

3.6.10 Stress testing
Stress tests produce information summarizing the Group's exposure to extreme, but possible, circumstances and offer a way of measuring and monitoring the portfolio against extreme price movements of this type. The Group's Risk and Compliance Unit employs four stress categories: profit rates, foreign exchange rates, equity prices and commodity prices. For each stress category, the worst possible stress shocks that might realistically occur in the market are defined.

3.6.11 Foreign subsidiary
The Group does not have any foreign subsidiary.

Table – 20. Market Risk Capital Requirements (PD-1.3.27 (b))

The following table summarises the capital requirement for foreign exchange risk as of 31 December 2010;

	Foreign exchange risk BD'000
Foreign exchange risk	**22,656**
Foreign exchange risk capital requirement	**2,719**
Maximum value capital requirement	**2,719**
Minimum value capital requirement	**1,821**

3.7 Operational Risk

3.7.1 Introduction
Operational risk is the risk of loss arising from system failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.7 Operational Risk (continued)

3.7.2 Sources of operational risk
The different sources of operational risks faced by the Group can be classified broadly into the following categories.

People risk which arises due to staffing inadequacy, unattractive remuneration structure, lack in staff development policies, lack in procedures for appointment, unhealthy professional working relationship and unethical environment;

Processes risk which arises due to inadequate general controls, inadequate application controls, improper business and market practices and procedures, inappropriate/inadequate monitoring and reporting; and

Systems (Technology) risk which arise due to integrity of information - lacking in timelines of information, omission and duplication of data; hardware failures due to power surge, obsolescence or low quality.

3.7.3 Operational risk management strategy
As a strategy the Bank will identify the sources of operational risks in coordination with each business unit. The Group carried out Risk Control Self-Assessments ("RCSA"), and plans to do a continuous and on-going exercise, to identify the operational risks it is exposed to.

The Group on a continuous basis will:

a. assess the effectiveness of controls associated with identified risks;
b. regularly monitor operational risk profiles and material exposures to losses; and
c. identify stress events and scenarios to which it is vulnerable and assess their potential impact, and the probability of aggregated losses from a single event leading to other risks.

3.7.4 Operational risk monitoring and reporting
The internal monitoring and reporting process ensures a consistent approach for providing pertinent information to senior management for the quick detection and correction of deficiencies in the policies, processes and procedures for managing operational risk through ongoing, periodic reviews.

The objective of the reporting process is to ensure relevant information is provided to senior management and the Board to enable the proactive management of operational risk. The process ensures a consistent approach for providing information that enables appropriate decision making and action taking.

3.7.5 Operational risk mitigation and control
The business units, in consultation with Risk and Compliance Unit will determine all material operational risks and decide the appropriate procedures to be used to control and/or mitigate the risks.

For those risks that cannot be controlled, the business units in conjunction with Risk and Compliance Unit will decide whether to accept the risks, reduce the level of business activity involved, transfer the risk outside the Group or withdraw from the associated activity completely. Risk and Compliance Unit facilitates the business units in co-developing the mitigation plans.

BASEL II, PILLAR III DISCLOSURES

For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.7 Operational Risk (continued)

3.7.6 Business Continuity Plan (BCP)

The Group has also developed a comprehensive business continuity plan detailing the steps to be taken in the event of extreme conditions to resume the Group's operations with minimum delay and disturbance. The plan is in implementation stage. Elements of contingency plans and disaster recovery processes include operating systems, physical space, telecommunications and resources.

Table - 21. Operational Risk Exposure (PD-1.3.30 (a), (b) & (c))

The following table summarises the amount of exposure subject to basic indicator approach of operational risk and related capital requirements:

	Gross income		
	2010	2009	2008
	BD '000	BD '000	BD '000
Total Gross Income	**18,777**	25,962	40,009

	2010
	BD '000
Indicators of operational risk	
Average Gross income	**28,249**
Multiplier	**12.5**
	353,113
Eligible Portion for the purpose of the calculation	**15%**
TOTAL OPERATIONAL RISK WEIGHTED EXPOSURE	**52,968**

The plan is reviewed periodically to assess and incorporate changes in the business and market conditions.

3.8 Equity Position in the Banking Book

Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio.

The accounting policies, including valuation methodologies and their related key assumptions, are disclosed in the consolidated financial statements. Available for sale investments and investments in properties are kept for capital gain purposes, all other investments including investments in associates are kept for strategic long term holdings.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.8 Equity Position in the banking book (continued)

Table – 22. Equity Position Risk in Banking Book (PD-1.3.31 (b) (c) & (f))

The following table summarises the amount of total and average gross exposure of equity based financing structures by types of financing contracts and investments as of 31 December 2010;

	Total gross exposure BD'000	* Average gross exposure BD'000	Publicly traded BD'000	Privately held BD'000	Risk weighted assets BD'000	Capital Requirements BD'000
Sukuk	62,863	76,707	-	62,863	12,650	1,518
Equity investments	31,804	32,241	18,672	13,132	39,567	4,748
Funds	32,339	36,621	-	32,339	54,337	6,520
Total	**127,006**	**145,569**	**18,672**	**108,334**	**106,554**	**12,786**

* Average balances are computed based on month end balances.

Table – 23. Equity Gains or Losses in Banking Book (PD-1.3.31 (d) & (e))

The following table summarises the cumulative realised and unrealised gains or (losses) during the year ended 31 December 2010;

	BD'000
Cumulative realized losses arising from sales or liquidations in the reporting year	**(1,429)**
Total unrealized losses recognized in the consolidated statement of financial position but not through consolidated statement of income	**(1,278)**
Unrealized losses included in Tier 1 Capital	**(2,412)**
Unrealized gains included in Tier 2 Capital	**773**

3.9 Unrestricted Investment Accounts ("URIA")

The Group may require to decrease or increase loses or profit on certain unrestricted investments for the purpose of income smoothing. Thus the Group is exposed to some of the price risk on assets funded by unrestricted Investment Account Holders ("IAH"). The CBB requires the Group to maintain capital to cover the price risk arising from 30% of assets funded by unrestricted IAH on a pro-rata basis.

The Bank is authorized by the IAH to invest the account holder's funds on the basis of Mudaraba contract in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested. Under this arrangement the Bank can commingle the investment accounts holder's funds with its own funds (owner's equity) or with other funds the Bank has the right to use (e.g. current accounts or any other funds which the Bank does not receive on the basis of Mudaraba contract). The IAH and the Bank generally participate in the returns on the invested funds. In such type of contract, the Bank is not liable for any losses incurred on the joint pool other than the loss resulting from gross negligence or willful misconduct on the part of the Bank or due to the Bank's violation of the terms and conditions as agreed between the Bank and the IAH.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.9 Unrestricted Investment Accounts ("URIA") (continued)

The amount received from the customer on account of URIA is not invested completely in the portfolio of selected investments as the Bank is required to maintain a cash reserve with CBB, in addition, the Bank requires to set aside certain amount to meet operational requirements. The income allocated to the URIA deposits being received is in accordance with the utilization of such deposits. The utilization rate is determined by the ALCO with the approval of Shari'a Supervisory Board.

If at any point of time in a particular pool the funds of IAH exceed the assets, the excess amount shall be treated to be invested in commodity Murabaha and earn the average rate of profit on Commodity Murabaha earned during the excess period. There should be no inter-pool financing at any point of time. The Bank should establish a control to avoid excess fund in any pool to be used in other pool.

Proposal for new products is initiated by the business lines within the Bank, ALCO review such proposal to ensure that the new product is in line with the Bank's business and risk strategy. All new products require the approval of the Shari'a Supervisory Board of the Bank. The business lines of the Bank have expertise in creating high end value added products offering a wide range of products, expected return, tenors and risk profile.

Information on new products or any change in the existing products will be placed on the Bank's website or published in the media.

The Bank has designed special quality assurance units whom reports complaints directly to the CEO. The complaints are investigated by personnel not directly related to the subject matter of the complaints.

The Bank offers URIA in different currencies for maturity periods ranging from 1 month, 3 month, 6 month, 9 month, 12 month and 36 month. The customer signs written contract covering all terms and conditions of the investment, including tenor, basis of profit allocation, and early withdrawal.

Because URIA is a significant funding source for the Bank, the Bank regularly monitors rate of return offered by competitors to evaluate the expectation of its IAH. The Bank's policy provide whole or partial waiver of the Mudarab share of income from investment in order to provide a reasonable return to its investors.

The Bank comingles its own funds and URIA funds which are invested together. The Bank has identified two pools of assets where the URIA funds are invested and income from which is allocated to such is account.

The Group is currently in the process of developing written policies and procedures applicable to its portfolio of unrestricted investment accounts. URIA funds are invested and managed in accordance with Shari'a requirements.

- Pool A: Low risk assets or generating low yield.
- Pool B: High risk assets or generating high yield.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.9 Unrestricted Investment Accounts ("URIA") (continued)

Profits of an investment jointly financed by the Bank and the URIA holders shall be allocated between them according to the contribution of each of the Bank and the IAH in the jointly financed investment separately for each Joint pool A and B. Operating expenses incurred by the Bank are not charged to investment account. In case of the loss resulting from the transactions in a jointly financed investment, such loss shall first be deducted from undistributed profits, if any. Any excess of such loss shall be deducted from Investment Risk Reserve (IRR). Any remaining of such loss shall be deducted from the total balance of fund available in the Joint pool, as at that date, in the respective ratio of the Bank's and IAH's respective contribution to the joint fund. Impairment provisions shall only be allocated to Pool B in the ratio of capital contribution by Bank and IAH of Pool B. The reversal of this provision in future year shall be allocated between Bank and IAH of Pool B in the ratio of capital contribution at the time the reversal is made. The loss can be entirely borne by the shareholders of the Bank subject to the approval of the Board. URIA deposits are measured at their book value.

In case of early withdrawal by URIA holder before completion of the term, the effective utilization method will be applied.

Table – 24. Unrestricted Investment Account (PD-1.3.33 (a))

The following table summarises the breakdown of unrestricted investment accounts as of 31 December 2010;

	BD'000
Customers	600,024
Banks and other financial institutions	141,358
Total	**741,382**

Table – 25. Unrestricted Investment Account Ratios (PD-1.3.33 (d) & (f))

The following table summarises the return on average assets and mudarib share as a percentage of the total investment profit for the year ended 31 December 2010;

Profit Paid on Average URIA Assets *	**2.65%**
Mudarib Fee to Total URIA Profits	**37%**

* Average assets funded by URIA have been calculated using month end balances.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.9 Unrestricted Investment Accounts ("URIA") (continued)

Table – 26. Unrestricted Investment Account Ratios (PD-1.3.33 (c), (e) & (g))

The following table summarises the profit distributed to IAH and financing ratios to the total of IAH by type of investment account holder for the year ended 31 December 2010

Type of Investment Account Holder	Profit distributed to total IAH	Percentage to total IAH
Saving accounts	2.81%	9.95%
Defined accounts - 1 month	0.94%	1.62%
Defined accounts - 3 months	0.43%	0.54%
Defined accounts - 6 months	0.48%	0.51%
Defined accounts - 9 months	0.01%	0.01%
Defined accounts - 1 year	2.66%	2.44%
Investment certificates	0.61%	0.31%
IQRA Deposits	0.15%	0.16%
Tejoori Deposit	2.03%	8.47%
Customer's deposits	80.28%	56.92%
Bank's deposits	9.60%	19.07%
	100%	**100%**

As of 31 December 2010, the Bank did not have any balance in the investment risk reserve. The calculation and distribution of profits was based on average balances.

Table – 27. Unrestricted Investment Account Financing to Total Financing (PD-1.3.33 (h) & (i))

The following table summarises the percentage of counterparty type to total financing for each type of Shari'a-compliant contract to total financing as of 31 December 2010;

	Percentage of Financing to Total Financing
Murabaha receivables	62.33%
Mudaraba investments	0.72%
Musharaka investments	11.58%
Ijarah Muntahia Bittamleek	15.21%
Investment in Sukuk	9.07%
Ijarah rental receivable	1.09%

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.9 Unrestricted Investment Accounts ("URIA") (continued)

Table – 27. Unrestricted Investment Account Financing to Total Financing (PD-1.3.33 (h) & (i)) (continued)

	Percentage of Counterparty Type to Total Financing				
	Aviation	Real Estate	Trading and Manufacturing	Banks and Financial Institutions	Others
Murabaha receivables	0.37%	5.11%	8.41%	33.20%	15.24%
Musharaka investments	0.00%	2.98%	1.68%	0.00%	6.92%
Ijarah Muntahia Bittamleek	3.04%	4.84%	1.13%	1.47%	4.73%
Mudaraba investments	0.00%	0.00%	0.00%	0.72%	0.00%
Investment in Sukuk	0.16%	3.12%	0.00%	0.92%	4.87%
Ijarah rental receivable	0.00%	0.00%	0.00%	0.00%	1.09%
	3.57%	**16.05%**	**11.22%**	**36.31%**	**32.85%**

Table – 28. Unrestricted Investment Account Share of Profit (PD-1.3.33 (l) (m) & (n))

The following table summarises the share of profits earned by and paid out to unrestricted investment accounts and the Group as Mudarib for the year ended 31 December 2010;

Share of profit earned by URIA before transfer to/from reserves - BD '000'	17,721
Percentage share of profit earned by URIA before transfer to/from reserves	2.39%
Share of profit paid to URIA after transfer to/from reserves - BD '000'	17,721
Percentage share of profit paid to URIA after transfer to/from reserves	2.39%
Share of profit paid to Bank as mudarib - BD '000'	10,467

Table – 29. Unrestricted Investment Account Percentage Return to Profit Rate of Return (PD-1.3.33 (q))

The following table summarises the average declared rate of return or profit rate on profit sharing investment accounts for the year ended 31 December 2010;

	3 month	6 month	12 month	36 month
Percentage of average declared rate of return to profit rate of return	1.96%	2.21%	2.46%	4.00%

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.9 Unrestricted Investment Accounts (“URIA”) (continued)

Table – 30. Unrestricted Investment Account Type of Assets (PD-1.3.33 (r) & (s))

The following table summarises the average declared rate of return or profit rate on profit sharing investment accounts for the year ended 31 December 2010;

	Opening Actual Allocation BD’000	Movement During the Period * BD’000	Closing Actual Allocation BD’000
Cash and balances with Central Bank of Bahrain and other banks	27,000	(130)	26,870
Murabaha receivables	381,058	34,880	415,938
Mudaraba investments	13,984	(9,146)	4,838
Musharaka investments	71,693	5,624	77,317
Investment in sukuk	79,057	(18,488)	60,569
Ijarah muntahia bittamleek	100,104	1,437	101,541
Ijarah rental receivable	3,485	3,808	7,293
Total	**676,381**	**17,985**	**694,366**

* The movement is for the six months period ended 31 December 2010.

Table – 31. Unrestricted Investment Account Profit Earned and Paid (PD-1.3.33 (w))

The following table summarises the amount and percentage of profits earned by the Group and paid out to profit sharing investment accounts over the past five years;

	Profit Earned (jointly financed)		Profit Paid to (PSIA)	
	BD’000	%age	BD’000	%age
2010	**33,083**	**4.46%**	**17,721**	**2.39%**
2009	35,694	5.27%	17,638	2.61%
2008	36,934	5.87%	17,702	2.81%
2007	31,463	7.80%	15,609	3.87%
2006	24,705	8.12%	12,660	4.16%

BASEL II, PILLAR III DISCLOSURES
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3. RISK MANAGEMENT (continued)

3.9 Unrestricted Investment Accounts ("URIA") (continued)

Table – 32 Treatment of assets financed by PSIA (PD-1.3.33-v)

The following table summarises the average declared rate of return or profit rate on profit sharing investment accounts for the year ended 31 December 2010;

	Assets BD'000	RWA BD'000	RWA for Capital Adequacy BD'000	Capital Requirements BD'000
Cash and balances with Central Bank of Bahrain and other banks	26,870	-	-	-
Murabaha receivables*	415,938	251,013	75,304	9,036
Mudaraba investments	4,838	2,295	689	83
Musharaka investments*	77,317	66,770	20,031	2,404
Investment in sukuk	60,569	38,857	11,657	1,399
Ijarah muntahia bittamleek*	101,541	87,688	26,306	3,157
Ijarah rental receivable	7,293	6,298	1,889	227
	694,366	**452,921**	**135,876**	**16,305**

* The movement is for the six months period ended 31 December 2010.

3.10 Liquidity Risk

3.10.1 Introduction
Liquidity risk is defined as "the risk that the Group will be unable to meet its obligations as they come due because of an inability to obtain adequate funding or to liquidate assets.

3.10.2 Sources of liquidity risk
The sources of liquidity risk can broadly be categorized in the following:

a. Funding risk is the risk of not being able to fund net outflows due to unanticipated withdrawal of capital or deposits;
b. Call risk is the risk of crystallization of a contingent liability; and
c. Event risk is the risk of rating downgrades or other negative public news leading to a loss of market confidence in the Group.

3. RISK MANAGEMENT (continued)

3.10 Liquidity Risk (continued)

3.10.3 Bank's funding strategy

The Board reviews the funding strategy on an annual basis and amends the existing strategy, as deemed necessary. For this purpose, all business units advise the Treasurer of their projected liquidity requirements and contributions at the start of each year as part of annual budgeting process.

The funding strategy highlights any anticipated liquidity shortfalls, the funding requirements to finance these shortfalls and their impact on the statement of financial position. The Bank is in the process of developing a liquidity contingency plan to deal with stressed scenarios and outlines an action plan that can be taken in the event of a loss of market liquidity.

3.10.4 Liquidity risk strategy

The Group monitors the liquidity position by comparing maturing assets and liabilities over different time buckets of up to 1 month, 1-3 months, 3-6 months, 6 months to 1 year, 1-3 years, and over 3 years. The Group carries out stress testing periodically using the worst case scenarios to assess the effects of changes in market conditions on the liquidity of the Group. As a strategy the Group maintains a large customer base and good customer relationships.

The Group's is in the process of implementing contingency liquidity plan to meet urgent liquidity requirements in stressed conditions that addresses how funding liquidity would be managed if either their specific financial conditions were to decline or broader conditions created a liquidity problem.

The Treasury Department, in conjunction with Risk and Compliance Unit periodically reviews/updates (at least annually) the liquidity risk strategy which is evaluated by ALCO before presenting to the EXCOM and the Board for approval.

3.10.5 Liquidity risk measurement tools

The Group uses a combination of techniques for measurement of its liquidity risk. These include liquidity gap analysis, liquidity ratio limits and minimum liquidity guidelines.

3.10.6 Liquidity risk monitoring

The Group has set the tolerance for liquidity risk which are communicated to the Risk and Compliance Department and Treasury Department. Based on these tolerances, Risk and Compliance Department and Treasury have established appropriate risk limits that maintain the Group's exposure within the strategic risk tolerances over a range of possible changes in liquidity situations.

3.10.7 Liquidity limits structure

The Group uses a combination of different limits to ensure that liquidity is managed and controlled in an optimal manner. The Group has set the following limits for monitoring liquidity risks:

a. Liquidity Gap limits;
b. Liquidity Ratio limits; and
c. Minimum Liquidity Guideline ("MLG").

BASEL II, PILLAR III DISCLOSURES
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3. RISK MANAGEMENT (continued)

3.10 Liquidity Risk (continued)

3.10.8 Liquidity risk stress testing
To evaluate whether the Group is sufficiently liquid, behavior of the Group's cash flows under different conditions are observed.

3.10.9 Contingency funding plan
The Group does contingency funding exercises which details procedures to be followed by the Group, in the event of a liquidity crisis or a situation where the Group faces stressed liquidity conditions. The contingency funding plan will be an extension of day to day liquidity management and involves maintenance of an adequate amount of liquid assets and management of access to funding resources. The ALCO members discuss and monitor the situation over regular time-intervals to ensure sufficient liquidity in the Group.

Table – 33. Liquidity Ratios (PD-1.3.37)

The following table summarises the liquidity ratios for the past five years;

	2010	2009	2008	2007	2006
Commodities Murabaha / Total Assets	**21.73%**	10.42%	14.98%	27.37%	40.93%
Islamic Financing / Customer Deposits excluding banks	**115.46%**	123.01%	144.62%	171.72%	224.08%
Customer Deposits / Total Assets	**64.13%**	57.28%	48.71%	36.04%	34.99%
Liquid Assets / Total Assets	**26.63%**	14.38%	20.66%	30.16%	44.47%
Growth in Customer Deposits	**14.86%**	21.98%	79.24%	55.50%	8.39%

3.11 Profit Rate Risk
Profit rate risk is the potential impact of the mismatch between the rate of return on assets and the expected rate of funding due to the sources of finance.

Senior management identifies the sources of profit rate risk exposures based upon the current as well as forecasted balance sheet structure of the Group. The profit rate risk in the Group may arise due to the following transactions:

a. Murabaha transactions;
b. Mudaraba transactions;
c. Ijarah Muntahia Bittamleek; and
d. Sukuk.

The Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and unrestricted investment accounts as the repricing of assets, liabilities and unrestricted investment accounts occur at similar intervals. The profit distribution to unrestricted investment accounts is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

3. RISK MANAGEMENT (continued)

3.11 Profit Rate Risk (continued)

3.11.1 Profit rate risk monitoring and reporting

The Group has implemented information systems for monitoring, controlling and reporting profit rate risk. Reports are provided on a timely basis to EXCOM and the Board of Directors. The Risk and Compliance Unit monitors these limits regularly. GM-C&RM reviews the results of gap limits and exceptions, if any, and recommends corrective action to be taken which is approved by ALCO or EXCOM, according to authority parameters approved by the Board.

Table – 34. Profit Rate Risk in Banking Book (PD-1.3.40 (b))

The following table summarises the effect on the value of assets, liabilities and economic capital for a benchmark change of 200bp in profit rates as of 31 December 2010;

	Effect on value of Asset BD'000	Effect on value of Liability BD'000	Effect on value of Economic Capital BD'000
Upward rate shocks:	(5,993)	11,806	5,813
Downward rate shocks:	5,993	(11,806)	(5,813)

Table – 35. Quantitative Indicators of Financial Performance and Position (PD-1.3.9(b))

The following table summarises the basic quantitative indicators of financial performance for the past 5 years;

	2010	2009	2008	2007	2006
Return on average equity	**-33.02%**	-12.64%	12.62%	19.10%	17.80%
Return on average assets	**-4.30%**	-2.17%	2.91%	4.57%	3.45%
Cost to Income Ratio	**107.73%**	70.66%	31.32%	32.41%	38.76%

BASEL II, PILLAR III DISCLOSURES
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3. RISK MANAGEMENT (continued)

3.12 Corporate Governance and Transparency

Table – 36. Board Members' Profile (PD-1.3.10 (b))

The information about the qualification and experience of each member is given on pages 10 and 11.

No Board member has more than one directorship of a retail or a wholesale bank.

All Board members are non-executive.

Remuneration of Board Members and Shari'a Board Members is approved in the AGM after being discussed at the Board level. Remuneration of CEO is approved in the Board meeting. For all Group staff there is a fixed bonus plus a performance bonus scheme. Performance bonus is based on staff performance and recommendation of respective departmental heads. The Board approves all fixed and performance bonus schemes for staff.

Table – 37. Executive Members' Profile (PD-1.3.10(b))

The following table summarises the information about the profession, business title, experience in years and the qualifications of each Executive member;

Name of Executive Member	Designation	Profession	Experience in year	Qualification
Mohammed Ebrahim Mohammed	CEO	Banker	33 Years	Master degree in Business Administration from University of Glamorgan- Wales
Abdulrahman Mohammed Turki	General Manager - Retail Banking	Banker	38 Years	Master Degree in Business Administration from University of Strathclyde, Scotland
Dr. Salah El Din Saeed	General Manager - Credit & Risk	Banker	33 Years	MBA from University of Hull
Mohammed Fikree	General Manager - Treasury & Investment	Banker	28 Years	B.Sc (Honours) in Mechanical Engineering from the UK
Nader Ebrahim	General Manager -Corporate Banking	Banker	28 Years	Executive Management & Leadership from University of Virginia, USA
Mohammed Ahmed Hassan	General Manager - Support Services	Banker	42 Years	Advance Management for Senior Decision Makers
Khalid Mohammed Al Dossari	Chief Financial Officer	Accountant	27 Years	CPA from American Institute of Certified Public Accountants
Khalid Mahmood Abdulla	Assistant General Manager - Internal Audit & Sharia	Accountant	17 Years	CPA from American Institute of Certified Public Accountant

3. RISK MANAGEMENT (continued)

3.12 Corporate Governance and Transparency (continued)

Table – 38. Board Committees Profile (PD-1.3.10)

The following table summarises the information about Board Committees, their members and objectives;

Board Committee	Members	Objective
Audit Committee	Sh. Hisham Al Khalifa Chairman Members · Mohammed Al Zarooq Rajab · Ali Al Olaimi	Oversight of integrity and reporting of the Bank's quarterly and annual financial statements Compliance with legal and regulatory requirements The committee meets four times per year
Remuneration and Nomination Committee	Khalid Al Bassam Chairman Members · Khalid Najeebi · Nabil Ameen · Yousif Al Awadhi	Oversight of the compensation and bonus policy Oversight of recruitment & promotion of key personnel The committee meets two times per year
Risk Management Committee	Khalid Al Bassam Chairman Members · Ali Al Olaimi · Mohammed Al Zarooq Rajab	Monitoring the enterprise-wide risk profile independently Risk Guidance to the Board and Management periodically The committee meets four times per year
Executive Committee	Khalid Najeebi Chairman Members · Nabil Ameen · Yousif Al Awadi · Mohammed Ebrahim	Review of strategy and performance Review of new investment proposals, credit proposals, and exit strategies Review of risk, provision and impairment. The committee meets six times per year

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.12 Corporate Governance and Transparency (continued)

Table – 39. Management Committees Profile (PD-1.3.10)

The following table summarises the information about Management Committees, their members and objectives;

Management Committee	Members	Objective
Asset & Liability Committee (ALCO)	Mohammed Ebrahim Chairman Members · Nader Ebrahim · A. Rahman Turki · Khalid Al Dosari · Mohammed Fikree · Salah Adden A. Qader · Mohammed Belgami	The main objective of ALCO is to manage and monitor the liquidity risk of the Bank on a coordinated and consistent basis.
Credit & Investment Committee (C&IC)	Mohammed Ebrahim Chairman Members · Nader Ebrahim · A. Rahman Turki · Mohammed Fikree · Salah Adden A. Qader **Permanent Invitees:** Mohammed Belgami Badriya A. Ghani	The main objectives of C&IC is to exercise due care, diligence and skill to oversee, direct and review the management of credit risk within the financing portfolio of the Bank and reviewing policies and strategies for achieving investment objectives.
Information Technology Steering Committee	Mohammed Ebrahim Chairman Members · Nader Ebrahim · Salah Adden A. Qader · Khalid Al Dosari · AbdulRazaq Abdulkhaliq · Khalid Mahmood	The main objective of the IT Committee is to plan, prepare, coordinate, implement, support and follow-up on all issues related to the IT and new projects implementation issue.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.12 Corporate Governance and Transparency (continued)

Table – 39. Management Committees Profile (PD-1.3.10) (continued)

Management Committee	Members	Objective
Human Resource Committee (HR)	Mohammed Ebrahim Chairman Members · Nader Ebrahim · Mohammed Hassan · A. Rahman Turki · Khalid Al Dosari · Mohammed Fikree · Salah Adden A. Qader · Khalid Mahmood · Aziz Ashor · Mohammed Khalifa Al Mulla	The main objectives of HR Committee is to monitor and assess the employer workforce regarding human resources issues and monitor, review and analyze legislative and/or administrative changes related to human resources.
Qarth Al Hassan, Donation & Zakah Committee	Mohammed Hassan Chairman Members · Isa Ahmed · Mustafa Al Khohaji · Ramadhan Ali Ramadhan	The main objective of Qard Al Hassan and Zakah Committee is to discharge the Group's social responsibilities toward its society through distributing zakah, charity funds, donations & good faith Qard for marriage, medical treatments, etc.

The following is the Shari's Committee members and its objective:

Members	Objective
Abdullatif Al Mahmood Chairman Members · MohammedAl Juffairi · Adnan Al Qattan · Nedham Yacoubi · Essam Al Orazi	The main objective of Sharia'a Committee is to advise the business units on any shari'a matter and to ensure compliance with the shari'a tenets and requirements in their operations. The Shari'a Committee is entrusted with the duty of directing, reviewing and supervising the activities of the Bank in order to ensure that the Bank is in compliance with Shari'a rules and AAOIFI.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.12 Corporate Governance and Transparency (continued)

New product information, Banks new announcement and information related to stakeholders are made available in timely manner through various channels of communication which may include publications, website, direct mailers, electronic mail and local media.

In addition, the Consolidated Financial Statement of at least past 3 years are available in the Bank's website.

The Group has a Quality Assurance Department which is responsible for managing customer complaints. After receiving a complaint, the department routes the complaint to the concerned department for their response. After analyzing the responses of the concerned department the customer is contacted accordingly. The customers may use the Group's website or the call centre for lodging a complaint.

Board and Directors' Responsibilities

The primary responsibility of the Board of Directors is to provide effective governance over the Bank's affairs for the benefit of its stakeholders, and to balance the interests of its diverse constituencies, including associated concerns, employees and other stakeholders. In all actions taken by the Board, the Directors are expected to exercise their business judgment in what they reasonably believe to be the best interests of the Bank.

The Board will approve and oversee the implementation of the Bank's strategies and will review and approve the Bank's strategic plan. As part of its strategic review process the Board will review major plans of action and business plans, set performance objectives and oversee major investments, divestitures and acquisitions.Every year, at an annual Board strategy session, the Board will formally reassess the Bank's objectives, strategies and plans.

One of the Board's most important responsibilities is identifying, evaluating and selecting candidates for the Board of Directors. The Board will seek members from diverse professional backgrounds who combine a broad spectrum of experience and expertise with a reputation for integrity. Directors should have had experience in positions with a high degree of responsibility, be leaders in the companies or institutions with which they are affiliated and be selected based upon the contributions they can make to the Board.

The factors to be considered by the Board in its review of potential candidates include:

- Whether the candidate has exhibited behaviour that indicates he or she is committed to the highest ethical standards and the values adhered to by the Bank.
- Whether the candidate has had broad business, governmental, non-profit or professional experience that indicates that the candidate will be able to make a significant and immediate contribution to the Board's discussion and decision-making in an array of complex issues.
- Whether the candidate has special skills, expertise and background that add to and complement the range of skills, expertise and background of the existing directors.

3. RISK MANAGEMENT (continued)

3.12 Corporate Governance and Transparency (continued)

Board and Directors' Responsibilities (continued)

- Whether the candidate has had a successful career that demonstrates the ability to make the kind of important and sensitive judgments that the Board is called upon to make.
- Whether the candidate will effectively, consistently and appropriately take into account and balance the legitimate interests and concerns of all of the Bank's shareholders and our other stakeholders in reaching decisions.
- Whether the candidate will be able to devote sufficient time and energy to the performance of his or her duties as a director.
- The application of these factors involves the exercise of judgment and cannot be measured in any mathematical or routine way.

Responsibilities

The following are the detailed responsibilities of the Board and Directors. The Board of Directors may not necessarily carry out all these responsibilities but should ensure that these have been delegated to various board committees or executive management committees to act on their behalf and communicate periodic reports to the Board for their review:

- Ensure that senior managements adequately manages the Bank's capital adequacy on a regular basis and periodic reports showing the adequacy of capital to support the business risks of the bank are prepared and submitted to the Board
- Establish policies for appointing senior managers, and ensuring that they have the necessary integrity, technical and managerial competence, and experience
- Overseeing succession planning and replacing key executives when necessary, and ensuring appropriate resources are available, and minimising reliance on key individuals
- Effectively monitoring and making formal (annual) evaluations of senior management's performance in implementing agreed strategy and business plans
- Approving budgets and reviewing performance against those budgets and key performance indicators
- The management of the bank's compliance risk
- Submit organizational structure or changes to the structure approved by the Board of Directors to the CBB for final approval
- Develop policy to review the systems and controls framework, and to identify any significant issues related to the bank's adopted governance framework, processes and practices
- Ensure to obtain the CBB's approval on the following function prior to their appointment:
  - Director
  - Member of Shari'a Supervisory Board
  - Chief Executive or General manager
  - Senior manager
  - Compliance Officer
  - Money Laundering Reporting Officer and
  - Financial Instrument Trader

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.12 Corporate Governance and Transparency (continued)

Board and Directors' Responsibilities (continued)

Responsibilities relating to Risk Management Function

- Approving the Bank's strategies and policies with respect to risk management i.e. credit, operational, market, liquidity, profit rate risk, strategic and legal, E-banking.
- Clearly define the committee responsible for managing the risk which responsibility includes the following:
  - Ensure risk management personnel are adequately qualified to investigate and resolve issues relating to potential risks
  - Determine acceptable limits of exposure to various types of risks
  - Ensure that the risk management function is subject to independent review at least annually and results are communicated to the Board
  - Review the Bank's strategy and significant policies at least annually with respect to Risk Management Function
  - Ensure that the senior management is adequately carrying out the delegated responsibilities with respect to the Risk Management Function
  - Approve disclosure policy in line with applicable regulations
- Clearly define responsibility of the individuals managing the risk
- To ensure that the Risk Management manual should clearly define reports to be used for monitoring risk, frequency at which these reports should be prepared and appropriate management levels to whom these should be submitted for review.

Responsibilities relating to Compliance Function

- The Board should appoint a senior member with responsibility for the management of compliance risk as their Compliance Officer/ Manager (CM).
- The Compliance Function should be independent and CM should report directly to the Board of Directors or to the Audit Committee. The CM should have direct access to senior management and all confidential information of the Bank.
- Prior to appointment of the CM, the Board should obtain the CBB's prior approval and ensure he has the necessary qualification and experience necessary for the proposed position.
- The Compliance Function is typically responsible for the following:
  - Independent assessment of compliance requirements in relation to the operating activities
  - Provide guidance on the applicable laws and regulations
  - Check and evaluate internal policies and limits
  - Evaluate practices adopted to disseminate information to respective business units
  - Develop programmes for training staff on laws, regulations and internal policies
  - Carryout compliance monitoring activities
  - Reporting exceptions to the senior management and the Board or its committee

3. RISK MANAGEMENT (continued)

3.12 Corporate Governance and Transparency (continued)

Number and names of independent board members

1. Khalid Al-Bassam
2. Sh.Hisham Al-Khalifa
3. Khalid Najibi

Board start date for each term for each director

1. Khalid Al-Bassam (Start date: 09-03-2008)
2. Sh.Hisham Al-Khalifa (Start date: 09-03-2008)
3. Khalid Najibi (Start date: 09-03-2008)
4. Ali Mohammed Al-Olaimi (Start date: 09-03-2008)
5. Mohammed Al-Zarroq Rajab (Start date: 09-03-2008)
6. Nabeel Ahmed Mohammed Amin (Start date: 09-03-2008)
7. Yousif Mohammed Al-Awadhi (Start date: 09-03-2008) no longer representing the BOD starting from Jan 2011

Code of Conduct

The Bank will adopt a Code of Conduct and other internal policies and guidelines designed to support the mission statement set forth above and to comply with the laws, rules and regulations that govern the Bank's business operations. The Code of Conduct will apply to all employees of the Bank and its subsidiaries, as well as to Directors, temporary workers and other independent contractors and consultants whether engaged by or otherwise representing the Bank and its interests.

The Directors have adopted the following Code of Conduct in respect of their behaviour.

- To act with honesty, integrity and in good faith, with due diligence and care, with a view to the best interest of the Bank and its stakeholders;
- To meet regularly with senior management and Internal Audit to establish and approve policies;
- To act only within the scope of their responsibilities;
- To have a proper understanding of the affairs of the Bank and to devote sufficient time to their responsibilities;
- To understand, identify and measure the significant risks to which the Bank is exposed in its business activities;
- To independently assess and question the policies, processes and procedures of the Bank with the intent to identify and initiate management action on issues requiring improvement;
- To keep confidential board discussions and deliberations;
- Not to make improper use of information gained through the position as a Director;

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

3. RISK MANAGEMENT (continued)

3.12 Corporate Governance and Transparency (continued)

Risk Management Committee (continued)

Code of Conduct (continued)

- Not to take improper advantage of the position of Director;
- To ensure his / her personal financial affairs will never cast doubt on the integrity of the Bank
- To maintain sufficient detailed knowledge of the Bank's business and performance to make informed decisions;
- To be independent in judgment and actions and to take all reasonable steps to be satisfied as to the soundness of all decisions of the Board;
- Not to agree to the business of the Bank being carried out or cause or allow the business to be carried on, in a manner likely to create a substantial risk of serious loss to the Bank's creditors and other key stakeholders;
- Not to agree to the Bank incurring an obligation unless he / she believes at the time, on reasonable grounds, that the Bank will be able to perform the obligations when it is required to do so;
- To treat fairly and with respect all of the Bank's employees and customers with whom they interact;
- Not enter into competition with the Bank;
- Not demand or accept substantial gifts from the Bank for himself or his associates;
- Not take advantage of business opportunities to which the Bank is entitled for himself or his associates;
- Report to the Board any potential conflict of interest;
- Declare interests in the Register of Interest; and
- Absent themselves from any discussions or decision-making that involves a subject in which they are incapable of providing objective advice or which involves a subject or proposed conflict of interest.
- Commitment to follow the applicable regulations and follow the best industry practices
- Handle disputes and complaints from the clients to their entire satisfaction and at the same time safeguarding the interest of the Bank

The Director's adherence to this Code will be periodically reviewed. Additionally, this Code of Conduct may be published in the Annual Report with copies also available on request.

Corporate Governance Assessment
A detailed assessment has been carried out to accomidate to the CBB's ammendments to the HC module and has been forwarded to the CBB. The below items are ammendments that will be implemented by the bank as set by the CBB deadline.

1. Updating the Director's Handbook to incorporate the new CBB guidelines and have in place a Corporate Governance policy.
2. Publish the Corporate Governance Guidelines (updated Directors Handbook) on the bank's website.
3. Corporate Governance Committee will be finalized before the proposed deadline.
4. CEO and CFO's certification of the financial statements.
5. Updating the nomination and Remunerations committee and it charter.
6. Compliance report to Shareholders on the HC Module

The Bank has been charged with two penalties by CBB during the year. A penalty of BD 2,300 and a penalty of BD 550 both regarding updation of BENEFIT data records.

BASEL II, PILLAR III DISCLOSURES
For the year ended 31 December 2010

4. GLOSSARY OF TERMS

ALCO	Assets and Liabilities Committee
BCP	Business Continuity Plan
BIsB	Bahrain Islamic Bank B.S.C.
BPV	Basis Point Value
CA Module	Capital Adequacy Module
CAR	Capital Adequacy Ratio
CBB	Central Bank of Bahrain
CRMD	Credit and Risk Management Department
CR & AD	Credit Review and Analysis Department
C&IC	Credit and Investment Committee
DCR	Displaced Commercial Risk
Excom	Executive Committee
FX	Foreign Exchange
GM-C&RM	General Manager-Credit and Risk Management
Group	Bahraini Islamic Bank B.S.C. and its subsidiary
HR Committee	Human Resource Committee
IAH	Investment Account Holder
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IT Committee	Information Technology Committee
IRR	Investment Risk Reserve
MLG	Minimum Liquidity Guidelines
PCD	Prudential Consolidation and Deduction Requirements Module
PD	Public Disclosure
PER	Profit Equalisation Reserve
PSIA	Profit Sharing Investment Account
RCSA	Risk and Control Self-Assessment
RMC	Risk Management Committee
RWE	Risk Weighted Exposures
URIA	Unrestricted Investment Accounts
VaR	Value-at-Risk

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E-Banking	+973 1751 5115	+973 1791 9115
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Information Technology	+973 1751 5135	+973 1791 5135
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