

**Investors Bank BSC (c)  
Public Disclosures Document  
2009**

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## **1 Executive Summary**

Basel 2 based guidelines of the Central Bank of Bahrain [“the CBB”] outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1 January 2008 in the Kingdom of Bahrain.

This document encompasses the detailed qualitative and quantitative public disclosure requirements (to enhance corporate governance and transparency). The document contains a description of following major aspects of Investors Bank [“the Bank” or “IB”]:

- Corporate Governance;
- Capital Adequacy Policies and Practices; and
- Risk Management

The Bank has adopted the Standardised Approach to determine the capital requirement for credit risk and market risk, and the Basic Indicator Approach for operational risk.

The disclosed Tier 1 and total capital adequacy ratios comply with the minimum capital requirements under the CBB’s Basel 2 framework.

The disclosures in this report are in addition to the disclosures set out in the financial statements for the year ended 31 December 2009 in accordance with Financial Accounting Standards issued by the Auditing Organisation for Islamic Financial Institutions and the Shari’a rules and principles as determined by the Shari’a Supervisory Board of the Bank.

## 2 Management Discussion and Analysis

During the year 2009, the global financial markets did not completely recover from the global economic crisis which affected the global economic markets in 2008. Currently markets are witnessing only very mild recovery at best. As most of the world economies got impacted by the credit and liquidity crisis, the economies of Middle East were also significantly affected. The regional markets witnessed a sharp fall in stock indices, severe fall in the real estate prices, high level of volatility in the equity and currency markets and disappointing corporate earnings. The announcement of debt restructuring by the UAE based entity did not help restore confidence in the regional markets.

The Bank was also not immune to the prevailing economic slowdown. The Bank's "held for trading investments" suffered a drop in market prices of US\$ 69,453 (2008: US\$ 24,794,626). Additionally the Bank had to make a net provision for impairment of US\$ 17,771,243 (2008: US\$ 12,343,522) for the decline in value of its real estate holdings (investment properties and office building) and recovery assessment of receivables. Therefore, the Bank reported a net loss of US\$ 21,216,840 (2008: US\$ 34,887,764) for the year ended 31 December 2009.

During the year 2009, in terms of business, IB was not active in the market and did not engage in significant investment activity. A significant portion of the assets of the Bank, before provisions, are in the form of receivables from the related parties or long term passive investments. On account of these investments and receivables the Bank does not have surplus funds for new investments.

Additionally, on account of significantly reduced liquidity in the market due to prevailing economic slowdown, the Bank could not unlock funds from the existing investments and receivables from various parties. However, in a few cases, the Bank swapped receivables with real estate assets from various related parties as settlement in kind.

The Bank believes that 2010 would be a challenging year for the banking sector as a whole and Investors Bank in particular. The Bank is currently attempting to restructure its activities and implement robust internal processes as per the guidelines of Central Bank of Bahrain. The delicate and uncertain economic situation demands caution in business approach in the immediate future. We are, therefore, exploring avenues to generate income from the real estate while keeping an eye on the opportunities to book capital gains once the market conditions improve. In light of this, it is the Bank's assessment that capital is adequate for current and future expected operations. The Board of Directors is also reflecting on options to raise additional capital / unlock existing capital.

Various ratios depicting the performance of the Bank are given below:

	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
ROAE %	-27.45	-32.08	-7.59	8.35	61.02	15.93
ROAA %	-25.07	-30.06	-7.20	7.92	53.10	11.44
Staff cost / Income %	321.17	N/A	N/A	14.93	2.16	12.52
Cost / Income %	5,184.63	N/A	N/A	26.58	9.63	32.35
Earning per share US\$	-0.09	-0.14	-0.04	0.05	0.35	0.18

### **3 Corporate Governance**

The Board of Directors is responsible for approving the Bank's overall business strategy, monitoring its operations, and taking critical business decisions. The Board, elected by the shareholders, is the ultimate decision making body of the Bank and has the following broad responsibilities, as enunciated in the Corporate Governance Manual of the Bank:

- Providing effective governance over the Bank's affairs for the benefit of its shareholders, employees, customers and other stakeholders;
- overseeing the conduct of the Bank's business so that it is effectively managed in the long-term interest of shareholders;
- selecting, evaluating and compensating the Chief Executive Officer (CEO) and planning for CEO succession, as well as monitoring management's succession planning for other key executives;
- reviewing, approving and monitoring the Bank's strategic plans and objectives;
- approving the policies of the Bank with respect to various risks and for ensuring that the management takes the steps necessary to identify, measure, monitor, and control these risks. The Board shall also approve policies that identify lines of authority and responsibility for managing risk exposures.
- monitoring the Bank's accounting and financial reporting practices and reviewing the Bank's financial and other controls; and
- overseeing the Bank's compliance with applicable laws and regulations.

As per the Articles of Association of the Bank, the Board should have not less than three and not more than 9 members. Currently the Bank has five members on its Board of Directors. The Board takes an active interest in the running of the Bank and the Board members meet frequently.

#### **3.1 Profiles of Members of the Board of Directors**

##### Dr. Abdulaziz Al Jenaie – Chairman

Dr. Al-Jenaie has a Doctorate degree in comparative Fiqh (Jurisprudence), from Azhar University in Egypt. He has over 20 years experience in various fields including Sharia supervisory in a number of Islamic investment companies, Research, Shari'a and Islamic education etc. He is currently Chairman of Ajal Holding Company. He has been an Assistant Undersecretary of Awqaf (Endowments) and Islamic Affairs, Cultural Affairs, Member of the Board of Directors of Research Centre for History, Arts and Culture (Istanbul), Media Advisor in supreme advisory committee aiming at fulfilment of implementation of Islamic Shari'a provisions, Seconded Professor at Faculty of Shari'a, Seconded Professor at the Public Authority for Applied Education, etc. Dr. Al Jenaie has attended various training courses including on Strategic Planning and Top Management (London), Motivation Strategies, Leadership and Crisis Management, Change Strategy Management etc.

Additionally, Dr. Al Jenaie has been an active contributor for the benefit of society. Dr. Al Jenaie is the Mosque orator on Fridays, Imam for His Highness, Amir of Kuwait. Dr. Al

Jenaei is also and Ex-member of the Board of Literacy Supreme Council, Shari'a authenticator since 1986 etc.

Mr. Ahmed Shabib Al Dhahery – Vice Chairman

Mr. Dhahery is the Executive Director of the Abu Dhabi Investment Authority. He is also a Board member in the Tunis and Emirates Bank (Tunis), Federal National Council, National Advisory Council for the College of Business Sciences (Zyed University, Abu Dhabi), Arab Tourism Organisation, Al Ain Sports Club etc. He has been a Board Member of Gulf Air Company, Abu Dhabi Fund for Development etc.

Educationally, he is an MBA from Abu Dhabi University, Masters in International Business from Ecole Nationale Des Ponts Et Chaussees (ENPC)- Paris and is a Bachelor in Economics from University of La Verne- California, USA

Mr. Ghassan Al Sultan – Member

Mr. Sultan has more than 28 Years of experience in real estate and investments. Mr. Sultan is currently the Chairman and Managing Director of Gulf United Real Estate and Tourism Investment Company (K.S.C.C.). He has also been in the positions of Chairman, Managing Director and General Manager of Pearl of Kuwait Real Estate Company, Director of Finance and International Investments in Fahad Sultan Sons & Co. W.L.L., Managing Director of Kuwait Computer Services Company, etc.

Mr. Sultan has also served on the Board of Directors in a USD 15 million Real Estate Fund managed by a joint venture between First Boston and Travelers Insurance Co., Board of Directors in a USD 20 million Venture Capital Fund, Board of Directors of Intrawest Corporation (USA). Educationally, Mr. Sultan has a Bachelors Degree in Industrial Engineering from University of Portland, Oregon USA.

Mr. Isa Abdulla Al Mannai – Member

Mr. Mannai has around 28 years experience in the Construction Industry. He is currently the Chairman of the Mannai Technical Services W.L.L., Isa Mannai Technical Services Est, Saudi Arabia, Chairman of Computer Systems Protection Chambers and Integrated Communications Co. Ltd Saudi Arabia and Director of Manorchem Engineering Pvt. Ltd in Chennai India.

Educationally, Mr. Mannai is MSc. (Engineering Management) from the Catholic University, Washington DC and BSc (Civil Engineering) University of Washington, Seattle.

Mr. Abdulwahab A'amer – Member

Mr. Abdulwahab has around 35 years of experience span in the fields of Banking, Transport and Real Estate. He is currently the Group General Manager of Haji Ali Haji Co. W.L.L. in Bahrain. Earlier he has worked in companies like Central Municipal Council Bahrain, Standard Chartered Bank, Al Ahli Commercial Bank, Citibank, etc. Mr. Abdulwahab has attended various training programmes including Standard Chartered Corporate Credit Workshop (U.K.), Credit Appraisal (U.K.), Financial Risk Management (U.K.) Project Lending (Bahrain), Development Banker's Negotiation Skills (Bahrain) etc. Educationally Mr. Abdulwahab is a GCE in Accounting from Cornwall College, UK.

## **3.2 Board Committees**

Consistent with the industry practices, the Board has established the following board sub-committees with defined roles and responsibilities:

### **3.2.1 Executive Committee (EXCOM)**

The EXCOM provides direction to the executive management on all business matters. The EXCOM is also responsible for business matters concerning risk management, strategy review and recommendation to the Board.

#### EXCOM Members:

Mr. Isa Abdulla Al Mannai – Chairman  
Mr. Ghassan Al Sultan – Member  
Mr. Ahmed Shabib Al Dhahery – Member

### **3.2.2 Audit Committee**

The Audit Committee has the responsibility to assist the Board in discharging its oversight duties relating to matters such as risk and compliance, including the integrity of the Bank's financial statements, financial reporting process and systems, internal controls and financial controls. The Committee also liaises between the External Auditors and the Board.

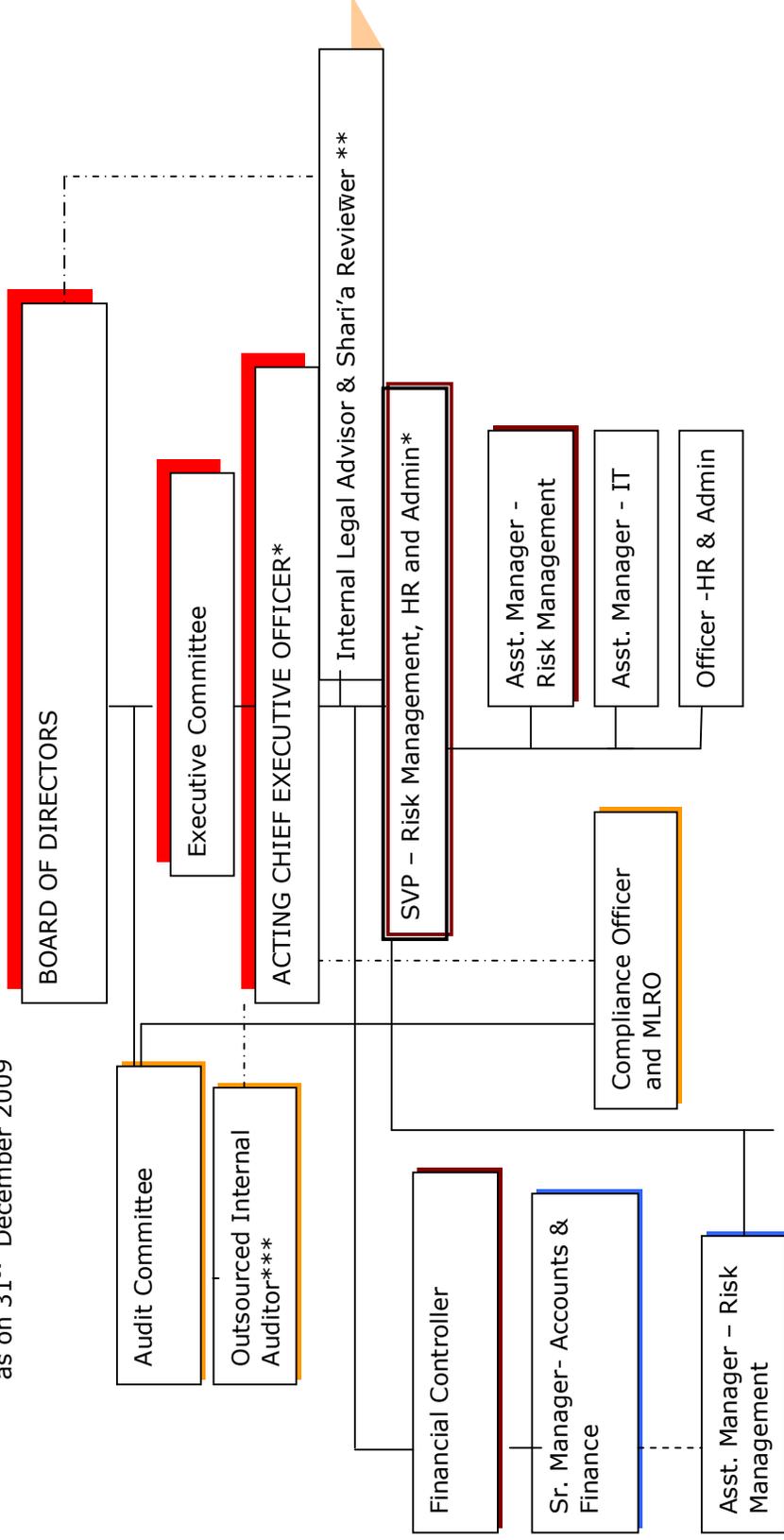
#### Audit Committee Members:

Mr. Abdulwahab A'amer - Chairman  
Mr. Ghassan Al Sultan – Member  
Mr. Ahmed Shabib Al Dhahery – Member

Members of management, representatives of internal and External Auditors, independent consultants and other specialists may be invited to attend meetings at the request of the Chairman of the Audit Committee.

Striving to enhance the Corporate Governance practices, commensurate with the size of operations and feasibility, the Bank may introduce additional board sub-committees (like Board Risk Committee) as well as management level committees to manage its affairs in an efficient and transparent manner.

**3.3 Organisational Chart**  
as on 31<sup>st</sup> December 2009



\* Current Acting CEO is also the Head of Risk Management

\*\* Also the Board Secretary

\*\*\* PWC Bahrain

### **3.4 Management Profile**

#### Mr. Yash Parasnis – Acting CEO and Sr. Vice President Risk Management

Mr. Parasnis has over 23 years of experience in banking and investment banking across project finance, international finance, capital markets and corporate restructuring. His experience includes positions of Head of Capital Markets at Bank of America in Mumbai, India; Head of Business Development at Times Bank in India and Chief Executive at Mega Fin (India) Ltd, a listed non-banking finance company. Mr. Parasnis holds a Bachelor degree in Technology from Indian Institute of Technology, Delhi and a Post Graduate Diploma in Management from Indian Institute of Management, Bangalore.

Additionally, the human resources, IT and admin functions reports to him.

#### Mr. Aref Hussain, Financial Controller

Mr. Hussain has over 13 years of experience in Telecommunication sector and over 3 years of experience in the Banking sector. He has experience across project management, management reporting, international and wholesale financial services, regulatory control and financial control. His experience includes positions of head of management reporting at Bahrain Telecommunication Company (Batelco); manager of international and wholesale financial services at Bahrain Telecommunication Company (Batelco) and manager of regulatory accounts at Telecommunication Regulatory Authority (TRA - Bahrain).

Mr. Hussain holds a Bachelor degree in Accounting from University of Bahrain and is a CMA (Certified management accountant) from Institute of Management Accountants from the United States of America.

#### Mr. Ismaeel Omar Ahmed Elnasri, Legal Advisor (Internal), Shari'a Reviewer and Secretary to the Board of Directors

Mr. Elnasri has an extensive experience of 7 years experience in Law. He has worked as an advocate in the Commissioner's office in Khartoum and with various other law firms as a Legal Advisor in Bahrain. He also has the responsibility of the secretary to General Assembly, Executive Committee, Audit Committee, Secretary to Sharia Board and Internal Sharia Controller.

Educationally he is a B. A in Law with first class Honors Degree, University of Elneelain, Khartoum – Sudan. Mr. Elnasri is a member of the Sudanese lawyers` Bar Association and a member of the Sudanese Network of the International Humanitarian Law. Mr. Elnasri has attended various training programs on Islamic Banking, Intellectual Property Rights, Human Rights and Human Law.

#### Mr. Ahmed Ateya, Compliance Officer and MLRO

Mr. Ateya has extensive experience of around 5 years in the Banking and Financial Institutions sector in Bahrain. He has worked in the Audit and Advisory Services of KPMG in Bahrain for various banks in the region. He has also attended various training courses on IFRS, AAOIFI, Islamic Insurance and other Banking related fields.

Educationally, Mr. Ateya holds a Bachelor degree in Accounting from University of Bahrain and is a Certified Public Accountant from California Board of Accountancy - United States of America.

Mr. Ateya reports functionally to the Audit Committee and administratively to the CEO.

### **3.5 Investment Committee**

The Board has approved the formation of management level "Investment Committee" in October 2009. This will be the highest management level authority on all investment credit and asset liability management related decisions. The overall role of the Investment Committee as approved by the Board will be to facilitate:

- the investment and credit business of the Bank in the most effective and efficient manner within the risk guidelines specified by the Board;
- to oversee and perform Asset Liability Management activities; and
- to oversee credit, market, liquidity, profit rate risk and other risks that the Bank is exposed to.

The Investment Committee is expected to be headed by the CEO and will comprise of heads of other departments as members e.g. Head of Risk, Head of Investments (currently vacant), Head of Finance and Control, etc.

### **3.6 Remuneration and Incentives**

The remuneration to the Board of Directors is governed by the Articles of Association of the Bank.

The remuneration to the employees of the Bank is on the basis of the employment contracts of the individuals. There is a system of annual appraisal based on which the terms of the contract are reviewed every year. Any bonus/ex-gratia payment is purely at the discretion of the Bank. The Articles of Association provides the guidelines for the employee incentive programme that has currently not been implemented.

### **3.7 Corporate Governance Events**

- As required by the CBB regulations, Mr. Abdulwahab A'amer was appointed as an independent director on the Board of Investors Bank in the month of October 2009.
- In October 2009, the Chairman of the Board Dr. Abdul Aziz resigned as the Chairman of Audit Committee, in line with industry best practice. Mr. Abdulwahab A'amer was appointed as the new Chairman of the Audit Committee.
- Departure of the Chief Executive Officer – As of 8<sup>th</sup> October 2009, Mr. Adel Mannai, ceased to be the CEO of the Investors Bank. Mr. Yash Parasnis was appointed as the Acting CEO with the approval of the CBB.
- Appointment of new Compliance Officer and MLRO – In order to segregate the duties and responsibilities of the existing Bank officials and to efficiently manage the compliance responsibilities, the Bank has appointed Mr. Ahmed Ateya as the Compliance Officer. Mr. Ateya also has the responsibility of the Money Laundering Reporting Officer (MLRO). Mr. Ateya joined the Bank on 18<sup>th</sup> October 2009. The Compliance function was earlier managed by Sr. Manager in Finance and Control Department while the responsibilities of MLRO were performed by the Financial Controller.

### **3.8 Communications Policy**

The Bank has a Board approved public disclosure policy, in compliance with CBB regulations under PD Module of the Volume 2 of CBB Rulebook, to disclose material information about its activities to various stakeholders. As a policy, the Bank maintains at least three years of financial data on its website.

The disclosure policy applies to all modes of communication to the public including written, oral and electronic communications. These disclosures are made on a timely basis in a manner required by applicable laws and regulatory requirements.

Management seeks to respond to shareholders' questions and concerns on a prompt basis, subject to the limitations imposed by law and the confidentiality of certain information. The Bank maintains a website at [www.investorsb.com](http://www.investorsb.com), which includes information of interest to various stakeholders including the regulatory authorities. Information available on the website includes the Annual Report and reviewed quarterly financials of the Bank.

### **3.9 Shari'a Compliance**

All the transactions entered into by the Bank are presented to Shari'a Supervisory Board, which comprises of three Shari'a scholars, for review on an annual basis and to ensure that the respective agreements are in compliance the principles of Shari'a. The internal legal advisor of the Bank is also the internal Sharia'a reviewer and Secretary to the Shari'a Board.

The Bank strives to make sure that it does not engage in non Shari'a compliant earning. However if there are any non compliant earnings, they are dealt with through cleansing principles as recommended by the Shari'a Board.

The Bank is currently relying on equity financing only to fund its existing activities.

### **3.10 Zakah contributions**

In the absence of appointment of the Bank to pay zakah on behalf of Shareholders, the responsibility of payment of zakah is on individual shareholders of the Bank.

## 4 Capital Adequacy and Management

The Central Bank of Bahrain (CBB) Basel 2 guidelines became effective from 1 January 2008 as the common framework for the implementation of the Basel Committee on Banking Supervision's (Basel Committee) Basel 2 capital adequacy framework for banks incorporated in the Kingdom of Bahrain.

Investors Bank follows CBB guidelines for the capital requirements of the Bank and maintains sufficient capital to ensure compliance with the minimum capital requirements of the CBB.

The Bank's regulatory capital is analysed in two tiers as per CBB guidelines and include:

- Tier 1: Core Capital - This includes issued and fully paid ordinary shares, statutory reserves, accumulated losses and 45% of the unrealised net gains recognised in income statement arising from fair valuing unlisted equities; and
- Tier 2: Supplementary Capital –retained profits and 45% of the unrealised gains arising on the re-measurement of fair valuing equities classified as available for sale.

### 4.1 Capital Structure

The Bank has capital in the form of equity and does not have any other equity related instrument including innovative, complex or hybrid capital instruments.

<b>CAPITAL STRUCTURE</b>		
<b>Components of capital</b>	<b>Tier One</b>	<b>Tier Two</b>
Core capital - Tier I:		
Issued and fully paid ordinary shares	80,000,000	-
Legal / statutory reserves	7,409,515	-
Accumulated losses	(23,912,862)	-
Less:		
Unrealized gross losses arising from fair valuing equity securities	(5,974)	-
<b>Tier 1 Capital</b>	<b>63,490,679</b>	<b>-</b>
Unrealized gross gains arising from fair valuing equities (45% only)	-	1,537,953
<b>Tier 2 Capital</b>	<b>-</b>	<b>1,537,953</b>
<b>Total Available Capital</b>	<b>63,490,679</b>	<b>1,537,953</b>
Deductions:		
Excess amount over maximum permitted large exposure limit		
- Tier 1	16,935,582	-
- Tier 2	-	1,537,953
<b>Net Available Capital</b>	<b>46,555,097</b>	<b>-</b>
<b>Total Eligible Capital</b>	<b>46,555,097</b>	

## 4.2 Capital Adequacy

Investors Bank follows CBB guidelines for the capital requirements of the Bank and maintains sufficient capital to ensure compliance with the minimum capital requirements of the CBB.

The Bank determines Risk Weighted Assets according to the Standardised Approaches for credit and market risk and Basic Indicator Approach for operational risk as per CBB guidelines that seek to reflect the varying levels of risk attached to the assets.

The Bank's policy is to maintain a capital adequacy ratio, at all times, in excess of the minimum required by CBB. The current requirement for the Bank has been increased from 12% (in 2008) to 15%. This increase in CAR ratio has been stipulated by CBB as the Bank did not have three years' positive gross income required for operational risk capital charge calculation (the Bank had only one year of positive income during last three years).

<b>Risk Assets/ Categories</b>	<b>Risk Weighted Assets (RWA)</b>	<b>Capital Charge @ 15% of RWA</b>
Credit Risk		
- Cash and cash equivalents	122,187	18,328
- Available for sale investments		
- Listed equities	14,462,839	2,169,426
- Unlisted equities	2,644,526	396,679
- Deferred payment sale receivables	1,721,446	258,217
- Investment properties	55,142,808	8,271,421
- Other assets	3,975,251	596,288
- Property and equipment	7,098,714	1,064,807
<b>Total Credit Risk</b>	<b>85,167,771</b>	<b>12,775,166</b>
Market Risk		
- Equity position risk	4,710,839	706,626
- Foreign exchange risk	13,273,011	1,990,952
<b>Total Market Risk</b>	<b>17,983,850</b>	<b>2,697,578</b>
<b>Total Operational Risk</b>	<b>41,130,394</b>	<b>6,169,559</b>
<b>Total Risk Weighted Assets (a)</b>	<b>144,282,015</b>	
<b>Total eligible capital (b)</b>	<b>46,555,097</b>	
<b>Tier 1 and Total Capital Adequacy Ratio ((b)/(a))</b>	<b>32.27%</b>	

## **5 Risk Management**

The Bank is exposed to the credit risk, liquidity risk and market risk during the course of its business along with other operational risks.

The Bank's Board of Directors has the overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established an Executive Committee (EXCOM), a board level sub committee that is responsible for developing and monitoring the Bank's operations and policies across various functions including the risk management framework.

The Bank's Audit Committee is responsible for monitoring compliance with the risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by outsourced Internal Audit function.

The Bank has an internal risk management function to provide independent review, monitoring and control of the various risks faced by the Bank. It works closely with the executive management and other functions. Various operating departments (the support functions) primarily manage the risks of their respective functions.

The Bank has established and implemented various exposure limits as well as set levels of risk that the Bank is willing to accept in relation to its available capital. The limit structure includes single obligor level limits, large exposure limits, industry level limits, rating based limits, country level limits etc.

The risk management philosophy of the Bank, as enunciated in the Risk Management Manual, is to identify, capture, monitor and manage the various dimensions of risk with the objective of protecting asset values and income streams so that the interests of the Bank's shareholders (and the Bank's creditors / lenders) are safeguarded.

### **5.1 Credit Risk**

Credit risk is the risk that a counterparty to a financial transaction does not discharge its obligations on due dates and causes the other party to incur a financial loss. Credit risk may arise from all products and services where counterparties of the Bank fail to meet their payment obligations in accordance with terms and conditions of the contract. This risk exists in all activities of the Bank, including the banking book and both on or off the balance sheet.

The Bank's credit risk arises mainly from cash and balances with banks, deferred payment sale receivables and other assets. The Bank manages its credit risk on cash and bank balances by placing funds with reputable banks having good credit ratings.

The following table demonstrates Bank's credit risk exposure:

<b>Credit Risk Exposure (all figures in US Dollars)</b>		
	<b>Own capital and current account</b>	
<b>Portfolios</b>	<b>Total gross credit risk exposure</b>	<b>Average gross credit exposure over the period *</b>
Cash and cash equivalents	612,263	1,199,699
Available-for-sale investments	22,057,592	22,159,330
Receivable from Mudarib	-	3,348,211
Receivables from sale of investments	-	8,305,469
Deferred payment sale receivables	3,680,203	3,680,203
Investment properties	27,571,404	28,563,797
Other assets	7,624,912	8,926,864
Property and equipment	7,098,715	8,246,406
<b>Total</b>	<b>68,645,089</b>	<b>84,429,979</b>

\* These have been computed based on a quarterly average.

As part of the Bank's credit risk strategy, the Bank has established a credit risk appetite which is quantified in terms of a limit structure for credit risk. The limit structure also helps the Bank's control over the credit risk and to maintain a proper diversification of its activities and thereby attempt to avoid concentration of risks for counterparty, country, sector, industry and region. The Bank manages credit risk of its exposures by constant monitoring of the limit structure. The updated limit structure, approved by the Board in October 2009, covers new investment exposures by the Bank. The Bank continues to have certain exposures, originated in earlier years, that exceed the limit stipulated under the CBB guidelines and the internal limit structure of the Bank.

The Risk Management Department ["RMD"] coordinates with the Bank's management in reviewing investment/credit proposals and post sanction review and monitoring, at all stages of the deal cycle.

For "Balances with banks", the Bank uses ratings assigned by External Credit Assessment Institutions ["ECAI"] for risk assessment and calculating risk weighted equivalents. ECAI considered by the Bank are Standard and Poor's, Moody's and Fitch.

Analysis of Bank's exposure to Credit Risk (Past due and impaired):

	<b>Banking and financial institutions</b>	<b>Investment Companies</b>	<b>Others</b>	<b>Total</b>
Past due but not impaired Islamic financing contracts	887,733	3,680,203	-	4,567,936
Impaired financing contracts	15,312,239	6,125,125	10,108,903	31,546,267
<b>Total</b>	<b>16,199,972</b>	<b>9,805,328</b>	<b>10,108,903</b>	<b>36,114,203</b>

Aging of past due and impaired financing contracts:

	<b>Banking financial institutions and</b>	<b>Investment Companies</b>	<b>Others</b>	<b>Total</b>
Less than 3 months	-	-	-	-
3 months – 1 year	-	-	-	-
1 year – 3 years	15,312,239	6,125,125	9,233,903	30,671,267
Over 3 years	887,733	3,680,203	875,000	5,442,936
Total	16,199,972	9,805,328	10,108,903	36,114,203

Movement in specific provisions during the year:

	<b>Banking financial institutions and</b>	<b>Investment Companies</b>	<b>Others</b>	<b>Total</b>
Balance at the beginning of the year	2,925,084	2,701,297	3,787,489	9,413,870
Net provision for impairment for the year	12,387,155	3,423,829	(197,162)	15,613,822
Balance at the end of the year	15,312,239	6,125,126	3,590,327	25,027,692

Past due exposures are those on which payments are not being made on time and are behind schedule, although partial payments may have been made.

The management of the Bank analyses its credit risk portfolio on a periodical basis to assess its recoverability. Impairment provisions for assets are based on the management's assessment of the expected realisations and consider the time value of the money. Specific impairments are identified by the Bank based on the various specific factors, which include financial health of the investee and expected cash flows or settlement in kind.

### **5.1.1 Credit Risk Mitigation**

The Bank does not generally engage in lending against collateral and does so by exception.

However, the Bank has designed policies and processes which are pending appropriate approvals for collateral valuation and management (wherever required) and will extend credit facilities only where it is supported by adequate tangible security and/or audited financial statements of its customers/counterparties.

Also the market value of security offered by prospective and existing customers/counterparties will be evaluated by the Bank based on market information.

### 5.1.2 Concentration Risk

Concentration risk arises when a number of counterparties are engaged in similar economic 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. The Bank seeks to manage its concentration risk by establishing geographic and industry wise concentration limits. Presently, most of the Bank's assets are, however, in GCC region as this has strategic fit with Bank's overall business approach and also the current market imperatives.

The Bank's assets are distributed over the following geographical areas and industry sectors:

#### Own capital

Asset category	Geographic area			
	Bahrain	Kuwait	Others countries	Total
Cash and cash equivalents	603,067	9,196	-	612,263
Available for sale investments	12,982,868	7,643,190	1,431,534	22,057,592
Deferred payment sale receivables	3,680,203	-	-	3,680,203
Investment properties	22,226,283	-	5,345,121	27,571,404
Other assets	1,106,336	6,043,576	475,000	7,624,912
Property and equipment	7,098,715	-	-	7,098,715
Total	44,017,269	17,376,165	7,251,655	68,645,089

Bank's Credit Risk exposures distribution by industry or counterparty is given below:

## Own capital

Asset category	Industry sector			
	Banks and financial institutions	Investment companies	Others	Total
Funded				
Cash and cash equivalents	612,263	-	-	612,263
Available for sale investments	19,878,026	672,456	1,507,110	22,057,592
Deferred payment sale receivables	-	3,680,203	-	3,680,203
Investment properties	-	-	27,571,404	27,571,404
Other assets	900,995	-	6,723,917	7,624,912
Property and equipments	-	-	7,098,715	7,098,715
Total	21,391,284	4,352,659	42,901,146	68,645,089

The Bank does not have any unfunded exposures.

As required by CBB, the Bank may not incur an exposure to an individual counterparty or group of closely related counterparties, which exceeds 15% of the bank's capital base without the prior written approval of the CBB. Also the Bank's shareholders with significant ownership of the Bank's capital are not allowed to obtain financing facilities from the Bank (i.e. a 0% limit). The Bank's concentrations of exposure to individual counterparties and group of closely related counterparties in excess of 15% and significant shareholders with limit exposure of greater than 0% are given below:

Concentration of risk	
Counterparties	Own capital
	Total exposure
Counterparty # 1 - Individual	11,455,214
Counterparty # 2 - Individual	5,673,633
Counterparties - Closely Related	20,853,278
Total	37,982,125

Additionally, Bank's past due exposures broken-down by geographical areas are given in the table below:

<b>Impaired exposures, Past Due exposures and allowances</b>		
<b>Own capital</b>		
<b>Geographic area</b>	<b>Past due Islamic financing contracts</b>	<b>Specific impairment provision</b>
Bahrain	887,733	-
Kuwait	34,351,469	24,627,692
Others countries	1,283,536	808,535
<b>Total</b>	<b>36,522,738</b>	<b>25,436,227</b>

## **5.2 Market Risk**

The Central Bank of Bahrain defines market risk as “the risk of losses in on and off-balance sheet positions arising from movements in market prices”.

Market risk is the risk of changes in the value of the security or transaction due to changes in underlying market exposure. Market risk may arise from movements in market dynamics such as reference rates, foreign exchange markets, equity markets or commodity markets.

The Bank has following sources of market risk:

- Equity price risk in the trading book (for listed equities); and
- Currency risk on account of foreign currency denominated investments in the trading as well as banking book.

The Bank’s trading book equity positions are listed in some GCC stock exchanges and have a ready market. The FX positions in the Banking book are structural in nature and have a ready market. Additionally, as part of trading book, the Bank does not have exposure to assets that do not have a ready market.

The following table demonstrates the sensitivity to a reasonable possible change in equity prices, with all other variables held constant, of the Bank’s income statement based on the balance sheet position as of 31 December:

<b>Particulars</b>	<b>20% decrease</b>	<b>20% increase</b>
Trading investments	(1,122,316)	1,122,316

As part of the overall market risk strategy, the Bank attempts to proactively measure and monitor market risk in its portfolio using appropriate measurement techniques (standardised measurement methodology suggested by CBB). Additionally, in order to control market risk the Bank holds sufficient capital in line with Pillar 1 regulatory capital requirements of the CBB. The Bank has also established a limit structure to provide a ceiling on the market risk exposure that can be taken.

Bank's capital requirements for Market Risk using the Standardised measurement method

<b>Particulars</b>	<b>Gross exposure</b>	<b>Risk weighted assets (RWA)</b>	<b>Capital requirements @ 15% of RWA</b>	<b>Maximum capital requirement during the year</b>	<b>Minimum capital requirement during the year</b>
Equity Position	5,611,582	4,710,839	706,626	1,192,928	617,892
Foreign Exchange Position	13,273,011	13,273,011	1,990,952	4,380,506	1,990,952

### 5.2.1 Currency Risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

The Bank had the following net foreign currency exposures as at 31 December:

<b>Currency</b>	<b>2009 (USD Equivalent)</b>
Bahraini Dinar	49,970,729
Kuwaiti Dinar	13,273,011
United Arab Emirates Dirham	5,345,121

Sensitivity Analysis:

The following table demonstrates the sensitivity to a reasonable possible change in foreign exchange rates, with all other variables held constant, of the Bank's income statement based on the balance sheet position as of 31 December:

<b>Currency</b>	<b>5% decrease</b>	<b>5% increase</b>
Kuwaiti Dinar	698,580	(632,048)

Note: Bahraini Dinar and UAE Dirham exposures are not considered to represent significant currency risk as both currencies are pegged to the US\$.

### 5.3 Operational Risk

Operational risk is defined as the risk of loss arising from inadequate or failed internal processes, people and systems or from external events which includes but is not limited to legal risk and Shari'a compliance risk. This definition excludes strategic and reputational risk.

The Bank has implemented an operational risk framework of the Basic Indicator Approach ["BIA"], as defined by the CBB guidelines. This framework includes measuring, monitoring and managing operational risk across the Bank. This framework uses tools like Risk and Control Self Assessment, identification of Key Risk Indicators, preparation of operational loss database, etc.

The operational risk framework will evolve with the changing needs of the Bank's businesses and regulatory guidance, taking into account internal and external operational risk events, business environment and internal control factors.

While individual functions have direct responsibility for the control and mitigation of operational risk, the proposed framework provides a consistent methodology across the Bank. The Bank attempts to manage operational risk through appropriate controls, appropriate training to the employees, and internal checks and balances including internal audit and compliance.

### 5.3.1 Risk and Control Self Assessment

The Bank has established RCSA methodology to provide an annual, forward-looking process for identifying and assessing risks, evaluating controls, establishing thresholds for risks and controls and determining the appropriate level of risk mitigation. This process will enable the Bank to better understand its risk profile and ensure that operational risk-taking is aligned with the Bank's risk appetite.

RCSA exercise is undertaken on an annual basis by the business and support units in co-ordination with RMD. The Bank completed RCSA of its activities in 2008 and 2009.

### 5.3.2 Operational Risk Loss Database

The Bank collects loss events' information for preparing Operational Risk Loss Database. The functional units of the Bank map their risk events and collect/record related operational loss event data as defined in the Basel II Accord. This data tracking provides a mechanism for early reporting and response to operational risk events and losses.

On a periodic basis, all process owners collect and record operational risk loss event data, using the template provided by the RMD in accordance with Basel II risk categorization framework.

The RMD is responsible for maintaining a comprehensive database for loss events reported as per the Basel II guidelines.

### 5.3.3 Operational Risk capital charge

Bank's capital charge for Operational Risk using Basic Indicator Approach

Particulars	Average gross income	Risk weighted asset	Capital charge
Operational risk	21,936,210	41,130,394	3,290,432

As required by CBB under section CA 6.2.3 of the CBB Rulebook, the operational risk capital charge is 15% of the average of annual gross income of last 3 years' profit. Figure for any year in which annual gross income is negative or zero has been excluded from both the numerator and denominator when calculating the average.

Bank's indicators of Operational Risk exposures for Basic Indicator Approach

Particulars	Amount
Gross Income	21,936,210
Amount of non-Shari'a-compliant income*	296
Number of Shari'a violations that were identified and reported during the financial year	None

The non-Shari'a compliant income is the interest income on the Bank's current accounts and forms part of undistributed charity funds (as approved by the Shari'a Board).

As per CBB rulebook, Gross income is defined as:

- Net income from financing activities which is gross of any provisions, operating expenses, realised profits/losses from the sale of securities in the banking book, and depreciation of Ijarah assets;
- Net income from investment activities; and
- Fee income (e.g. commission and agency fee)
- Less
- Investment account holders' share of income
- Takaful income

#### **5.3.4 Legal Risk – Current Litigations and Claims**

The Bank has an internal legal counsel that prepares and reviews all the legal documents. The Bank has appointed external legal advisor(s) for advice on various legal issues including legal documentation.

The current litigations and claims of the Bank are given below:

In 2004, the Bank entered into a sale and purchase agreement with a local financial institution to purchase shares of a related party on behalf of another related party. The net amount due to the financial institution was US\$ 3,670,202. In accordance with the terms of the agreement, the Bank pledged certain of its investments with a carrying value of US\$ 4,306,622 as at 31 December 2009. Subsequently, the agreement was terminated by the financial institution due to disputes with the Bank and as a result, the pledged investments have been retained by the financial institution. In the opinion of the Bank's lawyers and management, the agreement was wrongfully terminated and following the financial institution's refusal to settle the matter amicably, the Bank has filed a legal case in the Bahrain courts against the financial institution for wrongful possession of investments. As a result, the court has taken custody of the shares under dispute. The related party on whose behalf the transactions was entered has provided a manager's cheque for an equal amount which has been deposited with the court. This amount is included under deferred payment sale receivables.

- The related party on whose behalf the transaction was entered into has also agreed to reimburse the Bank for legal expenses and any losses arising on final settlement with the financial institution. Accordingly, in the opinion of the directors, no provision is required to be made in the financial statements against the investments pledged with the financial institution or for contingent claims that might arise on final settlement.
- There are three labour cases running against the bank from three former employees seeking compensations as a result of alleged unfair termination of their services with the bank. The Bank's legal position is strong and a material liability to the Bank is not expected from the cases.

The bank has appointed external law firm(s) to deal with the above cases.

#### 5.4 Liquidity Risk

Liquidity risk is defined as the risk that funds will not be available to meet liabilities as they fall due.

It is the Bank's policy to keep a significant part of its assets in liquid assets such as trading and available-for-sale investments.

The short-term liabilities of the bank mainly represent the operating account payables only. The Bank has established a limit structure to monitor the prevailing liquidity position and to control negative mismatches that may affect the fulfillment of short term obligations of the Bank.

The maturity profile of for cash and cash equivalents, Murabaha payables, receivables from Mudarib has been presented using contractual cash flows. For other balances, maturity profile is based on expected cash flows/ settlement profile.

2009	Up to 1 month	1 to 3 months	3 months to 1 year	Within 1 year	1 to 3 years	Over 3 years	No fixed maturity	Total
<b>Assets</b>								
Cash and cash equivalents	612,263	-	-	612,263	-	-	-	612,263
Investments	-	-	-	-	-	-	27,669,174	27,669,174
Deferred payment sale receivables	-	-	-	-	-	-	3,680,203	3,680,203
Investment properties	-	-	-	-	-	-	27,571,404	27,571,404
Other assets	-	10,038	59,512	69,550	134,292	1,499	7,419,571	7,624,912
Property & equipment	-	-	-	-	-	-	7,098,715	7,098,715
<b>Total assets</b>	<b>612,263</b>	<b>10,038</b>	<b>59,512</b>	<b>681,813</b>	<b>134,292</b>	<b>1,499</b>	<b>73,439,067</b>	<b>74,256,671</b>

Liabilities	Up to 1 month	1 to 3 months	3 Months to 1 year	Within 1 year	1 to 3 years	Over 3 years	No fixed maturity	Total
Due to a financial institution	-	-	-	-	-	-	3,670,202	3,670,202
Murabaha payable	-	-	-	-	-	-	3,229,064	3,229,064

Other liabilities	31,804	101,148	132,007	264,959	-	-	184,092	449,051
Total liabilities	31,804	101,148	132,007	264,959	-	-	7,083,358	7,348,317
Cumulative Liquidity Gap	580,459	489,349	416,854	416,854	551,146	552,645	66,908,354	

Following are the key liquidity ratios as at 31 December 2009:

Description	Ratio
Short Term Assets : Total Assets	0.29:1.00
Short Term Assets : Short Term Liabilities	47.80:1.00

### 5.5 Rate of Return Risk

Rate of return risk arises due to different timing of re-pricing of the Bank's assets and liabilities. The Bank's exposure to rate of return risk is limited to cash and cash equivalents. The cash and cash equivalents amount as on 31st December 2009 is USD 612,263. The Bank does not have significant rate of return risk sensitivity due to the short-term nature of its cash and cash equivalents.

### 5.6 Equity Price Risk in the Banking book

Equity price risk is the risk that quoted equity investments will depreciate in value due to movements in the quoted equity prices. The Bank has a few listed equity exposures in the available-for-sale portfolio. The price movement of these exposures are closely monitored by the Bank and reported to the management.

Sensitivity Analysis:

The following table demonstrates the sensitivity to a reasonable possible change in equity prices, with all other variables held constant, of the Bank's equity based on the balance sheet position as of 31 December:

Particulars	20% decrease	20% increase
Available-for-sale investments	(4,016,900)	4,016,900

#### 5.6.1 Valuations Policy

The Bank measures the fair value of quoted investments using the market bid-prices in an active market for that instrument. Fair value for unquoted managed funds is the fund's net assets value as determined by the fund manager.

#### 5.6.2 Equity based financing

The Bank has the following investments classified as quoted on an active market or privately held:

Types And Nature of Investments		
	Publicly	Privately

	<b>traded</b>	<b>held</b>
Investment in shares	19,652,965	1,764,107
Investment in managed funds	-	640,520
<b>Total</b>	<b>19,652,965</b>	<b>2,404,627</b>

Additionally the Bank has the following cumulative realized gains or losses arising from sales or liquidations, total unrealized gains and losses recognized in the balance sheet but not through the profit and loss statement, and any unrealized gains and losses included in Tier 1 and Tier 2 capital:

<b>Particulars</b>	<b>Amount</b>
Cumulative realized gains (losses) arising from sales or liquidations in the reporting period	6,530
Total unrealized gains (losses) recognized in the balance sheet but not through P&L	3,411,701
Unrealized gains (losses) included in Tier One Capital	(5,974)
Unrealized gains (losses) included in Tier Two Capital	1,537,953

The Bank has the following capital requirements broken down by equity groupings:

<b>Equity grouping</b>	<b>Risk weighted assets (RWA)</b>	<b>Capital requirements @ 15% of RWA</b>
Investment in shares	16,496,985	2,474,548
Investment in managed funds	610,380	91,557
<b>Total</b>	<b>17,107,365</b>	<b>2,566,105</b>

### **5.7 Displaced Commercial Risk**

The risk arises when an Islamic bank is under pressure to pay its investors-depositors a rate of return higher than what should be payable under actual terms of the investment contract.

Since the Bank does not take deposits from outside parties, displaced commercial risk is not currently relevant for the Bank.

## 6 Restricted Investment Accounts

The Bank has not, as a focused business proposition, opened Investment Accounts or accepted Investment Account deposit (restricted or unrestricted) except for certain transactions involving related parties in three cases and hence does not have any formal policies and procedures. The specific RIAs are opened according to the underlying arrangements. The bank accepted certain funds from a related party in 1999 under a Mudaraba arrangement which were deployed in a Murabaha with a non-related party. The Murabaha was partially repaid and the balance amount has been impaired. Appropriate impairment provisions have been made in the RIA.

Balance as of 31 Dec 2009 net of provision:

<b>Exposures</b>	<b>No of units (000)</b>	<b>Average value per share US\$</b>	<b>Total US\$</b>
Murabaha with Lotus Air Ltd	-	-	317,689
Investments in International Investment Group K.S.C.C. *	12,887	0.44	5,670,202
Portfolio managed by the Bank **	142,059	0.07	10,240,334

The Restricted Investment Accounts are not actively managed by the Bank and have not earned any income during the last six years.

\* On the instructions of a restricted investment account holder, a related party, the Bank has entered into a deferred payment purchase agreement with a financial institution to acquire shares of International Investment Group K.S.C.C. ('IIG'). The Bank then entered into a deferred payment sale agreement with the restricted investment account holder for sale of these shares. However, due to a legal dispute with the financial institution, the Bank could not effect the transfer of the IIG shares to the restricted investment account holder.

This account does not have a specific maturity due to it being a subject of litigation in the Bahrain courts.

### \*\* Managed Portfolio

The Bank has a signed portfolio Management Agreement with some related parties. The underlying assets of the portfolio comprise the shares of one of the related parties that is also a partial owner of the portfolio.

This portfolio may be liquidated on the instructions of the owners after due regulatory approvals are obtained and hence has no fixed maturity.

## 7 Related party transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties also include directors and shareholders of the Bank and companies in which they have an ownership interest.

A significant portion of the Bank's income arises from transactions with related parties. Transactions with related parties are undertaken on terms agreed between the parties which may not necessarily be on arm's length basis.

Significant balances with related parties at 31 December comprise:

<b>Assets</b>	<b>Counterparty</b>	<b>2009</b>	<b>2008</b>
Trading investments	Grand Real Estate Projects Co.	5,411,638	5,451,147
Available-for-sale investments			
	International Investment Group	3,431	2,815
	Gulf Monetary Group	31,936	31,936
	Takaful International – Bahrain	7,771,808	7,291,300
	Gulf Monetary Group – Managed portfolio	208,986	217,529
	Takaful International – Kuwait	720,568	750,023
	International Projects Consultancy	43,539	45,319
Murabaha receivables	Other related party	-	3,243,848
Mudaraba investments	International Investment Group	-	4,000,000
Receivables from sale of investments			
	International Investment Group	-	8,328,852
	Gulf Monetary Group	-	3,517,690
Deferred payment sale receivables	Gulf Monetary Group	3,680,203	3,680,203
Receivable from Mudarib	International Investment Group	-	6,127,801
Other assets:			
Current account			
	Gulf Monetary Group	-	150,371
	International Investment Group	-	33,467
	Grand Real Estate Projects Co.	6,043,576	13,979,891
Dividend receivable			
	International Investment Group	-	2,581
	Grand Real Estate Projects Co.	-	1,776,670
		23,915,685	58,631,444

<b>Liabilities</b>			
Murabaha payables	International Investment Group	3,229,064	3,229,064
Other Liabilities			
	Takaful International – Bahrain	15,957	-
	Key Management Personnel	240,254	175,145
		3,485,275	3,404,209

Significant transactions with related parties include:

<b>Income</b>	<b>Counterparty</b>	<b>2009</b>	<b>2008</b>
Income from trading investments	Grand Real Estate Projects Co.	-	1,007,824
Income from available-for-sale investments	International Investment Group	-	569
Fair value losses on trading investments	Grand Real Estate Projects Co.	(39,509)	(24,275,927)
Income from Mudaraba investment	International Investment Group	-	192,452
Income from Mudaraba investment	International Investment Group	63,680	-
Other income – refund of payments to Managing Director	Key Management Personnel	-	1,000,000
<b>Expenses</b>			
Provision for impairment			
	Grand Real Estate Projects Co.	1,706,897	1,483,430
	International Investment Group	12,387,156	2,925,084
	Gulf Monetary Group	3,423,829	2,701,297
Provision Write Back	Other related party	(1,897,619)	-
Board of Directors	Board of Directors	29,882	37,069
Shari’a Supervisory Board	Shari’a Board	31,552	45,721
		15,681,697	7,193,601

The Group entities include those entities, which are subject to common control or influence of certain shareholders of the Bank.

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

	<b>2009</b>	<b>2008</b>
Salaries and other short-term benefits	496,927	447,113
Post employment benefits	31,397	27,356

