AL SALAM BANK-BAHRAIN B.S.C.

BASEL II - PILLAR III DISCLOSURES

31st December 2009

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1. Introduction

The new Central Bank of Bahrain (CBB) requirements, which act as a common framework for the implementation of the Basel II accord in the Kingdom of Bahrain came into effect on 1 January 2008.

The Basel II accord is built on three pillars:

- **Pillar I** defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk. The requirement of capital has to be covered by own regulatory funds.
- **Pillar II** addresses the Bank's internal processes for assessing overall capital adequacy in relation to risks (ICAAP). Pillar II also introduces the Supervisory Review and Evaluation Process (SREP), which assesses the internal capital adequacy.
- **Pillar III** complements the other two pillars and focuses on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy.

In November 2007 the CBB issued directives on the Pillar III disclosures under the Basel II framework applicable to licensed Islamic banks in Bahrain. These directives set out enhanced disclosure requirements required under Basel II framework. In accordance with the above requirement, Al Salam Bank-Bahrain B.S.C. (the "Bank" or "ASBB") developed this document which gathers all the elements of the disclosure required under Pillar III for the Bank and its subsidiary, the Bahraini Saudi Bank ("BSB"), together known as the "Group" . The document is organized as follows:

Firstly, it provides the profile of the risk weighted assets according to the "standard portfolio" as defined by the CBB.

Secondly, an overview of risk management practices and framework at the Group is presented with specific emphasis on credit, market and operational risks and sets out the related monitoring processes and credit mitigation initiatives.

Finally, this document provides all other disclosures required under the public disclosure module of the CBB.

The disclosures in this document are in addition to the disclosures included in the consolidated financial statements which are prepared in accordance with Financial Accounting Standards issued by Accounting and Auditing Organization for Islamic Financial Institutions.

2. Financial Performance and Position

The parent company, Al Salam Bank-Bahrain B.S.C., (the “Bank” or “ASBB”) was incorporated on 19 January 2006 in the Kingdom of Bahrain. The Bank operates under Islamic Shari’a principles in accordance with the regulatory requirements for Islamic banks set by the Central Bank of Bahrain (CBB). The Bank is listed on Bahrain Stock Exchange and Dubai Stock Exchange and operates under an Islamic retail banking license issued by CBB.

The Bank’s subsidiary, Bahraini Saudi Bank B.S.C. (BSB) is a publicly listed commercial bank in the Kingdom of Bahrain. BSB operates under a retail banking license issued by the CBB. BSB has applied for an Islamic retail banking license with the CBB and is awaiting approval as of 31 December 2009.

The consolidated financial statements and capital adequacy regulatory disclosure of the Group have been prepared on a consistent basis where applicable.

Table 2.1 ***Key Financial Indicators (PD 1.3.9 a,b,c)***

Amt. in BD millions	**2009**	**2008**	**2007**	**2006***
Total Operating Income	23.7	37.6	32.7	20.4
Net Profit	14.0	25.5	23.1	16.4
Total equity	201.8	172.5	159.5	136.5
Total assets	785.9	554.5	397.8	188.1
Key Ratios	**2009**	**2008**	**2007**	**2006***
Return on average equity (%)	7.6	15.8	15.6	15.1
Earnings per share (fils)	10.7	21.3	19.3	15.1
Return on average assets (%)	2.1	4.7	7.9	11.2
Cost to operating income (%)	40.6	31.3	33.5	19.6
Dividend payout ratio (%)	51.0	47.0	51.8	-
Dividend yield ratio (%)	5.4	11.4	4.9	-

* Represents the period from 19 January 2006 (date of incorporation) to 31 December 2006.

Table 2.2 *Financial Summary*

(BD '000)

Financial Position	**2009**	**2008**	**2007**	**2006***
Cash and balances with Central Bank of Bahrain	126,739	83,534	15,174	2,942
Murabaha receivables from banks	149,304	87,167	224,451	105,090
Central Bank of Bahrain Sukuk	32,908	31,095	20,380	-
Corporate Sukuk	16,950	-	-	-
Murabaha and Mudaraba receivables	87,274	72,484	32,642	22,963
Ijarah Muntahia Bittamleek	46,315	41,531	10,436	10,382
Musharaka financing	5,384	-	-	-
Assets under conversion**	98,305	-	-	-
Non-trading investments	184,680	116,930	62,736	32,619
Investment in Associate	7,659	8,012	8,272	-
Murabaha and Wakala payables to banks	89,398	32,881	96,983	23,647
Assets held-for-sale	-	88,934	9,024	-
Wakala from non-banks	317,370	289,005	106,909	-
Customers' current accounts	32,700	42,986	5,689	5,674
Liabilities under conversion**	120,402	-	-	-
Unrestricted Investment Accounts	9,409	6,370	19,770	20,112
Capital	**2009**	**2008**	**2007**	**2006***
Capital adequacy	28.6%	24.7%	48.7%	79.8%
Equity/total assets	25.7%	31.1%	40.1%	72.5%
Total deposits/equity (times)	2.3x	2.2x	1.4x	0.4x
Liquidity and Other	**2009**	**2008**	**2007**	**2006***
Islamic financing contracts/total assets	40.9%	41.9%	72.4%	73.6%
Investments/total assets	30.1%	38.6%	20.1%	19.1%
Liquid assets/total assets	40.2%	30.8%	60.3%	57.5%
Islamic financing contracts/customer deposits	70.0%	68.6%	217.5%	536.9%
Number of employees	*231*	*116*	*110*	*58*

* Represents the period from 19 January 2006 (date of incorporation) to 31 December 2006.
**These represent assets and liabilities of BSB which are under conversion to Shari'a compliant products.

3. Capital structure

The Group's capital base comprises of Tier 1 capital and Tier 2 capital which are detailed in the following table: (PD 1.3.11)

The issued and paid up share capital of the Group was BD 142,577 thousand as of 31 December 2009, comprising of 1,425,775 thousand shares of BD 0.100 each. (PD 1.3.11)

The Group's capital base of BD 179,564 thousand comprises Tier 1 and Tier 2 capital as detailed below: (PD 1.3.11)

Table 3.1 Breakdown of Capital Base (PD 1.3.12, 13, 14, 15, 16) **BD '000s**

	Tier 1	Tier 2	Total
Paid-up share capital	**142,577**	[redacted]	**142,577**
Legal / statutory reserves	7,910	[redacted]	7,910
Share premium		[redacted]	
Proposed dividend	2,573	[redacted]	2,573
Retained earnings	12,575	[redacted]	12,575
Others	6,692	[redacted]	6,692
Unrealized gains arising from fair valuing equities (45%)	11,810	[redacted]	11,810
Minority Interest	3,587	[redacted]	3,587
Less:		[redacted]	
Current interim cumulative net loss	-	[redacted]	-
Unrealized gross losses arising from fair valuing equity securities	507	[redacted]	507
Tier 1 Capital before Prudential consolidation and deduction (PCD) requirements	**187,217**	[redacted]	**187,217**
Investment Risk reserve	-	7	7
Tier 2 Capital before PCD requirements (2.1 to 2.5 inclusive less 2.6)	-	7	7
Total available capital	**187,217**	**7**	**187,224**
Regulatory deductions:			
Significant minority investments in banking, securities and other financial entities unless pro-rata consolidated	(3,830)	(3,830)	(7,660)
Additional deduction from Tier-1 to absorb deficiency in Tier-2	(3,823)	3,823	**-**
Total Deductions	**(7,653)**	**(7)**	**7,660**
Net Available Capital	**179,564**	**-**	**179,564**
Total Eligible Capital (Tier I + Tier II) (a) (PD 1.3.20 a)			**179,564**

Table 3.2 **BD '000s**

Risk Weighted Assets (RWA)	**Amount**
Credit risk	555,389
Market risk	2,950
Operational risk	68,803
Total Risk Weighted Assets (b)	**627,142**
Capital adequacy ratio (a/b) (PD 1.3.20 a)	**-**
Tier I ratio (PD 1.3.20 a)	**28.6%**
Tier II ratio (PD 1.3.20 a)	**-**
Total ratio (PD 1.3.20 a)	**28.6%**
Minimum required by CBB regulations under Basel II (%)	**12%**

4. Capital Adequacy Ratios (CAR)

No impediments on the transfer of funds or reallocation of regulatory capital exist within the Group. (PD 1.3.6.c)

4.1 Capital Management

Internal Capital Adequacy Assessment Process (ICAAP)

The Group's capital management aims to maintain an optimum level of capital to enable it to pursue strategies that build long-term shareholder value, whilst always maintaining minimum regulatory ratio requirements.

The key principles driving capital management at ASBB include:

- Adequate capital is maintained as buffer for unexpected losses to protect stakeholders i.e. shareholders and depositors.
- Maximize return on capital and generate sustainable return above the cost of capital.

The adequacy of the Group's capital is monitored using, primarily, the rules and ratios established by the Basel Committee on Banking Supervision and adopted by the Central Bank of Bahrain. The primary objective of the Group's capital management is to ensure that it complies with externally imposed capital requirements. The Group complied in full with all externally imposed capital requirements during the year ended 31 December 2009.

5. Profile of Risk-weighted assets and capital charge

The Group has adopted the standardized approach for credit risk and market risk and the basic indicator approach for operational risk for regulatory reporting purposes. The Group's risk-weighted capital requirement for credit, market and operational risks are given below.

5.1 Credit risk

a) Definition of exposure classes per Standard Portfolio (PD 1.3.21 a)

The Group has a diversified funded and unfunded credit portfolio. The exposures are classified as per the Standard portfolio approach mentioned under the CBB's Basel II capital adequacy framework covering the standardized approach for credit risk.

The descriptions of the counterparty classes along with the risk weights to be used to derive the risk weighted assets are as follows:

a. Claims on sovereigns

These pertain to exposures to governments and their central banks. Claims on Bahrain and GCC sovereigns are risk weighted at 0%. Claims on all other sovereigns are given a risk weighting of 0% where such claims are denominated and funded in the relevant domestic currency of that sovereign. Claims on sovereigns, other than those mentioned above are risk weighted based on their credit ratings.

b. Claims on public sector entities (PSEs)

Listed Bahrain PSEs are assigned 0% risk weight. Other sovereign PSE's, in the relevant domestic currency and for which the local regulator has assigned risk weight as 0%, are assigned 0% risk weight by the CBB. PSEs other than those mentioned above are risk weighted based on their credit ratings.

c. Claims on banks

Claims on banks are risk weighted based on the ratings assigned to them by external rating agencies, however, short term claims on locally incorporated banks may be assigned a risk weighting of 20% where such claims on the banks are of an original maturity of three months or less and the claims are denominated and funded in either Bahraini Dinars or US Dollars.

Preferential risk weights that are one category more favorable than the standard risk weighting are assigned to claims on foreign banks licensed in Bahrain of an original maturity of three months or less denominated and funded in the relevant domestic currency. Such preferential risk weights for short-term claims on banks licensed in other jurisdictions are allowed only if the relevant supervisor also allows this preferential risk weighting to short-term claims on its banks.

5.1 Credit risk (continued)

c. Claims on banks (continued)

No claim on an unrated bank would receive a risk weight lower than that applied to claims on its sovereign of incorporation. Investment in subordinated debt of banking, securities and financial entities are risk weighted at a minimum risk weight of 100% for listed entities or 150% for unlisted entities, unless such investments exceed 20% of the eligible capital of investee entity, in which case they are deducted from the Bank's capital.

d. Claims on corporate portfolio, including insurance companies

Claims on corporate portfolio including insurance companies are risk weighted based on credit ratings. Risk weightings for unrated corporate claims are assigned at 100%.

e. Claims on regulatory retail portfolio

Retail claims that are included in the regulatory retail portfolio are assigned risk weights of 75% (except for past due Islamic financing contracts), if it meets the criteria mentioned in the CBB's rule book.

f. Mortgages

Claims secured by mortgages on commercial real estate are subject to a minimum of 100% risk weight.

g. Past due receivables (PD 1.3.22 a)

The unsecured portion of the account receivables and lease payment receivable (other than a qualifying residential mortgage financing contract) that is past due for more than 90 days, is risk-weighted as follows (net of specific provisions and including partial write-offs):

(a) 150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan.
(b) 100% risk weight when specific provisions are greater than 20% of the outstanding amount of the loan.

h. Investment in securities and sukuk

Investments in listed equities are risk weighted at 100% while unlisted equities are risk weighted at 150%.

5.1 Credit risk (continued)

i. Holding of real estate

All holdings of real estate by banks (i.e. owned directly or by way of investments in Real estate companies, subsidiaries or associate companies or other arrangements such as trusts, funds or REITs) are risk-weighted at 200%. Premises occupied by the Group are weighted at 100%

j. Underwriting of non-trading book items

Where the Group has acquired assets on its balance sheet in the banking book which it is intending to place with third parties under a formal arrangement and is underwriting the placement, the following risk weightings apply during the underwriting period (which may not last for more than 90 days). Once the underwriting period has expired, the usual risk weights should apply.

(a) For holdings of private equity, a risk weighting of 100% applies instead of the usual 150%.
(b) For holdings of Real Estate, a risk weight of 100% applies instead of the usual 200% risk weight.

k. Other assets

These are risk weighted at 100%.

Table 5.1 Funded and Unfunded Exposures

BD '000s	Gross Credit Exposure	Average Gross Credit Exposure	Funded Exposure	Unfunded Exposure (after CCF)	Cash Collateral	Eligible Guarantees	Eligible CRM	Risk-Weighted Assets (RWA)	RWA for CAR	Min. Capital Charge
Cash	3,538	7,155	3,538	-	-	-	-	-	-	-
Claims on sovereigns	172,539	169,437	172,539	-	-	243	-	-	-	-
Claims on public sector entities	4,901	4,901	4,901	-	-	-	-	980	980	118
Claims on banks	163,069	148,109	163,069	-	-	300	-	45,771	44,193	5,303
Claims on corporate portfolio	123,378	129,495	106,562	16,816	22,404	-	24,514	74,427	74,427	8,931
Claims on regulatory retail portfolio	462	448	462	-	-	-	-	347	347	42
Mortgages	68,916	57,495	68,916	-	-	-	28,079	39,432	39,432	4,732
Past due receivables over 90 days	22,889	16,103	22,889	-	2,000	-	5,512	26,020	26,020	3,122
Investments in Securities and Sukuk	43,143	53,309	43,143	-	-	-	-	64,430	64,430	7,732
Holding of Real Estate	119,345	110,524	119,345	-	-	-	-	238,690	238,690	28,643
Other assets and Specialized financing	64,583	83,794	64,340	243	116	-	112	66,870	66,870	8,024
	786,763	**780,770**	**769,704**	**17,059**	**24,520**	**543**	**58,217**	**556,967**	**555,389**	**66,647**

* The amounts in the above table are based on the exposures as reported in the prudential returns.

5.1 Credit risk (continued)

Following is the Gross credit exposure by Islamic financing contracts which represents the exposure on accounts receivable and lease payments receivable which are collateralized by cash or eligible guarantee: (PD 1.3.25 b, c)

Table 5.2 Portfolio by Islamic financing contract **BD '000s**

	Gross Credit Exposure	Average Credit Exposure	Funded Exposure	Unfunded Exposure (after CCF)	Cash Collateral	Eligible Guarantees	Eligible CRM	Risk-Weighted Assets	RWA for CAR	Capital Charge
Central Bank of Bahrain Sukuk	32,995	32,855	32,995	-	-	-	-	-	-	-
Murabaha and Mudaraba with banks	149,386	123,084	149,386	-	-	-	-	43,197	41,489	4,979
Murabaha financing	88,463	103,173	88,463	-	4,000	300	3,675	56,600	56,600	6,792
Ijarah Muntahia Bittamleek	47,571	41,665	47,571	-	-	243	31,617	11,181	11,181	1,341
Musharaka Financing	5,733	5,733	5,733	-	-	-	5,234	499	499	60
Total	**324,148**	**306,510**	**324,148**	**-**	**4,000**	**543**	**40,526**	**111,477**	**109,769**	**13,172**

5.1 Credit risk (continued)

Excessive risk concentration (PD 1.3.26 a)

Concentrations 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 indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

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

Credit risk concentrations and thresholds

The first level of protection against undue credit risk is through country, industry and threshold limits, together with customer and customer group credit limits, set by the Risk Committee. Credit exposure to individual customers or customer groups is then controlled through a tiered hierarchy of delegated approval authorities based on the risk rating of the customer under the Group's internal credit rating system. Where unsecured facilities sought are considered to be beyond prudential limits, Group policies require collateral to mitigate the credit risk in the form of cash, securities, and legal charges over the customer's assets or third-party guarantees. The Group also employs Risk Adjusted Return on Capital (RAROC) as a measure to evaluate the risk/reward relationship at the transaction approval stage. RAROC analysis is also conducted on a portfolio basis, aggregated for each business segment, business unit and for the whole group.

Single name concentrations are monitored on an individual basis. Under the CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's approval for any planned exposure to a single counterparty, or group of connected counterparties exceeding 15 percent of the regulatory capital base.

As at 31 December 2009, the Group's exposures in excess of 15% of the obligor limits to individual counterparties, and excluding Central Bank exposures was Nil. The obligor limits referred to herein reflect the eligible capital base as per CBB rules and regulations. (PD 1.3.23 f)

Table 5.3 (PD 1.3.23 b) **BD '000s**

	Financed by Equity and Current Account		Financed by Unrestricted Investment Account Holders		Total Exposure
	On Balance Sheet Exposure	**Off Balance Sheet Exposure**	**On Balance Sheet Exposure**	**Off Balance Sheet Exposure**	
Counterparty A	-	-	-	-	-
Counterparty B	-	-	-	-	-
Total	**-**	-	-	-	**-**

Risk mitigation, collateral and other credit enhancements

The amount and type of collateral depends on an assessment of the credit risk of the counterparty. The types of collateral mainly include cash, lien on property and guarantees from banks. With the exception of cash, the Group monitors the concentration of its credit risk mitigants in order to minimize exposure to one type of collaterals. As on 31 December 2009, the collaterals (before applying regulatory haircuts) amounted to BD 324 million. (PD 1.3.25 a)

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses with respect to Murabaha and Ijara facilities. The Group also makes use of master netting agreements with counterparties where relevant. (PD 1.3.25 a)

The main types of guarantors include rated banks & other financial institutions and Sovereigns which are rated by ECAI's along with personal guarantees of the Board of Directors/ key management personnel of the borrower and other high net worth individuals.

The Group obtains additional collateral as and when the value of the collateral originally obtained is assessed at lower than the minimum acceptable LTV ratio of collateral. Also where the customer is not in a position to provide additional collateral the Group, in consultation with its legal department evaluates the available legal and contractual options.

The Group ensures that at the inception of the facility, third party valuation of the tangible collaterals is obtained and performs an annual review of the facility whereby the revised collateral valuation is obtained from the third party. In line with the Basel II Pillar II regulations, the Group performs monthly collateral value stress tests to evaluate the effect of devaluations on their collateral portfolio. The devaluation parameters differ depending on the collateral type.

In case of default, the Group will work with the counterparty to discuss how the outstanding facility can be settled. As a last resort, the counterparty's assets will be used to settle the outstanding obligation.

5.1.1 Geographical distribution of exposures

The exposures are allocated to individual geographic areas based on the country where the exposure risk specific to the facility exists. The Geographical distribution of exposures by exposure type and funded or unfunded by is as follows:

Table 5.4 (PD 1.3.23 b) **BD '000s**

Contribution by Equity and Current Account							
Exposure type	**GCC countries**	**Arab World**	**Europe**	**Asia**	**America**	**Others**	**Total**
Cash and balances with Central Bank of Bahrain	122,621	-	2,203	20	1,895	-	126,739
Central Bank of Bahrain Sukuk	32,908	-	-	-	-	-	32,908
Murabaha and Mudaraba with banks	139,895	-	-	-	-	-	139,895
Corporate Sukuk	16,950	-	-	-	-	-	16,950
Murabaha financing	87,273	-	-	-	-	-	87,273
Ijarah Muntahia Bittamleek	46,315	-	-	-	-	-	46,315
Musharaka	5,384	-	-	-	-	-	5,384
Assets under conversion	75,437	3	17,136	2,909	380	2,440	98,305
Non-trading investments	152,929	1,904	3,110	24,157	-	2,580	184,680
Investment in an associate	-	7,659	-	-	-	-	7,659
Investment properties	1,178	-	-	-	-	-	1,178
Receivables and prepayments	26,244	-	638	20	-	-	26,902
Premises and equipment	2,337	-	-	-	-	-	2,337
Total funded exposures	**709,471**	**9,566**	**23,087**	**27,106**	**2,275**	**5,020**	**776,525**
Commitments	32,550	-	48	12,347	-	3,545	48,490
Total unfunded exposures	**32,550**	**-**	**48**	**12,347**	**-**	**3,545**	**48,490**
TOTAL	**742,021**	**9,566**	**23,135**	**39,453**	**2,275**	**8,565**	**825,015**

The Geographical distribution of exposures by exposure type and funded or unfunded by is as follows:

Table 5.5 (PD 1.3.23 b) **BD '000s**

Contribution by Unrestricted Investment Account Holders							
Exposure Type	**GCC Countries**	**Arab World**	**Europe**	**Asia**	**America**	**Others**	**Total**
Cash and balances with Central Bank of Bahrain	-	-	-	-	-	-	-
Central Bank of Bahrain Sukuk	-	-	-	-	-	-	-
Murabaha and Mudaraba with banks	9,409	-	-	-	-	-	9,409
Corporate Sukuk	-	-	-	-	-	-	-
Murabaha financing	-	-	-	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	-
Assets under conversion	-	-	-	-	-	-	-
Non-trading investments	-	-	-	-	-	-	-
Investment in an associate	-	-	-	-	-	-	-
Investment properties	-	-	-	-	-	-	-
Receivables and prepayments	-	-	-	-	-	-	-
Premises and equipment	-	-	-	-	-	-	-
Investments held-for-sale	-	-	-	-	-	-	-
Total funded exposures	**9,409**	**-**	**-**	**-**	**-**	**-**	**9,409**
Commitments	-	-	-	-	-	-	-
Total unfunded exposures	**-**	-	-	-	-	-	**-**
TOTAL	**9,409**	**-**	**-**	**-**	**-**	**-**	**9,409**

5.1.1 Geographical distribution of exposures (continued)

The Group has a few past due Islamic financing contracts that have not been settled as of 31December 2009. All past due but not impaired Murabaha and Ijara financing are covered by sufficient collaterals that include cash, personal and sovereign guarantees. However, no provisions need to be taken in lieu of the past due contracts due to their recoverability. Thus, no collective or specific impairment provision has been created as on 31 December 2009. (PD 1.3.23 h, i)

Table 5.6 The geographical distribution of exposures including impaired assets and the related impairment provisions (PD 1.3.23 i)

BD '000s

Contribution by Equity and Current Account					
	Gross funded credit Exposure	Past Due Islamic Financing Contracts (funded)	Specific Provision Impaired Islamic Financing Contracts	Impaired Islamic Financing Contracts	Specific Provision Impaired Investments
GCC Countries	709,472	20,036	-	-	-
Arab World	9,566	-	-	-	-
Europe	23,087	-	-	-	-
Asia	27,106	-	-	-	-
America	2,275	-	-	-	-
Other	5,019	-	-	-	-
Total	**776,525**	**20,036**	**-**	**-**	**-**

Table 5.7 **BD'000s**

Contribution by Unrestricted Investment Account Holders					
	Gross Credit Exposure	Impaired Islamic Financing Contracts	Specific Provision Impaired Islamic Financing Contracts	Impaired Investments	Specific Provision Impaired Investments
GCC Countries	9,409	-	-	-	-
Arab World	-	-	-	-	-
Europe	-	-	-	-	-
Asia	-	-	-	-	-
America	-	-	-	-	-
Other	-	-	-	-	-
Total	**9,409**	**-**	**-**	**-**	**-**

5.1.2 Exposure by Industry

Table 5.8 Exposure by type of credit exposure (PD 1.3.23 c) **BD '000s**

Contribution by Equity and Current Account							
Exposure Type	**Trading & Manufacturing**	**Banks & Financial Institutions**	**Real Estate**	**Aviation**	**Individuals**	**Others**	**Total**
Cash & balances with the CBB	-	65,937	-	-	-	60,802*	126,739
CBB Sukuk	-	-	-	-	-	32,908*	32,908
Murabaha & Mudaraba with banks	-	127,193	-	-	-	12,702	139,895
Corporate Sukuk	-	-	-	3,722	-	13,228	16,950
Murabaha financing	827	9,424	24,731	-	21,847	30,444	87,273
Ijarah Muntahia Bittamleek	737	-	8,981	3,596	15,773	17,229	46,316
Musharaka financing	-	-	5,234	-	150	-	5,384
Assets under conversion	8,838	35,076	18,122	-	7,597	28,328	97,961
Non-trading investments	-	-	128,624	3,042	-	53,013	184,679
Investment in an associate	-	7,659	-	-	-	-	7,659
Investment properties	-	-	1,178	-	-	-	1,178
Receivables and prepayments	17	2,472	1,212	13	402	23,671	27,787
Premises & equipment	-	-	-	-	-	1,796	1,796
Total funded	**10,419**	**247,761**	**188,082**	**10,373**	**45,769**	**274,121**	**776,525**
Commitments	16,627	344	23,332	-	1,726	6,461	48,490
Total unfunded	**16,627**	**344**	**23,332**	**-**	**1,726**	**6,461**	**48,490**
Total exposure	**27,046**	**248,105**	**211,414**	**10,373**	**47,495**	**280,582**	**825,015**

* Exposures with the Central Bank of Bahrain.

Table 5.9 Exposure by type of credit exposure (PD 1.3.23 c) **BD '000s**

Contribution by Unrestricted Investment Account Holders							
Exposure Type	**Trading & Manufacturing**	**Banks & Financial Institutions**	**Real Estate**	**Aviation**	**Individuals**	**Others**	**Total**
Cash & balances with the CBB	-	-	-	-	-	-	-
-CBB Sukuk	-	-	-	-	-	-	-
Corporate Sukuk	-	-	-	-	-	-	-
Murabaha & Mudaraba with banks	-	9,409	-	-	-	-	9,409
Murabaha financing	-	-	-	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	-
Assets under conversion	-	-	-	-	-	-	-
Non-trading investments	-	-	-	-	-	-	-
Investment in an associate	-	-	-	-	-	-	-
Investment properties	-	-	-	-	-	-	-
Receivables and prepayments	-	-	-	-	-	-	-
Premises & equipment	-	-	-	-	-	-	-
Investment held-for-sale	-	-	-	-	-	-	-
Total funded	-	**-**	-	-	-	-	-
	-	**9,409**	**-**	**-**	**-**	**-**	**9,409**
Undrawn commitments	-	-	-	-	-	-	-
Total unfunded	-	-	-	-	--	-	-
Total exposure	**-**	**9,409**	**-**	**-**	**-**	**-**	**9,409**

Table 5.10 The exposure by industry including impaired assets and the related impairment is as follows:

BD '000s

Contribution by Equity and Current Account							
	Gross Exposure	**Funded Exposure**	**Unfunded Exposure**	**Impaired Islamic Financing Contracts**	**Impaired Securities**	**Specific Provision Islamic Financing Contracts**	**Specific Provision Securities**
Trading and manufacturing	27,046	10,419	16,627	-	-	-	-
Banks and financial institutions	248,105	247,761	344	-	-	-	-
Real estate	211,414	188,082	23,332	-	-	-	-
Aviation	10,373	10,373	-	-	-	-	-
Individuals	47,495	45,769	1,726	-	-	-	-
Others	280,582	274,121	6,461	-	-	-	-
Total	**825,015**	**776,525**	**48,490**	**-**	**-**	**-**	**-**

Table 5.11 The exposure by industry including impaired assets and the related impairment is as follows: **BD '000s**

Contribution by Unrestricted Investment Account Holders							
	Gross Exposure	**Funded Exposure**	**Unfunded Exposure**	**Impaired Islamic Financing Contracts**	**Impaired Securities**	**Specific Provision Islamic Financing Contracts**	**Specific Provision Securities**
Trading and manufacturing	-	-	-	-	-	-	-
Banks and financial institutions	9,409	-	-	-	-	-	-
Real estate	-	-	-	-	-	-	-
Aviation	-	-	-	-	-	-	-
Individuals	-	-	-	-	-	-	-
Others	-	-	-	-	-	-	-
Total	**9,409**	**-**	**-**	**-**	**-**	**-**	**-**

5.1.3 Exposure by external credit rating

The Group uses external ratings from Standard & Poor's', Moody's, Fitch ratings, Islamic International Rating Agency and Capital Intelligence (accredited External Credit Assessment Institutions (ECAI's). The Group follows the lowest of the above ECAI's ratings. The breakdown of the Group's exposure into rated and unrated categories is as follows: (PD 1.3.22 c, d, e)

Table 5.12 **BD '000s**

	Gross Credit Exposure	Rated Exposure	Unrated Exposure
Cash	3,538	3,538	-
Claims on sovereigns	172,539	155,518	17,021
Claims on public sector entities	4,901	4,901	-
Claims on multilateral development banks	-	-	-
Claims on banks	163,069	113,595	49,474
Claims on corporate portfolio	123,378	-	123,378
Regulatory retail exposure	462	-	462
Past due exposures	22,889	-	22,889
Mortgages	68,916	-	68,916
Investments in Securities and Sukuk	43,143	43,143	-
Holding of Real Estate	119,345	-	119,345
Other exposures	64,583	-	64,583
Total	**786,763**	**320,695**	**466,068**

5.1.3 Exposure by external credit rating (continued)

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio through internal risk rating system. As such, the Group is in the process of introducing risk ratings that are supported by a variety of financial analytics, combined with processed market information, to provide the main inputs for the measurement of counterparty credit risk. All internal ratings are tailored to the various categories and are derived in accordance with the Group's credit policy, are assessed and updated regularly. Each risk rating class is mapped to grades equivalent to Standard & Poor's', Moody's, Fitch ratings and Capital Intelligence rating agencies. (PD 1.3.22 e)

5.1.4 Maturity analysis of funded exposures

Table 5.13 Residual contractual maturity of the Group's major types of funded credit exposures are as follows: (PD 1.3.23 g) (PD 1.3.24 a)

BD '000s

	within 1 month	1 - 3 months	3 - 6 months	6 - 12 months	Total within 12 months	1 – 5 years	5-10 years	10 - 20 years	Over 20 years	Total over 12 months	Total
Cash	3,538	-	-	-	**3,538**	-	-	-	-	**-**	**3,538**
Claims on sovereigns	121,671	307	532	43,136	**165,646**	4,336	2,557	-	-	**6,893**	**172,539**
Claims on banks	158,593	2,591	-	-	**161,184**	1,885	-	-	-	**1,885**	**163,069**
Claims on public sector entities	4,853	48	-	-	**4,901**	-	-	-	-	**-**	**4,901**
Claims on corporate portfolio	1,372	3,484	9,384	7,796	**22,036**	84,449	77	-	-	**84,526**	**106,562**
Regulatory retail exposures	78	29	59	118	**284**	158	20	-	-	**178**	**462**
Past due exposures	11,269	-	-	-	**11,269**	-	-	-	11,620	**11,620**	**22,889**
Mortgages portfolio	5,294	6,231	3,114	4,645	**19,284**	45,237	3,937	458	-	**49,632**	**68,916**
Equity Portfolios	186	-	-	1,988	**2,174**	141,782	1,178	-	-	**142,960**	**145,134**
Other exposures	29,106	14,774	128	1,315	**45,323**	35,830	541	-	-	**36,371**	**81,694**
Total	**335,960**	**27,464**	**13,217**	**58,998**	**435,639**	**313,677**	**8,310**	**458**	**11,620**	**334,065**	**769,704**

* The amounts in the above table are based on the exposures as reported in the prudential returns.

5.1.5 Maturity analysis of unfunded exposures

Table 5.14 The residual contractual maturity analysis of unfunded exposures is as follows: **BD '000s**

	within 1 month	1 - 3 months	3 - 6 months	6 – 12 months	Total within 12 months	1 – 5 years	5-10 years	10 - 20 years	Over 20 years	Total over 12 months	Total
Claims on sovereigns	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Claims on public sector entities	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Claims on banks	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Claims on corporate portfolio	22,889	176	1,068	1,134	**25,267**	-	-	-	-	**-**	**25,267**
Regulatory retail exposures	-	-	-	-	-	-	-	-	-	**-**	**-**
Mortgages Portfolio	-	-	-	1,105	**1,105**	4,097	-	-	-	**4,097**	**5,202**
Other Exposures	10,341	-	1,049	4,410	**15,800**	2,221	-	-	-	**2,221**	**18,021**
Total	**33,230**	**176**	**2,117**	**6,649**	**42,172**	**6,318**	-	-	-	**6,318**	**48,490**

Unfunded exposures are divided into the following exposure types in accordance with the calculation of credit risk weighted assets in the CBB's Basel II capital adequacy framework:

Credit-related contingent items: Credit-related contingent items comprise undrawn contracted financing commitments and operating lease commitments etc as detailed below:

Undrawn amount on Islamic financing contracts, operating lease commitments and other commitments represent commitments that have not been drawn down or utilized at the reporting date and are due to be paid from the future use of the resources respectively. The nominal amount provides the calculation base to which a CCF is applied for calculating the exposure. CCF ranges between 20% and 50% for commitments with original maturity of up to one year and over one year respectively & 0% CCF is applicable for commitments which can be unconditionally cancelled at any time.

The table below summarizes the notional principal amounts and the relative exposure before applying credit risk mitigation:

Table 5.15 **BD '000s**

	Notional Principal	Credit Exposure*
Credit related to contingent items	21,161	13,603
Operating lease commitments	750	0
Undrawn Islamic financing contracts commitments and other commitments	26,579	3,456
RWA	**48,490**	**17,059**

* Credit exposure is after applying CCF.

At 31 December 2009, the Bank held eligible cash collaterals in relation to credit-related contingent items amounting to BD 13,261k.

Table 5.16 Residual maturity analysis by major type of credit exposure **BD '000s**

Funded	**within 1 months**	**1 - 3 months**	**3 - 6 months**	**6 - 12 months**	**Total within 12 months**	**1 – 5 years**	**5-10 years**	**10 - 20 years**	**Over 20 years**	**Total over 12 months**	**Total**
Cash and balances with Central Bank of Bahrain	109,372	0	0	0	**109,372**	17,367	0	0	0	**17,367**	**126,739**
Central Bank of Bahrain Sukuk	0	0	32,908	0	**32,908**	0	0	0	0	**0**	**32,908**
Murabaha receivables from banks	146,716	2,588	0	0	**149,304**	0	0	0	0		**149,304**
Corporate Sukuk	0	0	0	0	**0**	16,949	0	0	0	**16,949**	**16,949**
Murabaha and Mudaraba receivables	18,287	1,810	1,816	12,849	**34,762**	52,512	0	0	0	**52,512**	**87,274**
Ijarah Muntahia Bittamleek	1,549	5,513	2,835	7,286	**17,183**	22,179	6,421	531	0	**29,131**	**46,314**
Musharaka	1	4	5	11	**21**	5,363	0	0	0	**5,363**	**5,384**
Assets under conversion		30,901		17,156	**48,057**	50,248				**50,248**	**98,305**
Non-trading investments	0	0	0	0	**0**	184,680	0	0	0	**184,680**	**184,680**
Investment in an associate	0	0	0	0	**0**	7,659	0	0	0	**7,659**	**7,659**
Investment properties	0	0	0	0	**0**	0	1,178	0	0	**1,178**	**1,178**
Receivables and prepayments	22,846	2,388	1,126	4	**26,364**	539	0	0	0	**539**	**26,903**
Premises and equipment	0	0	0	0	**0**	2,337	0	0	0	**2,337**	**2,337**
Total	**298,771**	**43,204**	**38,690**	**37,306**	**417,971**	**359,833**	**7,599**	**531**	**0**	**367,963**	**785,934**

Table 5.16 Residual maturity analysis by major type of credit exposure

Unfunded	**within 1 months**	**1 - 3 months**	**3 - 6 months**	**6 - 12 months**	**Total within 12 months**	**1 – 5 years**	**5-10 years**	**10 - 20 years**	**Over 20 years**	**Total over 12 months**	**Total**
Cash and balances with Central Bank of Bahrain	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Central Bank of Bahrain Sukuk	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Murabaha receivables from banks	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Murabaha and Mudaraba receivables	1,303	-	1,818	784	**3,905**	2,500	-	-	-	**2,500**	**6,405**
Ijarah Muntahia Bittamleek	56	-	-	1,029	**1,085**	501	-	-	-	**501**	**1,586**
Musharaka financing		-	-			1,096				**1,096**	**1,096**
Assets under conversion	21,586	176		572	**22,334**	25	-	-	-	**25**	**22,359**
Non-trading investments	10,220	-	-	3,545	**13,765**	-	-	-	-	**-**	**13,765**
Investment in an associate	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Investment property	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Receivables and prepayments	65		300	718	**1,083**	2,196				**2,196**	**3,279**
Premises and equipment	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Assets held-for-sale	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Total	**33,230**	**176**	**2,118**	**6,648**	**42,172**	**6,318**	**-**	**-**	**-**	**6,318**	**48,490**

Table 5.17 Residual maturity analysis by major type of funding (expected maturity profile) **BD '000s**

	within 1 months	1 - 3 months	3 - 6 months	6 - 12 months	Total within 12 months	1 – 5 years	5-10 years	10 - 20 years	Over 20 years	Total over 12 months	Total
Murabaha and Wakala payables to banks	-	-	-	-	-	89,398	-	-	-	89,398	89,398
Wakala from Non-Banks	-	-	8,618	39,264	47,882	269,487	-	-	-	269,487	317,369
Customers' Current account	32,700	-	-	-	32,700	-	-	-	-	-	32,700
Liabilities under conversion	-	87,810	-	14,120	101,930	18,472	-	-	-	18,472	120,402
Unrestricted Investment accounts	-	-	-	-	-	9,409	-	-	-	9,409	9,409
Other liabilities	10,056	3,457	178	919	14,610	267	-	-	-	267	14,877
Total	**42,756**	**91,267**	**8,796**	**54,303**	**197,122**	**387,033**	-	-	-	**387,033**	**584,155**

For maturity profile of the Group's financial liabilities at 31 December 2009 based on contractual undiscounted repayment obligation, please refer Note 22 "Liquidity Risk" of consolidated financial statements of the Group for the year ended 31 December 2009.

5.2 Market risk

Market risk arises from fluctuations in global yields on financial instruments and foreign exchange rates that could have an indirect effect on the Group's assets value and equity prices. The Board has set limits on the risk that may be accepted. This is monitored on a regular basis by the Group's Asset and Liability Committee. (PD 1.3.27 a)

Table 5.18 The Group's capital charge in respect of market risk in accordance with the standardized methodology is as follows: (PD1.3.18) (PD 1.3.27 b)

BD '000s

	RWA	Year End Capital Charge	Capital Charge – Minimum*	Capital Charge – Maximum*
Equity position risk	-	-	-	-
Sukuk risk	-	-	-	-
Foreign exchange risk	2,950	236	109	236
Options risk	-	-	-	-
Total market risk	**2,950**	**236**	**109**	**236**

Foreign exchange positions constitute a major component of the market risk capital charge. The Group maintains a conservative market risk exposure that is focused on the foreign exchange risk coming from the Group's banking book open positions. The open positions were taken in order of running the Group's day to day operations that include private equity funding for the Group's investment portfolio. The Group monitors these open positions on a daily basis through the automated system reports. (PD 1.3.27 a)

* The information in these columns shows the minimum and maximum capital charge of each of the market risk categories on a day during the year ended 31 December 2009.

5.3 Operational risk

(PD 1.3.21 c)
Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes or systems, or from external events. Operational risk is inherent in all business activities and can never be eliminated entirely; however shareholder value can be preserved and enhanced by managing, mitigating and, in some cases, insuring against operational risk. To achieve this goal, the Group has developed an operational risk framework which encompasses identification, measurement, management and monitoring of risk through risk control or mitigation. A variety of underlying processes are being deployed across the Group including risk and control self-assessments, Key Risk Indicators (KRI), event management, new product review and approval processes and business contingency plans.

The Group policy dictates that the operational functions of booking, recording and monitoring of transactions are carried out by staff that are independent of the individuals initiating the transactions. Each business line - including Operations, Information Technology, Human Resources, Legal & Compliance and Financial Control - is further responsible for employing the aforementioned framework processes and control programs to manage its operational risk within the guidelines established by the policy, and to develop internal procedures that comply with these policies. To ensure that all operational risks to which the Group is exposed to are adequately managed, support functions are also involved in the identification, measurement, management, monitoring and control/mitigation of operational risk, as appropriate. (PD 1.3.28) (PD 1.3.29)

Consistent with the fundamental principle of ownership, the relevant business units are accountable and responsible for managing the operational risks relevant to their respective businesses. Consequently, business and support units have documented procedures and controls in place along with departmental instruction manuals. All changes to all such procedures are subject to sign off by the Board of Directors, Risk Management and Compliance Group and Internal Audit and agreed by all respective business units. (PD 1.3.28) (PD 1.3.29)

The Group has a well established disaster recovery program, and has documented updated procedures covering all activities necessary for business continuity in case of an eventuality. Internal Audit also provides an independent assessment to evaluate the program’s effectiveness.

Due to their independence from the business units within the Group, the Internal Audit Department have a well drafted audit program to periodically review all business areas, and communicate all exceptions and control lapses, if any, to the business unit’s head. In turn, the business unit’s head will amend the policies and procedures to cover the gaps identified in the audit report. In line with best practices, the Internal Audit function reports directly to the Audit Committee.

In accordance with the basic indicator approach methodology of Basel II, the total minimum capital charge in respect of operational risk was BD 8.3 million. This capital charge was computed by categorizing the Group’s activities into its specific business lines (as defined by the Basel II framework) and multiplying the business line's average gross income for the last three financial years by a pre-defined beta factor. (PD 1.3.19)

5.3 Operational risk (continued)

Table 5.19 **BD '000s**

	2009 (consolidated)	2008	2007
Gross income	26,936	38,294	21,163
Number of years with positive gross income	3	3	2
Average	36,695	21,552	13,181

The Group uses the Temenos T24 core system developed by Globus, for consolidating all reporting and analysis of events and data related to credit, market and operational risk assessment which is an integral part of the Group's Risk Management Framework. The Group is also working on implementing the Fermat integrated risk solution package that would allow for automated capital adequacy calculations, asset liability management and exposure analysis. (PD 1.3.30 a, b)

5.4 Rate of return risk

(PD 1.3.21 e)
Rate of return risk arises from the possibility that changes in return rates will affect future profitability or the fair values of financial instruments. The Group is exposed to rate of return risk as a result of mismatches of return rate re-pricing of assets and liabilities. In addition, rate of return risk can also affect the Group through market wide rate changes that are brought on by changes in the economy. The effect of the market rates is reflected and can be seen in the Group's pricing of contracts as they carry competitive pricing that follows the market. When risks are high, the market tends to place a higher rate of return to maintain the risk/ return profile. Accordingly, the market reduces the rate of return when it identifies a decrease in the market wide risk that would be reflected by banks decreasing their rate of return pricing.

This risk is minimized as the Group's rate sensitive assets and liabilities are mostly for short tenures. In addition, the Group's cautious asset liability strategy avoids funding short term lending facilities from long term borrowings. The Group has set limits for profit return risk and these are monitored on an ongoing basis by the Group's Asset and Liability Committee (ALCO).

The Group has implemented a system to automate the process of monitoring, measuring and reporting profit rate risk on a daily basis through the use of gap analysis based on repricing buckets. Any fixed rate assets and liabilities will be repriced at their maturity date. In addition, the system generates stress tests to analyze the effect of shock changes in profit rates on the Group's assets and liabilities. This monitoring process is independently run on a daily basis from within the Risk Management & Compliance Group. Material rate of return risks are identified and mitigated through the coordinate of the Market Risk Department and ALCO.

The below table provides a summary of the Group's profit rate of return sensitivity position based on the contractual re-pricing or maturity dates, whichever is earlier for the year ended 31 December 2009.

Table 5.20

Profit rate risk in the Banking Book			
200bp Profit Rate shocks			
Rate shock	**Currency**	**Effect on net profit 2009 (in BD '000)**	**Effect on net profit 2008 (in BD '000)**
Upward rate shocks:	US$	1,437	4,049
	BHD	2,752	13,248
Downward rate shocks:	US$	(1,437)	(4,049)
	BHD	(2,752)	(13,248)

5.5 Equity position risk

(PD 1.3.21 d) (PD 1.3.31)
Equity position risk arises from the possibility of changes in the price of equities or equity indices will affect future profitability or the fair values of financial instruments. The Group is exposed to equity risk in the non-trading position and investment portfolio primarily in its core international and GCC markets.

Equity risk in the banking book is effectively managed by the active involvement of the Executive and Investment committees; adhering to the policies and procedures in place; involvement of competent professionals; adequate internal control environment and independent internal audit department.

Executive and Investment Committee oversight

The Board's involvement begins with the approval of the Investment Policy which essentially determines the following: aggregate portfolio parameters, asset class restrictions, approval authorities, risk tolerance, maturity considerations, exit strategy and governance issues.

The Executive Committee has delegated authority within the overall Board authority. It provides direction to the Executive Management on all business matters and assumes the role of the Board to address matters arising between Board meetings. The Committee is responsible for business matters concerning credit and market risks, strategy review and recommendation to the Board. The Investment Committee reviews and approves all transactions related to corporate and real estate investments and monitoring their performance on an ongoing basis. In addition, the Committee is responsible to oversee the performance of the fund managers and recommend exit strategies to maximize return to its investors.

The objectives are defined in terms of risks, returns & time horizon. When approved by the Board, the Investment Policy for the Group will outline the permissible investments, asset classes, limits on asset classes & lines of authority for approvals. The policy will allow the Group to deploy the Investment Committee's strategy as per the Board approved structure. The policy is to be reviewed on a yearly basis for comparison to the prevailing economic climate and expectations for the medium to long term. The Investment Committee maintains regular oversight over the investment portfolio.

Policies & procedures

Investment Policies, as approved by the Board, are documented and communicated to the appropriate personnel. Senior management reviews and ensures the existence of adequate policies, procedures and management information systems for managing equity investment activities on regular and long term basis. Through their qualified professionals, the Investments Department is responsible for measuring, monitoring, controlling and reporting on the equity risks with respect to investments to both the Senior Management and the Investment Committee. In addition to the aforesaid policies, the Investment Procedure Manual documents the processes and procedures for all investment actions. Investment Department Responsibilities include initial due diligence of investments, periodic review of holdings, investment valuation and realization of returns. All equity investments are reviewed for their suitability in the portfolio in light of the portfolio objectives, policy allocations and risk limits defined by the Board. All of the investment portfolio is subject to independent third party valuations that are conducted periodically.

Internal Controls

With regard to internal controls, the investment activity is subject to the same rigorous checks and balances in place for the commercial banking activity. Adequacy of internal controls is ensured by the recruitment of adequate qualified professionals, proper definition and communication of departmental and personnel roles, separation of responsibilities of origination and implementation, independent reporting by the Financial Controls Department, periodic internal audit of the existence and implementation of processes and controls. All recommendations of the Investment Department are documented in the form of an Investment Portfolio Reports and Investment Memorandums and are subject to independent risk review by Risk Management. Responsibility for all deployments and receipt of redemption proceeds vests with the Investment Administration Department. The Investment Department ensures transparency in valuation by sourcing pricing from the available sources and using conservative valuation principles in accordance with international accounting standards. In addition, the Investment Middle Office operates as an independent department that is responsible for undergoing the due diligence for investments proposed by the Investments Department. This way, the Investment Department can specialize in sourcing deals and performing the initial analysis, whereas the Investment Middle Office will focus on preparing the detailed due diligence analysis at the start of an investment. The Investment Middle Office will also be able to perform the investment management duties of monitoring the investment company and preparing performance reports along with other required documentation. This set up helps streamline processes as each group will focus on a specific set of duties that result in time savings as well as having independence controls.

Table 5.21 Equity positions in the Banking Book **BD '000s**

Quoted Equities	4,342
Unquoted Equities	180,337
	184,679
Profit earned for URIA before smoothing	338
Realized gains (losses) during the year	11,781
Unrealized gains (losses) during the year	5,772

The Group's equity positions strategy consists of investments that are expected to bring in capital gains or for strategic reasons. The strategy has been drafted after considering the Board's risk appetite and the Board approved liquidity, market risk and capital management policies. In line with the Board approved policies, the investment strategy is conservative in the sense that it avoids investments with high volatility returns.

5.6 Displaced commercial risk

(PD 1.3.41) (PD 1.3.21 f)
The Bank is exposed to displaced commercial risk in the event of having unrestricted investment accounts (URIA) profit rates that are lower than market rates, thus putting the Bank in risk of paying URIA account holders from shareholder funds to cover the profit volatility risk. ASBB has mitigated this risk through the set up of an investment risk reserve that will be used in case of a drop in URIA profit rates. The reserve is funded from the excess returns during periods of high profit returns in order to normalize profit rate drops that can arise.

5.7 Liquidity risk

(PD 1.3.36)(PD 1.3.37)
The Group monitors on an active manner its liquidity profile through analysis of the liquidity gap across specific timeframes in order to maintain the net asset liability position that is within the Board's risk appetite. The maintenance of the net asset liability position is done through the monitoring of the Bank's liquidity indicators through which the Bank's liquidity profile can be assessed. In addition, ASBB further mitigates its liquidity risk by establishing multiple funding sources to decrease it correlation to an individual funding counterparty. The multiple funding lines can be used to offset any shortage resulting from the Bank's obligations and/ or to settle any shortage from each of the current accounts and unrestricted investment accounts.

6. Unrestricted Investment Accounts

Unrestricted investment accounts ("URIA") are funds of investors held by the Bank which it can invest as it deems appropriate without restriction as to where, how and for what purpose the funds are invested. URIA funds are invested in short term Murabaha with banks using specific limits assigned for each institution. The Mudaraba accounts are payable on demand and the account holder has the right to withdraw or transfer funds without penalty. In general, URIA provides a profit earning investment option for the risk averse account holder.

ASBB provides the unrestricted investment accounts as a service to savings accounts clients. Therefore, it is not the practice of the Bank to guarantee the preservation of capital through the investment risk reserves. As a result, the Bank has no displaced commercial risk. (PD 1.3.32 a, i)

This allocation of assets has not changed since the last financial period. The funds are invested and managed in accordance with Shari'a principles. (PD 1.3.32 b)

Unrestricted investment account holders' funds are commingled with the Bank's funds and invested mostly in short-term highly liquid Commodity Murabahas and/or Wakala deposits. According to the terms of acceptance of the unrestricted investment accounts, 100% of the funds are invested after deducting a mandatory reserve. There were no major movements during the period in the investment risk reserve and the ending balance amounted to BD 7k. In order to avoid excessive risk concentration the Bank invests the commingled funds in such a way so as to comply with the CBB's large exposures limits. All unrestricted investment accounts are classified as Mudarabas where fees are deducted before profit allocation, as they there is no limit against their withdrawal. It should however be noted that Mudaraba account fees are subject to being partially or total waived in order to match investment account holder market returns. (PD 1.3.32 c, j, k)

Profit paid to the URIA holders is based on the rate of return earned by the pool of profit-bearing assets in which the URIA have participated. The account holder participates in 45% of the profits earned in full after netting off the Mudarib fee as above. As a result, the share of profits earned by the URIA holders for their Mudaraba accounts is equal to the share of profits paid to them. All unrestricted investment accounts are carried at cost plus accrued profits less amounts repaid. Income to unrestricted investment account holders is allocated on the basis of their average daily balances in proportion to shareholders' balances. The profits paid to URIA and the rate of return earned over the previous periods are disclosed in the below table. (PD 1.3.32 d, l)

The Risk weighted assets of the Bank include the contribution from URIA which are subject to the 30% risk weight.

The Bank has neither pledged any asset as collateral nor given any clean guarantee to date.

The URIA holders and other customers can use the Bank's relationship managers for any advice, mediation services, grievances and complaints. (PD 1.3.10 j)

There is no variation between Mudarib agreed sharing and contractual agreed ratio. Profit earned and paid and Rate of return comparatives for the Unrestricted Investment Account

Holders for the year ended 31 December 2009 and 31 December 2008 are as follows: (PD 1.3.33 e, l, mn)

Table 6.1 **BD '000s**

Total Mudaraba Profit (URIA)	**2008**	**2009**
Shareholders	4,880	835
IAH (before smoothing)	402	338
Total Profit	**5,282**	**1,173**
Profit earned for URIA before smoothing	402	338
Profit paid for URIA after smoothing	220	155
Balance		
Profit Equalization Reserve (PER)	N/A	N/A
Investment Risk Reserve (IRR)	38	7
Annual Rate of Return Benchmark	4.50%	3%
Annual Rate of Return (URIA)	2.50%	1.25%
PER Amount	N/A	N/A
PER %	N/A	N/A
IRR Amount	38	7
IRR %	-	-
Mudaraba Earned Profit	402	338
Mudarib fees	(215)	(152)
Profit credited to URIA accounts	187	186
IRR movements *	33	(31)
Profit on URIA	220	155
URIA Balance	6,370	9,409
RWA as PIRI Report	1,274	2,440

Table 6.2 **BD '000s**

Balance Sheet Date	Profit Earned and Paid to URIA	Rate of Return
31 December 2008 31 December 2009	**402 profit earned 220 profit paid** **338 profit earned 155 profit paid**	**2.50%** **1.25%**
Return on average assets (ROAA)	**2008:0.07%** **2009:0.05%**	
Return on average equity (ROAE)	**2008:0.25%** **2009:0.18%**	

Table 6.3 Unrestricted Investment Account by Counterparty Type and Islamic Product-Murabaha (PD 1.3.33 i) **BD '000s**

Counterparty	2009	2008	% of URIA to Total
Sovereign	-	-	
Financial Institutions	9,409	6,370	100%
Multi-national Development Bank	-	-	
Investment Firms	-	-	
Corporate	-	-	
Retail	-	-	
Total	**9,409**	**6,370**	

Table 6.4 The changes in asset allocation ratio for URIA in 2009 by the Bank are as follows: (PD 1.3.32 d) **BD '000s**

	Murabaha receivables from banks		**Murabaha and Mudaraba receivables**	
	URIA	Self & Call Accounts	URIA	Self & Call Accounts
Asset Allocation as on 31 December 2009	9,409	139,894	-	87,273
Asset Allocation as on 31 December 2008	6,370	80,797	-	72,483

There are no off balance sheet exposures arising from investment decisions attributable to the URIA holders because the URIA are used for short term Islamic financing contracts.

7. Other disclosures

7.1 Currency risk

The Group's is exposed to foreign exchange rate risk through both its foreign exchange trading and its structural positions. Foreign exchange rate risk is managed by appropriate trading limits and stop loss parameters determined by ALCO and approved by its Board Executive committee. The Group's consolidated structural balance sheet positions are reviewed regularly by ALCO in accordance with the Group's strategic plans and managed on a dynamic basis by the Treasury hedging such exposures, as appropriate.

7.2 Related party transactions

Related parties represent associated companies, major shareholders, directors and key management personnel of the Group and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Group's Senior Management. For further details refer Note 17 titled related party transactions in the consolidated financial statements for 31 December 2009. (PD 1.3.10 e) (PD 1.3.23 d)

7.3 Restructured facilities

During the year, BD of 7,987k financing facilities to individuals and corporate were renegotiated. All renegotiated facilities are performing and are fully secured. In general, facilities are renegotiated to optimize a facility's credit profile with respect to its recoverability. This can involve changing any of the profit rate, tenure or security package. Given that the renegotiated facilities are performing, no provision for impairment is needed. (PD 1.3.23 j)

7.4 Assets sold under recourse agreements

The Group has not entered into any recourse agreement during the year ended 31 December 2009. (PD 1.3.23 k)