AL SALAM BANK-BAHRAIN

BASEL II - PILLAR III DISCLOSURES

31 DECEMBER 2008

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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 for the year ended 31 December 2008. These directives set out enhanced disclosure requirements required under Basel II framework. In accordance with the above requirement, the 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 and 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 Bank 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

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

Key Financial Indicators (PD 1.3.9 a,b,c)

	2008	2007	2006*
Net Operating Income (BD millions)	37.6	32.7	20.4
Net Profit	25.5	23.1	16.4
Return on average equity (%)	15.8	15.6	15.1
Total equity (BD millions)	172.5	159.5	136.5
Earnings per share (fils)	21.3	19.3	15.1
Return on average assets (%)	4.7%	7.9%	11.2%
Total assets (BD ‘million)	554.5	397.8	188.1
Cost to operating income (%)	31.32	33.5	19.63
Dividend payout ratio (%)	46.98	51.84	-
Dividend yield ratio (%)	11.36	4.88	-

Financial Summary

Financial Position *(BD millions)*	**2008**	**2007**	**2006***
Murabaha and Mudaraba with banks	87,167	224,451	105,090
Investment in CBB Sukuk	31,095	20,380	-
Murabaha financing	72,484	32,642	22,963
Ijarah Muntahia Bittamleek	41,531	10,436	10,382
Non-trading investments	116,930	62,736	32,619
Investment in Associate	8,012	8,193	-
Murabaha from banks	32,881	96,983	23,647
Assets held-for-sale	88,934	9,024	-
Murabaha from non-banks	289,005	106,909	-
Customers' current accounts	3,231	5,689	5,674
Unrestricted Investment Account	46,125	19,770	20,112
Capital	**2008**	**2007**	**2006***
Capital adequacy	24.72%	48.7%	79.8%
Equity/total assets	31.11%	40.10%	72.53%
Total deposits/equity (times)	2.2x	1.4x	0.4x
Liquidity and Other	**2008**	**2007**	**2006***
Islamic financing contracts/total assets	41.89%	72.39%	73.61%
Investments/total assets	38.57%	20.10%	19.07%
Liquid assets/total assets	30.79%	60.26%	57.45%
Islamic financing contracts/customer deposits	68.65%	217.51%	536.87%
Number of employees	116	110	58

Financial Performance and position

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

Despite the challenging market environment brought on by the global financial crises ASBB reported a profit of BD 25.5 million ($ 67.7 million) for the year ended 31 December 2008 as compared to BD 23.1 million ($61.3 million) during 2007.

The solid growth in customer deposits led total assets growth to BD 554 million ($1,470 million) from BD 398 million ($1,056 million) in the past year.

The operating income increased to BD 37.6 million ($ 100 million) in 2008 from BD 32.7 million ($ 86.7 million) that was reported in 2007. On the other hand, operating expense amounted to BD 11.8 million ($ 31.3 million) against BD 9.5 million ($ 25.1 million) in 2007 with the cost-to-income ratio for the year reaching 31.3% compared to 28.9% in 2007.

The earnings per share (EPS) grew by over 10% for the year amounting to 21.3 fils compared to 19.3 fils in 2007. A cash dividend of 10% or 10 fils per share of the paid-up capital was approved by the shareholders during the annual general meeting.

ASBB's shareholders' equity totaled BD 172.5 million ($457.6 million) against BD 159.5 million ($ 423 million) at 31 December 2007. The year-end liquidity position and capital adequacy of the Bank remained extremely strong with a liquidity ratio of 40% and a Basel II capital adequacy ratio of 24.7%. The capital adequacy ratio is net of proposed dividends and appropriations.

At 31 December 2008, ASBB maintained liquid funds of over BD 115 million ($ 304 million) with the Central Bank of Bahrain cash balances and reserves amounting to BD 111 ($ 295 million); thereby, cementing ASBB's position as a net lender to the Banking System.

During June 2008, the Bank incorporated two investment offices that relate to the Bank's Investments Department. The offices are not meant to be considered as branches and will act as a catalyst from which ASBB will source and monitor its investments. The details of these two offices are given below:

	Date of Incorporation	**Country of Incorporation**	**Shareholding % of ASBB**
Salam Europe Limited**	6 June 2008	United Kingdom	100
Al Salam Asia-Pacific PTE. Limited***	4 June 2008	Singapore	100

The subsidiaries of the ASBB have 31 December 2008 as their year end.

As on 31 December 2008, the investment offices were under the initial stage of establishment and are yet to commence their operations. As such, there is no impact on the financial performance of the Bank. (PD 1.3.9 c)

3. Corporate Governance and transparency

Board of Directors and its Role ***(PD 1.3.10 a, c)***

The Board is committed to establishing the highest standards in Corporate Governance. To this end, it has established various committees in line with industry best practice and has also directed the Senior Management to establish various management committees with relevant members. The Board Charter imposes the highest level of ethical conduct; doing what it proclaims to be its responsibility; reporting results with accuracy and transparency in a timely manner; and ensuring full compliance with the by-laws, and the rules and regulations that govern the Bank's business. The Board has adopted a Board Policy, which together with the Bank's Memorandum and Articles of Association and the Charters of various Board Committees, provides the authority and practices for governance of the Bank.

The Board provides central leadership to the Bank. It has established and defined the objectives and strategies that direct the ongoing activities of the Bank to enable it to achieve its objectives. The roles and responsibilities of the Board of Directors, their independence, code of conduct and ethics are described in the Board Charter.

Consistent with the industry's best practice, the Board has established three committees with defined roles and responsibilities. The Standing Committees of the Board are the Executive Committee, the Audit Committee and the Remuneration Committee. Please refer to the section titled Board Committees in the annual report.

The Board of Directors is responsible for the Bank’s overall management. In particular, the Board is responsible for approving the Bank’s overall business strategy, monitoring its operations and taking critical business decisions. In line with international best practice, the Board has instituted corporate governance measures to ensure that the interests of the shareholders are protected, including the appointment to the independent non-executive directors in the Board as required by CBB.

The Board of Directors meets regularly (usually four times a year) and has a formal schedule of matters reserved to it, considering key aspects of the Bank’s affairs referred to it for decision. The Board reviews the Bank’s strategy and financial plans, all proposed material changes to the Bank’s policies, structure and organization, reports provided to it on the operations of the Bank (with emphasis on organizational development, risk management and information technology development) and the performance of executive management. The Board and its Committees are supplied with full and timely information to enable them to discharge their responsibilities. All Directors have access to the advice and services of the Secretary, who is responsible for ensuring that the Board procedures and applicable rules and regulations are observed.

The Board of Directors has overall responsibility for the Bank’s system of internal control and its effectiveness. There are established and ongoing procedures in place for identifying, evaluating and managing significant risks faced by the Bank, which are regularly reviewed by the Board. The Bank’s system of internal control provides for a documented and auditable trail of accountability and applies across its operations, is designed to ensure effective and

3. Corporate Governance and transparency (continued)

efficient operation and compliance with all applicable laws and regulations, and seeks to manage risk with a view to avoiding material errors, losses and fraud.

Incentive Structure

The Bank conducts a formal written appraisal for all management and staff at least once a year. Depending on general performance and specific goals achievement, Management and staff may receive an annual performance bonus and/or award a salary increment. The Directors approve the aggregate amount of discretionary bonuses, together with the specific payments made (if any) to the Chief Executive Officer. The Audit Committee approves the bonus payout for Internal Audit personnel.

The Board approves the aggregate amount of planned increments as part of its approval of the annual budget.

The Annual Report offers more details with regards to shareholding pattern of directors, nature and extent of transactions with related parties.

Board and related committees' size, membership and changes in the structure of the committees can be found in the Board/ respective committees' Charter. *(PD 1.3.10 a & 1.3.10 f)*

Details on the structure in terms of Business lines and legal can be found in the annual report section titled Management Review of Operations and Activities. *(PD 1.3.10 a)*

The Bank's Risk Management & Corporate Governance framework is covered under the Risk Management & Compliance as well as the Corporate Governance sections of the annual report. *(PD 1.3.10 a)*

Information about the profession, business title and experience of each Board member as well as the Chairman can be found in the section titled Board Members in the Annual Report. The background, qualification and experience of senior management can be found in the section titled Executive Management in the Annual Report (PD 1.3.10 b)

Descriptive information on the managerial structure, including committees; segregation of duties; reporting lines and responsibilities are shown under section titled Corporate Governance. (PD 1.3.10 c)

Code of Conduct (PD 1.3.10 a & c)

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

***Compliance** (PD 1.3.10 a & c)*

The Bank has comprehensive policies and procedures in place to ensure full compliance with the relevant rules and regulations of the Central Bank of Bahrain and the Bahrain Stock Exchange, including anti-money laundering, prudential and insider trading reporting. Also the Bank is ensuring that the subsidiaries should implement the policies and procedures to ensure compliance to all the above.

***Communications** (PD 1.3.10 a & c)*

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

Communications to the Bahrain Stock Exchange are made through the Bank's Compliance Officer. A summary of the Bank's quarterly and annual financial statements are published in local and regional newspapers. All other external communications are handled by the Communications Officer, under the direction of the Chief Executive Officer.

The Bank maintains a website (www.alsalambahrain.com) which contains the latest Annual Report, together with summary financial data covering the previous three years results. It also contains a profile for ASBB, details of the principal Islamic financing contracts and deposit products and information concerning ASBB's other products and services. The Bank conducts various advertisement campaigns at various national and international levels to bring awareness to the customers about the products available with the Bank. (PD 1.3.10 g, h, i)

***Additional governance controls** (PD 1.3.10 l)*

The Board has approved a number of policies which are communicated to Management and all staff. They cover subjects including anti-money laundering, confidentiality, personal share dealing, ethical behavior, personal conduct, communications, legal issues and human resource issues.

The Shari'a Supervisory Board ensures that the activities and transactions carried out are in compliance with Islamic Shari'a principles and specific Fatwas. The Shari'a Supervisory Board carries out its role by guiding various departments and conducting various meetings to comply with the above. The Shari'a Supervisory Board supervises the internal Shari'a audit of the Bank's transactions that the transactions are executed in compliance with above. The Shari'a Supervisory Board also reviews the financial statements, related notes and disclosures to ensure that they are prepared in compliance with and AAOIFI.

Corporate governance is also supported by ongoing reviews performed by the Internal Audit Department.

Any income classified as non-shari'a compliant income is excluded from the Bank's earnings and is credited to the charity account for use as part of the Bank's social contribution. (PD 1.3.10 m)

***Management Committees** (PD 1.3.10 a, c)*

The Chief Executive Officer is supported by a number of management committees each having a specific mandate to focus on to areas of business, risk and strategy. The various committees and their roles and responsibilities are:

Committees	Responsibility
Credit/ Risk committee (CRC)	Recommending the risk policy and framework to the Board. Its Primary role is the selection and implementation of risk management systems, portfolio monitoring, stress testing, risk reporting to Board, Board Committees, Regulators and Executive Management. In addition to these responsibilities, individual credit transaction approval and monitoring is an integral part of the responsibilities. The Committee is a robust control against possible conflicts of interest due to its voting members coming from business lines as well as support and middle office functions.
Asset liability committee (ALCO)	This Committee's primary responsibility is to review the trading and liquidity policy for the overall management of the balance sheet and its associated risks.
Investment committee	The role of this Committee is to review and approve all transactions related to corporate and real estate investments and monitoring their performance on an ongoing basis. In addition, this Committee is responsible to oversee the performance of the fund managers and recommend exit strategies to maximize return to its investors.
Technology steering Committee (TSC)	ITSC oversees the information technology function of the Bank. It recommends the annual IT budget and plans, drawn up in accordance with the approved strategy for the Bank, to the CEO for submission to the Board of Directors for their approval. It supervises the implementation of the approved IT annual plan within set deadlines and budgetary allocations. The ITSC plays a major role in managing the Bank's information security as well as process execution risks related to its automated systems.

Social contribution (PD 1.3.10 k)

Since its inception, social responsibility formed a priority for ASBB. The Bank adopts a very balanced policy to contribute to the social and economic well-being of the communities in which it operates. The Bank focused on several educational initiatives such as the donation towards the Crown Prince International Scholarship Program.

ASBB has several effective sponsorships and participations in local and international conferences and events such as to the University of Bahrain, Crown Prince International Scholarship Program, and the Royal Charity Organization.

The Bank adopts a policy that supports training and employment. Bahrainis accounted for 86% per cent of all employees at the end of 2008.

During the year, the Bank has allocated part of its profit to aid society and enhance the quality of life for everyone, through its support for charitable, educational, medical, scientific, cultural, social, sporting and environmental organizations.

The total Zakah payable as of 31 December 2008 amounted to BD 1,437,774of which BD 822,525 representing the Zakah on the statutory reserve, general reserve and retained earnings balances for the period from 19 January 2006 to 31 December 2008, is payable by the Bank. The remaining Zakah balance amounting to BD 615,249 or 0.513 fils per share is due and payable by the shareholders. (PD 1.3.10 n)

4. Capital structure

The Bank'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 Bank was BD 120,000 thousand at 31 December 2008, comprising of 1,200,000 thousand shares of BD 0.100 each. (PD 1.3.11)

The Bank's capital base of BD 107,989 thousand comprises Tier 1 capital of BD 107,989 thousand as detailed below: (PD 1.3.11)

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

	Tier 1	Tier 2	Total
Paid-up share capital	120,000		120,000
General reserve	-		-
Legal / statutory reserves	6,514		6,514
Proposed dividend	-		-
Retained earnings	10,525		10,525
Others	921		921
Unrealized gains arising from fair valuing equities (45%)	10,135		10,135
Less:			
Current interim cumulative net loss	-		-
Tier 1 Capital before Prudential consolidation and deduction (PCD) requirements	148,095		148,095
Tier 2 Capital before PCD requirements (2.1 to 2.5 inclusive less 2.6)			
Total available capital	**148,095**		**148,095**
Regulatory deductions:			
Significant minority investments in banking, securities and other financial entities unless pro-rata consolidated	4,006	4,006	8,012
Large exposures	16,047	16,047	32,094
Total Deductions	20,053	20,053	40,106
Net Available Capital	128,042	20,053	107,989
Total Elegible Capital (Tier I + Tier II) (a) (PD 1.3.20 a)	**128,042**		**107,989**

BD '000s

Risk Weighted Assets (RWA)	**Amount**
Credit risk	393,252
Market risk	3,213
Operational risk	40,410
Total Risk Weighted Assets (b)	**436,875**
Capital adequacy ratio (a/b) (PD 1.3.20 a)	
Tier I ratio (PD 1.3.20 a)	**24.72%**
Tier II ratio (PD 1.3.20 a)	-
Total ratio (PD 1.3.20 a)	**24.72%**
Minimum required by CBB regulations under Basel II (%)	**12%**

5. Capital Adequacy Ratios (CAR)

The purpose of capital management at ASBB is to ensure the efficient utilization of capital in relation to business requirements and growth, risk profile and shareholders' returns and expectations.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank will undertake required initiations. No changes have been made in the objectives, policies and processes from the previous year.

The Bank's total capital adequacy ratio as at 31 December 2008 was 24.72% compared with the minimum regulatory requirement of 12%. The Tier 1 ratio was 24.72% for the Bank. The Bank ensures adherence to the CBB's requirements by monitoring its capital adequacy against higher internal limits. From this the CAR is found to be adequate to support current and future activities of the Bank.

The Bank uses the standardized approach for assessing credit and market risks and the basic indicator approach for operational risk.

No impediments on the transfer of funds or reallocation of regulatory capital exist within the Bank as it is does not have subsidiaries that require regulatory funding. (PD 1.3.6.c)

5.1 Capital Management

Internal Capital Adequacy Assessment Process (ICAAP)

The Bank'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 Bank'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 Bank's capital management is to ensure that it complies with externally imposed capital requirements. The Bank complied in full with all externally imposed capital requirements during the years ended 31 December 2008 and 31 December 2007.

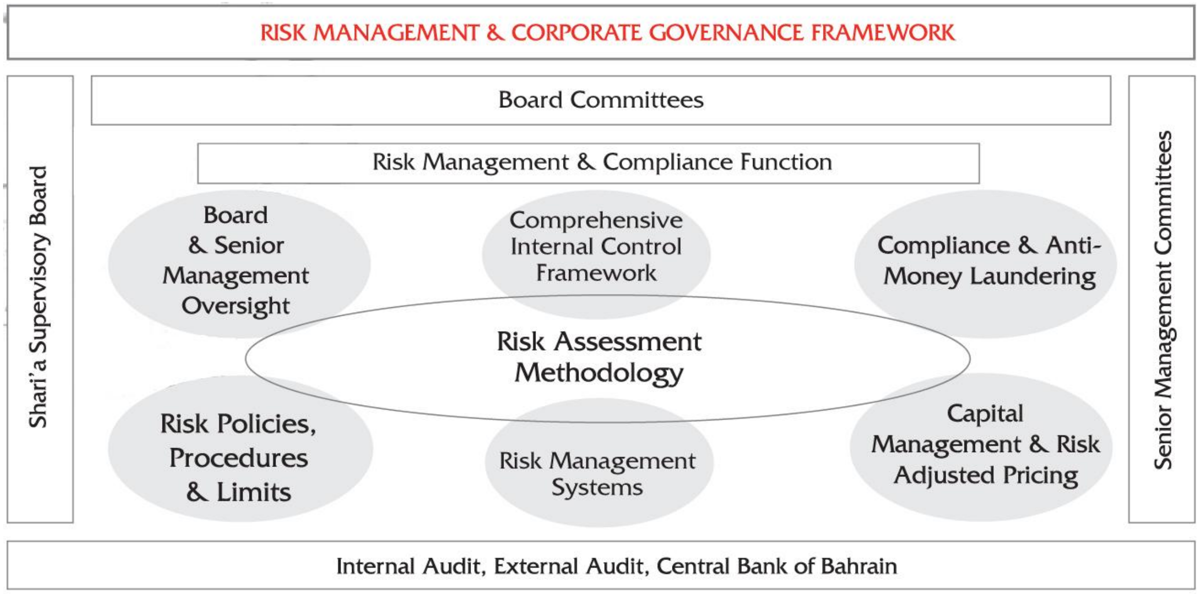
6. Risk management

6.1 Introduction

Risk is inherent in the Bank's activities and is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. The Bank is exposed to credit risk, market risk, operational risk, equity risk in the banking book, rate of return risk, displaced commercial risk, liquidity risk, legal and strategic risk as well as other forms of risk inherent in its financial operations.

Since inception the Bank has invested heavily into developing a comprehensive and robust risk management infrastructure. The Risk Management & Corporate Governance Framework below reflects the scope of the assessment methodology as well as the framework's structural oversight. The framework includes risk identification processes under credit, market & operational risk spectrums, risk measurement models and rating systems as well as a strong business process to monitor and control these risks. The Risk Management Framework has been effective throughout the reporting period. For more details please refer to the Risk Management & Compliance section of the annual report.

Figure 1



6.2 Risk management structure

Figure 2: Risk Management Structure (Page 31 second chart of annual report)

The Risk Management & Compliance Group operates as an independent function from business lines with a direct reporting line to the Chief Executive Officer. The Risk Management Group Head is the Chairman of the Credit/ Risk Committee and a member of the Asset Liability Management Committee and Investment Committee. All proposals for financing or investment are routed to the relevant committee for approval after detailed review and analysis by the Risk Management & Compliance Group. Please refer to ASBB's Annual Report for a diagram of the Risk Management Framework.

The Bank invested a considerable amount of human and financial resources towards meeting the Basel II implementation deadline by 2008 as set out by the Central Bank of Bahrain. The Bank views the implementation of and compliance with the Basel II Accord as a strategic element of our business model as it will facilitate the strengthening of our risk management framework and better alignment of risk and rewards leading to efficient utilization of capital.

6.2 Risk management structure (continued)

The Compliance function under this group ensures that the Bank has adequate compliance policies and procedures, all relevant staff received appropriate compliance and anti-money laundering training, timely periodic reporting to the Board and Executive Management and successful resolution of any significant matters related to compliance.

At ASBB we appreciate the fact that we are in the business of taking risks and our success is largely dependent on how efficiently we identify, measure, control and manage these risks. Hence, we view risk management as a core competency from a strategic point of view and the Basel II Accord as a catalyst to the successful implementation of the pillars of risk management.

The fundamental principle underlying our risk management framework is ensuring that accepted risks are within Board approved risk appetite and the returns are commensurate with the risks taken. The objective is creating shareholder value through protecting the Bank against unforeseen losses, ensuring maximization of earnings potential and opportunities vis-à-vis the Bank's risk appetite and ensuring earnings stability.

With this in mind, the Bank's establishment plan gave priority to the development of an effective and practical risk management framework and independent risk management and compliance function in line with best risk management practice locally and internationally, the requirements of Central Bank of Bahrain and the Basel II Accord.

6.3 Risk Management Framework

The risk management framework defines the risk culture of ASBB and sets the tone throughout ASBB to practice the right risk behavior consistently to ensure that there is always a balance between business profits and risk appetite.

The risk management framework achieves this through the definition of the Bank's key risk management principles covering credit, market, operational, strategic and reputation risks, the role and responsibilities of the Board, Risk Management Group and Senior Management towards risk management, the risk assessment methodology based on likelihood and consequences, the major risk policies, procedures and risk limits, the risk management information systems and reports, the internal control framework and the Bank's approach to capital management.

The effectiveness of the risk management framework is independently assessed and reviewed through internal audits, External audits and Central Bank of Bahrain supervision. In addition, business and support groups carry out periodic control risk self assessments.

As a result, the risk management framework creates an alignment between business and risk management objectives. (PD 1.3.21)

Risk management Vis-a-Vis Capital management

The cornerstone of risk management framework is the optimization of risk-reward relationship against the capital available through a focused and well monitored capital management process involving Risk Management, Finance and Business groups.

6.4 Risk Ownership

Within the broader governance infrastructure, the Board Committees carry the main responsibility of best practice management and risk oversight. The implementation of the risk management framework group-wide is the responsibility of the Risk Management & Compliance Group. Ownership of the various risks across the Bank lies with the business and support Heads and it is their responsibility to ensure that these risks are managed in accordance with the risk management framework. Risk Management will assist business and support heads in identifying concerns and risks, identifying risk owners, evaluating risks as to likelihood and consequences, assessing options for accommodating the risks, prioritizing risk management efforts, developing risk management plans, authorizing implementation of risk management plans and tracking risk management efforts.

Risk management and compliance organization

ASBB Risk Management and Compliance Group function is headed by an independent Chief Risk Officer with a direct reporting line to the Chief Executive Officer.

Figure 2 on the second page depicts the Board approved policies currently being implemented in the bank that cover the credit, market, operational, capital management and compliance and anti-money laundering functions. More policies have been drafted over the year to cover all other functions and are pending Board approval.

Figure 2


Board Approved Policies, Procedures and Limits
Credit Risk Management
Market Risk Management
Operational Risk Management
Capital Management
Compliance & Anti Money Laundering
Exposures and limits Monitoring
Portfolio Management
Timely Reporting to Credit Committee
Internal Rating Methodology
Positions and Limits Monitoring
Risk Measurement Methodology
Timely reporting to ALCO
Periodic Stress Testing and Scenario Analysis
Control Self Assessments
Key Risk Indicators Monitoring
Risk & Loss Events Database
IT Security Management
Business Continuity Planning
Outsourcing Risk Management
Basel II Compliance
Risk Adjusted Pricing
Reporting to Board Executive Committee
Scenario Analysis
Compliance Monitoring
Anti-money Laundering control
Training and Awareness
Systems Controls

7. Profile of Risk-weighted assets and capital charge

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

7.1 Credit risk

(PD 1.3.21 a)

a) Definition of exposure classes per Standard Portfolio

The Bank 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.

7.1 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 equity and Sukuk

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

i. Holding of real estate

Profit of Risk-weighted assets and capital charge

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) must be risk-weighted at 200%. Premises occupied by the bank may be weighted at 100%

7.1 Credit risk (continued)

j. Underwriting of non-trading book items

Where the Bank 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% will apply instead of the usual 150%.
(b) For holdings of Real Estate, a risk weight of 100% will apply instead of the usual 200% risk weight.

k. Other assets

These are risk weighted at 100%.

Profit of Risk-weighted assets and capital charge

BD '000s	Gross Credit Exposure	Funded Exposure	Unfunded Exposure (after CCF)	Cash Collateral	Eligible Guarantees	Eligible CRM	Risk-Weighted Assets (RWA)	RWA for CAR	Capital Charge
Cash	4,135	4,135	-	-	-	-	-	-	-
Claims on sovereigns	127,754	127,754	-	-	120	-	-	-	-
Claims on public sector entities	-	-	-	-	-	-	-	-	-
Claims on banks	89,808	89,808	-	-	625	-	21,056	14,599	1,752
Claims on corporate portfolio	64,923	53,559	11,364	-	-	4,218	51,260	51,260	6,151
Claims on regulatory retail portfolio	1	1	-	-	-	-	1	1	-
Mortgages	37,601	37,528	73	1,500	-	19,681	16,040	16,040	1,925
Past due receivables	3,693	3,693	-	-	-	-	5,540	5,540	665
Investments in Securities and Sukuk	31,884	31,884	-	-	-	-	47,826	47,826	5,739
Holding of Real Estate	101,840	101,840	-	-	-	-	203,680	203,680	24,442
Underwriting of Non-Trading Book Items	-	-	-	-	-	-	-	-	-
Other assets	52,039	52,039	-	-	-	-	54,306	54,306	6,517
	513,678	**502,241**	**11,437**	**1,500**	**745**	**23,899**	**399,709**	**393,252**	**47,191**

7.1 Credit risk (continued)

Portfolio by Islamic financing contract

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)

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	31,370	25,616	31,370	-	-	-	-	-	-	-
Murabaha and Mudaraba with banks	87,280	202,527	87,280	-	-	-	-	20,550	14,092	1,691
Murabaha financing	73,123	64,806	73,050	73	-	745	-	59,789	59,789	7,175
Ijarah Muntahia Bittamleek	41,790	22,665	41,790	-	1,500	-	23,899	20,969	20,969	2,516
Total	**233,563**	**315,614**	**233,490**	**73**	**1,500**	**745**	**23,899**	**101,308**	**94,850**	**11,382**

7.1 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, Bank 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 CRC and allocated between the Bank and its subsidiaries. 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 Bank's internal credit rating system. Where unsecured facilities sought are considered to be beyond prudential limits, Bank 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. ASBB 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 2008, the Bank’s exposures in excess of 15% of the obligor limits to individual counterparties amounted to BHD 78 million and was funded from the Bank’s own funds. The obligor limits referred to herein reflect the bank’s eligible capital base as per CBB rules and regulations. (PD 1.3.23 f)

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 ASBB monitors the concentration of its credit risk mitigants in order to minimize exposure to one type of collaterals. As on 31 December 2008, the collaterals (before applying regulatory haircuts) amounted to BD 149 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 Bank 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 Bank 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 ASBB in consultation with its legal department evaluates the available legal and contractual options.

The Bank 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 Bank 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 Bank will work with the counterparty to discuss how the outstanding facility can be settled. As a last resort, and under consultation from the courts, the counterparty's assets will be used to settle the outstanding obligation.

7.1.1 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:

Profit of Risk-weighted assets and capital charge

(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	80,699	-	1,127	-	1,709	-	83,535
Central Bank of Bahrain Sukuk	31,095	-	-	-	-	-	31,095
Murabaha and Mudaraba with banks	36,252	-	4,791	-	-	-	41,043
Murabaha financing	72,459	-	25	-	-	-	72,484
Ijarah Muntahia Bittamleek	41,440	-	90	-	-	-	41,530
Non-trading investments	80,847	1,904	-	32,196	-	1,981	116,928
Investment in an associate	-	8,012	-	-	-	-	8,012
Investment properties	1,178	-	-	-	-	-	1,178
Receivables and prepayments	20,928	2	73	26	-	4	21,033
Premises and equipment	2,584	-	-	-	-	-	2,584
Investments held-for-sale	88,934	-	-	-	-	-	88,934
Total funded exposures	**456,416**	**9,918**	**6,106**	**32,222**	**1,709**	**1,985**	**508,356**

Profit of Risk-weighted assets and capital charge

Contribution by Equity and Current Account							
Exposure type	**GCC countries**	**Arab World**	**Europe**	**Asia**	**America**	**Others**	**Total**
Commitments	2,466	-	-	2,279	-	2,718	7,463
Total unfunded exposures	**2,466**	-	-	**2,279**	-	**2,718**	**7,463**
TOTAL	**458,882**	**9,918**	**6,106**	**34,501**	**1,709**	**4,703**	**515,819**

Profit of Risk-weighted assets and capital charge

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

(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	46,125	-	-	-	-	-	46,125
Murabaha financing	-	-	-	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	-
Non-trading investments	-	-	-	-	-	-	-
Investment in an associate	-	-	-	-	-	-	-
Investment properties	-	-	-	-	-	-	-
Receivables and prepayments	-	-	-	-	-	-	-
Premises and equipment	-	-	-	-	-	-	-
Investments held-for-sale	-	-	-	-	-	-	-

Profit of Risk-weighted assets and capital charge

Contribution by Unrestricted Investment Account Holders							
Exposure Type	**GCC Countries**	**Arab World**	**Europe**	**Asia**	**America**	**Others**	**Total**
Total funded exposures	**46,125**	-	-	-	-	-	**46,125**
commitments	-	-	-	-	-	-	-
Total unfunded exposures	**-**	**-**	**-**	**-**	**-**	**-**	**-**
TOTAL	**46,125**	-	-	-	-	-	**46,125**

7.1.1 Geographical distribution of exposures (continued)

The Bank has a few past due Islamic financing contracts that have not been settled as of fiscal year end. All past due but not impaired Murabaha and Ijara financing are covered by sufficient collaterals that include cash 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 2008. An aging schedule of the Bank's past due financing contracts can be found in the section titled Credit Risk of the financial statements (PD 1.3.23 h, i)

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 Credit Exposure	Past Due Islamic Financing Contracts	Specific Provision Impaired Islamic Financing Contracts	Impaired Islamic Financing Contracts	Specific Provision Impaired Investments
GCC Countries	456,415	5,750	-	-	-
Arab World	9,918	-	-	-	-
Europe	6,107	-	-	-	-
Asia	32,222	-	-	-	-
America	1,709	-	-	-	-
Other	1,985	-	-	-	-
Total	**508,356**	**5,750**	**-**	**-**	**-**

Profit of Risk-weighted assets and capital charge

BHD'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	46,125	-	-	-	-
Arab World	-	-	-	-	-
Europe	-	-	-	-	-
Asia	-	-	-	-	-
America	-	-	-	-	-
Other	-	-	-	-	-
Total	**46,125**	**-**	**-**	**-**	**-**

7.1.2 Exposure by Industry

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	-	4,123	-	-	-	79,411	83,534
CBB Sukuk	-	-	-	-	-	31,095	31,095
Murabaha & Mudaraba with banks	-	41,042	-	-	-	-	41,042
Murabaha financing	11,754	9,628	17,673	-	11,004	22,425	72,484
Ijarah Muntahia Bittamleek	947	-	8,435	3,837	11,913	16,399	41,531
Non-trading investments	-	-	77,420	1,195	-	38,315	116,930
Investment in an associate	-	8,012	-	-	-	-	8,012
Investment properties	-	-	1,178	-	-	-	1,178
Receivables and prepayments	51	269	13,945	59	283	6,425	21,032

Profit of Risk-weighted assets and capital charge

Contribution by Equity and Current Account							
Exposure Type	**Trading & Manufacturing**	**Banks & Financial Institutions**	**Real Estate**	**Aviation**	**Individuals**	**Others**	**Total**
Premises & equipment	-	-	-	-	-	2,584	2,584
Investment held-for-sale	-	-	49,219	-	-	39,715	88,934
Total funded	**12,752**	**63,074**	**167,870**	**5,091**	**23,200**	**236,369**	**508,356**
Commitments	49	-	4,243	-	1,167	2,004	7,463
Total unfunded	**49**	-	**4,243**	**-**	**1,167**	**2,004**	**7,463**
Total exposure	**12,801**	**63,074**	**172,113**	**5,091**	**24,367**	**238,373**	**515,819**

Exposure by type of credit exposure (PD 1.3.23 c) **BHD '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	-	-	-	-	-	-	-
Murabaha & Mudaraba with banks	-	46,125	-	-	-	-	46,125
Murabaha financing	-	-	-	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	-
Non-trading investments	-	-	-	-	-	-	-
Investment in an associate	-	-	-	-	-	-	-
Investment properties	-	-	-	-	-	-	-
Receivables and prepayments	-	-	-	-	-	-	-
Premises & equipment	-	-	-	-	-	-	-
Investment held-for-sale	-	-	-	-	-	-	-

Contribution by Unrestricted Investment Account Holders							
Exposure Type	**Trading & Manufacturing**	**Banks & Financial Institutions**	**Real Estate**	**Aviation**	**Individuals**	**Others**	**Total**
Total funded	-	**46,125**	-	-	-	-	**46,125**
Undrawn commitments	-	-	-	-	-	-	-
Total unfunded	-	-	-	-	-	-	-
Total exposure	**-**	**46,125**	**-**	**-**	**-**	**-**	**46,125**

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	12,801	12,752	49	-	-	-	-
Banks and financial institutions	63,075	63,075		-	-	-	-
Real estate	172,112	167,869	4,243	-	-	-	-
Aviation	5,091	5,091		-	-	-	-
Individuals	24,367	23,200	1,167	-	-	-	-
Others	238,373	236,369	2,004	-	-	-	-
Total	**515,819**	**508,356**	**7,463**	**-**	**-**	**-**	**-**

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	46,125	46,125	-	-	-	-	-
Real estate	-	-	-	-	-	-	-
Aviation	-	-	-	-	-	-	-
Individuals	-	-	-	-	-	-	-
Others	-	-	-	-	-	-	-
Total	**46,125**	**46,125**	-	-	-	-	-

7.1.3 Exposure by external credit rating

ASBB 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 Bank follows the lowest of the above ECAI's ratings. The breakdown of the Bank's exposure into rated and unrated categories is as follows: (PD 1.3.22 c, d, e)

BD '000s

	Net Credit Exposure (Post CRM)	**Rated Exposure**	**Unrated Exposure**
Cash	4,135	-	4,135
Claims on sovereigns	127,754	-	127,754
Claims on public sector entities	-	-	-
Claims on multilateral development banks	-	-	-
Claims on banks	89,807	68,303	21,504
Claims on corporate portfolio	51,260	-	51,260
Regulatory retail exposure	1	-	1
Past due exposures	3,693	-	3,693
Mortgages	17,920	-	5,845
Investments in Securities and Sukuk	31,884	-	133,724
Holding of Real Estate	101,840	-	-
Other exposures	52,039	-	64,114
Total	**480,333**	**68,303**	**412,030**

7.1.3 Exposure by external credit rating (continued)

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio through internal risk rating system. As such, the Bank 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 ASBB'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)

7.1.4 Maturity analysis of funded exposures

Residual contractual maturity of the Bank'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	4,135	-	-	-	4,135	-	-	-	-	-	4,135
Claims on sovereigns	86,289	1,850	11,308	3,454	102,901	24,738	115	-	-	24,853	127,754
Claims on public sector entities	-	-	-	-	-	-	-	-	-	-	-
Claims on multilateral development banks	-	-	-	-	-	-	-	-	-	-	-
Claims on banks	87,861	28	-	-	87,889	1,920		-	-	1,920	89,809
Claims on corporate portfolio	4,888	12,120	-	-	17,008	3,898	32,652	-	-	36,550	53,558
Regulatory retail exposures	-	-	-	-	-	-	-	-	-	-	-
Past due exposures	3,693	-	-	-	3,693	-	-	-	-	-	3,693
Mortgages portfolio	1,723	6,996	6,638	6,734	22,091	13,645	697	1,095	-	15,437	37,528
Equity portfolios	-	-	-	-	-	169,061	-	-	-	169,061	169,061
Other exposures	75	-	19,756	45,992	65,823	3,119	-	-	-	3,119	68,942
Total	**188,664**	**20,994**	**37,702**	**56,180**	**303,540**	**216,381**	**33,464**	**1,095**	**-**	**250,940**	**554,480**

7.1.5 Maturity analysis of unfunded exposures

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	-	-	-	-	-	-	1,219	-	-	1,219	1,219
Claims on public sector entities	-	-	-	-	-	-	-	-	-	-	-
Claims on banks	-	-	-	-	-	-	-	-	-	-	-
Claims on corporate portfolio				49	49	5,028	-	-		5,028	5,077
Regulatory retail exposures	-	-	-	-	-	-	-	-	-	-	-
Mortgages Portfolio	-	-	-	-	-	-		1,167	-	1,167	1,167
Total	**-**	**-**	**-**	**49**	**49**	**5,028**	**1,219**	**1,167**	**-**	**7,414**	**7,463**

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

Profit of Risk-weighted assets and capital charge

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: **BD '000s**

	Notional Principal	Credit Exposure*
Undrawn Islamic financing contracts commitments	2,435	-
Operating lease commitments	899	-
Other commitments	**5,027**	**-**
RWA	**8,361**	**-**

* Credit exposure is after applying CCF.

At 31 December 2008, the Bank held cash collaterals in relation to credit-related contingent items amounting to BD 9,308k.

Residual maturity analysis by major type of credit exposure

	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	83,534	-	-	-	83,534	-	-	-	-	-	83,534
Central Bank of Bahrain Sukuk	-	-	6,620	-	6,620	24,475	-	-	-	24,475	31,095
Murabaha and Mudaraba with banks	85,642	1,525	-	-	87,167	-	-	-	-	-	87,167
Murabaha financing	27,245	2,563	9,506	6,500	45,814	26,556	115		-	26671	72,485
Ijarah Muntahia Bittamleek	3,991	2,033	3,617	275	9,916	26,506	4,015	1,094	-	31,615	41,531
Non-trading investments	-	-	-	-	-	116,930		-	-	116,930	116,930
Investment in an associate	-	-	-	-	-	-	8,012	-	-	8,012	8,012
Investment properties	-	-	-	-	-	-	1,178	-	-	1,178	1,178
Receivables and prepayments	149	19,906	79	178	20,312	720	-	-	-	720	21,032
Premises and equipment	-	-	-	-	-	2,584	-	-	-	2,584	2,584
Investments held-for-sale	-	-	-	19,714	19,714	69,219	-	-	-	69,219	88,933
Total	**200,561**	**26,027**	**19,822**	**26,667**	**273,077**	**266,990**	**13,320**	**1,094**	**-**	**281,404**	**554,481**

Profit of Risk-weighted assets and capital charge

	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 and Mudaraba with banks	-	-	-	-	-	-	-	-	-	-	-
Murabaha financing	-	-	-	49	49	-	-	-	-	-	49
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	1,219	1,167	-	2,386	2,386
Non-trading investments	-	-	-	-	-	5,028	-	-	-	5,028	5,028
Investment in an associate	-	-	-	-	-	-	-	-	-	-	-
Investment properties	-	-	-	-	-	-	-	-	-	-	-
Receivables and prepayments	-	-	-	-	-	-	-	-	-	-	-
Premises and equipment	-	-	-	-	-	-	-	-	-	-	-
Investments held-for-sale	-	-	-	-	-	-	-	-	-		
Total	**-**	**-**	**-**	**49**	**49**	**5,028**	**1,219**	**1,167**	**-**	**7,414**	**7,463**

7.2 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 Bank'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 Bank's Asset and Liability Committee. (PD 1.3.27 a)

ASBB's capital charge in respect of market risk in accordance with the standardized methodology is as follows: (PD 1.3.18) (PD 1.3.27 b)

BD '000s

	RWA	Period End Capital Charge	Capital Charge – Minimum*	Capital Charge – Maximum*
Equity position risk	-	-	-	-
Sukuk risk	-	-	-	-
Foreign exchange risk	3,213	257	257	380
Options risk	-	-	-	-
Total market risk	**3,213**	**257**	**257**	**380**

Equity positions and foreign exchange positions constitute a major component of the market risk capital charge. The Bank maintains a conservative market risk exposure that is focused on the foreign exchange risk coming from the Bank's banking book open positions. The open positions were taken in order of running the Bank's day to day operations that include private equity funding for the Bank's investment portfolio. The Bank monitors these open positions on a daily basis through the automated system reports. For information on the Bank's exposure to foreign exchange risk refer to note 18.3 of the audited financial statements. (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 2008.

7.3 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 Bank 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 Bank including risk and control self-assessments, Key Risk Indicators (KRI), event management, new product review and approval processes and business contingency plans.

The Bank 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 Bank's policy, and to develop internal procedures that comply with these policies. To ensure that all operational risks to which ASBB 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)

ASBB 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 Bank, 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 capital charge in respect of operational risk was BD 4.8k. This capital charge was computed by categorizing ASBB'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)

7.3 Operational risk (continued)

	2008	2007	2006
Gross income	38,294	21,163	5,199
Number of years with positive gross income	3	2	1
Average	21,552	13,181	5,199

ASBB 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 Bank's Risk Management Framework. ASBB 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)

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

The Bank 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 Bank’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.

A summary of Bank’s rate of return sensitivity position at the balance sheet date based on the contractual re-pricing or maturity dates, whichever is earlier, is presented in note 18.2 of the audited financial statements.

Profit rate risk in the Banking Book			
200bp Profit Rate shocks			
Rate shock	**Currency**	**Effect on profit 2008**	**Effect on profit 2007**
Upward rate shocks:	US	1,012,307	467,758
	BHD	3,312,053	722,757
Downward rate shocks:	USD	(1,012,307)	(467,758)
	BHD	(3,312,053)	(722,757)

7.5 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 Bank 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. More information on the equity price risk can be found in note 18.1 of the audited financial statements.

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 Executive committee consists of three members of which is the CEO and two members from 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 Investment Committee is a sub-set of the Management and consists of seven members: The CEO, COO, EVP – MENA Banking and Investments, EVP – Asia Investments, EVP – Europe Investments and the Advisor to the CEO.

The objectives are defined in terms of risks, returns & time horizon. When approved by the Board, the Investment Policy for the Bank will outline the permissible investments, asset classes, limits on asset classes & lines of authority for approvals. The policy will allow the Bank 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 ASBB's 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. With regard to valuations, independent third party valuations from fund managers &/or calculation agents are used except in the case of unquoted instruments in which case reliance is placed on latest available financial statements. In any event, the Bank’s exposure to unquoted financial securities is minimal BD 36,779k.

Internal Controls

With regard to internal controls, the Bank’s 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.

Profit of Risk-weighted assets and capital charge

Equity positions in the banking book

Quoted Equities	4,045
Unquoted Equities	201,818
	205,863
Profit earned for URIA before smoothing	2,148
Realized gains (losses) during the period	30,266
Unrealized gains (losses) during the period	2,050

The Bank'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.

7.6 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. Refer to section 8 for details on URIA investment structures.

7.7 Liquidity risk

(PD 1.3.36)(PD 1.3.37)
The Bank 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. More details can be found in the notes to the financial statements within the Annual Report under the section titled Liquidity Risk.

8. 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 year in the investment risk reserve and the ending balance was amounting to BD 38,006. 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 Mudareb agreed sharing and contractual agreed ratio. Profit earned and paid and Rate of return comparatives for the Unrestricted Investment Account Holders for the all previous financial year is as follows: (PD 1.3.33 e, l, m, n)

BHD '000s

Total Mudarabaha Profit (URIA)	**2007**	**2008**
Shareholders	6,464	3,134
IAH (before smoothing)	634	2,148
Total Profit	**7,098**	**5,282**
Profit earned for URIA before smoothing	634	2,148
Profit paid for URIA after smoothing	245	220
Balance		
PER	N/A	N/A
IRR	5	38*
Annual Rate of Return Benchmark	3.20%	4.60%
Annual Rate of Return (Shareholder)	0.03%	0.01%
Annual Rate of Return (URIA)	3.20%	4.60%
PER Amount	N/A	N/A
PER %	N/A	N/A
IRR Amount	5	38
IRR %	-	-
Mudaraba Earned Profit	634	2,148
Mudarib fees	(285)	(966)
Profit after Mudarib Fees	349	1,182
IRR*	(104)	(962)
Profit Paid to URIA	245	220
URIA Balance	19,770	46,125
RWA as PIRI Report	3,954	9,225

*The ending balance of the IRR after other adjustments is BHD 38k.

BD '000s

Period End	Profit Earned and Paid to URIA	Rate of Return
31 December 2006		
31 December 2007	**634 profit earned 245 profit paid**	**3.2%**
31 December 2008	**2,148 profit earned 220 profit paid**	**4.6%**
Return on average assets (ROAA)	**2008:0.45%** **2007:0.13%**	
Return on average equity (ROAE)	**2008:1.3%** **2007:0.38%**	

Unrestricted Investment Account by Counterparty Type and Islamic Product (PD 1.3.32 g) **BD '000s**

Murabaha				
Counterparty	**Total Exposures**	**Funded by URIA**	**Funded by Self**	**% of URIA to Total**
Sovereign	-	-	-	-
Bank	46,125	46,125	-	100%
Multi-national Development Bank	-	-	-	-
Investment Firms	-	-	-	-
Corporate	-	-	-	-
Retail	-	-	-	-
Total	**46,125**	**46,125**	**-**	**100%**

Unrestricted Investment Accounts

BD '000s

Mudaraba				
Counterparty	**Total exposures**	**Funded by URIA**	**Funded by Self**	**% of URIA to Total**
Sovereign	-	-	-	-
Bank	-	-	-	-
Multi-national Development Bank	-	-	-	-
Investment Firms	-	-	-	-
Corporate	-	-	-	-
Retail	-	-	-	-
Total	**-**	**-**	**-**	**-**

BD '000s

Musharaka				
Counterparty	**Total exposures**	**Funded by URIA**	**Funded by Self**	**% of URIA to Total**
Sovereign	-	-	-	-
Bank	-	-	-	-
Multi-national Development Bank	-	-	-	-
Investment Firms	-	-	-	-
Corporate	-	-	-	-
Retail	-	-	-	-
Total	**-**	**-**	**-**	**-**

The amounts relating to URIA are invested in Murabaha and the return rate is as follows: Analysis of Investment risk reserve (IRR) and Return on URIA

URIA	URIA Return Before Mudarib Fees	URIA Return After Mudarib Fees	Mudarib Fees	Return on URIA After Mudarib Fees
BD '000s	**BD '000s** **2,148**	**BD '000s** **1,182**	**BD '000s** **966**	***%*** ***55%***

Average profit rate or rate of return over the different period buckets:

	Up to 3 months	More than 3 months up to 6 months	More than 6 months up to 1 year	More than an year up to 3 years	Total
Average Profit rate or rate of return (%)	2%	3%	5%	3%	13%

The changes in asset allocation ratio in the last six months by the Bank are as follows: (PD 1.3.32 d)

	Murabaha and Mudaraba with banks		**Murabaha financing**	
	URIA	Self & Call Accounts	URIA	Self & Call Accounts
Asset Allocation as on 31 December 2008	46,125	41,042	-	114,015
Asset Allocation as on 31 December 2008	19,770	204,681	-	43,077

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.

9. Other disclosures

9.1 Impairment of assets

Impairment and uncollectability of financial assets (PD 1.3.22 b)

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset or group of financial assets may be impaired. If such evidence exists, an impairment loss is recognized in the consolidated statement of income.

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

Impairment is determined as follows:

(a) For assets carried at amortized cost, impairment is based on the present value of estimated future cash flows discounted at the original effective rate of return;

(b) For assets carried at fair value, impairment is the difference between cost and fair value; and

(c) For assets carried at cost, impairment is based on the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

The Bank uses the provision account method to record impairments except for equity and similar investments, which are written down, with future increases in their fair value being recognized directly in equity.

Impairment losses on financial assets

On a quarterly basis the Bank assesses whether any provision for impairment should be recorded in the consolidated statement of income. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provision required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes in such provisions.

Impairment against specific groups of financial assets

In addition to specific provisions against individually significant Islamic financing contracts and investments, ASBB also makes a provision to cover impairment against specific group of financial assets where there is a measurable decrease in estimated future cash flows. This provision is based on the findings of the credit facility reviews that are carried out at least once a year. The amount of provision is based on the historical loss pattern for Islamic financing contracts within the facility's peer group and is adjusted to reflect current economic changes.

The annual credit review process takes into consideration factors such as collateral held deterioration in country risk, industry and technological obsolescence as well as identified structural weakness or deterioration in cash flows.

In accordance with the guidelines issued by the CBB, credit facilities are placed on non-accrual status and profit suspended when either principal or profit is overdue by 90 days. Following an assessment of impairment, specific provision is established if there is objective evidence that a credit facility is impaired, as detailed in section 9.1.

As of 31 December 2008, the Bank does not have any specific or collective impairment provision on account of impairment of any Islamic financing contract, investments and other assets (excluding profit in suspense). (PD 1.3.24 b, c, d) (PD 1.3.23 h, i)

9.2 Business risk

Business risk represents the earnings volatility inherent in all business activities due to the uncertainty of revenues and costs associated with changes in the economic and competitive environment. Business risk is evaluated through a Business and Strategy Development process. A Risk Budget is developed at the start of each year along with a Business Planned by each unit. Subsequently, the actual quarterly performance is compared with that budgeted including the historical volatility in earnings, and detailed financial budget, which supports both the decision making and the planning process.

9.3 Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its liabilities when they fall due under normal and stress circumstances. Liquidity risk can be caused by market disruptions or credit downgrades which may impact certain sources of funding. Liquidity risk is monitored and managed by the Asset and Liability Committee (ALCO), which meets regularly.

To mitigate the risk, ASBB has diversified funding sources, and manages its assets with liquidity in mind, by maintaining an adequate balance of cash and cash equivalents at all times. In the event of a liquidity problem, management coordination becomes crucial and ALCO would serve as a Liquidity Crisis Committee expected to hold meetings on a daily basis until the situation is resolved. In such scenarios the Liquidity Crisis Committee will consider a number of different options as appropriate.

The Bank is generally in a position of excess liquidity, its principal sources of liquidity being its Wakala deposits, liquidity derived from its operations, unrestricted investment accounts and Murabaha from banks and non-banks. ASBB believes that most of the customer deposits will be renewed and available to Bank. Also the Bank has been successful in getting some of the big ticket customer deposits renewed as of 31 December 2008.

The Bank monitors this risk through daily cash forecasts, which take into account the Bank’s maturity profile.

At the end of 2008, the Bank's liquid assets to total assets ratio was 31 % and short term assets to short term liabilities ratio is over 251%. The liquidity risk summarized in note 19 of the audited financial statements provides an overview of the liquidity profile of the Bank.

The risk exposure for funding from current accounts and URIA is monitored by using the funds for maintaining adequate liquidity and hence invested mostly in short term Islamic financing contracts like Murabaha with Banks and balance with the CBB.

9.4 Legal risk

Inadequate documentation, legal and regulatory incapacity or insufficient authority of a counterparty and contract invalidity or unenforceability are all examples of legal risk. Identification and management of this risk are the responsibilities of the Legal Department and are carried out through consultation with internal and external legal counsels, together with close monitoring of the litigation cases involving the Bank.

ASBB has established an independent and focused unit to coordinate the implementation of compliance and Anti-Money Laundering and Anti-Terrorist Financing program. The program covers policies and procedures for managing compliance with regulations, anti-money laundering, disclosure standards on material and sensitive information and insider trading.

In line with its commitment to combat money laundering and terrorist financing, ASBB through its Anti-Money Laundering policies ensures that adequate preventive and detective internal controls and systems operate effectively. The policies govern the guidelines and procedures for client acceptance, maintenance and monitoring in line with the Central Bank of Bahrain and International standards such as FATF 40 + 9 recommendations and Basel Committee papers.

All inward and outward electronic transfers are screened against identified sanction lists issued by certain regulatory bodies including the UN Security Council Sanctions Committees and US Department of the Treasury - OFAC, in addition to those designated by the Central Bank of Bahrain.

The compliance program also ensures that all applicable Central Bank of Bahrain regulations are complied with and/or non-compliance is detected and addressed in a timely manner. The program includes compliance with regulations set by Ministry of Industry & Commerce and Bahrain and Dubai Stock Exchange.

9.5 Currency risk

The Bank 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. ASBB's structural balance sheet positions is reviewed regularly by ALCO in accordance with the Bank's strategic plans and managed on a dynamic basis by the Treasury hedging such exposures, as appropriate.

9.6 Profit Rate risk

The Bank has exposure to fluctuations in the profit rates on its assets and liabilities. The Bank recognizes income on certain financial assets on a time-apportioned basis. The Bank has set limits for profit return risk and these are monitored on an ongoing basis by the Bank’s ALCO. The Bank manages exposures to the effects of various risks associated with fluctuations in the prevailing levels of market profit rates on its financial position and cashflows. The effect on income solely due to reasonably possible immediate and sustained changes in profit return rates, affecting both floating rate assets and liabilities and fixed rate assets and liabilities with maturities less than one year are as follows:

Profit rate risk in the Banking Book			
25bp Profit Rate shocks			
Rate Shock	**Currency**	**Effect on Profit 2008**	**Effect on Profit 2007**
Upward Rate Shocks:	US	506,153	233,879
	BHD	1,656,026	361,379
Downward Rate Shocks:	USD	(506,153)	(233,879)
	BHD	(1,656,026)	(361,379)

9.7 Related party transactions

Related parties represent associated companies, major shareholders, directors and key management personnel of the Bank and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Bank's Senior Management. For further details refer section titled related party disclosure. (PD 1.3.10 e) (PD 1.3.23 d)

9.8 Restructured facilities

During the year, BD 2,350,000 of financing facilities to individuals 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)

9.9 Assets sold under recourse agreements

ASBB has not entered into any recourse agreement during the year ended 31 December 2008. (PD 1.3.23 k)