Investors Bank BSC (c)
Public Disclosures Document
2008

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1. Executive Summary

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

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

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

The Bank has adopted the standardised approach to determine the capital requirement for credit risk and market risk, and the basic indicator approach for operational risk.

The disclosed Tier 1 and Total Capital Adequacy Ratios comply with the minimum capital requirements under the CBB's Basel 2 framework.

The disclosures in this report are in addition to the disclosures set out in the financial statements for the year ended 31 December 2008, in accordance with Financial Accounting Standards issued by the Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

2. Management Discussion and Analysis

During the past 6 months, the global financial markets have seen unprecedented disruptions. As the economies of United States and Europe got impacted by the credit and liquidity crisis, the economies of Middle East have also been affected.

The Middle-East markets also witnessed financial problems due to global financial crises, fears of a deep recession and a consequent sudden and severe fall in crude oil prices. This led to a sharp fall in stock indices in the region, severe fall in the real estate prices, high level of volatility in the equity and currency markets and disappointing corporate earnings results.

Investors Bank was also not immune to the global meltdown. The Bank suffered a huge drop in the market prices mainly of held for trading investments to the tune of US$ 24,794,626 (2007: US$ 9,566,793). Additionally the Bank had to make an impairment allowance of US$ 12,416,732 (2007: US$ 2,712,594) on account of a drop in the market value of its real estate investments and on reassessment of the recovery of its receivables. Therefore, despite an increase in net income from assets held for sale during 2008 (US$ 2,930,193) comparing to the same period of 2007 (US$ 1,257,051), the bank reported a net loss of US$ 34,887,764 (2007: US$ 10,260,855) for the year ended 31 December 2008.

The Bank believes that 2009 would be very challenging year for the banking sector as a whole and Investors Bank would be no exception to these challenges. However, the Bank is using this opportunity to implement robust internal processes as per the guidelines of the Central Bank of Bahrain for an efficient functioning. Additionally, in co-operation with external consultants the Bank has formulated its business plan and will implement it depending on the external economic environment stabilising. The Bank is also taking steps in opening new channels of communication with other countries and to become more active with business emanating from different markets so as to diversify its reach.

The delicate and uncertain economic situation demands caution in business approach in the immediate future. We are, therefore, exploring avenues to generate income from real estate while keeping an eye on the opportunities to book capital gains once the market conditions improve.

	2008	**2007**	**2006**	**2005**	**2004**
ROAE	(32.08)%	(7.59)%	8.35 %	61.02 %	15.93 %
ROAA	(30.06)%	(7.20)%	7.92 %	53.10 %	11.44 %
Staff cost/ Income	N/A	N/A	14.93 %	2.16 %	12.52 %
Cost/Income	N/A	N/A	26.58 %	9.63 %	32.35 %
Earning per share US$	(0.14)	(0.04)	0.05	0.35	0.18

N/A: The Bank has earned negative income in 2008 and 2007.

3. Corporate Governance

The Board of Directors is responsible for approving the Bank's overall business strategy, monitoring its operations, and taking critical business decisions. The Board, elected by the shareholders, is the ultimate decision making body of the Bank and has the following broad responsibilities, as enunciated in the corporate governance manual (under preparation):

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

As per the Articles of Association of the Bank, the board should have not less then three and not more than 9 members. Currently the Bank has four members in its Board of Directors. The Board takes an active interest in the running of the Bank through various Board level committees.

3.1 Board Committees

Consistent with the industry practices, the Board has established the following committees with defined roles and responsibilities

3.1.1 Executive Committee (EXCOM)

The EXCOM provides direction to the executive management on all business matters and assumes the role of the Board to execute the decisions made in Board meetings. The EXCOM is also responsible for business matters concerning risk management, strategy review and recommendation to the Board.

EXCOM Members

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

3.1.2 Audit Committee

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

Audit Committee Members

- Dr. Abdulaziz Al Jenaei – Chairman
- Mr. Ahmed Shabib Al Dhahery – Member
- Mr. Ghassan Al Sultan – Member

The Internal Auditor of the Bank is the Secretary of The Audit Committee.

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

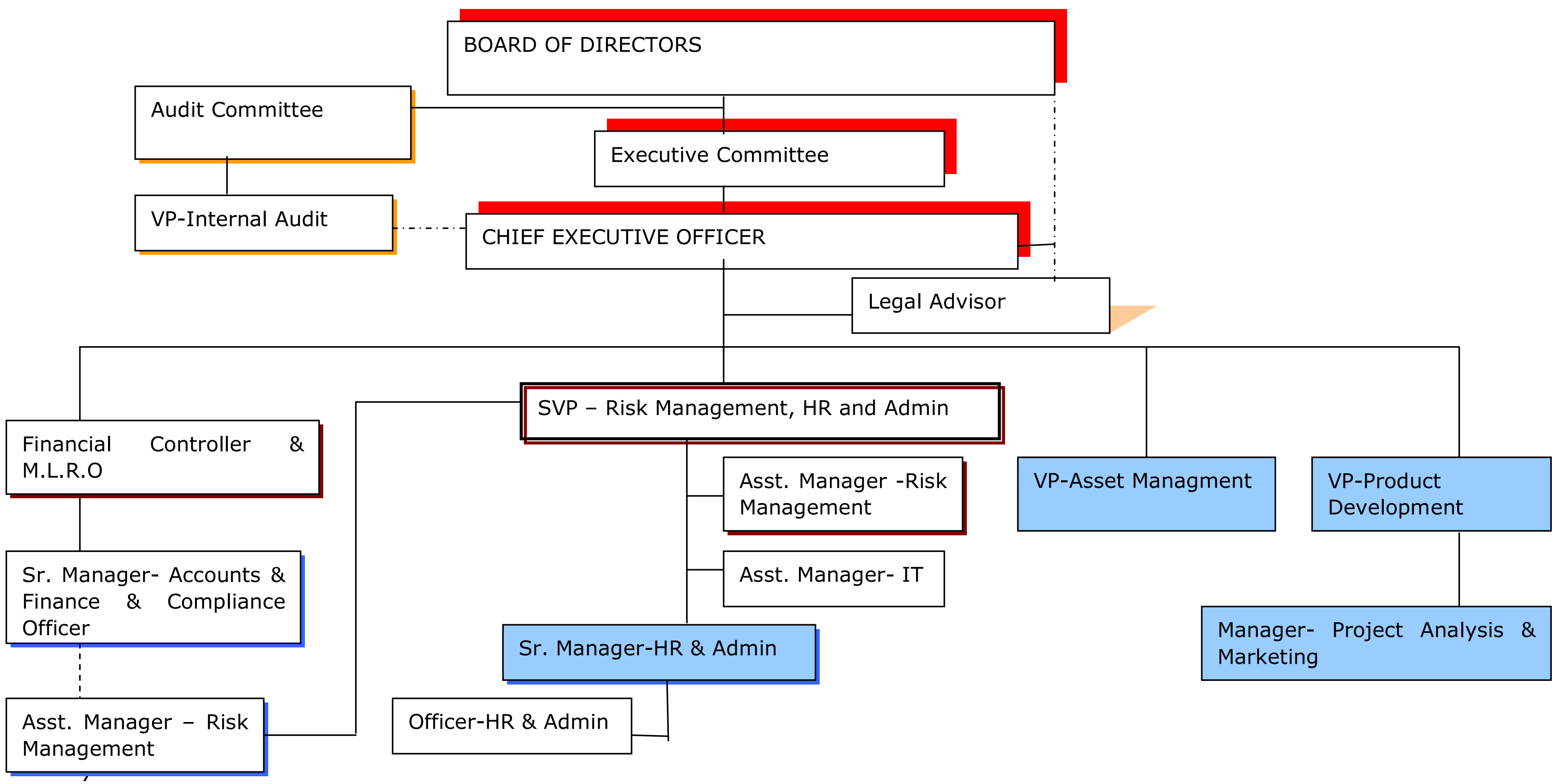
<u>The Bank currently does not have any managerial committee as on December 31st, 2008.</u> At the management level, the Bank is proposing to formalise an Investment Committee that will be the highest management level authority on all investment exposures. This committee is proposed to have additional responsibilities of credit decision making as well as Asset Liability Management. The constitution of such a committee & its terms of reference would be subject to the approval of the Board of Directors. As on December 31st, 2008 the structure was not approved and formalised by the Board of Directors.

The overall role of the proposed Investment Committee will be to facilitate:

- the investment and credit business of the Bank in the most effective and efficient manner within the risk guidelines specified by the Board; and
- to oversee market, liquidity and profit rate risk in the Bank.

The investment committee is proposed to be headed by the CEO and comprise of heads of other departments as members e.g. Head of Risk, Head of Investments, Head of Finance and Control etc.

3.2 Organisational Chart 2008



Note:
Positions shaded were vacant

3.3 Profiles of Board of Directors

Dr. Abdulaziz Al Jenaei – Chairman

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

Additionally, Dr. Jenaei has been an active contributor for the benefit of society. Dr. Jenaei is the Mosque orator on Fridays, Imam for His Highness, Amir of Kuwait. Dr. Jenaei has also been a member of resistance group during unjust Iraqi aggression, Ex-member of the Board of Literacy Supreme Council, Shari'a authenticator since 1986 etc.

Mr. Ahmed Shabib Al Dhahery – Vice Chairman

Mr. Dhahery is the Executive Manager of the Abu Dhabi Investment Authority. He is also a Board member in the Banque de Tunisie et des Emirats, Gulf Air Company, Abu Dhabi Fund for Development. Educationally, he has a Bachelor Degree in Economics and Finance.

Mr. Ghassan Al Sultan – Member

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

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

Mr. Isa Abdulla Al Mannai - Member

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

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

3.4 Management Profile

Mr. Adel Al Mannai – CEO

Mr. Mannai has over 30 years of experience in Banking and financial markets across project financing, loan syndication, retail banking, consumer finance, business development etc. His experience includes positions of Group Head, retails and Commercial Banking Group at Shamil Bank, CEO Khaleej Finance and Investment Company, General Manager Mashreq Bank, Bahrain and Doha and Vice President and Marketing Manager – Corporate Banking at ABN AMRO Bank.

Mr. Mannai is an MBA from University of Glamorgan – Wales. Additionally he has done various courses in Banking and Finance Management (City University London), Strategic Leadership, SWAP Financing, Corporate Finance etc.

Mr. Yash Parasnis

Mr. Parasnis has over 22 years of experience in banking and investment banking across project finance, international finance, capital markets and corporate restructuring. His experience includes positions of Head of Capital Markets at Bank of America in Mumbai, India; Head of Business Development at Times Bank in India and Chief Executive at Mega Fin (India) Ltd,a non-banking finance company. Mr. Parasnis holds a Bachelor degree in Technology from Indian Institute of Technology, Delhi and a Masters in Business Administration from Indian Institute of Management, Bangalore.

He reports to the CEO. Additionally, he is in–charge of the HR& Admin function.

Mr. Aref Hussain, Financial Controller and MLRO

Mr. Hussein has over 12 years of experience in Telecommunication sector and over 2 years of experience in the Banking sector. He has experience across project management, management reporting, international and wholesale financial services, Regulatory control and financial control. His experience includes positions of head of management reporting at Bahrain Telecommunication Company (Batelco); manager of international and wholesale financial services at Bahrain Telecommunication Company (Batelco) and manager of regulatory accounts at Telecommunication Regulatory Authority (TRA- Bahrain).

Mr. Hussein holds a Bachelor degree in Accounting from university of Bahrain and a CMA (Certified management accountant) from institute of management accounts from United States of America.

3.5 Remuneration and Incentives

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

The remuneration to the employees of the Bank is on the basis of the employment contracts of the individuals. Any bonus/ex-gratia payment is purely at the discretion of the Bank. The Articles of Association provides the guidelines for the employee Incentive Programme that has currently not been implemented.

3.6 Changes in the structure of the Board

The Bank's Chairman, Mr. Sami Al Bader, passed away in August, 2008. Subsequent to this, the Vice Chairman looked after the duties of the Chairman until The Board of Directors nominated Dr. Abdulaziz Al Jenaei as the new Chairman effective 30 August 2008.

3.7 Communications Policy

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

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

Management seeks to respond to shareholders' questions and concerns on a prompt basis, subject to the limitations imposed by law and the confidentiality of certain information. The Bank maintains a website at www.investorsb.com, which includes information of interest to various stakeholders including the regulatory authority. Information available on the website includes the Annual Report, quarterly reports, supplemental quarterly financial information, and other disclosure requirements as determined by the CBB from time to time.

3.8 Shari'a Compliance

All the transactions entered into by the Bank are presented to Shari`a Board for review on an annual basis and to ensure that the respective agreements are in compliance the principles of Shari`a.

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

3.9 Zakah contributions

Zakah is directly borne by the shareholders and, accordingly, no provision is made by the bank for Zakah. The bank computes the zakah payable by the shareholder on the net investment funds method. The basis of computation is approved by the Shari’a Board.

4 Capital Adequacy and Management

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

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

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

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

4.1 Capital Structure

Bank has equity of USD 80,000,000 and does not have any other equity related instrument including innovative, complex or hybrid capital instruments.

CAPITAL STRUCTURE		
Components of capital	**Tier One**	**Tier Two**
Core capital - Tier I:		
Issued and fully paid ordinary shares	80,000,000	-
Legal / statutory reserves	7,409,515	-
Retained earnings	(2,696,022)	-
Less:		
Unrealized gross losses arising from fair valuing equity securities	(1,995,759)	-
Tier 1 Capital	**82,717,734**	**-**
Unrealized gross gains arising from fair valuing equities (45% only)	-	2,229,893
Tier 2 Capital	**-**	**2,229,893**
Total Available Capital	**82,717,734**	**2,229,893**
Deductions:		
Excess amount over maximum permitted large exposure limit		
- Tier One	43,659,407	-
- Tier Two	-	2,229,893
Net Available Capital	39,058,327	0
Total Eligible Capital		**39,058,327**

4.2 Capital Adequacy

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

The Bank determines Risk weighted Assets according to CBB guidelines that seek to reflect the varying levels of risk attached to the assets.

The Bank's policy is to maintain a capital ratio, at all times, in excess of the minimum required by CBB. The current requirement for the Bank is 12%. Additionally the Bank is working along with a consultancy firm to formulate a comprehensive capital adequacy assessment plan relevant to the Bank's size and operations.

With effect from 1 January 2008, the Bank is required to comply with the provisions of the revised Capital Adequacy Module of the CBB (revised based on the Basel II framework) in respect of regulatory capital. The Bank has adopted the Standardised Approach for credit risk and market risk and the Basic Indicator Approach for operational risk management under the revised framework.

Risk Assets/ Categories	**Risk Weighted Assets (RWA)**	**Capital Charge @ 12% of RWA**
Credit Risk		
- Cash and cash equivalents	511,171	61,341
- Available for sale investments		
- Listed equities	11,941,124	1,432,935
- Unlisted equities	2,416,671	290,001
- Murabaha receivables	1,305,118	156,614
- Receivables from sale of investments	1,415,295	169,835
- Deferred payment sale receivables	1,480,680	177,682
- Investment property	21,484,887	2,578,186
- Asset held-for-sale	13,595,564	1,631,468
- Other assets	5,321,255	638,551
- Fixed assets	1,579,576	189,549
Total Credit Risk	**61,051,341**	**7,326,162**
Market Risk		
- Equity position risk	3,314,993	397,799
- Foreign exchange risk	24,797,704	2,975,724
Total Market Risk	**28,112,697**	**3,373,523**
Total Operational Risk	**74,857,969**	**5,988,638**
Total Risk Weighted Assets (a)	164,022,007	
Total eligible capital (b)	39,058,327	
Tier 1 and Total Capital Adequacy Ratio ((b)/(a))	23.81%	

5 Risk Management

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

In keeping with the industry best practices, the Bank's Board of Directors has the overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established an Executive Committee (EXCOM) that has the responsibilities of overall risk management, risk strategy and policies of the Bank. EXCOM is also responsible for developing and monitoring bank's operations and policies across various other functions. The Executive Committee consists of three non-executive directors of the Bank along with the Chief Executive Officer (CEO) as an attendee. The Executive Committee reviews and approves the CEO's recommendations for investment strategies, investment proposals, various products and services and where deemed necessary, also refers decisions to the Board of Directors. The Risk Management Department assists with the overall management of the Bank's risks.

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

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

The Bank with the help of external consultants has formulated a 5 year business plan. Further, the Bank is in the process of establishing and implementing exposure limits, commensurate with its new business strategy and market environment as well as set levels of risk the Bank is willing to accept in relation to its available capital.

The risk management philosophy of the Bank as enunciated in the Risk Management Manual under preparation is to identify, capture, monitor and manage the various dimensions of risk with the objective of protecting asset values and income streams so that the interest of the Bank's shareholders (and others to whom the Bank owes a liability) are safeguarded.

As on 31st December, 2009 the risk management strategies for the risk areas, to which the Bank is exposed to, were not finalised and implemented, thus no comments can be given regarding the effectiveness of the same throughout the reporting period.

5.1 Credit and Counterparty Risk

Credit risk may arise from all products and services where counterparties of the Bank fail to meet their payment obligations in accordance with terms and conditions of the contract. This risk exists in all activities of the Bank, including the banking book and both on or off the balance sheet.

The Bank's credit risk arises mainly from cash and balances with banks, Murabaha receivables, Mudaraba investment, receivable from sale of investments, receivable from Mudarib, deferred payment sale receivables, dividend receivable and other assets.

The following table demonstrates Bank's credit risk exposure:

Credit Risk Exposure (all figures in US Dollars)		
	Own capital and current account	
Portfolios	**Total gross credit risk exposure**	**Average gross credit exposure over the period ***
Cash and cash equivalents	2,557,184	6,447,784
Available for sale investments	21,252,382	24,946,216
Murabaha receivables	3,243,848	3,243,848
Mudaraba investment	4,000,000	4,250,000
Receivable from mudarib	6,127,801	6,882,394
Receivables from sale of investments	11,846,542	20,110,926
Deferred payment sale receivables	3,680,203	3,680,203
Investment property	10,742,443	10,598,853
Asset held-for-sale	6,797,782	9,770,542
Other assets	17,460,260	14,211,595
Fixed assets	1,579,576	1,742,972
Total	**89,288,021**	**105,885,333**

* These have been computed based on a quarterly average.

The Bank is in process to form an Investment committee which will be the highest management-level authority on all investment exposures. The constitution & terms of reference of this committee would be subject to the approval of the Board of Directors of the Bank. The overall role of Investment Committee will be to facilitate the investment business of the Bank in the most effective and efficient manner.

As part of the Bank's credit risk strategy, the Bank will establish a credit risk appetite which will be quantified in terms of a limit structure for credit risk. The limit structure will also strength the Bank's control over the credit risk and to maintain a proper diversification of its activities thereby avoiding concentration of risks for counterparty, country, sector, industry and region.

The Risk Management Department (RMD) coordinates with the Bank's management in reviewing investment/credit proposals and post sanction review and monitoring, at all stages of the deal cycle, up to exit and provides an independent review.

Bank has initiated steps to ensure adequate segregation of duties so that the RMD will independently deal with:

- Formulating investment and credit policies in consultation with business units, covering credit assessment, risk reporting, documentary and legal procedures, and compliance with relevant regulatory requirements.
- Establishing the authorization structure for the approval and renewal of investment and credit facilities. Authorization limits are currently allocated to Executive committee and Board of Directors.
- Reviewing and assessing investment and credit risk.
- Limiting concentrations of exposure to counterparties, geographies and industries and product types.
- Developing and maintaining the Bank's risk grading in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The current risk grading framework consists of two broad grades "Unimpaired" and "Impaired", reflecting risk of default and the availability of collateral or other credit risk mitigation. Risk is assessed on an individual basis for each investment / receivable and is reviewed on a need basis i.e. without any fixed periodicity of review. The management of the Bank analyses its credit risk portfolio to assess its recoverability and classifies its exposures as impaired only when it establishes that the time value of money related to any recovery is significant. What is significant requires management judgment and varies from one exposure to another.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types.

The Bank places its liquid assets like cash only with Islamic financial institutions of requisite standing.

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

	Banking and financial institutions	**Investment Companies**	**Others**	**Total**
Past due but not impaired Islamic financing contracts	7,018,115	3,680,203	1,776,670	12,474,988
Impaired financing contracts	12,061,513	6,218,987	20,678,651	38,959,151
Total	**19,079,628**	**9,899,190**	**22,455,321**	**51,434,139**

Aging of past due and impaired financing contracts:

	Banking and financial institutions	**Investment Companies**	**Others**	**Total**
Less than 3 months	-	-	-	-
3 months – 1 year	-	-	969,093	969,093
1 year – 3 years	19,079,628	6,218,987	20,611,228	45,909,843
Over 3 years	-	3,680,203	875,000	4,555,203
Total	**19,079,628**	**9,899,190**	**22,455,321**	**51,434,139**

Movement in specific provisions during the year:

	Banking and financial institutions	**Investment Companies**	**Others**	**Total**
Balance at the beginning of the year	-	-	2,304,059	2,304,059
Impaired charge during the year	2,925,084	2,701,297	1,483,430	7,109,811
Balance at the end of the year	**2,925,084**	**2,701,297**	**3,787,489**	**9,413,870**

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

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

Financial assets, which are past due but not impaired are primarily with related parties and are considered to be low risk as these are not disputed and are being negotiated among the group companies for settlement by way of exchange with other investment grade assets.

5.1.1 Credit Risk Mitigation

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

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

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

5.1.2 Concentration Risk

Concentration risk arises when a number of counterparties are engaged in similar economic activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. The Bank seeks to manage its concentration risk by establishing geographic and industry wise concentration limits. Presently, all of the Bank’s assets are, however, in GCC region as this has strategic fit with Bank’s overall business approach and also the current market imperatives.

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

Own capital

Asset category	Geographic area			
	Bahrain	Kuwait	Others countries	Total
Cash and cash equivalents	2,550,737	6,447		2,557,184
Available for sale investments	14,525,290	5,496,788	1,230,304	21,252,382
Murabaha receivables		3,243,848		3,243,848
Mudaraba investment		4,000,000		4,000,000
Receivables from mudarib		6,127,801		6,127,801
Receivables from sale of investments		11,846,542		11,846,542
Deferred payment sale receivables		3,680,203		3,680,203
Investment property	10,742,443		6,797,782	17,540,225
Other assets	1,042,280	15,942,980	475,000	17,460,260
Fixed assets	1,579,576			1,579,576
Total	**28,860,750**	**50,344,608**	**8,503,086**	**89,288,021**

Bank's Credit Risk exposures distribution by industry or counterparty

Own capital and current account

Asset category	Industry sector			
	Banks and financial institutions	Investment companies	Others	Total
Funded				
Cash and cash equivalents	2,557,184			2,557,184
Available for sale investments	18,313,757	479,769	2,458,856	21,252,382
Murabaha receivables			3,243,848	3,243,848
Mudaraba investment	4,000,000			4,000,000
Receivable from Mudarib	6,127,801			6,127,801
Receivables from sale of investments	8,328,852	3,517,690		11,846,542
Deferred payment sale receivables		3,680,203		3,680,203
Investment property			17,540,225	17,540,225
Other assets	1,744,621	150,371	15,565,268	17,460,260
Fixed assets			1,579,576	1,579,576
Total	**41,072,215**	**7,828,033**	**40,387,773**	**89,288,021**

The Bank does not have any unfunded exposures.

As required by CBB under section CM 4.4.5 of the CBB Rulebook, the Bank may not incur an exposure to an individual counterparty or group of closely related counterparties, which exceeds 15% of the bank's capital base without the prior written approval of the Agency. The Bank's concentrations of exposure to individual counterparties and group of closely related counterparties in excess of 15% are given below

Concentration of risk	
Counterparties	Own capital
	Total exposure
Counterparty # 1 – Individual	20,400,131
Counterparty # 2 - Individual	19,303,093
Counterparties – Closely Related	18,928,219
Total	**58,631,443**

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

Impaired exposures, Past Due exposures and allowances		
Own capital		
Geographic area	**Past due Islamic financing contracts**	**Specific impairment provision**
Bahrain	887,733	
Kuwait	49,671,406	9,013,870
Others countries	1,283,536	808,535
Total	**51,842,675**	**9,822,405**

5.2 Market Risk

The overall risk management philosophy of the Bank as enunciated in the Risk Management Manual under preparation is to identify, capture, monitor and manage the various dimensions of risk with the objective of protecting asset values and income streams such that the interests of the Bank's various stakeholders are safeguarded.

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

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

The Bank has following sources of market risk:

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

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

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

Particulars	5% decrease	5% increase
Trading investments	(286,937)	286,937

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

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

Particulars	Gross exposure	Risk weighted assets (RWA)	Capital requirements @ 12% of RWA	Maximum capital requirement during the year	Minimum capital requirement during the year
Equity Position	5,738,749	3,314,993	397,799	4,518,864	397,799
Foreign Exchange Position	24,797,704	24,797,704	2,975,724	7,962,262	2,975,724

5.2.1 Currency Risk

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

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

Currency	2008 US$ Equivalent
Bahraini Dinar	48,638,488
Kuwaiti Dinar	24,797,704
United Arab Emirates Dirham	6,797,782

Sensitivity Analysis:

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

Currency	**5% decrease**	**5% increase**
Kuwaiti Dinar	1,305,142	(1,180,843)

Note: the sensitivity analysis is not done for currencies (Bahraini Dinar and UAE Dirham) that are pegged to US Dollar

5.3 Operational Risk

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

The Bank is in the process of implementing an operational risk framework of the Basic Indicator Approach (BIA), as per CBB guidelines. This framework includes measuring, monitoring and managing operational risk across the Bank. This framework uses tools like Risk and Control Self Assessment (RCSA), identification of Key Risk Indicators, preparation of operational loss database etc.

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

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

The overall responsibility for the management and control of operational risk rests with the Board of Directors. However this responsibility is delegated to the CEO and the RMD.

5.3.1 Risk and Control Self Assessment

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

RCSA exercise is proposed to be undertaken on an annual basis by the business and support units in co-ordination with RMD. The Bank has already undertaken RCSA of its activities in 2008.

5.3.2 Operational Risk Loss Database

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

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

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

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

Particulars	**Average gross income**	**Risk weighted asset**	**Capital charge**
Operational risk	39,924,250	74,857,969	5,988,638

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

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

Particulars	**Amount**
Gross Income	39,924,250
Amount of non-Shari'a-compliant income	634
Number of Shari'a violations that were identified and reported during the financial year	None

As per CBB rulebook, Gross income is defined as:

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

Less

- Investment account holders' share of income
- Takaful income

5.3.3 Legal Risk – Current Litigations and Claims

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

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

- In 2004, the Bank entered into a sale and purchase agreement with a local financial institution to purchase shares of a related party on behalf of another related party. The net amount due to the financial institution was US$ 3,670,202. In accordance with the terms of the agreement, the Bank pledged certain of its investments with a carrying value of US$ 6,321,010 as at 31 December 2008. Subsequently, the agreement was terminated by the financial institution due to disputes with the Bank and as a result, the pledged investments have been retained by the financial institution. In the opinion of the Bank's lawyers and management, the agreement was wrongfully terminated and following the financial institution's refusal to settle the matter amicably, the Bank has filed a legal case in the Bahrain courts against the financial institution for wrongful possession of investments. As a result, the court has taken custody of the shares under dispute. The related party on whose behalf the transactions was entered has provided a manager's cheque for an equal amount which has been deposited with the court. This amount is included under deferred payment sale receivables.

The related party on whose behalf the transaction was entered into has also agreed to reimburse the Bank for legal expenses and any losses arising on final settlement with the financial institution. Accordingly, in the opinion of the directors, no provision is required to be made in the financial statements against the investments pledged with the financial institution or for contingent claims that might arise on final settlement.

- There are two labour cases running against the bank from two former employees seeking compensations as a result of alleged unfair termination of their services with the bank. The Bank's legal position is strong and a material liability to the Bank is not expected on the cases.

The bank has appointed an external law firm to deal with the above cases.

5.4 Liquidity Risk

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

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

The short-term liabilities of the bank mainly represent the operating account payables only. The Bank is in the process of establishing a senior management level investment committee, which will set policies and procedures for liquidity management also.

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

2008	**Up to 1 month**	**1 to 3 months**	**3 months to 1 year**	**1 to 3 years**	**Over 3 years**	**Total**
Assets						
Cash and cash equivalents	2,557,184	-	-	-	-	2,557,184
Trading investments	-	-	5,738,750	-	-	5,738,750
Available-for-sale investments	-	-	6,538,539	14,713,843	-	21,252,382
Murabaha receivables	3,243,848	-	-	-	-	3,243,848
Receivable from Mudarib	6,127,801	-	-	-	-	6,127,801
Mudaraba investment	-	-	4,000,000	-	-	4,000,000
Receivables from sale of investments	11,846,542	-	-	-	-	11,846,542

Deferred payment sale receivables	-	-	3,680,203	-	-	3,680,203
Investment property	-	-	-	10,742,443	-	10,742,443
Asset held-for-sale	-	-	6,797,782	-	-	6,797,782
Other assets	14,163,730	1,083	3,194,024	86,662	14,761	17,460,260
Equipment	-	-	-	-	1,579,576	1,579,576
Total assets	**37,939,105**	**1,083**	**29,949,298**	**25,542,948**	**1,594,337**	**95,026,771**

Liabilities						
Due to a financial institution	-	-	3,670,202	-	-	3,670,202
Murabaha payable	3,229,064	-	-	-	-	3,229,064
Other liabilities	137,378	81,796	115,368	119,911	-	454,453
Total liabilities	**3,366,442**	**81,796**	**3,785,570**	**119,911**	**-**	**7,353,719**
Off-balance sheet items						
Restricted investment accounts	**-**	**-**	**16,646,823**	**-**	**-**	**16,646,823**

Following are the key liquidity ratios as at 31 December 2008:

Description	Ratio
Short Term Assets : Total Assets	0.71 : 1.00
Short Term Assets : Short Term Liabilities	9.39 : 1.00

5.5 Rate of Return Risk

Rate of return risk arises due to different timing of re-pricing of the Bank's assets and liabilities. The Bank's exposure to rate of return risk is limited to cash and cash equivalents. The cash and cash equivalents amount as on 31st December 2008 is USD 2,557,184. The Bank does not have significant rate of return risk sensitivity due to the short-term nature of its cash and cash equivalents.

Although the Bank's exposure to the rate of return risk is insignificant the Bank is considering the implementation of a strategy to clearly identify the rate of return risk sensitive products and activities it wishes to engage in. In addition the Bank proposes to establish a limit structure to monitor and control the rate of return risk.

5.6 Equity Price Risk in the Banking book

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

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

Particulars	**5% decrease**	**5% increase**
Available-for-sale investments	(961,976)	961,976

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

5.6.2 Equity based financing
The Bank has following gross and average exposures to equity-based financing structure by type of financing contract.

Total and Average Gross Exposure - Equity based financing structures		
Portfolios	**Total gross exposure**	**Average gross exposure**
Mudaraba	4,000,000	4,250,000
Total	**4,000,000**	**4,250,000**

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

Types And Nature of Investments		
	Publicly traded	**Privately held**
Investment in shares	19,009,208	1,795,341
Investment in managed funds		447,833
Total	**19,009,208**	**2,243,174**

Additionally the Bank has following cumulative realized gains or losses arising from sales or liquidations, total unrealized gains and losses recognized in the balance sheet but not through the P&L, and any unrealized gains and losses included in Tier One and Tier Two capital:

Particulars	**Amount**
Cumulative realized gains (losses) arising from sales or liquidations in the reporting period	42,787
Total unrealized gains (losses) recognized in the balance sheet but not through P&L	2,959,559
Unrealized gains (losses) included in Tier One Capital	(1,995,759)
Unrealized gains (losses) included in Tier Two Capital	2,229,893

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

Equity grouping	**Risk weighted assets (RWA)**	**Capital requirements @ 12% of RWA**
Investment in shares	18,982,341	2,277,881
Investment in managed funds	660,227	79,227
Total	**19,642,568**	**2,357,108**

5.7 Displaced Commercial Risk

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

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

6 Restricted Investment Accounts

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

Balance as of 31 Dec 2008 net of provision:

Exposures	No of units (000)	Average value per share US$	Total US$
Murabaha with Lotus Air Ltd	-	-	317,689
Investments in International Investment Group K.S.C.C. *	12,887	0.44	5,670,202
Portfolio managed by the Bank **	2,940	3.63	10,658,932
			16,646,823

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

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

** Managed Portfolio
During 2009, the Bank signed a portfolio Management Agreement with some related parties. The underlying assets of the portfolio comprise the shares of one of the related parties that is also a partial owner of the portfolio.

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

7 Related party transactions

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

A significant portion of the Bank's income arises from transactions with related parties. Transactions with related parties are undertaken on terms agreed between the parties.

Receivables from related parties are due from a considerable period of time and restructuring has not been done on these exposures.

Significant balances with related parties at 31 December comprise:

Assets	**Nature of relationship**	**2008**	**2007**
Trading investments	Group entity	5,451,147	29,727,074
Available-for-sale investments	Shareholders	252,280	267,567
	Group entities	8,086,642	8,045,630
		8,338,922	8,313,197
Murabaha receivables	Group entity	3,243,848	3,243,848
Mudaraba investments	Shareholder	4,000,000	4,500,000
Receivables from sale of investments	Shareholders	11,846,542	29,860,901
Deferred payment sale receivables	Shareholder	3,680,203	3,680,203
Receivable from Mudarib	Shareholder	6,127,801	11,896,174
Other assets:			
Advance towards purchase of available-for-sale investments	Group entity	-	45,579
Current account	Shareholders	183,839	175,693
	Group entity	13,979,891	5,490,793
		14,163,730	5,666,486
Dividend receivable	Shareholder	2,581	2,044
	Group entity	1,776,670	812,215
		1,779,251	814,259
Due from Chairman	Key Management Personnel	-	99,161
Management and advisory fees receivable	Group entity	-	71,701

Liabilities			
Murabaha payables	Shareholder	3,229,064	3,229,064

Significant transactions with related parties include:

Income		**2008**	**2007**
Income from trading investments	Group entity	1,007,824	771,937
Income from available-for-sale investments	Shareholder	569	955
Fair value losses on trading investments	Group entity	(24,275,927)	(9,566,793)
Income from Mudaraba investment	Group entity	192,452	79,377
Income from Murabaha receivables	Group entity	-	222,858
Other income – refund of payments to Managing Director	Key Management Personnel	1,000,000	-
Expenses			
Impairment allowance	Group entity	1,483,430	2,312,594
	Shareholders	5,626,381	-
		7,109,811	2,312,594

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

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

	2008	**2007**
Salaries and other short-term benefits	244,105	168,572
Post employment benefits	9,655	3,820