

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2009

1. ACTIVITIES

National Bank of Bahrain BSC, a public shareholding company, was incorporated in the Kingdom of Bahrain by an Amiri decree in January 1957. The Bank operates in Bahrain under a banking licence issued under Rule Book Volume 1 by the Central Bank of Bahrain. The overseas branches in Abu Dhabi (United Arab Emirates) and Riyadh (Kingdom of Saudi Arabia) operate under the laws of those respective countries. The Bank is principally engaged in providing retail and wholesale commercial banking services, treasury and investment activities, and investment advisory services.

The Bank's registered address is National Bank of Bahrain BSC, P.O.Box 106, NBB Tower, Government Avenue, Manama, Kingdom of Bahrain. The shares of the Bank are listed on the Bahrain Stock Exchange, Manama, Kingdom of Bahrain.

2. SIGNIFICANT ACCOUNTING POLICIES

a. Statement of Compliance

The financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS), the requirements of the Bahrain Commercial Companies Law 2001 and the Central Bank of Bahrain and Financial Institutions Law 2006.

b. Basis of preparation

The financial statements of the Bank are presented in Bahraini Dinar (BHD) being the functional currency of the Bank. The US Dollar (US\$) amounts are presented for the convenience of the reader. The Bahraini Dinar has been translated to US dollar at the rate of BHD 0.376 to US\$ 1 (2008: BHD 0.376 to US\$ 1).

The financial statements have been prepared on the historical cost convention except for financial instruments at fair value through profit or loss, available for sale securities and derivative financial instruments which are measured at fair value. The principal accounting policies applied in the preparation of these financial statements have been consistently applied to all the years presented except as described in note 2.b.i) below:

i) Standards, amendments and interpretations effective on or after 1 January 2009

The following standards, amendments and interpretations, which became effective in 2009 are relevant to the Bank.

IAS 1 (revised) - Presentation of Financial Statements

Revised IAS 1- Presentation of Financial Statements (2007) became effective as of 1 January 2009. As a result, the Bank presents in the statement of changes in equity all owners' changes in equity, whereas all non-owners' changes in equity are presented in the statement of comprehensive income. Total comprehensive income may be presented in either:

- a single statement of comprehensive income (effectively combining both the income statement and all non-owners' changes in equity in a single statement), or
- in an income statement and a separate statement of comprehensive income.

The Bank has opted to present the total comprehensive income in two separate statements - a statement of income and a separate statement of comprehensive income.

In accordance with the transitional requirements of the Standard, the Bank has provided full comparative information. The adoption of the amendment results in additional disclosures but does not have an impact on the financial position or the comprehensive income of the Bank.

Amendments to IFRS 7 - Financial instruments disclosures

The IASB published amendments to IFRS 7 in March 2009. The amendment requires enhanced disclosures about fair value measurements and liquidity risk. In particular, the amendment requires disclosure of fair value measurements by level of a fair value measurement hierarchy. The adoption of the amendment results in additional disclosures but does not have an impact on the financial position or the comprehensive income of the Bank.

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IFRS 8 - Determination and presentation of operating segments

IFRS 8 - Determination and presentation of operating segments became effective as of 1 January 2009. The Bank's operating segments for external reporting is based on the information that is internally provided to the Chief Executive Officer, who is the Bank's chief operating decision maker. Previously, operating segments were determined and presented in accordance with IAS 14 Segment Reporting. There is no change in the determination of the operating segments arising from the adoption of this standard.

Comparative segment information has been re-presented in conformity with the transitional requirement of IFRS 8 and only impacts presentation and disclosures aspects but does not have an impact on the financial position or the comprehensive income of the Bank.

Improvements to IFRS (issued in May 2008)

Improvements to IFRS issued in May 2008 contained numerous amendments to IFRS that the IASB considers non-urgent but necessary. 'Improvements to IFRS' comprise amendments that result in accounting changes to presentation, recognition or measurement purposes, as well as terminology or editorial amendments related to a variety of individual IFRS standards. The amendments effective for annual periods beginning on or after 1 January 2009 have been adopted by the Bank and no material changes to accounting policies arose as a result of these amendments.

ii) Standard and interpretations issued but not yet effective

The following new / amended IFRS's and interpretations have been issued which are not yet mandatory for adoption by the Bank.

IFRS 9 Financial instruments part 1: Classification and measurement

IFRS 9 was issued in November 2009 and is applicable for reporting period beginning on or after 1 January 2013. This standard replaces those parts of IAS 39 relating to the classification and measurement of financial assets and the key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flows represent only payments of principal and interest (i.e. it has only 'basic loan features'). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognize unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

The Bank is considering the implications of the standard, its impact and the timing of its adoption.

IAS 24 Related Party Disclosures (revised 2009)

The revised standard is applicable for reporting period beginning on or after 1 January 2011. The revised IAS 24 Related Party Disclosures amends the definition of a related party and modifies certain related party disclosure requirements for government-related entities. The revised standard will result in certain changes to disclosures on Related Parties.

Amendments to IFRS 8 Operating Segments

These amendments are applicable for reporting periods beginning on or after 1 January 2010 and clarify that segment information with respect to total assets is required only if such information is regularly reported to the chief operating decision maker. This amendment is not expected to result in any change in the Bank's financial statements.

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Improvements to IFRS (issued in April 2009)

Improvements to IFRS issued in April 2009 contained numerous amendments to IFRS that the IASB considers non-urgent but necessary. 'Improvements to IFRS' comprise amendments that result in accounting changes to presentation, recognition or measurement purposes, as well as terminology or editorial amendments related to a variety of individual IFRS standards. The amendments are effective for annual periods beginning on or after 1 January 2010 with earlier adoption permitted. No material changes to accounting policies are expected as a result of these amendments.

iii) Early adoption of standards

The Bank did not early adopt new or amended standards in 2009.

c. Foreign currencies

Foreign currency transactions

Foreign currency transactions are initially recorded at rates of exchange prevailing at the value date of the transactions. Monetary assets and liabilities in foreign currencies are translated to respective functional currencies at the rates of exchange prevailing at the balance sheet date. Realised and unrealised exchange gains and losses arising on such translation are included in Other Income.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in income statement, except for differences arising on the retranslation of available-for-sale equity instruments which are recognised directly in equity.

Foreign Operations

The assets and liabilities of the overseas branches are translated into Bahraini Dinar at the period-end rates of exchange. The income and expenses of these overseas branches are translated into Bahraini Dinar at average exchange rates for the period. Differences resulting from the translation of the opening net investment in these overseas branches are taken directly to equity.

d. Use of estimates and management judgement

The preparation of financial statements requires management to make estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses.

The use of considerable judgement and estimates is principally required in the estimation of the amount and timing of future cash flows when determining the level of provisions required for individually significant non-performing loans and advances, estimating incurred losses that are inherent within the loans and advances portfolio, classification of financial assets and impairment losses for available-for-sale financial assets.

The Bank considers that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below cost. The determination of significant or prolonged decline requires judgment. In making this judgment, the Bank evaluates among other factors, the normal volatility in share price for the specific equity instrument and also the general market index. In addition, the Bank considers impairment when there is evidence of deterioration in the financial health of the investee company, industry and sector performance, changes in technology and operational and financing cash flows.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised, if the revision affects only that period or in the period of the revision and future period if the revision affects both current and future periods.

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e. Accounting for income and expenses

i) Interest income and expenses are recognised in the income statement on an accrual basis using the effective interest rate method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial asset or liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or liability. The application of the effective interest rate method has the effect of recognising interest income and interest expense evenly in proportion to the amount outstanding over the period to maturity or repayment. In calculating the effective interest rate, cash flows are estimated taking into consideration all contractual terms of the financial instrument but excluding future credit losses.

ii) Fees and commissions that are integral to the effective interest rate of a financial asset or liability are included in the calculation of the effective interest rate. Other fees and commissions are recognised as the related services are performed or received, and are included in fee and commission income.

iii) Dividend income is recognised when the right to receive a dividend is established.

iv) Short term employee benefit obligations are measured on an undiscounted basis and are expensed as the related services are provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit sharing plans if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

The Bank has different retirement benefit schemes for its employees in Bahrain and its overseas branches, which are in accordance with the relevant labour laws of the respective countries. The retirement benefit scheme is in the nature of a 'Defined Contribution Plan' for employees who are covered by the social insurance pension schemes in Bahrain and the overseas branches. Other employees are entitled to leaving indemnities payable in accordance with the employment agreements or under the respective labour laws, based on length of service and final remuneration. This liability, which is unfunded, is considered as a 'Defined Benefit Plan' which represents a defined benefit scheme under IAS 19, and is provided for on the basis of the cost had all such employees left at the balance sheet date. The cost of providing these retirement benefits is charged to the income statement.

The Bank has a voluntary employees saving scheme. The Bank and the employees contribute monthly on a fixed percentage of salaries basis to the scheme. The scheme is managed and administered by a board of trustees who are the employees of the Bank. The Bank's share of contribution to this scheme is charged to the income statement.

v) Other expenses are recognised in the period in which they are incurred on an accrual basis.

f. Financial assets and liabilities

i) Investments at fair value through profit or loss

Investments at fair value through profit or loss: Investment securities which are acquired with an intent to hold for an indefinite period of time, and are managed, evaluated and reported internally on a fair value basis are designated as investments at fair value through profit or loss. These investments are carried at fair value based on quoted market prices, lead manager quotes or amounts derived from cash flow models as appropriate. Any unrealised gains and losses arising from changes in fair value are recognised in the income statement.

Trading Securities: Securities which are either acquired for the purpose of generating a profit from short-term fluctuations in price or are included in a portfolio in which a pattern of short-term profit taking exists are categorised as trading securities. These securities are initially recognised at fair value and subsequently measured at fair value based on quoted market prices. Realised and unrealised gains and losses on trading securities are included in the income statement.

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ii) Held To Maturity Investments

Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank positively intends, and is able, to hold until maturity. Held to maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method, less any impairment losses.

iii) Available-for-Sale Securities

Securities which are non-derivative and which are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity, changes in interest rates or concerns with respect to credit deterioration are categorised as available-for-sale securities. Available-for-sale securities which comprise both debt and equity securities are initially recognised at fair value, including transaction costs, and subsequently measured at fair value based on quoted market prices or amounts derived from cash flow models as appropriate. Unquoted and illiquid equity investments for which fair values cannot be reliably measured are stated at cost less provision for impairment. Unrealised gains and losses arising from changes in the fair values of available-for-sale securities are recognised in other comprehensive income. The cumulative fair value adjustments on available-for-sale securities which are sold or otherwise disposed of and which had previously been recognised in other comprehensive income are transferred to the income statement.

iv) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances are stated at amortised cost, adjusted for changes in fair value under any effective hedging arrangement, less provision for impairment.

v) Customer deposits

Customer deposits are initially recognised at their fair value and subsequently measured at their amortised cost using the effective interest method.

vi) Financial guarantees

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specific debtor fails to make payment when due in accordance with the contractual terms.

Financial guarantees are initially recognised at fair value (which is the premium received on issuance). The premium received is amortised over the life of the financial guarantee. The guarantee liability (the notional amount) is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). The unamortised portion of the premium on these financial guarantees is included under other liabilities.

vii) Derivative financial instruments

All derivative financial instruments are initially recognised at cost, being the fair value at contract date, and are subsequently re-measured at their fair values. Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in same income statement line as the hedged item.

In the case of fair value hedges that meet the criteria for hedge accounting, any gain or loss arising from remeasuring the hedging instruments to fair value as well as the related changes in fair value of the item being hedged are recognised in Other Income.

In the case of cash flow hedges that meet the criteria of hedge accounting, the portion of the gain or loss on that hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion, if any, is recognised in the income statement.

All derivative financial instruments are recognised in the balance sheet as either assets (positive fair values) or liabilities (negative fair values).

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viii) Repos and Reverse repos

Where securities are sold subject to a commitment to repurchase them at a specified future date (repo) and at a predetermined price, they are not derecognised and the consideration received is classified as Borrowings under Repurchase Agreements. The difference between the sale and repurchase price is treated as an interest expense and accrued over the life of the repo agreement using the effective yield method. Conversely, securities purchased under a commitment to resell them at a specified future date (reverse repo) and at a predetermined price are not recognised on the balance sheet and the consideration paid is recorded in Placements with Banks and Other Financial Institutions. The difference between the purchase and resale price is treated as an interest income and accrued over the life of the reverse repo agreement using the effective yield method.

ix) Cash and cash equivalents

Cash and cash equivalents comprise cash, balances at central banks excluding mandatory cash reserves, placements with banks and other financial institutions that mature within three months of the date of placement, and short-term highly liquid investments that are readily convertible to cash and which are subject to an insignificant risk of change in value and mature within three months of the date of acquisition.

x) Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method.

xi) Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Bank establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available) and discounted cash flow analyses with accepted economic methodologies for pricing financial instruments.

xii) Categorisation of financial assets

The categorisation of financial assets into fair value through profit or loss, available-for-sale and held-to-maturity is done on the basis of the management intent at the time these securities are acquired and laid down investment policies.

g) Impairment

The carrying amount of the Bank's financial assets is reviewed at each reporting period to determine whether there is objective evidence that a specific asset may be impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reasonably. If any such evidence exists, the recoverable amount of the asset is estimated to determine the extent of impairment.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognised in income statement and reflected in an allowance account against loans and advances. When subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through income statement.

Impairment losses on available-for-sale investment securities are recognised by transferring the difference between amortised cost and current fair value out of equity to income statement. When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through income statement. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly to equity.

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Provision for impairment, pertaining to individually significant impaired loans and advances, is determined based on the difference between the net carrying amount and the estimated recoverable amount of the loans and advances, measured at the present value of estimated future cash flows from such loans and advances and discounting them based on their original effective interest rate. If a loan has a floating interest rate, the discount rate is the current effective rate determined under the contract.

Impairment and uncollectability is also measured and recognised on a portfolio basis for a group of similar loans and advances, that are not individually identified as impaired, on the basis of estimates of incurred losses that are inherent but not yet specifically identified within the loans and advances portfolio at the balance sheet date. The estimates are based on internal risk ratings, historical default rates, rating migrations, loss severity, macroeconomic and other relevant factors with historic loss experience being adjusted to reflect the effect of prevailing economic and credit conditions.

Loans and advances are written off after all reasonable attempts at restructuring and possible courses of action to achieve recovery have been exhausted and the possibility of any further recovery is considered to be remote.

h. Investment in associates

Associates are those entities in which the Bank has significant influence, but not control, over their financial and operating policies. Significant influence is presumed to exist when the Bank holds between 20 and 50 percent of the voting power of another entity. Associates are accounted for using the equity method and are recognised initially at cost. The financial statements of the Bank include its share of the income and expenses and equity movements of associates, after adjustments to align the accounting policies with those of the Bank, from the date that significant influence commences until the date that significant influence ceases. When the Bank's share of losses exceeds its interest in an associate, the carrying amount of that interest is reduced to nil and the recognition of further losses is discontinued except to the extent that the Bank has an obligation or has made payments on behalf of the associate.

i. Property and equipment

Property and equipment are initially recorded at cost and subsequently stated at cost less accumulated depreciation and impairment losses. Land is not depreciated and is stated at cost at the date of acquisition. Where an item of property and equipment comprises major components having different useful lives, they are accounted for separately. The cost of an item of property and equipment comprises its purchase price and any costs directly attributable to bringing the asset to the location and condition necessary for it to be put to its intended use. Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the property and equipment. The estimated useful lives are as follows:

Buildings	20 to 40 years
Furniture and Equipment	3 to 8 years

The residual value and the useful life of property and equipment are reviewed periodically and, if expectations differ from previous estimates, the change is recognised prospectively in the income statement over the remaining estimated useful life of the property and equipment.

j. Other provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

k. Off-setting

Financial assets and financial liabilities are only set-off and the net amount reported in the balance sheet when there is a legally enforceable right to set-off the recognised amounts and the Bank intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

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i. Settlement date accounting

All "regular way" purchases and sales of financial assets except for derivatives are recognised on the settlement date i.e. the date the Bank receives or delivers the asset. Regular way purchases and sales are those that require delivery of assets within the time frame generally established by regulation or convention in the market place. Derivative transactions are recognised on trade date i.e. the date the Bank contracts to purchase or sell.

m. Proposed appropriations

Dividends and other proposed appropriations are recognised as a liability in the period in which they are approved by the shareholders.

n. Remuneration policy

Board of Directors - The remuneration of the Board of Directors is approved by the shareholders. In addition, directors are paid nominal fees for attending meetings of the Board and its Committees.

Employees - The Bank's remuneration policies, which are approved by the Board of Directors, is applicable for all employees including the Chief Executive Officer. The remuneration primarily consists of monthly salaries and allowances. The Bank also has a discretionary profit sharing scheme based on the net income for the year and considering the employees' performance during the year.

o. Segment reporting

An operating segment is a component of the Bank that engages in business activities from which it may earn revenue and incur expenses, including revenues and expenses that relate to transactions with any of the other components of the Bank. All operating results of the operating segments are reviewed regularly by the Chief Executive Officer to make decisions about resource allocation and assess its performance, and for which discrete financial information is available.

p. Earnings per share

The Bank presents basic earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period.

q. Income tax liability

Companies are not liable to income tax in Bahrain.

3. FINANCIAL RISK MANAGEMENT

The Bank is exposed to the following types of risks:

- credit risk
- liquidity risk
- market risk
- operational risk

Risk management framework

The overall authority for risk management in the Bank is vested in the Board of Directors. The Board authorises appropriate credit, liquidity and market risk policies as well as operational guidelines based on the recommendation of Management. The Bank has established various committees that review and assess all risk issues. Approval authorities are delegated to different functionaries in the hierarchy depending on the amount, type of risk and nature of operations or risk. The Credit Policy and Risk Management (CPRM) division of the Bank provides the necessary support to Senior Management and the business units in all areas of risk management. This division functions independent of the business units and reports directly to the Chief Executive Officer.

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The Audit Committee of the Board is responsible for monitoring compliance with the Bank's 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 the Management Internal Control division, which undertakes both regular and adhoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee and to Management.

Credit Risk

Credit risk represents the potential financial loss as a consequence of a customer's inability to honour the terms and conditions of a credit facility. Such risk is measured with respect to counterparties for both on-balance sheet assets and off-balance sheet items.

The Bank has well laid out procedures, not only to appraise but also regularly monitor credit risk. Credit appraisal is based on the financials of the borrower, performance projections, market position, industry outlook, external ratings (where available) track record, account conduct, repayment sources and ability, tangible and intangible security, etc. Regular reviews are carried out for each account and risks identified are mitigated in a number of ways, which include obtention of collateral, counter-guarantees from shareholders and/or third parties. Adequate margins are maintained on the collateral to provide a cushion against adverse movement in the market price of collateral.

The Credit Review Department of the Bank analyses risks and puts forth its recommendations prior to approval by the appropriate authorities. In addition to rigorous credit analysis, the terms and conditions of all credit facilities are strictly implemented by the Credit Administration Department. An internal grading system and review process ensures prompt identification of any deterioration in credit risk and consequent implementation of corrective action.

The Bank's internal ratings are based on a 10-point scale, which takes into account the financial strength of a borrower as well as qualitative aspects to arrive at a comprehensive snapshot of the risk of default associated with the borrower. Ratings are further subdivided into categories, which reflect estimates of the potential maximum loss in an event of default. Risk Ratings assigned to each borrower are reviewed at least on an annual basis. Regular monitoring of the portfolio enables the Bank to identify accounts, which witness deterioration in risk profile. Consumer credit facilities which are granted based on pre-defined criteria such as salary assignment, maximum repayment obligation as a percentage of salary etc., are excluded from this rating system.

The Bank also uses the ratings by established rating agencies, viz., Moody's, Standard & Poor and Fitch as part of the appraisal process while considering exposures to rated entities.

Liquidity Risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk management ensures that funds are available at all times to meet the funding requirements of the Bank.

The asset/liabilities management policies of the Bank define the proportion of liquid assets to total assets with the aim of minimising liquidity risk. The Bank maintains adequate liquid assets such as inter-bank placements, treasury bills and other readily marketable securities, to support its business and operations. The Treasury department monitors the maturity profile of assets and liabilities so that adequate liquidity is maintained at all times. The Asset Liability Committee (ALCO) chaired by the Chief Executive Officer reviews the Liquidity Gap Profile and the Liquidity scenario and addresses strategic issues concerning liquidity.

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Market Risk

Market Risk is the risk of potential losses arising from movements in market prices of interest rate related instruments and equities in the trading portfolio and foreign exchange and commodities holdings throughout the Bank. The Bank's trading activities are governed by conservative policies that are clearly documented, by adherence to comprehensive limit structures set annually and by regular reviews. Quality and rating are the main criteria in selecting a trading asset. The Bank uses the Value-at-Risk (VaR) measure to estimate the exposure of the trading portfolio and total currency book to market risk. Daily reports in this regard are submitted to senior management for review and decision making purposes. The Bank also uses back testing to validate the VaR model and the results confirm that the model adequately captures risk within the Bank's trading portfolio.

Operational Risk

Operational Risk is the risk of monetary loss on account of human error, fraud, systems failures or the failure to record transactions. The Bank has well laid out procedures and systems that set out the methodologies for carrying out specific tasks. These systems and procedures are constantly reviewed and revised to address any potential risks.

The scope of the Bank's internal audit department encompasses audits and reviews of all business units, support services and branches. The internal audit process focuses primarily on assessing risks and controls and ensuring compliance with established policies, procedures and delegated authorities. New products and services are reviewed by the internal audit department and assessed for operational risks prior to their implementation. The internal audit department is operationally independent and reports significant internal control deficiencies to the Audit Committee.

Capital Management

The Bank's policy is to maintain sufficient capital to sustain investor, creditor and market confidence and to support future development of the business. The impact of the level of capital on return on shareholder's equity is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Central Bank of Bahrain's (CBB) Basel II guidelines outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1st January 2008. The Bank ensures that the capital adequacy requirements are met on a consolidated basis and also with local regulator's requirements, if any, in countries in which the Bank has branches. The Bank has complied with regulatory capital requirements throughout the year.

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4. TREASURY BILLS

Treasury bills are short-term treasury bills issued by the Government of Bahrain, Government of Saudi Arabia and short-term Islamic bills issued by the Government of Bahrain.

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
Government of Bahrain	114,915	305,625	6,408	17,043
Government of Saudi Arabia	10,012	26,628	10,169	27,045
Total	124,927	332,253	16,577	44,088

5. PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

Placements with banks and other financial institutions is part of the Bank's money market activities and comprises short-term lending to banks and other financial institutions.

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
Placements with banks	230,129	612,045	378,392	1,006,362
Placements with other financial institutions	15,962	42,452	32,091	85,348
Total	246,091	654,497	410,483	1,091,710

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
Current and call accounts	7,128	18,957	10,535	28,019
Placements Term	238,963	635,540	399,948	1,063,691
Total	246,091	654,497	410,483	1,091,710

6. TRADING SECURITIES

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
Equity Securities	391	1,040	385	1,024
Debt Securities	1,246	3,314	-	-
Total	1,637	4,354	385	1,024

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7. LOANS AND ADVANCES

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
Loans and advances to non-banks	1,054,917	2,805,630	975,504	2,594,426
Loans and advances to banks	111,338	296,112	133,103	353,997
Less: Provision for impairment	(14,832)	(39,447)	(12,896)	(34,298)
Total	1,151,423	3,062,295	1,095,711	2,914,125

b) Loans and advances are of a floating rate nature, since as per the Bank's loan agreements, the Bank reserves the right to change the rate of interest at any time in the event of money market fluctuations and/or other credit/banking considerations which may be set out from time to time by the Bank and/or any governmental or regulatory authority.

c) As at 31 December 2009, the amount of floating rate loans for which interest was reset by the Bank on agreed dates and based on an agreed fixed margin over a benchmark interest rate, amounted to BD 750.8 million (US\$ 1,996.8 million) [31 December 2008: BD 768.2 million (US\$ 2,043.1 million)].

d) The Bank holds collateral in the form of mortgage on properties, shares, cash deposits and counter-guarantees from shareholders and/or third parties etc against its credit exposures.

e) In accordance with the Central Bank of Bahrain guidelines, loans on which payments of interest or repayments of principal are 90 days past due, are defined as non-performing. The following is the ageing schedule of non-performing and other impaired and past due loans and advances.

The table shows the time period since the date of last repayment of principal or interest by the customer.

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
Over 3 months to 1 year	2,431	6,465	2,291	6,093
1 to 3 years	1,482	3,942	1,545	4,109
Over 3 years	3,507	9,327	4,815	12,806
Total	7,420	19,734	8,651	23,008

As at 31 December 2009, loans on which payments of interest or repayments of principal are overdue up to 90 days amounted to BD 3.56 million (US\$ 9.47 million) [31 December 2008: BD 1.26 million (US\$ 3.35 million)].

As at 31 December 2009, the principal outstanding of the non-performing loans portfolio on which interest is not being accrued amounted to BD 6.57 million (US\$ 17.47 million) [31 December 2008: BD 7.50 million (US\$ 19.95 million)].

Management estimates the fair value of collaterals held against individually impaired loans and advances to reasonably approximate BD 8.85 million (US\$ 23.54 million) [31 December 2008: BD 7.25 million (US\$ 19.28 million)].

f) During 2009, credit facilities amounting to BD 45.83 million (US\$ 121.89 million) were restructured [2008: BD 1.39 million (US\$ 3.70 million)]. Restructuring concessions mainly related to deferral of loan installments to assist customers overcome temporary cash crunch situations or to realign the payments with the borrowers'/projects' revised cash flow projections. Due to minor nature of concession, there was no significant impact on the Bank's provisions for loans and advances impairment and present and future earnings.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2009

g) Exposure to credit risk

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
TOTAL CARRYING AMOUNT	1,151,423	3,062,295	1,095,711	2,914,125
1. Individually impaired				
Substandard	847	2,252	1,150	3,058
Doubtful	268	713	177	471
Loss	9,894	26,314	12,055	32,061
Gross amount	11,009	29,279	13,382	35,590
Interest in suspense	(3,589)	(9,545)	(4,731)	(12,582)
Specific allowance for impairment	(6,601)	(17,556)	(7,521)	(20,003)
Individually impaired carrying amount	819	2,178	1,130	3,005
2. Past due below 90 days but not impaired				
Gross amount	3,556	9,457	1,257	3,343
Collective impairment provision	(25)	(66)	(6)	(16)
Past due but not impaired carrying amount	3,531	9,391	1,251	3,327
3. Neither past due nor impaired by internal rating				
Rated 1	81,286	216,186	107,598	286,165
Rated 2	46,199	122,870	28,999	77,125
Rated 3	155,328	413,106	326,846	869,271
Rated 4	243,606	647,888	261,372	695,138
Rated 5	298,221	793,141	135,642	360,750
Rated 6	40,850	108,644	2,697	7,173
Not rated *	289,789	770,715	235,545	626,450
Gross amount	1,155,279	3,072,550	1,098,699	2,922,072
Collective impairment provision	(8,206)	(21,824)	(5,369)	(14,279)
Carrying amount of neither past due nor impaired	1,147,073	3,050,726	1,093,330	2,907,793
Total carrying amount	1,151,423	3,062,295	1,095,711	2,914,125

* Includes mainly consumer loans and other facilities which are not assigned any ratings at inception.

h) Impairment provisions for loans and advances

Movements during the year	Specific Provision		Collective Impairment Provision		Total Provisions		Interest in Suspense	
	2009	2008	2009	2008	2009	2008	2009	2008
Amounts in BD 000's								
At 1 January	7,521	8,054	5,375	6,491	12,896	14,545	4,731	4,371
Charge for the year	938	128	3,500	-	4,438	128	722	744
Amounts written off against provision	(1,569)	(344)	(8)	(5)	(1,577)	(349)	(1,624)	(7)
Recoveries & write backs	(289)	(317)	(636)	(1,111)	(925)	(1,428)	(240)	(377)
At 31 December	6,601	7,521	8,231	5,375	14,832	12,896	3,589	4,731

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2009

In accordance with IAS 39, provision for impairment of loans and advances that are measured and recognized on a portfolio basis are collectively evaluated for impairment based on an incurred loss model.

The provisions and interest in suspense relate to loans and advances to non-banks.

In accordance with the Bank's policy and the Central Bank of Bahrain guidelines, interest on non-performing loans is reversed from income and is accounted for on a cash basis. During 2009, the suspension of interest income relating to such non-performing loans had an insignificant impact on the Banks' net interest income.

8. INVESTMENT SECURITIES

Investment securities comprises of the following:

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
Available-for-sale securities	480,903	1,278,997	377,705	1,004,535
Investment at fair value through profit or loss	8,107	21,561	26,683	70,965
Total	489,010	1,300,558	404,388	1,075,500
Provision for impairment on available for sale debt securities	(5,889)	(15,662)	(5,212)	(13,862)
Total investment securities	483,121	1,284,896	399,176	1,061,638

A) Available for sale securities

I. Breakdown of quoted and unquoted securities

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
Quoted:				
Debt securities	362,312	963,596	285,555	759,455
Equity securities	49,729	132,258	57,325	152,460
Provision for impairment on available for sale debt securities	(5,845)	(15,545)	(5,212)	(13,862)
Total quoted securities	406,196	1,080,309	337,668	898,053
Unquoted:				
Debt securities	53,990	143,590	19,347	51,455
Equity securities	14,872	39,553	15,478	41,165
Provision for impairment on available for sale securities	(44)	(117)	-	-
Total unquoted securities	68,818	183,026	34,825	92,620
Total available-for-sale securities	475,014	1,263,335	372,493	990,673

Available-for-sale securities at 31 December 2009 include securities amounting to BD 125.58 million (US\$ 334.01 million) [31 December 2008:BD 31.82 million (US\$ 84.64 million)], sold under agreement to repurchase.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2009

ii. Breakdown between fixed rate and floating rate available-for-sale debt securities (net of provision for impairment)

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
Fixed rate debt securities	231,938	616,856	111,771	297,263
Floating rate debt securities	178,647	475,125	187,919	499,785
Total	410,585	1,091,981	299,690	797,048

iii. Breakdown of available-for-sale debt securities by rating (net of provision for impairment)

The ratings given below are by established rating agencies.

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
AAA	179,165	476,503	116,348	309,436
AA	40,528	107,787	25,661	68,247
A	130,860	348,032	122,977	327,067
BBB	40,502	107,718	17,206	45,761
B+	1,340	3,564	-	-
Not-rated	18,190	48,377	17,498	46,537
Total	410,585	1,091,981	299,690	797,048

B) Investments at fair value through profit or loss

Fair value through profit or loss investment securities comprise investments in managed funds and capital protected notes as follows:

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
Investments in managed funds	1,852	4,925	19,345	51,449
Investments in capital protected notes	6,255	16,636	7,338	19,516
Total	8,107	21,561	26,683	70,965

9. ACCRUED INTEREST RECEIVABLE AND OTHER ASSETS

As at 31 December	2009		2008	
	BD'000	US\$'000	BD'000	US\$'000
Accrued interest receivable	6,333	16,843	8,355	22,221
Accounts receivable & prepayments	1,324	3,521	1,043	2,774
Others *	4,821	12,822	3,111	8,274
Total	12,478	33,186	12,509	33,269

* Others include investment of BD 1.73 million (US\$ 4.60 million) [31 December 2008: BD 1.35 million (US\$3.58 million)] in an associate company - The Benefit Company BSC (c) in which the Bank has an interest of 34.84 %. The carrying amount represents the cost of the investment and the share of profits less dividends received.

* Others include BD 1.32 million (US\$ 3.51 million) [31 December 2008 : BD 1.32 million (US\$ 3.51 million)] in respect of land and buildings acquired from customers and now held for disposal. The land and buildings are stated at lower of cost or net realisable value.