

**Bahrain Islamic Bank B.S.C.
Basel II, Pillar III Disclosures
31 December 2010
(Unaudited)**

Bahrain Islamic Bank B.S.C.

Basel II, Pillar III Disclosures

for the year ended 31 December 2010 (Unaudited)

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1 Background

The Public Disclosures under this section have been prepared in accordance with the Central Bank of Bahrain ("CBB") requirements outlined in its Public Disclosure Module ("PD"), Section PD-1: Annual Disclosure requirements, CBB Rule Book, Volume II for Islamic Banks. Rules concerning the disclosures under this section are applicable to Bahrain Islamic Bank B.S.C. (the "Bank") being a locally incorporated Bank with a retail banking license, and its subsidiary together known as (the "Group").

The Board of Directors seeks to optimize the Bank's performance by enabling the various Group business units to realize the Group's business strategy and meet agreed business performance targets by operating within the agreed capital and risk parameters and the Group risk policy framework.

2 Capital Structure and Capital Adequacy

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issuing sukuk etc. No changes were made in the objectives, policies and processes from the previous years.

The Group's capital structure is primarily made up of its paid-up capital, including share premium and reserves. From a regulatory perspective, the significant amount of the Group's capital is in Tier 1 form as defined by the CBB, i.e., most of the capital is of permanent nature.

The Group's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of financing facilities growth expectations for each business group, expected growth in off-balance sheet facilities and future sources and uses of funds. To assess its capital adequacy requirements in accordance with CBB requirements, the Group adopts the Standardized Approach for its Credit Risk, Basic Indicator Approach for its Operational Risk and Standardized Measurement Approach for its Market Risk. All assets funded by unrestricted investment accounts are subject to Board approval.

All transfer of funds or regulatory capital within the Group is only carried out after proper approval process.

As part of the risk management practice, the Bank has already implemented Sunguard system to be Basel II compliant as prescribed by CBB.

For the purposes of guidance every table was cross referenced with the relevant para number of the Central Bank of Bahrain's Public Disclosures Module.

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2 Capital Adequacy (continued)

Table – 1. Capital Structure (PD-1.3.12, 1.3.13, 1.3.14 and 1.3.15)

The following table summarizes the eligible capital as of 31 December 2010 after deductions for Capital Adequacy Ratio (CAR) calculation;

	Tier 1 BD'000	Tier 2 BD'000
Components of capital		
Issued and fully paid ordinary shares	72,552	-
General reserves	1,000	-
Legal / statutory reserves	10,268	-
Share premium	43,936	-
Retained earnings / losses (excluding current year net income/loss)	(4,798)	-
Less:		
Net losses for the year	(21,661)	-
Unrealized gross losses arising from fair valuing equity securities	(2,412)	-
Tier 1 Capital before PCD deductions	98,885	-
Asset revaluation reserve (45% only)		19
Unrealized gains arising from fair valuing equities (45% only)		348
Tier 2 Capital before PCD deductions		367
Total available capital		99,252
Deductions		
Significant minority investments in banking, securities and other financial entities unless pro-rata consolidated	(2,557)	(2,557)
Investment in insurance entity greater than or equal to 20%	(832)	(832)
Excess amount over maximum permitted large exposure limit	(8,069)	(8,069)
Total Deductions	(11,458)	(11,458)
Tier 1 and Tier 2 eligible capital before additional deduction	87,427	(11,091)
Additional deduction from Tier 1 to absorb deficiency in Tier 2	(11,091)	11,091
Tier 1 and Tier 2 eligible capital	76,336	-
TOTAL ELIGIBLE CAPITAL	76,336	-

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2 Capital Adequacy (continued)**Table – 1. Capital Structure (PD-1.3.12, 1.3.13, 1.3.14 and 1.3.15) (continued)**

	<i>Amount of exposures BD'000</i>
Total Credit Risk Weighted Assets	465,798
Total Market Risk Weighted Assets	22,656
Total Operational Risk Weighted Assets	52,968
TOTAL REGULATORY RISK WEIGHTED ASSETS	541,422
CAPITAL ADEQUACY RATIO	14.10%
Minimum requirement	12%

Table – 2. Capital requirements by type of Islamic financing contracts (PD-1.3.17)

The following table summarises the amount of exposures as of 31 December 2010 subject to standardized approach of credit risk and related capital requirements by type of Islamic financing contracts;

Type of Islamic Financing	<i>Risk Weighted Assets BD'000</i>	<i>Capital requirements BD'000</i>
Murabaha receivables*	209,853	25,182
Ijarah Muntahia Bittamleek*	24,933	2,992
Musharaka investments*	18,985	2,278
Mudaraba investments	747	90
Investment in Sukuk	12,650	1,518
Ijarah rental receivable	2,464	296
Other credit exposures	196,166	23,540
	465,798	55,896

*The amounts have been allocated on pro-rata basis due to system limitation.

2 Capital Adequacy (continued)

Table – 3. Capital requirements for market risk (PD-1.3.18)

The following table summarises the amount of exposures as of 31 December 2010 subject to standardized approach of market risk and related capital requirements;

	<i>BD'000</i>
Market Risk - Standardised Approach	
Foreign exchange risk	1,812
Total of Market Risk - Standardised Approach	1,812
Multiplier	12.5
RWE to be used in CAR Calculation	22,656
Total Market Risk Exposures	22,656
Total Market Risk Exposures - Capital Requirement	2,719

Table – 4. Capital Requirements for operational risk (PD-1.3.30 (a & b) and PD-1.3.19)

The following table summarises the amount of exposures as of 31 December 2010 subject to basic indicator approach of operational risk and related capital requirements;

	<i>Capital charge BD'000</i>
Indicators of operational risk	
Average Gross income	28,249
Multiplier	12.5
	353,113
Eligible Portion for the purpose of the calculation	15%
Total Operational Risk Exposure	52,968
Total Operational Risk Exposures - Capital Requirement	6,356

2 Capital Adequacy (continued)**Table – 5. Capital Adequacy Ratios (PD-1.3.20)**

The following are Capital Adequacy Ratios as of 31 December 2010 for total capital and Tier 1 capital;

	Total capital ratio	Tier 1 capital ratio
Top consolidated level	14.10%	14.10%

3 Risk Management**3.1 Bank-wide Risk Management Objectives**

The risk management philosophy of the Group 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 interest of the Group's shareholders (and others to whom the Group owes a liability) are safeguarded, while maximizing the returns intended to optimize the Group's shareholder return while maintaining its risk exposure within self-imposed parameters.

The Group has defined its risk appetite within the parameters of its Risk Strategy. The Group reviews and realigns its risk appetite as per the evolving business plan of the Group with changing economic and market scenarios. The Group also assesses its tolerance for specific risk categories and its strategy to manage these risks.

In addition to satisfying the minimum regulatory capital requirements of CBB, the Group seeks to constantly identify and quantify, to the extent possible, the various risks that are inherent in the normal course of its business and maintain appropriate internal capital levels as per the ICAAP framework. The main objective of the Group's ICAAP is to ensure that adequate capital is retained at all times to support the risks the Group undertakes in the course of its business.

The Bank has an established internal capital adequacy process (ICAAP) as per the requirements under Pillar of the Basel II. ICAAP prescribes and measure designed to ensure appropriate identification, measurement, aggregation and monitoring of the Bank risk. It also defines an appropriate level of internal capital in relation to the Bank overall risk profile and business plan.

3.2 Strategies, Processes and Internal Controls**3.2.1 Bank's risk strategy**

Capital Management policies and Risk Charter define the Bank's risk strategy. Comprehensive Risk Management Policy Framework is approved by the Board. These are also supported by appropriate limit structures. These policies provide an enterprise-wide integrated risk management framework in the Bank.

The risk charter identifies risk objectives, policies, strategies and risk governance both at the Board and the management level. The capital management policy is aimed at ensuring financial stability by allocating enough capital to cover unexpected losses.

Limit structures serve as a key component in articulating risk strategy in quantifiable risk appetite. They are further supported by a comprehensive framework for various risk silos with its own policies and methodology documents. In addition, the Bank is in the process of implementing various risk systems to help quantify not just the regulatory capital but also the economic capital allocated to various portfolios.

The Bank is exposed to various types of risk, such as market, credit, profit rate, liquidity and operational, all of which require the comprehensive controls and ongoing oversight. The risk management framework summarises the spirit behind Basel II, which includes management oversight and control, risk culture and ownership, risk recognition and assessment, control activities and segregation of duties, adequate information and communication channels, monitoring risk management activities and correcting deficiencies.

3 Risk Management (continued)

3.2 Strategies, Processes and Internal Controls (continued)

3.2.2 Credit risk

The Bank manages its credit risk exposure by evaluating each new product/activity with respect to the credit risk introduced by it. The Group has established a limit structure to avoid concentration of risks for counterparty, sector and geography.

3.2.3 Market risk

The Group proactively measures and monitors the market risk in its portfolio using appropriate measurement techniques such as limits on its foreign exchange open positions although they are insignificant. The Bank is in the process of developing techniques to carry out stress testing to assess the impact of adverse market conditions on its market risk sensitive portfolio.

The Bank has established a limit structure to monitor and control the market risk in its trading and available for sale equity portfolio. These limits include maximum Stop-loss limits, position limits, VaR limits and maturity limits.

3.2.4 Operational risk

The Bank has implemented SunGard's Operational Risk Management system 'SWORD' for recording the potential risks, controls and events on a continuous basis. As part of implementation, the Bank has carried out Risk Control Self Assessment ("RCSA") exercise on a regular basis. The system also measures the Operational risk appetite based on the predefined limits/thresholds.

The Group has established a clear segregation of duties, through documentation and implementation of policies and procedures. This ensures objectivity, security and avoids conflicts of interest. Maker checker concept and dual eye principles are applied across the Bank, where possible.

3.2.5 Equity price risk

Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the investment portfolio. The Bank manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

3.2.6 Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Group's management believes that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and unrestricted investment accounts. The profit distribution to unrestricted investment accounts is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

However, the profit sharing agreements will result in displaced commercial risk when the Group's results do not allow the Group to distribute profits inline with the market rates.

3.2.7 Displaced Commercial Risk

Displaced commercial risk ("DCR") refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by the liabilities, when the return on assets is under performing as compared with competitor's rates.

The Group manages its displaced commercial risk by placing gap limits between the returns paid to investors and market returns.

The Group is currently in the process of developing detailed written policies and procedures for displaced commercial risk. The Group may forego its fee in case displaced commercial risk arises. The Group benchmarks its rates with other leading banks in the market.

All the above strategies used have been effective throughout the reporting year.

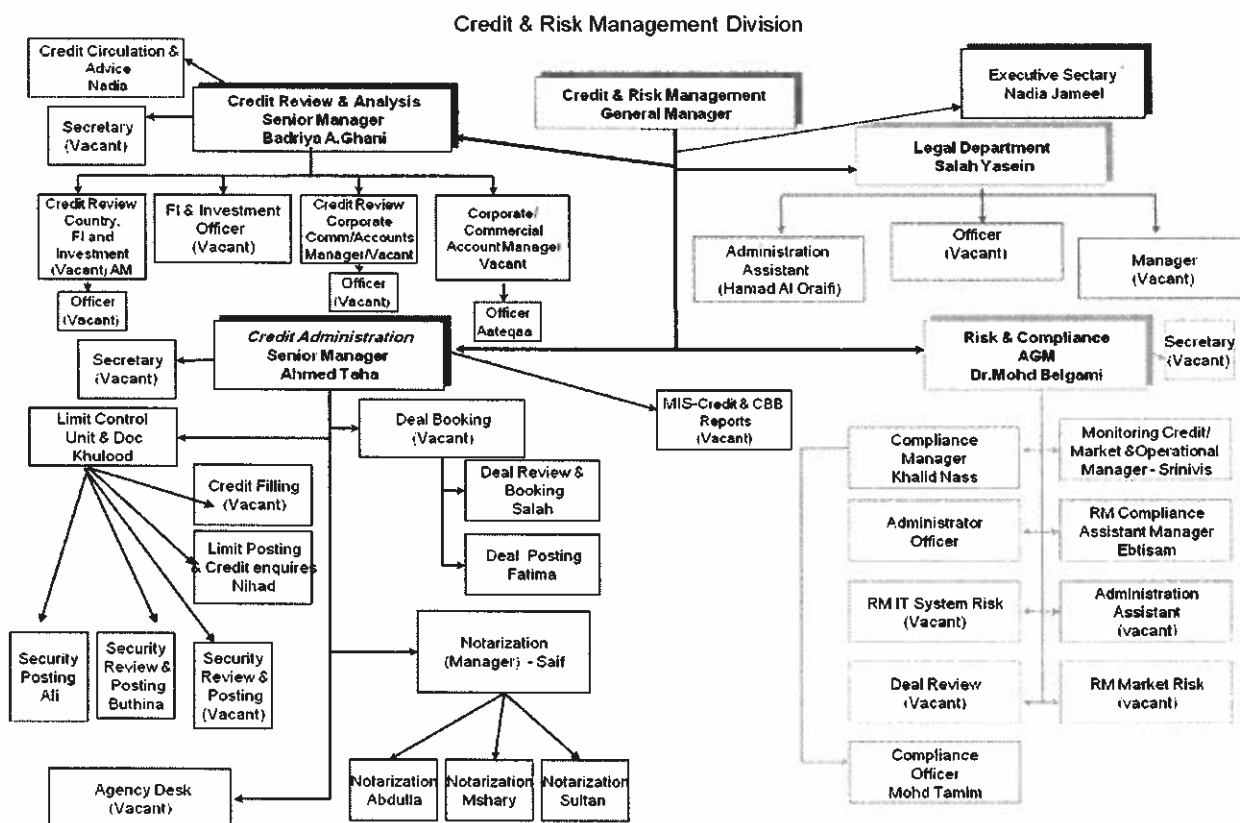
3 Risk Management (continued)

3.3 Structure and Organization of Risk Management Function

Risk Management Structure includes all levels of authorities (including Board level Risk committee), organizational structure, people and systems required for the smooth functioning of risk management processes in the Bank. The responsibilities associated with each level of risk management structure and authorities include the following:

The Board retains ultimate responsibility and authority for all risk matters, including:

- Establishing overall policies and procedures, and
- Delegating authority to Executive Committee, Credit Committee, the Chief Executive Officer and further delegation to the management to approve and review.



3.4 Risk Measurement and Reporting Systems

Based on risk appetite of the Bank, the Bank has put in place various limits. These limits have been approved by the Board of Directors. Any limit breaches are reported to the respective senior management committees and the Board by the Credit and Risk Management Department ("CRMD"). The limits are reviewed and revised at least on an annual basis or when is deemed required.

The Bank has developed a risk measurement and reporting system that generates various types of reports which has enhanced the monitoring process of the Bank.

3 Risk Management (continued)

3.5 Credit Risk

3.5.1 Introduction

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from lending and investment activities. The Bank controls credit risk by monitoring credit exposures, and continually assessing the creditworthiness of counterparties. Financing contracts are mostly secured by collateral in the form of mortgage financed or other tangible securities.

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept in terms of counterparties, product types, geographical area and industry sector. The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision by the Credit Review and Analysis Department ("CR&AD"). Any changes to the Credit Risk Policy will be approved by the Board.

All credit proposals undergo a comprehensive risk assessment examining the customer's financial condition, trading performance, nature of the business, quality of management, and market position, etc. In addition, the Bank's internal risk rating model scores these quantitative and qualitative factors. The credit approval decision is then made and terms and conditions are set.

Exposure limits are based on the aggregate exposure to counterparty and any connected entities across the Bank. Corporate contracts/facilities are reviewed on an annual basis by CR&AD.

3.5.2 Types of credit risk

Financing contracts mainly comprise Murabaha receivables, Mudaraba investments, Musharaka investments and Ijarah Muntahia Bittamleek.

Murabaha receivables

The Group finances these transactions through buying the commodity which represents the object of the Murabaha contract and then resells this commodity to the Murabeh (beneficiary) at a profit. The sale price (cost plus profit margin) is repaid in installments by the Murabeh over the agreed period. The transactions are secured at times by the object of the Murabaha contract (in case of real estate finance) and other times by a total collateral package securing the facilities given to the Murabeh.

Mudaraba investments

The Group enters into Mudaraba contracts by investing in funds operated by other banks and financial institutions for a definite period of time.

Musharaka investments

Musharaka is a form of partnership between the Group and its clients whereby each party contributes to the capital of partnership in equal or varying degrees to establish a new project or share in an existing one, whereby each of the parties becomes an owner of the capital on a permanent or declining basis. Profits are shared in an agreed ratio, but losses are shared in proportion to the amount of capital contributed.

Ijarah Muntahia Bittamleek

The legal title of the assets under Ijarah Muntahia Bittamleek only passes to the lessee at the end of the Ijarah term, through gift, consideration or gradual sale, provided that all Ijarah installments are settled.

3 Risk Management (continued)

3.5 Credit Risk (continued)

3.5.3 Past Due and impaired Islamic financing

The Bank defines non-performing facilities as the facilities that are overdue for period of 90 days or more. These exposures are placed on a non-accrual status with income being recognized to the extent that it is actually received. It is the Bank's policy that when an exposure is overdue for a period of 90 days or more, the whole financing facility extended is considered as non performing, not only the overdue installments/payments.

As a policy the Group places on a non-accrual basis any facility where there is reasonable doubt about the collectability of the receivable irrespective of whether the customer concerned is currently in arrears or not.

3.5.4 External credit assessment institutions

The Bank relies on external ratings for rated corporate customers and counterparties. The Bank uses Standard & Poor's, Fitch, Moody's and Capital Intelligence to provide ratings for such counterparties. In case of unrated counterparties, the Bank will assess the credit risk on the basis of defined parameters. These ratings are used for risk assessment and calculation of risk weighted equivalents.

3.5.5 Definition of Geographical distribution

The geographic distribution of the credit exposures is monitored on an ongoing basis by Group's Risk Management Department and reported to the Board on a quarterly basis. The Group's classification of geographical area is according to its business needs and the distribution of its portfolios.

3.5.6 Concentration risk

Concentration risk is the credit risk stemming from not having a well diversified credit portfolio, i.e. being overexposed to a single customer, industry sector or geographic region. As per CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's prior approval for any planned exposure to a single counterparty, or group of connected counterparties, exceeding 15% of the regulatory capital base.

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

3.5.7 Credit risk mitigation

Credit risk mitigation refers to the use of a number of techniques, like collaterals and guarantees to mitigate the credit risks that the Group is exposed to. Credit risk mitigants reduce the credit risk by allowing the Group to protect against counterparty non-performance of credit contracts through collaterals, netting agreements and guarantees.

Generally, the Group extends credit facilities only where supported by adequate tangible collateral security and/or audited financial statements. Facilities may be considered without adequate tangible collateral security, when audited financial statements reveal satisfactory financial position/repayment ability and the facilities are properly structured and supported by assignments, guarantees, etc. as appropriate. Name lending (i.e. lending without audited financial statements and tangible collateral security) is discouraged and is approved only on an exceptional basis after careful analysis of the quality of the customer, market reputation, approximate personal net worth etc.

In general, personal guarantees of the partners/promoters/directors of the borrowing entity are obtained in support of credit facilities. In all cases, a statement of net worth of the guarantor is to be compiled by the Account Officer, so that adequate information is available at a future date in case the guarantees need to be enforced.

3 Risk Management (continued)

3.5 Credit Risk (continued)

3.5.7 Credit risk mitigation (continued)

The market value of tangible collateral security are properly evaluated by the Bank approved valuers (for properties) or based on publicly available quotations. Only the Loan-able Value of such security is taken into account while considering credit facilities.

From time to time, the Credit Committee reviews and approves the loan-able value of securities. It has also approved a list of acceptable securities.

The majority of the Group's current credit portfolio is secured through mortgage of commercial real estate properties. The Group may dispose off the assets as a last resort after carrying out due legal process.

3.5.7.1 General policy guidelines of collateral management

Acceptable Collaterals: The Bank has developed guidelines for acceptable collaterals. Assets offered by customers must meet the following criteria to quantify as acceptable collateral:

- a. Assets must be maintaining their value, at the level prevalent at inception, until maturity date of the facility granted;
- b. Such assets should be easily convertible into cash, if required (liquidity);
- c. There should be a reasonable market for the assets (marketability); and
- d. The Group should be able to enforce its rights over the asset if necessary (enforceability).

Ownership: Prior to valuation or further follow up on the offered collateral, Credit Administration ensures satisfactory evidence of the borrower's ownership of the assets.

Valuation: All assets offered as collateral are valued by an appropriate source either in-house (through another department in the Group) or by an external appraiser (real estate related collateral). The Group maintains a list of independent appraisers, approved by management.

- a. **Valuation of shares and goods:** Where competent staff is available within the Group, the valuation is conducted in-house. The Group performs in-house valuation on the following types of securities:
 - Pledge of shares of local companies;
 - Pledge of international marketable shares and securities; and
 - Pledge and hypothecation of goods.

International shares are valued at the quotes available from stock exchanges, periodicals, etc.

- b. **Valuation of real estate and others:** Besides assets mentioned above the valuation of following securities are also conducted:
 - Real Estate;
 - Equipment and machinery; and
 - Precious metals and jewelers.

The Credit Administration requests the concerned department to arrange for the valuation from approved valuers.

3 Risk Management (continued)

3.5 Credit Risk (continued)

3.5.7 Credit risk mitigation (continued)

3.5.7.1 General policy guidelines of collateral management (continued)

The following additional guidelines are also followed by the Group:

- a. No facility should be disbursed until credit documentation is properly signed and security/guarantees required have been signed and registered, where required. Exceptional cases can be considered by sanctioning authorities; and
- b. All documents received as security or support for credit facilities will be lodged in the safe custody through the Credit Administration and should be kept under dual control. Group must ascertain that collateral providers are authorized and acting within their capacity.

3.5.7.2 Guarantees

In cases where a letter of guarantee from parent company or a third party is accepted as credit risk mitigants, the Group ensures that all guarantees are irrevocable, legal opinion has been obtained from a legal counselor domiciled in the country of guarantor (overseas) regarding the enforceability of the guarantee, if the guarantor / prime obligor is domiciled outside Bahrain and all guarantees should be valid until full settlement of the facilities. Also no maturity (negative) mismatch is permissible between the guarantee and exposure.

3.5.7.3 Custody/ collateral management

The assets, or title to the asset, will be maintained in the Group's custody or with custodian approved by the Group. The Credit Administration will obtain confirmation of the assets held with each custodian on an annual basis.

The release of collateral without full repayment of all related financial obligations requires authorization of the same level that originally approved and sanctioned the facility. Substitution of collateral is permitted if the new collateral would further minimize the Group's risk exposure.

When collateral is released to the customer, the Head of Credit Administration obtains and maintains in his records acknowledgement of receipt from the customer or his/her authorized representative.

3.5.8 Counterparty credit risk

The Group has adopted the Standardized Approach to allocate capital for counterparty credit risk. The Group has put in place an internal counterparty limit structure which is based on internal/external ratings for different types of counterparties. The Group has also set concentration limits as a percentage of its capital based on internal and external grades. In case of a counterparty rating downgrade/deterioration, the Group may require further collateral or advise the counterparty to reduce its exposure on a case by case basis.

3.5.8.1 Exposure

The measure of exposure reflects the maximum loss that the Group may suffer in case counterparty fails to fulfill its commitments. Exposure shall always be calculated on the basis of approved limits or actual outstanding exposure (Financing facilities, Investments or others), whichever is higher.

3.5.8.2 Counterparty

A counterparty is defined as an obligor (individual/company/other legal entity), a guarantor of an obligor, or a person receiving funds from the Group, the issuer of a security in case of a security held by the Group, or a party with whom a contract is made by the Group for financial transactions.

3 Risk Management (continued)

3.5 Credit Risk (continued)

3.5.8 Counterparty credit risk (continued)

3.5.8.3 Group exposure

Group exposure is defined as the total exposure to all counterparties closely related or connected to each other. For this purpose, Group is two or more counterparties related in such a way that financial soundness of one may affect the financial soundness of the other(s) and one of them has a direct or indirect control over other(s).

3.5.8.4 Connected counterparties

Connected counterparties are companies or individuals connected with the Group or its subsidiaries and associated companies (whether such association is due to control or shareholding or otherwise), Directors and their associates (whether such association is due to control, family links or otherwise), members of the Shari'a Supervisory Board, management and other staff and shareholders holding more than 10% or more of the equity voting rights in the Group.

3.5.8.5 Large exposure

Large exposure is any exposure whether direct, indirect or funded by unrestricted investment accounts to a counterparty or a group of closely related counterparties which is greater than or equal to 10% of the Group's capital base.

Prior written approval from the CBB is required in the following cases:

- a. If any counterparty (single/group) exposure exceeds 15% of Group's Capital Base; and
- b. If any facility (new/extended) to an employee is equal or above BD100, 000 (or equivalent).

3.5.8.6 Maximum exposure

The Group has set an internal maximum exposure limit in the light of CBB guidelines.

3.5.8.7 Reporting

The Group reports large counterparty exposures (as defined above) to CBB on periodic basis. The Group reports the exposures on a gross basis without any set-off. However, debit balances on accounts may be offset against credit balances where both are related to the same counterparty, provided the Group has a legally enforceable right to do so.

3.5.8.8 Other matters

As a Group's strategy exposure to connected counterparties may be undertaken only when negotiated and agreed on an arm's length basis.

The Group shall not assume any exposure to its external auditors.

3.5.9 Related party transactions

The disclosure relating to related party transactions has been made in the consolidated financial statements. All related party transactions have been made on arm's length basis.

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3 Risk Management (continued)

3.5 Credit Risk (continued)

Table – 6. Credit Risk Exposure (PD-1.3.23(a))

The following table summarises the amount of gross funded and unfunded credit exposure as of 31 December 2010 and average gross funded and unfunded exposures over the year ended 31 December 2010 allocated in own capital and current account and profit sharing investment account (PSIA);

	Own capital and current account		Profit Sharing Investment Account	
	Total gross credit exposure BD'000	*Average gross credit exposure over the Year BD'000	Total gross credit exposure BD'000	*Average gross credit exposure over the year BD'000
Funded				
Cash and balances with Central				
Bank of Bahrain and other banks	18,961	18,165	26,870	26,144
Murabaha receivables	15,754	13,724	415,938	362,331
Mudaraba investments	32,522	37,041	4,838	11,098
Musharaka investments	2,929	2,818	77,317	74,388
Investments	34,098	35,040	80,569	73,908
Investment in associates	6,778	7,427	-	-
Investment in Ijarah assets	9,635	9,898	-	-
Ijarah Muntahia Bittamleek	3,845	4,096	101,541	108,143
Investment in properties	105,192	121,887	-	-
Ijarah rental receivables	276	143	7,293	3,790
Other assets	11,318	16,175	-	-
Unfunded				
Bank's liability under L/C and L/G	13,230	15,148	-	-
Total	254,538	281,162	694,366	659,802

*Average balances are computed based on month end balances.

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3 Risk Management (continued)

3.5 Credit Risk (continued)

Table -- 7. Credit Risk -- Geographic Breakdown (PD-1.3.23(b))

The following table summarises the geographic distribution of exposures as of 31 December 2010, broken down into significant areas by major types of credit exposure:

	Own capital and current account				Profit Sharing Investment Account					
	* Geographic area				* Geographic area					
	North America BD'000	Europe BD'000	Middle East BD'000	Rest of Asia BD'000	Total BD'000	North America BD'000	Europe BD'000	Middle East BD'000	Rest of Asia BD'000	Total BD'000
Cash and balances with Central Bank of Bahrain and other banks	3,826	310	14,733	92	18,961	-	-	26,870	-	26,870
Murabaha receivables	-	1,712	14,042	-	15,754	-	45,206	370,732	-	415,938
Mudaraba investments	856	7,943	21,762	1,961	32,522	-	-	4,838	-	4,838
Musharaka investments	-	-	2,929	-	2,929	-	-	77,317	-	77,317
Investments	-	-	34,098	-	34,098	-	-	60,569	-	60,569
Investment in associates	-	-	6,778	-	6,778	-	-	-	-	-
Investment in Ijarah assets	-	-	9,635	-	9,635	-	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	3,845	-	3,845	-	-	101,541	-	101,541
Investment in properties	-	-	105,192	-	105,192	-	-	-	-	-
Ijarah rental receivables	-	-	276	-	276	-	-	7,293	-	7,293
Other assets	-	-	11,318	-	11,318	-	-	-	-	-
Total	4,682	9,965	224,608	2,053	241,308	-	45,206	649,160	-	694,366

* Geographical distribution of exposure into significant areas by major type of credit exposure is based on counterparty's country of incorporation.

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3 Risk Management (continued)

3.5 Credit Risk (continued)

Table – 8. Credit Risk – Industry Sector Breakdown (PD-1.3.23(c))

The following table summarises the distribution of funded and unfunded exposures as of 31 December 2010 by industry, broken down into major types of credit exposure:

	Own Capital and Current Account					Profit Sharing Investment Account						
	Industry Sector					Industry Sector						
	Trading and Manufacturing BD'000	Banks and Financial Institutions BD'000	Real Estate BD'000	Aviation BD'000	Others BD'000	Total BD'000	Trading and Manufacturing BD'000	Banks and Financial Institutions BD'000	Real Estate BD'000	Aviation BD'000	Others BD'000	Total BD'000
Funded												
Cash and balances with Central Bank of Bahrain and other banks	-	12,921	-	-	6,040	18,961	-	26,870	-	-	-	26,870
Murabaha receivables	2,126	8,389	1,293	94	3,852	15,754	56,133	221,488	34,133	2,490	101,694	415,938
Mudaraba investments	-	956	15,520	-	16,046	32,522	-	4,838	-	-	-	4,838
Musharaka investments	426	-	752	-	1,751	2,929	11,247	-	19,862	-	46,208	77,317
Investments	4,246	16,303	3,181	42	10,326	34,098	-	6,158	20,842	1,090	32,479	60,569
Investment in associates	-	6,778	-	-	-	6,778	-	-	-	-	-	-
Investment in Ijarah assets	-	-	9,635	-	-	9,635	-	-	-	-	-	-
Ijarah Muntahia Bittamleek	286	371	1,224	769	1,195	3,845	7,547	9,788	32,311	20,316	31,579	101,541
Investment in properties	-	-	105,192	-	-	105,192	-	-	-	-	-	-
Ijarah rental receivables	-	-	-	-	276	276	-	-	-	-	7,293	7,293
Other assets	-	-	-	-	11,318	11,318	-	-	-	-	-	-
Unfunded												
Bank's liability under L/C and L/G	6,621	2,475	3,410	-	724	13,230	-	-	-	-	-	-
Total	13,705	48,193	140,207	905	51,528	254,538	74,927	269,142	107,148	23,896	219,253	694,366

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3 Risk Management (continued)

3.5 Credit Risk (continued)

Table – 9. Credit Risk – Intra-group transactions (PD-1.3.23(d))

The balances of major transactions with the subsidiary are as follows:

	Own Capital and Current Account BD'000'	Profit Sharing Investment Account BD'000	Total BD'000
Customers' current accounts	83	-	83
Other liabilities	8,580	-	8,580
Other assets	47	-	47
Investment in associates	25,000	-	25,000

The income and expenses arising from dealing with the subsidiary eliminated in the consolidated statement of income are as follows:

	Own Capital and Current Account BD'000'	Profit Sharing Investment Account BD'000	Total BD'000
Net income from investments	34	-	34
Other expenses	15	-	15
Gross return to unrestricted investment accounts	-	9	9

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3 Risk Management (continued)

3.5 Credit Risk (continued)

Table – 10. Credit Risk – Financing Facilities to Highly Leveraged or Other High Risk Counterparties (PD-1.3.23(e))

Following balances representing the financing facilities to highly leveraged or other high risk counterparties as of 31 December 2010:

Counterparties	Own Capital and Current Account BD'000	Profit Sharing Investment Account BD'000	Total BD'000
Counterparty # 1	458	12,084	12,542
Counterparty # 2	294	7,775	8,069
Counterparty # 3	285	7,532	7,817
Counterparty # 4	282	7,443	7,725
Counterparty # 5	77	2,021	2,098
	1,396	36,855	38,251

Table – 11. Credit Risk – Concentration of Risk (PD-1.3.23(f))

Following balances representing the concentration of risk to individual counterparties as of 31 December 2010:

Counterparties *	Own capital and current account BD'000	Profit Sharing Investment Account BD'000	Total BD'000
Counterparty # 1	868	22,923	23,791
Counterparty # 2 **	1,733	20,063	21,796
Counterparty # 3	718	18,947	19,665
Counterparty # 4	633	16,714	17,347
	3,952	78,647	82,599

* The exposure is in excess of the 15% individual obligor limit.

** This is a group exposure

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3 Risk Management (continued)

3.5 Credit Risk (continued)

Table – 12. Credit Risk – Residual Contractual Maturity Breakdown (Own Capital and Current Account) (PD-1.3.23(g))

The following table summarises the residual contractual maturity of own capital and current account breakdown of the whole credit portfolio as of 31 December 2010, broken down by major types of credit exposure;

	Own capital and current account										Total BD '000
	Up to One month BD '000	1-3 month BD '000	3-6 month BD '000	6-12 month BD '000	1-3 years BD '000	3-5 years BD '000	5-10 years BD '000	10-20 years BD '000	Over 20 years BD '000	No fixed maturity BD '000	
Assets											
Cash & balances with											
Central Bank of Bahrain											
and other banks											
Murabaha receivables *	18,961	-	-	-	-	-	-	-	-	-	18,961
Mudaraba investments	7,092	1,287	666	854	901	1,091	1,540	-	2,323	-	15,754
Musharaka Investments *	156	-	27	-	-	-	-	-	32,339	-	32,522
Investments *	122	167	192	15	118	374	941	-	1,000	-	2,929
Investment in associates	176	18,672	464	24	528	990	35	-	77	13,132	34,098
Investment in Ijarah assets	-	-	-	-	-	-	-	-	-	6,778	6,778
Ijarah Muntahia Bittamleek *	41	4	5	1	425	465	1,376	-	1,528	9,635	9,635
Investment in properties	-	-	-	-	-	-	-	-	-	-	3,845
Ijarah rental receivables	-	-	276	-	-	-	-	-	-	105,192	105,192
Other assets	-	-	6,597	-	-	-	-	-	-	4,721	276
	-	-	-	-	-	-	-	-	-	-	11,318
Total Assets	26,548	20,130	8,227	894	1,972	2,920	3,892	-	37,267	139,458	241,308

* All non performing facilities have been classified as over 20 years.

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3 Risk Management (continued)

3.5 Credit Risk (continued)

Table – 13. Credit Risk – Residual Contractual Maturity Breakdown (Profit Sharing Investment Account) (PD-1.3.23(g))

The following table summarises the residual contractual maturity of profit sharing investment account breakdown of the whole credit portfolio as of 31 December 2010, broken down by major types of credit exposure;

	Profit Sharing Investment Account										Total BD'000
	Up to One month BD'000	1-3 month BD'000	3-6 month BD'000	6-12 month BD'000	1-3 years BD'000	3-5 years BD'000	5-10 years BD'000	10-20 years BD'000	Over 20 years BD'000	No fixed maturity BD'000	
Assets											
Cash & balances with Central Bank of Bahrain and other banks	-	-	-	-	-	-	-	-	-	26,870	26,870
Murabaha receivables *	187,241	33,967	17,570	22,541	23,782	28,816	40,660	-	61,361	-	415,938
Mudaraba investments	4,118	-	720	-	-	-	-	-	-	-	4,838
Musharaka Investments *	3,214	4,412	5,072	387	3,106	9,883	24,842	-	26,401	-	77,317
Investments *	4,660	-	12,257	621	13,949	26,147	915	-	2,020	-	60,569
Ijarah Muntahia Bittamleek *	1,084	104	130	24	11,214	12,275	36,339	-	40,371	-	101,541
Ijarah rental receivables	-	-	7,293	-	-	-	-	-	-	-	7,293
Total Assets	200,317	38,483	43,042	23,573	52,051	77,121	102,756	-	130,153	26,870	694,366

* All non performing facilities have been classified as over 20 years.

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3 Risk Management (continued)

3.5 Credit Risk (continued)

Table – 14. Credit Risk – Impaired Exposures and Allowances (Own capital and current account by industry sector) (PD-1.3.23(h) PD-1.3.24(b) PD-1.3.24(d))

The following table summarises the impaired facilities, past due facilities and allowances financed by own capital and current account disclosed by major industry sector 31 December 2010;

	Own capital and current account									
	Non-performing or past due or impaired				Specific allowances				* General allowances	
	Aging of Past Due Facilities				Balance at the beginning of the year				General allowances beginning balance	
	3 months to 1 year	1 to 3 years	Over 3 years		BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
Islamic financing contracts										
Trading and Manufacturing	2,434	1,212	719	30	781		339	1,016	-	-
Real Estate	2,809	1,453	325	-	-		-	-	-	-
Banks & Financial Institutions	54	50	1	-	-		140	140	-	-
Others	960	251	39	7	87		154	241	-	-
No specific sector	-	-	-	-	-		-	-	175	(167)
Total	6,257	2,966	1,084	37	888		633	1,397	175	(167)
										8

* General allowance represents collective impairment provision against exposures which, although not specifically identified, have a greater risk of default than when originally granted.

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3 Risk Management (continued)

3.5 Credit Risk (continued)

Table – 15. Credit Risk – Impaired Exposures, Past Due Exposures and Allowances (profit sharing investment account by industry sector) (PD-1.3.23(h))

The following table summarises the impaired facilities, past due facilities and allowances financed by profit sharing investment account disclosed by major industry sector as of 31 December 2010;

Profit Sharing Investment Account													
Non-performing or past due or impaired	Aging of Past Due Facilities				Specific allowances				* General allowances				
	3 months to 1 year	1 to 3 years	Over 3 years		Balance at the beginning of the year	Charges during the year	Charge-offs during the year	Balance at the end of the year	General allowances beginning balance	General allowances movement	General allowances ending balance		
Islamic financing contracts	BD '000	BD '000	BD '000	BD '000	BD '000	BD '000	BD '000	BD '000	BD '000	BD '000	BD '000	BD '000	
Trading and Manufacturing	64,263	32,009	18,991	796	20,433	6,388	-	26,821	-	-	-	-	
Real Estate	25,353	38,354	8,586	-	-	-	-	-	-	-	-	-	
Banks & Financial Institutions	74,170	1,314	13	-	-	3,689	-	3,689	-	-	-	-	
Others	1,413	6,618	1,036	178	2,279	4,093	-	6,372	-	-	-	-	
No specific sector	-	-	-	-	-	-	-	-	4,618	(4,432)	-	186	
Total	165,199	78,295	28,626	974	22,712	14,170	-	36,882	4,618	(4,432)	-	186	

* General allowance represents collective impairment provision against exposures which, although not specifically identified, have a greater risk of default than when originally granted.

Although the above table shows the portion of impairment provision related to PSIA, the Bank has taken all the provision to their own capital. Hence the PSIA were not charged for any of the impairment provision.

3 Risk Management (continued)

3.5 Credit Risk (continued)

Table – 16. Credit Risk – Impaired Exposures, Past Due Exposures and Allowances (own capital and current account and profit sharing investment account by geographic area) (PD-1.3.23(i) PD-1.3.24(c))

The following table summarises the past due facilities and allowances financed by own capital and current account and profit sharing investment account disclosed by geographical area as of 31 December 2010;

	Own capital and current account			Profit Sharing Investment Account		
	Past due Islamic financing contracts BD'000	Specific Impairment provision BD'000	Collective Impairment provision BD'000	Past due Islamic financing contracts BD'000	Specific Impairment provision BD'000	Collective Impairment provision BD'000
Middle East	6,257	1,397	8	165,199	36,882	186
Total	6,257	1,397	8	165,199	36,882	186

Table – 17. Credit Risk – Restructured Financing Facilities (PD-1.3.23(j))

The following table summarises the aggregate amount of restructured financing facilities during the year financed by own capital and current account and profit sharing investment account as of 31 December

	Own capital and current account	Profit Sharing Investment Account
	Aggregate amount BD'000	Aggregate amount BD'000
Restructured financing facilities	655	17,293
Total	655	17,293

The provision on restructured facilities is nil and the impact on present and future earnings is not significant.

3 Risk Management (continued)

3.5 Credit Risk (continued)

Table – 18. Credit Risk Mitigation (PD-1.3.25 (b) and (c))

The following table summarises the exposure as of 31 December 2010 by type of Islamic financing contract covered by eligible collateral;

	<i>Total exposure covered by</i>	
	<i>Eligible collateral</i>	<i>Guarantees</i>
	<i>BD'000</i>	<i>BD'000</i>
Murabaha receivables	10,076	-
Musharaka investments	439	-
Ijarah Muntahia Bittamleek	4,656	-
Total	15,171	-

Table – 19. Counterparty Credit (PD-1.3.26 (b))

The following table summarises the counterparty credit risk exposure covered by collateral after the application of haircuts as of 31 December 2010;

	<i>BD'000</i>
Gross positive fair value of contracts	935,674
Netting Benefits	-
Netted current credit exposure	935,674
Collateral held:	
-Cash	15,171
-Shares	5,512
-Real Estate	210,832
Total	231,515

A haircut of 30% is applied on the Real Estate collateral.

3.6 Market Risk

3.6.1 Introduction

The Bank has accepted the definition of market risk as defined by CBB as “the risk of losses in on- and off-balance-sheet positions arising from movements in market prices.”

3 Risk Management (continued)

3.6 Market Risk (continued)

3.6.2 Sources of market risk

For the Group, market risk may arise from movements in profit rates, foreign exchange markets, equity markets or commodity markets. A single transaction or financial product may be subject to any number of these risks.

Profit rate risk is the sensitivity of financial products to changes in the profit rates. Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and unrestricted investment accounts as the repricing of assets, liabilities and unrestricted investment accounts occur at similar intervals. The profit distribution to unrestricted investment accounts is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

Foreign exchange risk is the sensitivity of financial products to changes in spot foreign exchange rates. The value of the Group's portfolio which is denominated in a number of currencies may be exposed to these risks when converted back to the Group's base currency.

Equity price risk is the sensitivity of financial products to the changes in equity prices. Equity risk arises from holding open positions in equities or equity based instruments, thereby creating exposure to a change in the market price of the equity. In addition to Group performance expectations, equity prices are also susceptible to general economic data and sector performance expectations.

Commodity risk; products may have an inherent risk as a result of sensitivity to changes in commodity prices. Since prices in commodity markets are determined by fundamental factors (i.e. supply and demand of the underlying commodity) these markets may be strongly correlated within particular sector and less correlated across sectors.

3.6.3 Market risk strategy

The Group's Board is responsible for approving and reviewing (at least annually), the risk strategy and significant amendments to the risk policies. The Group's senior management is responsible for implementing the risk strategy approved by the Board, and continually enhancing the policies and procedures for identifying, measuring, monitoring and controlling risks.

In line with the Group's risk management objectives and risk tolerance levels, the specific strategies for market risk management include:

- 1 The Group will manage its market risk exposure by evaluating each new product/ activity with respect to the market risk introduced by it;
- 2 The Group will proactively measure and continually monitor the market risk in its portfolio;
- 3 The Group will at all time hold sufficient capital in line with the CBB Pillar 1 regulatory capital requirements;
- 4 The Group will establish a market risk appetite which will be quantified in terms of a market risk limit structure;
- 5 The Group will establish a limit structure to monitor and control the market risk in its portfolio. These limits will include position limits, maximum/stop loss limits, factor sensitivity limits, VaR limits and maturity limits;
- 6 The Group will carry out stress testing periodically using the worst case scenarios to assess the effects of changes in the market value due to changing market conditions;
- 7 The Group will periodically carry out back testing of market risk assessment models in order to evaluate their accuracy and the inherent model risk;
- 8 The Group will match the amount of floating rate assets with floating rate liabilities; and
- 9 The Group will clearly identify the foreign currencies in which it wishes to deal in and actively manage its market risk in all foreign currencies in which it has significant exposure.

3 Risk Management (continued)

3.6 Market Risk (continued)

3.6.4 Market risk measurement methodology

Market risk measurement techniques includes the use of a number of techniques for market risk measurement. The risk measurement techniques mentioned in this section are used for measuring market risk in both trading book as well as banking book.

The various techniques which are used by the Group for the measurement, monitoring and control of market risk are as follows:

- a. Overnight open positions;
- b. Stop loss limits;
- c. Factor sensitivity limits;
- d. VaR limits; and
- e. Profit rate risk gap analysis.

3.6.5 Market risk monitoring and limits structure

The Asset and Liability Committee (ALCO) proposes through the Executive Committee and Board the tolerance for market risk. Based on these tolerances, Risk and Compliance Department and Treasury have established appropriate risk limits that maintain the Group's exposure within the strategic risk tolerances over a range of possible changes in market prices and rates.

3.6.6 Limits monitoring

The Treasury Department and Risk and Compliance Unit monitor the risk limits for each transaction, ensure that the limits are well within set parameters and report periodically to top management.

3.6.7 Breach of limits

In case a limit is breached, an approval from the CEO is required to continue with the transaction. An immediate report is provided to the ALCO after every significant limit breach. This breach is also reported to the Executive Committee (EXCOM). The limits are revised at least bi-annually or when deemed required.

3.6.8 Portfolio review process

On a monthly basis, Risk and Compliance Unit reviews the Group's assets and liabilities portfolio to evaluate the overall corporate exposure to market risk. As part of the review, Risk and Compliance Department also monitors the Group's overall market exposure against the risk tolerance limits set by the Board. Risk and Compliance Unit also reviews the adherence to approved limits to control the market risk. Changes, if any, in market risk limits are communicated to business units after review by the GM-C&RM/CEO and approval by the ALCO or EXCOM, as per the delegated authorities approved by the

3.6.9 Reporting

Risk and Compliance Unit generates over regular periodic intervals market risk management reports. These reports aim to provide the Group's senior management with an up-to-date view of its market risk exposure.

3.6.10 Stress testing

Stress tests produce information summarizing the Group's exposure to extreme, but possible, circumstances and offer a way of measuring and monitoring the portfolio against extreme price movements of this type. The Group's Risk and Compliance Unit employs four stress categories: profit rates, foreign exchange rates, equity prices and commodity prices. For each stress category, the worst possible stress shocks that might realistically occur in the market are defined.

3 Risk Management (continued)

3.6 Market Risk (continued)

3.6.11 Foreign subsidiary

The Group does not have any foreign subsidiary.

Table – 20. Market Risk Capital Requirements (PD-1.3.27 (b))

The following table summarises the capital requirement for foreign exchange risk as of 31 December 2010;

	<i>Foreign exchange risk BD'000</i>
Foreign exchange risk	22,656
Foreign exchange risk capital requirement	2,719
Maximum value capital requirement	2,719
Minimum value capital requirement	1,821

3.7 Operational Risk

3.7.1 Introduction

Operational risk is the risk of loss arising from system failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

3.7.2 Sources of operational risk

The different sources of operational risks faced by the Group can be classified broadly into the following categories.

People risk which arises due to staffing inadequacy, unattractive remuneration structure, lack in staff development policies, lack in procedures for appointment, unhealthy professional working relationship and unethical environment;

Processes risk which arises due to inadequate general controls, inadequate application controls, improper business and market practices and procedures, inappropriate/inadequate monitoring and reporting; and

Systems (Technology) risk which arise due to integrity of information - lacking in timelines of information, omission and duplication of data; hardware failures due to power surge, obsolescence or low quality.

3.7.3 Operational risk management strategy

As a strategy the Bank will identify the sources of operational risks in coordination with each business unit. The Group carried out Risk Control Self-Assessments ("RCSA"), and plans to do a continuous and on-going exercise, to identify the operational risks it is exposed to.

3 Risk Management (continued)

3.7 Operational Risk (continued)

3.7.3 Operational risk management strategy (continued)

The Group on a continuous basis will:

- assess the effectiveness of controls associated with identified risks;
- regularly monitor operational risk profiles and material exposures to losses; and
- identify stress events and scenarios to which it is vulnerable and assess their potential impact, and the probability of aggregated losses from a single event leading to other risks.

3.7.4 Operational risk monitoring and reporting

The internal monitoring and reporting process ensures a consistent approach for providing pertinent information to senior management for the quick detection and correction of deficiencies in the policies, processes and procedures for managing operational risk through ongoing, periodic reviews.

The objective of the reporting process is to ensure relevant information is provided to senior management and the Board to enable the proactive management of operational risk. The process ensures a consistent approach for providing information that enables appropriate decision making and action taking.

3.7.5 Operational risk mitigation and control

The business units, in consultation with Risk and Compliance Unit will determine all material operational risks and decide the appropriate procedures to be used to control and/or mitigate the risks.

For those risks that cannot be controlled, the business units in conjunction with Risk and Compliance Unit will decide whether to accept the risks, reduce the level of business activity involved, transfer the risk outside the Group or withdraw from the associated activity completely. Risk and Compliance Unit facilitates the business units in co-developing the mitigation plans.

3.7.6 Business Continuity Plan (BCP)

The Group has also developed a comprehensive business continuity plan detailing the steps to be taken in the event of extreme conditions to resume the Group's operations with minimum delay and disturbance. The plan is in implementation stage. Elements of contingency plans and disaster recovery processes include operating systems, physical space, telecommunications and resources.

Table - 21. Operational Risk Exposure (PD-1.3.30 (a), (b) & (c))

The following table summarises the amount of exposure subject to basic indicator approach of operational risk and related capital requirements:

	<i>Gross income</i>		
	<i>2010</i>	<i>2009</i>	<i>2008</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
Total Gross Income	18,777	25,962	40,009
Indicators of operational risk			<i>2010</i>
Average Gross income			<i>BD '000</i>
Multiplier			28,249
			12.5
			353,113
Eligible Portion for the purpose of the calculation			15%
TOTAL OPERATIONAL RISK WEIGHTED EXPOSURE			52,968

The plan is reviewed periodically to assess and incorporate changes in the business and market conditions.

3 Risk Management (continued)

3.8 Equity Position in the banking book

Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio.

The accounting policies, including valuation methodologies and their related key assumptions, are disclosed in the consolidated financial statements. Available for sale investments and investments in properties are kept for capital gain purposes, all other investments including investments in associates are kept for strategic long term holdings.

Table – 22. Equity Position Risk in Banking Book (PD-1.3.31 (b) (c) & (f))

The following table summarises the amount of total and average gross exposure of equity based financing structures by types of financing contracts and investments as of 31 December 2010;

	<i>Total gross exposure BD'000</i>	<i>* Average gross exposure BD'000</i>	<i>Publicly traded BD'000</i>	<i>Privately held BD'000</i>	<i>Risk weighted assets BD'000</i>	<i>Capital Requirements BD'000</i>
Sukuk	62,863	76,707	-	62,863	12,650	1,518
Equity investments	31,804	32,241	18,672	13,132	39,567	4,748
Funds	32,339	36,621	-	32,339	54,337	6,520
Total	127,006	145,569	18,672	108,334	106,554	12,786

*Average balances are computed based on month end balances.

Table – 23. Equity Gains or Losses in Banking Book (PD-1.3.31 (d) & (e))

The following table summarises the cumulative realised and unrealised gains or (losses) during the year ended 31 December 2010;

	<i>BD'000</i>
Cumulative realized losses arising from sales or liquidations in the reporting year	(1,429)
Total unrealized losses recognized in the consolidated statement of financial position but not through consolidated statement of income	(1,278)
Unrealized losses included in Tier 1 Capital	(2,412)
Unrealized gains included in Tier 2 Capital	773

3 Risk Management (continued)

3.9 Unrestricted Investment Accounts ("URIA")

The Group may require to decrease or increase losses or profit on certain unrestricted investments for the purpose of income smoothing. Thus the Group is exposed to some of the price risk on assets funded by unrestricted Investment Account Holders ("IAH"). The CBB requires the Group to maintain capital to cover the price risk arising from 30% of assets funded by unrestricted IAH on a pro-rata basis.

The Bank is authorized by the IAH to invest the account holder's funds on the basis of Mudaraba contract in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested. Under this arrangement the Bank can commingle the investment accounts holder's funds with its own funds (owner's equity) or with other funds the Bank has the right to use (e.g. current accounts or any other funds which the Bank does not receive on the basis of Mudaraba contract). The IAH and the Bank generally participate in the returns on the invested funds. In such type of contract, the Bank is not liable for any losses incurred on the joint pool other than the loss resulting from gross negligence or willful misconduct on the part of the Bank or due to the Bank's violation of the terms and conditions as agreed between the Bank and the IAH.

The amount received from the customer on account of URIA is not invested completely in the portfolio of selected investments as the Bank is required to maintain a cash reserve with CBB, in addition, the Bank requires to set aside certain amount to meet operational requirements. The income allocated to the URIA deposits being received is in accordance with the utilization of such deposits. The utilization rate is determined by the ALCO with the approval of Shari'a Supervisory Board.

If at any point of time in a particular pool the funds of IAH exceed the assets, the excess amount shall be treated to be invested in commodity Murabaha and earn the average rate of profit on Commodity Murabaha earned during the excess period. There should be no inter-pool financing at any point of time. The Bank should establish a control to avoid excess fund in any pool to be used in other pool.

Proposal for new products is initiated by the business lines within the Bank, ALCO review such proposal to ensure that the new product is in line with the Bank's business and risk strategy. All new products require the approval of the Shari'a Supervisory Board of the Bank. The business lines of the Bank have expertise in creating high end value added products offering a wide range of products, expected return, tenors and risk profile.

Information on new products or any change in the existing products will be placed on the Bank's website or published in the media.

The Bank has designed special quality assurance units whom reports complaints directly to the CEO. The complaints are investigated by personnel not directly related to the subject matter of the complaints.

The Bank offers URIA in different currencies for maturity periods ranging from 1 month, 3 month, 6 month, 9 month, 12 month and 36 month. The customer signs written contract covering all terms and conditions of the investment, including tenor, basis of profit allocation, and early withdrawal.

Because URIA is a significant funding source for the Bank, the Bank regularly monitors rate of return offered by competitors to evaluate the expectation of its IAH. The Bank's policy provide whole or partial waiver of the Mudarab share of income from investment in order to provide a reasonable return to its

The Bank comingles its own funds and URIA funds which are invested together. The Bank has identified two pools of assets where the URIA funds are invested and income from which is allocated to such is account.

The Group is currently in the process of developing written policies and procedures applicable to its portfolio of unrestricted investment accounts. URIA funds are invested and managed in accordance with Shari'a requirements.

- Pool A: Low risk assets or generating low yield.
- Pool B: High risk assets or generating high yield.

3 Risk Management (continued)

3.9 Unrestricted Investment Accounts ("URIA") (continued)

Profits of an investment jointly financed by the Bank and the URIA holders shall be allocated between them according to the contribution of each of the Bank and the IAH in the jointly financed investment separately for each Joint pool A and B. Operating expenses incurred by the Bank are not charged to investment account. In case of the loss resulting from the transactions in a jointly financed investment, such loss shall first be deducted from undistributed profits, if any. Any excess of such loss shall be deducted from Investment Risk Reserve (IRR). Any remaining of such loss shall be deducted from the total balance of fund available in the Joint pool, as at that date, in the respective ratio of the Bank's and IAH's respective contribution to the joint fund. Impairment provisions shall only be allocated to Pool B in the ratio of capital contribution by Bank and IAH of Pool B. The reversal of this provision in future year shall be allocated between Bank and IAH of Pool B in the ratio of capital contribution at the time the reversal is made. The loss can be entirely borne by the shareholders of the Bank subject to the approval of the Board. URIA deposits are measured at their book value.

In case of early withdrawal by URIA holder before completion of the term, the effective utilization method will be applied.

Table – 24. Unrestricted Investment Account (PD-1.3.33 (a))

The following table summarises the breakdown of unrestricted investment accounts as of 31 December 2010;

	<i>BD'000</i>
Customers	600,024
Banks and other financial institutions	141,358
Total	741,382

Table – 25. Unrestricted Investment Account Ratios (PD-1.3.33 (d) & (f))

The following table summarises the return on average assets and mudarib share as a percentage of the total investment profit for the year ended 31 December 2010;

Profit Paid on Average URIA Assets *	2.65%
Mudarib Fee to Total URIA Profits	37%

* Average assets funded by URIA have been calculated using month end balances.

Table – 26. Unrestricted Investment Account Ratios (PD-1.3.33 (c), (e) & (g))

The following table summarises the profit distributed to IAH and financing ratios to the total of IAH by type of investment account holder for the year ended 31 December 2010;

<i>Type of Investment Account Holder</i>	<i>Profit distributed to total IAH</i>	<i>Percentage to total IAH</i>
Saving accounts (including VEVO)	2.81%	9.95%
Defined accounts - 1 month	0.94%	1.62%
Defined accounts - 3 months	0.43%	0.54%
Defined accounts - 6 months	0.48%	0.51%
Defined accounts - 9 months	0.01%	0.01%
Defined accounts - 1 year	2.66%	2.44%
Investment certificates	0.61%	0.31%
IQRA Deposits	0.15%	0.16%
Tejoori Deposit	2.03%	8.47%
Customer's deposits	80.28%	56.92%
Bank's deposits	9.60%	19.07%
	100%	100%

3 Risk Management (continued)

3.9 Unrestricted Investment Accounts ("URIA") (continued)

As of 31 December 2010, the Bank did not have any balance in the investment risk reserve.
The calculation and distribution of profits was based on average balances.

Table – 27. Unrestricted Investment Account Financing to Total Financing (PD-1.3.33 (h) & (i))

The following table summarises the percentage of counterparty type to total financing for each type of Shari'a-compliant contract to total financing as of 31 December 2010;

	<i>Percentage Financing to Total Financing</i>
Murabaha receivables	62.33%
Mudaraba investments	0.72%
Musharaka investments	11.58%
Ijarah Muntahia Bittamleek	15.21%
Investment in Sukuk	9.07%
Ijarah rental receivable	1.09%

	<i>Percentage of Counterparty Type to Total Financing</i>				
	<i>Aviation</i>	<i>Real Estate</i>	<i>Trading and Manufacturing</i>	<i>Banks and Financial Institutions</i>	<i>Others</i>
Murabaha receivables	0.37%	5.11%	8.41%	33.20%	15.24%
Musharaka investments	0.00%	2.98%	1.68%	0.00%	6.92%
Ijarah Muntahia Bittamleek	3.04%	4.84%	1.13%	1.47%	4.73%
Mudaraba investments	0.00%	0.00%	0.00%	0.72%	0.00%
Investment in Sukuk	0.16%	3.12%	0.00%	0.92%	4.87%
Ijarah rental receivable	0.00%	0.00%	0.00%	0.00%	1.09%
	3.57%	16.05%	11.22%	36.31%	32.85%

Table – 28. Unrestricted Investment Account Share of Profit (PD-1.3.33 (l) (m) & (n))

The following table summarises the share of profits earned by and paid out to unrestricted investment accounts and the Group as Mudarib for the year ended 31 December 2010;

Share of profit earned by URIA before transfer to/from reserves - BD '000'	17,721
Percentage share of profit earned by URIA before transfer to/from reserves	2.39%
Share of profit paid to URIA after transfer to/from reserves - BD '000'	17,721
Percentage share of profit paid to URIA after transfer to/from reserves	2.39%
Share of profit paid to Bank as mudarib - BD '000'	10,467

3 Risk Management (continued)

3.9 Unrestricted Investment Accounts ("URIA") (continued)

Table – 29. Unrestricted Investment Account Percentage Return to Profit Rate of Return (PD-1.3.33 (q))

The following table summarises the average declared rate of return or profit rate on profit sharing investment accounts for the year ended 31 December 2010;

	<i>3 month</i>	<i>6 month</i>	<i>12 month</i>	<i>36 month</i>
Percentage of average declared rate of return to profit rate of return	1.96%	2.21%	2.46%	4.00%

Table – 30. Unrestricted Investment Account Type of Assets (PD-1.3.33 (r) & (s))

The following table summarises the types of assets in which the funds are invested and the actual allocation among various types of assets for the year ended 31 December 2010;

	<i>Opening Actual Allocation BD'000</i>	<i>Movement During the Period * BD'000</i>	<i>Closing Actual Allocation BD'000</i>
Cash and balances with Central Bank of Bahrain and other banks	27,000	(130)	26,870
Murabaha receivables	381,058	34,880	415,938
Mudaraba investments	13,984	(9,146)	4,838
Musharaka investments	71,693	5,624	77,317
Investment in sukuk	79,057	(18,488)	60,569
Ijarah muntahia bittamleek	100,104	1,437	101,541
Ijarah rental receivable	3,485	3,808	7,293
Total	676,381	17,985	694,366

* The movement is for the six months period ended 31 December 2010.

Table – 31. Unrestricted Investment Account Profit Earned and Paid (PD-1.3.33 (w))

The following table summarises the amount and percentage of profits earned by the Group and paid out to profit sharing investment accounts over the past five years;

	<i>Profit Earned (jointly financed) BD'000 %age</i>		<i>Profit Paid to (PSIA) BD'000 %age</i>	
2010	33,083	4.46%	17,721	2.39%
2009	35,694	5.27%	17,638	2.61%
2008	36,934	5.87%	17,702	2.81%
2007	31,463	7.80%	15,609	3.87%
2006	24,705	8.12%	12,660	4.16%

3 Risk Management (continued)

3.9 Unrestricted Investment Accounts ("URIA") (continued)

Table – 32 Treatment of assets financed by PSIA (PD-1.3.33-v)

	Assets	RWA	Capital Adequacy Purposes	Capital Requirements
	BD'000	BD'000	BD'000	BD'000
Cash and balances with Central Bank of Bahrain and other banks	26,870	-	-	-
Murabaha receivables*	415,938	251,013	75,304	9,036
Mudaraba investments	4,838	2,295	689	83
Musharaka investments*	77,317	66,770	20,031	2,404
Investment in sukuk	60,569	38,857	11,657	1,399
Ijarah muntahia bittamleek*	101,541	87,688	26,306	3,157
Ijarah rental receivable	7,293	6,298	1,889	227
	694,366	452,921	135,876	16,305

*The amounts have been allocated on pro-rata basis due to system limitation.

3.10 Liquidity Risk

3.10.1 Introduction

Liquidity risk is defined as "the risk that the Group will be unable to meet its obligations as they come due because of an inability to obtain adequate funding or to liquidate assets".

3.10.2 Sources of liquidity risk

The sources of liquidity risk can broadly be categorized in the following:

- Funding risk** is the risk of not being able to fund net outflows due to unanticipated withdrawal of capital or deposits;
- Call risk** is the risk of crystallization of a contingent liability; and
- Event risk** is the risk of rating downgrades or other negative public news leading to a loss of market confidence in the Group.

3.10.3 Bank's funding strategy

The Board reviews the funding strategy on an annual basis and amends the existing strategy, as deemed necessary. For this purpose, all business units advise the Treasurer of their projected liquidity requirements and contributions at the start of each year as part of annual budgeting process.

The funding strategy highlights any anticipated liquidity shortfalls, the funding requirements to finance these shortfalls and their impact on the statement of financial position. The Bank is in the process of developing a liquidity contingency plan to deal with stressed scenarios and outlines an action plan that can be taken in the event of a loss of market liquidity.

3 Risk Management (continued)

3.10 Liquidity Risk (continued)

3.10.4 Liquidity risk strategy

The Group monitors the liquidity position by comparing maturing assets and liabilities over different time buckets of up to 1 month, 1-3 months, 3-6 months, 6 months to 1 year, 1-3 years, and over 3 years. The Group carries out stress testing periodically using the worst case scenarios to assess the effects of changes in market conditions on the liquidity of the Group. As a strategy the Group maintains a large customer base and good customer relationships.

The Group's is in the process of implementing contingency liquidity plan to meet urgent liquidity requirements in stressed conditions that addresses how funding liquidity would be managed if either their specific financial conditions were to decline or broader conditions created a liquidity problem.

The Treasury Department, in conjunction with Risk and Compliance Unit periodically reviews/updates (at least annually) the liquidity risk strategy which is evaluated by ALCO before presenting to the EXCOM and the Board for approval.

3.10.5 Liquidity risk measurement tools

The Group uses a combination of techniques for measurement of its liquidity risk. These include liquidity gap analysis, liquidity ratio limits and minimum liquidity guidelines.

3.10.6 Liquidity risk monitoring

The Group has set the tolerance for liquidity risk which are communicated to the Risk and Compliance Department and Treasury Department. Based on these tolerances, Risk and Compliance Department and Treasury have established appropriate risk limits that maintain the Group's exposure within the strategic risk tolerances over a range of possible changes in liquidity situations.

3.10.7 Liquidity limits structure

The Group uses a combination of different limits to ensure that liquidity is managed and controlled in an optimal manner. The Group has set the following limits for monitoring liquidity risks:

- a. Liquidity Gap limits;
- b. Liquidity Ratio limits; and
- c. Minimum Liquidity Guideline ("MLG").

3.10.8 Liquidity risk stress testing

To evaluate whether the Group is sufficiently liquid, behavior of the Group's cash flows under different conditions are observed.

3.10.9 Contingency funding plan

The Group does contingency funding exercises which details procedures to be followed by the Group, in the event of a liquidity crisis or a situation where the Group faces stressed liquidity conditions. The contingency funding plan will be an extension of day to day liquidity management and involves maintenance of an adequate amount of liquid assets and management of access to funding resources. The ALCO members discuss and monitor the situation over regular time-intervals to ensure sufficient liquidity in the Group.

3 Risk Management (continued)

3.10 Liquidity Risk (continued)

Table – 33. Liquidity Ratios (PD-1.3.37)

The following table summarises the liquidity ratios for the past five years;

	2010	2009	2008	2007	2006
Commodities Murabaha / Total Assets	21.73%	10.42%	14.98%	27.37%	40.93%
Islamic Financing / Customer					
Deposits excluding banks	115.46%	123.01%	144.62%	171.72%	224.08%
Customer Deposits / Total Assets	64.13%	57.28%	48.71%	36.04%	34.99%
Liquid Assets / Total Assets	26.63%	14.38%	20.66%	30.16%	44.47%
Growth in Customer Deposits	14.86%	21.98%	79.24%	55.50%	8.39%

3.11 Profit Rate Risk

Profit rate risk is the potential impact of the mismatch between the rate of return on assets and the expected rate of funding due to the sources of finance.

Senior management identifies the sources of profit rate risk exposures based upon the current as well as forecasted balance sheet structure of the Group. The profit rate risk in the Group may arise due to the following transactions:

- a. Murabaha transactions;
- b. Mudaraba transactions;
- c. Ijarah Muntahia Bittamleek; and
- d. Sukuk.

The Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and unrestricted investment accounts as the repricing of assets, liabilities and unrestricted investment accounts occur at similar intervals. The profit distribution to unrestricted investment accounts is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

3 Risk Management (continued)

3.11 Profit Rate Risk (continued)

3.11.1 Profit rate risk monitoring and reporting

The Group has implemented information systems for monitoring, controlling and reporting profit rate risk. Reports are provided on a timely basis to EXCOM and the Board of Directors. The Risk and Compliance Unit monitors these limits regularly. GM-C&RM reviews the results of gap limits and exceptions, if any, and recommends corrective action to be taken which is approved by ALCO or EXCOM, according to authority parameters approved by the Board.

Table – 34. Profit Rate Risk in Banking Book (PD-1.3.40 (b))

The following table summarises the effect on the value of assets, liabilities and economic capital for a benchmark change of 200bp in profit rates as of 31 December 2010;

	<i>Effect on value of Asset BD'000</i>	<i>Effect on value of Liability BD'000</i>	<i>Effect on value of Economic Capital BD'000</i>
Upward rate shocks:	(5,993)	11,806	5,813
Downward rate shocks:	5,993	(11,806)	(5,813)

Table – 35. Quantitative Indicators of Financial Performance and Position (PD-1.3.9(b))

The following table summarises the basic quantitative indicators of financial performance for the past 5 years;

	2010	2009	2008	2007	2006
Return on average equity	-33.02%	-12.64%	12.62%	19.10%	17.80%
Return on average assets	-4.30%	-2.17%	2.91%	4.57%	3.45%
Cost to Income Ratio	107.73%	70.66%	31.32%	32.41%	38.76%

Bahrain Islamic Bank B.S.C.

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3 Risk Management (continued)

3.12 Corporate governance and transparency

Table – 36. Corporate Governance and Transparency – Board Members' Profile (PD-1.3.10(b))

The following table summarises the information about the profession, business title, experience in years and the qualifications of each Board member;

<i>Name of Board Member</i>	<i>Profession</i>	<i>Status</i>	<i>Business Title</i>	<i>Experience in years</i>	<i>Qualification</i>
Khalid Abdulla Al Bassam	Businessman	Independent	Chairman of the Board & Head of Remuneration and Nomination Committee & Head of Risk Management Committee	26 Years	Bachelor Degree in Business Administration from Eastern New Mexico University, USA. May 1988
Sh.Hisham Bin A.Rahman Al Khalifa	Businessman	Independent	Vice Chairman of the Board & Head of Audit Committee	20 Years	MBA Finance - Suffolk University Bachelor of Science in Business & Management from University of Bahrain
Khalid Mohamed Najibi	Businessman	Independent	Board Member & Head of the Executive Committee	18 Years	CPA from American Institute of Certified Public Accountant Bachelor's Degree in Financial Management from Schiller International University - London , UK
Yousif Mohammed Al Awadhi	Businessman	Independent	Board Member & Member of the Executive Committee	40 Years	Bachelor's Degree in Management from University of Cairo
Nabil Ahmed Mohammed Amin	Businessman	Investment Dar	Board Member & Member of the Executive Committee	26 Years	Bachelor's Degree in Business Administration from American University – Switzerland
Mohammed Al Zaroq Rajab	Businessman	Islamic Development Bank	Board Member & Member of the Audit Committee	42 years	Bachelor's Degree in Accounting from Libyan University
Ali Mohammed Al Olimi	Businessman	Independent	Board Member & Member of the Audit Committee	30 Years	Bachelor's Degree in Accounting from University of Kuwait

No Board member has more than one Directorship of a Retail Bank and a Wholesale Bank.

All Board members are non-executive.

Remuneration of Board Members and Shari'a Board Members is approved in the AGM after being discussed at the Board level. Remuneration of CEO is approved in the Board meeting. For all Group staff there is a fixed bonus plus a performance bonus scheme. Performance bonus is based on staff performance and recommendation of respective departmental heads. The Board approves all fixed and performance bonus schemes for staff.

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3 Risk Management (continued)

3.12 Corporate governance and transparency (continued)

Table – 37. Corporate Governance and Transparency – Executive Members' Profile (PD-1.3.10(b))

The following table summarises the information about the profession, business title, experience in years and the qualifications of each Executive member;

<i>Name of Executive Member</i>	<i>Designation</i>	<i>Profession</i>	<i>Business Title</i>	<i>Experience in year</i>	<i>Qualification</i>
Mohammed Ebrahim Mohammed	CEO	Banker	CEO & Member of the Executive Committee	33 Years	Master degree in Business Administration from University of Glamorgan- Wales 1998
Abdulrahman Mohammed Turki	General Manager- Retail Banking	Banker	General Manager	38 Years	Master Degree in Business Administration from University of Strathclyde Scotland 2002
Dr. Salah El Din Saeed	General Manager- Credit & Risk	Banker	General Manager	33 Years	MBA from University of Hull 1998
Mohammed Fikree	General Manager- Treasury & Investment	Banker	General Manager	28 Years	Associate accounting diploma from university of Bahrain & Banking and Finance diploma (BIBF)
Nader Ebrahim	General Manager- Corporate Banking	Banker	General Manager	28 Years	Executive Management & Leadership from University of Virginia, USA
Mohammed Ahmed Hassan	General Manager- Support Services	Banker	General Manager	42 Years	High School Diploma
Khalid Mohammed Al Dossari	Chief Financial Officer	Accountant	Assistant General Manager	27 Years	CPA from American Institute of Certified Public Accountants
Khalid Mahmood Abdulla	Assistant General Manager - Internal Audit & Sharia	Accountant	Assistant General Manager	17 Years	CPA from American Institute of Certified Public Accountant

3 Risk Management (continued)**3.12 Corporate governance and transparency (continued)****Table – 38. Corporate Governance and Transparency – Board Committees Profile (PD-1.3.10)**

The following table summarises the information about Board Committees, their members and objectives;

Board Committee	Members	Objective
Audit Committee	<ul style="list-style-type: none">• Sh. Hisham Al Khalifa (Chairman)• Mohammed Al Zarooq Rajab• Ali Al Olaimi	<p>1. Oversight of integrity and reporting of the Bank's quarterly and annual financial statements</p> <p>2. Compliance with legal and regulatory requirements etc.</p> <p>The committee meets four times per year</p>
Remuneration and Nomination Committee	<ul style="list-style-type: none">• Khalid Al Bassam (Chairman)• Khalid Najeebi• Nabil Ameen• Yousif Al Awadhi	<p>1. Oversight of the compensation and bonus policy</p> <p>2. Oversight of recruitment & promotion of key personnel</p> <p>The committee meets two times per year</p>
Risk Management Committee	<ul style="list-style-type: none">• Khalid Al Bassam (Chairman)• Ali Al Olaimi• Mohammed Al Zarooq Rajab	<p>1. Monitoring the enterprise-wide risk profile independently</p> <p>2. Risk Guidance to the Board and Management periodically</p> <p>The committee meets four times per year</p>
Executive Committee	<ul style="list-style-type: none">• Mohammed Ebrahim (Chairman)• Khalid Najeebi• Nabil Ameen• Yousif Al Awadhi	<p>1. Review of strategy and performance. 2. Review of new investment proposals, credit proposals, and exit strategies. 3. Review of risk, provision and impairment.</p> <p>The committee meets six times per year</p>

3 Risk Management (continued)

3.12 Corporate governance and transparency (continued)

Table – 39. Corporate Governance and Transparency – Management Committees Profile (PD-1.3.10)

The following table summarises the information about Management Committees, their members and objectives;

Management Committee	Members	Objective
Asset & Liability Committee (ALCO)	<p>Chairman Mohammed Ebrahim</p> <p>Members</p> <ul style="list-style-type: none"> • Nader Ebrahim • A. Rahman Turki • Khalid Al Dosari • Mohammed Fikree • Salah Adden A. Qader • Mohammed Belgami 	The main objective of ALCO is to manage and monitor the liquidity risk of the Bank on a coordinated and consistent basis.
Credit & Investment Committee (C&IC)	<p>Chairman Mohammed Ebrahim</p> <p>Members</p> <ul style="list-style-type: none"> • Nader Ebrahim • A. Rahman Turki • Mohammed Fikree • Salah Adden A. Qader <p>Permanent Invitees: Mohammed Belgami Badriya A. Ghani</p>	The main objectives of C&IC is to exercise due care, diligence and skill to oversee, direct and review the management of credit risk within the financing portfolio of the Bank and reviewing policies and strategies for achieving investment objectives.
Information Technology Steering Committee	<p>Chairman Mohammed Ebrahim</p> <p>Members</p> <ul style="list-style-type: none"> • Nader Ebrahim • Salah Adden A. Qader • Khalid AL Dossari • AbdulRazaq Abdulkhaliq • Khalid Mahmood 	The main objective of the IT Committee is to plan, prepare, coordinate, implement, support and follow-up on all issues related to the IT and new projects implementation issue.

3 Risk Management (continued)

3.12 Corporate governance and transparency (continued)

Table – 39. Corporate Governance and Transparency – Management Committees Profile (PD-1.3.10(b)) (continued)

Management Committee	Members	Objective
Human Resource Committee (HR)	<p>Chairman Mohammed Ebrahim</p> <p>Members</p> <ul style="list-style-type: none"> • Nader Ebrahim • Mohammed Hassan • A.Rahman Turki • Khalid Al Doosari • Mohammed Fikree • Salah Adden A. Qader • Khalid Mahmood • Aziz Ashor • Mohammed Khalifa Al Mulla 	The main objectives of HR Committee is to monitor and assess the employer workforce regarding human resources issues and monitor, review and analyze legislative and/or administrative changes related to human resources.
Qarth Al Hassan, Donation & Zakah Committee	<p>Chairman Mohammed Hassan</p> <p>Members</p> <ul style="list-style-type: none"> • Isa Ahmed • Mustafa Al Khohaji • Ramadhan Ali Ramadhan 	The main objective of Qard Al Hassan and Zakah Committee is to discharge the Group's social responsibilities toward its society through distributing zakah, charity funds, donations & good faith Qard for marriage, medical treatments, etc.

The following is the Shari's Committee members and its objective:

Members	Objective
<p>Chairman Abdullatif Al Mahmood</p> <p>Members</p> <ul style="list-style-type: none"> • Mohammed Jufari • Adnan Al Qattan • Netham Yacoobi • Essam Anzi 	The main objective of Sharia'a Committee is to advise the business units on any shari'a matter and to ensure compliance with the shari'a tenets and requirements in their operations. The Shari'a Committee is entrusted with the duty of directing, reviewing and supervising the activities of the Bank in order to ensure that the Bank is in compliance with Shari'a rules and AAOIFI.

New product information, Banks new announcement and information related to stakeholders are made available in timely manner through various channels of communication which may include publications, website, direct mailers, electronic mail and local media.

In addition, the Consolidated Financial Statement of at least past 3 years are available in the Bank's website.

The Group has a Quality Assurance Department which is responsible for managing customer complaints. After receiving a complaint, the department routes the complaint to the concerned department for their response. After analyzing the responses of the concerned department the customer is contacted accordingly. The customers may use the Group's website or the call centre for lodging a complaint.

3 Risk Management (continued)

3.12 Corporate governance and transparency (continued)

Board and Directors' Responsibilities

The primary responsibility of the Board of Directors is to provide effective governance over the Bank's affairs for the benefit of its stakeholders, and to balance the interests of its diverse constituencies, including associated concerns, employees and other stakeholders. In all actions taken by the Board, the Directors are expected to exercise their business judgment in what they reasonably believe to be the best interests of the Bank.

The Board will approve and oversee the implementation of the Bank's strategies and will review and approve the Bank's strategic plan. As part of its strategic review process the Board will review major plans of action and business plans, set performance objectives and oversee major investments, divestitures and acquisitions. Every year, at an annual Board strategy session, the Board will formally reassess the Bank's objectives, strategies and plans.

One of the Board's most important responsibilities is identifying, evaluating and selecting candidates for the Board of Directors. The Board will seek members from diverse professional backgrounds who combine a broad spectrum of experience and expertise with a reputation for integrity. Directors should have had experience in positions with a high degree of responsibility, be leaders in the companies or institutions with which they are affiliated and be selected based upon the contributions they can make to the Board.

The factors to be considered by the Board in its review of potential candidates include:

- Whether the candidate has exhibited behaviour that indicates he or she is committed to the highest ethical standards and the values adhered to by the Bank.
- Whether the candidate has had broad business, governmental, non-profit or professional experience that indicates that the candidate will be able to make a significant and immediate contribution to the Board's discussion and decision-making in an array of complex issues.
- Whether the candidate has special skills, expertise and background that add to and complement the range of skills, expertise and background of the existing directors.
- Whether the candidate has had a successful career that demonstrates the ability to make the kind of important and sensitive judgments that the Board is called upon to make.
- Whether the candidate will effectively, consistently and appropriately take into account and balance the legitimate interests and concerns of all of the Bank's shareholders and our other stakeholders in reaching decisions.
- Whether the candidate will be able to devote sufficient time and energy to the performance of his or her duties as a director.

The application of these factors involves the exercise of judgment and cannot be measured in any mathematical or routine way.

3 Risk Management (continued)

3.12 Corporate governance and transparency (continued)

Responsibilities

The following are the detailed responsibilities of the Board and Directors. The Board of Directors may not necessarily carry out all these responsibilities but should ensure that these have been delegated to various board committees or executive management committees to act on their behalf and communicate periodic reports to the Board for their review:

- Ensure that senior managements adequately manages the Bank's capital adequacy on a regular basis and periodic reports showing the adequacy of capital to support the business risks of the bank are prepared and submitted to the Board
- Establish policies for appointing senior managers, and ensuring that they have the necessary integrity, technical and managerial competence, and experience
- Overseeing succession planning and replacing key executives when necessary, and ensuring appropriate resources are available, and minimising reliance on key individuals
- Effectively monitoring and making formal (annual) evaluations of senior management's performance in implementing agreed strategy and business plans
- Approving budgets and reviewing performance against those budgets and key performance indicators
- The management of the bank's compliance risk
- Submit organizational structure or changes to the structure approved by the Board of Directors to the CBB for final approval
- Develop policy to review the systems and controls framework, and to identify any significant issues related to the bank's adopted governance framework, processes and practices
- Ensure to obtain the CBB's approval on the following function prior to their appointment:
 - o Director
 - o Member of Shari'a Supervisory Board
 - o Chief Executive or General manager
 - o Senior manager
 - o Compliance Officer
 - o Money Laundering Reporting Officer and
 - o Financial Instrument Trader

Responsibilities relating to Risk Management Function

- Approving the Bank's strategies and policies with respect to risk management i.e. credit, operational, market, liquidity, profit rate risk, strategic and legal, E-banking.
- Clearly define the committee responsible for managing the risk which responsibility includes the following:
 - o Ensure risk management personnel are adequately qualified to investigate and resolve issues relating to potential risks
 - o Determine acceptable limits of exposure to various types of risks
 - o Ensure that the risk management function is subject to independent review at least annually and results are communicated to the Board
 - o Review the Bank's strategy and significant policies at least annually with respect to Risk Management Function
 - o Ensure that the senior management is adequately carrying out the delegated responsibilities with respect to the Risk Management Function
 - o Approve disclosure policy in line with applicable regulations
- Clearly define responsibility of the individuals managing the risk
- To ensure that the Risk Management manual should clearly define reports to be used for monitoring risk, frequency at which these reports should be prepared and appropriate management levels to whom these should be submitted for review.

3 Risk Management (continued)

3.12 Corporate governance and transparency (continued)

Responsibilities relating to Compliance Function

- The Board should appoint a senior member with responsibility for the management of compliance risk as their Compliance Officer/Manager (CM).
- The Compliance Function should be independent and CM should report directly to the Board of Directors or to the Audit Committee. The CM should have direct access to senior management and all confidential information of the Bank.
- Prior to appointment of the CM, the Board should obtain the CBB's prior approval and ensure he has the necessary qualification and experience necessary for the proposed position.
- The Compliance Function is typically responsible for the following:
 - o Independent assessment of compliance requirements in relation to the operating activities
 - o Provide guidance on the applicable laws and regulations
 - o Check and evaluate internal policies and limits
 - o Evaluate practices adopted to disseminate information to respective business units
 - o Develop programmes for training staff on laws, regulations and internal policies
 - o Carryout compliance monitoring activities
 - o Reporting exceptions to the senior management and the Board or its committee

Number and names of independent board members

- 1- Khalid Al-Bassam.
- 2- Sh.Hisham Al-Khalifa.
- 3- Khalid Najibi.

Board start date for each term for each director

- 1- Khalid Al-Bassam (Start date: 09-03-2008).
- 2- Sh.Hisham Al-Khalifa (Start date: 09-03-2008).
- 3- Khalid Najibi (Start date: 09-03-2008).
- 4- Ali Mohammed Al-Olaimi (Start date: 09-03-2008).
- 5- Mohammed Al-Zarroq Rajab (Start date: 09-03-2008).
- 6- Nabeel Ahmed Mohammed Amin (Start date: 09-03-2008).
- 7- Yousif Mohammed Al-Awadhi (Start date: 09-03-2008) no longer representing the BOD starting from Jan
- 8- Ghassan AlBaraheem (Start date: 02-2011).
- 9- Abdulrahman Al-Dawood (Start date: 01-2011)

3 Risk Management (continued)

3.12 Corporate governance and transparency (continued)

Risk Management Committee

Code of Conduct

The Bank will adopt a Code of Conduct and other internal policies and guidelines designed to support the mission statement set forth above and to comply with the laws, rules and regulations that govern the Bank's business operations. The Code of Conduct will apply to all employees of the Bank and its subsidiaries, as well as to Directors, temporary workers and other independent contractors and consultants whether engaged by or otherwise representing the Bank and its interests.

The Directors have adopted the following Code of Conduct in respect of their behaviour:

- To act with honesty, integrity and in good faith, with due diligence and care, with a view to the best interest of the Bank and its stakeholders;
 - To meet regularly with senior management and Internal Audit to establish and approve policies;
 - To act only within the scope of their responsibilities;
 - To have a proper understanding of the affairs of the Bank and to devote sufficient time to their responsibilities;
 - To understand, identify and measure the significant risks to which the Bank is exposed in its business activities;
 - To independently assess and question the policies, processes and procedures of the Bank with the intent to identify and initiate management action on issues requiring improvement;
 - To keep confidential board discussions and deliberations;
 - Not to make improper use of information gained through the position as a Director;
 - Not to take improper advantage of the position of Director;
 - To ensure his / her personal financial affairs will never cast doubt on the integrity of the Bank;
 - To maintain sufficient detailed knowledge of the Bank's business and performance to make informed decisions;
 - To be independent in judgment and actions and to take all reasonable steps to be satisfied as to the soundness of all decisions of the Board;
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- Not to agree to the business of the Bank being carried out or cause or allow the business to be carried on, in a manner likely to create a substantial risk of serious loss to the Bank's creditors and other key stakeholders;
 - Not to agree to the Bank incurring an obligation unless he / she believes at the time, on reasonable grounds, that the Bank will be able to perform the obligations when it is required to do so;
 - To treat fairly and with respect all of the Bank's employees and customers with whom they interact;
 - Not enter into competition with the Bank;
 - Not demand or accept substantial gifts from the Bank for himself or his associates;
 - Not take advantage of business opportunities to which the Bank is entitled for himself or his associates;
 - Report to the Board any potential conflict of interest;
 - Declare interests in the Register of Interest; and
 - Absent themselves from any discussions or decision-making that involves a subject in which they are incapable of providing objective advice or which involves a subject or proposed conflict of interest.
 - Commitment to follow the applicable regulations and follow the best industry practices
 - Handle disputes and complaints from the clients to their entire satisfaction and at the same time safeguarding the interest of the Bank

The Director's adherence to this Code will be periodically reviewed. Additionally, this Code of Conduct may be published in the Annual Report with copies also available on request.

3 Risk Management (continued)

3.12 Corporate governance and transparency (continued)

Corporate Governance Assessment

A detailed assessment has been carried out to accommodate to the CBB's amendments to the HC module and has been forwarded to the CBB. The below items are amendments that will be implemented by the bank as set by the CBB deadline.

1. Updating the Director's Handbook to incorporate the new CBB guidelines and have in place a Corporate Governance policy.
2. Publish the Corporate Governance Guidelines (updated Directors Handbook) on the bank's website.
3. Corporate Governance Committee will be finalized before the proposed deadline.
4. CEO and CFO's certification of the financial statements.
5. Updating the nomination and Remunerations committee and its charter.
6. Compliance report to Shareholders on the HC Module

The Bank has been charged with two penalties by CBB during the year. A penalty of BD 2,300 and a penalty of BD 550 both regarding updation of BENEFIT data records.

5 Glossary of Terms

ALCO	Assets and Liabilities Committee
BCP	Business Continuity Plan
BIsB	Bahrain Islamic Bank B.S.C.
BPV	Basis Point Value
CA Module	Capital Adequacy Module
CAR	Capital Adequacy Ratio
CBB	Central Bank of Bahrain
CRMD	Credit and Risk Management Department
CR & AD	Credit Review and Analysis Department
C&IC	Credit and Investment Committee
DCR	Displaced Commercial Risk
Excom	Executive Committee
FX	Foreign Exchange
GM-C&RM	General Manager-Credit and Risk Management
Group	Bahraini Islamic Bank B.S.C. and its subsidiary
HR Committee	Human Resource Committee
IAH	Investment Account Holder
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IT Committee	Information Technology Committee
IRR	Investment Risk Reserve
MLG	Minimum Liquidity Guidelines
PCD	Prudential Consolidation and Deduction Requirements Module
PD	Public Disclosure
PER	Profit Equalisation Reserve
PSIA	Profit Sharing Investment Account
RCSA	Risk and Control Self-Assessment
RMC	Risk Management Committee
RWE	Risk Weighted Exposures
URIA	Unrestricted Investment Accounts
VaR	Value-at-Risk