1 CAPITAL MANAGEMENT

1.1 Regulatory capital

	30 June 2010 US$	*31 December 2009 US$*
Tier 1 Capital		
Issued and fully paid ordinary shares	**80,000,000**	80,000,000
Legal / statutory reserves	**7,409,515**	7,409,515
Retained earnings	**(39,758,881)**	(23,912,862)
Unrealised gross losses arising from fair valuing equity securities	**(497,720)**	(5,974)
	47,152,914	63,490,679
Excess amount over maximum permitted large exposure limit	**(11,507,477)**	(16,935,582)
Total Tier 1 Capital	**35,645,437**	46,555,097
Tier 2 Capital		
Unrealised gross gains arising from fair valuing equities (45% only)	**1,262,784**	1,537,953
Profit for the period / year	**-**	-
	1,262,784	1,537,953
Excess amount over maximum permitted large exposure limit	**(1,262,784)**	(1,537,953)
Total Tier 2 Capital	**-**	-
Total Eligible Capital	**35,645,437**	46,555,097

1.2 Risk weighted assets

	30 June 2010 US$	*31 December 2009 US$*
Credit risk weighted assets	**73,061,625**	85,167,771
Operational risk weighted assets	**41,130,394**	41,130,394
Market risk weighted assets	**11,101,210**	17,983,850
	125,293,229	144,282,015

The Bank has adopted the Standardised Approach for credit risk and market risk and the Basic Indicator Approach for operational risk management under the revised framework.

1 CAPITAL MANAGEMENT

1.3 Capital adequacy ratio

	30 June 2009 US$	*31 December 2009 US$*
Total capital base (a) (note 6.1)	**35,645,437**	46,555,097
Risk weighted assets (b) (note 6.2)	**125,293,229**	144,282,015
Capital adequacy (a/b x 100)	**28.4%**	32.3%

The Bank's policy is to maintain it's capital adequacy ratio in excess of the minimum required by the CBB at all times. The current minimum requirement for the Bank is 15% (31 December 2008: 12.5%).

2 RISK MANAGEMENT

Credit risk

Credit risk arises from all products and services where counterparties of the Bank fail to meet their payment obligations in accordance with terms and conditions of the contract. This risk exists in all activities of the Bank, including the banking book and both on or off the balance sheet. The Bank's credit risk arises mainly from cash and balances with banks, murabaha receivables, mudaraba investment, receivable from sale of investments, receivable from mudarib, deferred payment sale receivables, dividend receivable and other assets.

The table below shows the maximum exposures to credit risk for components of the statement of financial position. There are no unfunded exposures and no significant use of master netting and collateral agreements.

	30 June 2010		*31 December 2009*	
	Total gross credit risk exposure US$	***Average gross credit exposure over the period* US$***	*Total gross credit risk exposure US$*	*Average gross credit exposure over the period * US$*
Cash and balances with banks	**314,864**	**405,691**	612,263	1,199,699
Available-for-sale investments	**17,640,418**	**19,063,442**	22,057,592	22,159,330
Receivable from Mudarib	**-**	**-**	-	3,348,211
Receivable from sale of investments	**-**	**-**	-	8,305,469
Deferred payment sale receivables	**3,680,203**	**3,680,203**	3,680,203	3,680,203
Investment property	**25,582,920**	**26,499,990**	27,571,404	28,563,797
Other assets	**1,519,784**	**4,560,470**	7,624,912	8,926,864
Property and equipment	**5,130,137**	**6,039,018**	7,098,715	8,246,406
	53,868,326	**60,248,814**	68,645,089	84,429,979

* These have been computed based on a quarterly average balances.

2 RISK MANAGEMENT (continued)

Credit risk (continued)

Geographical distribution of credit risk exposures:

	30-Jun-10			
	Bahrain	***Kuwait***	***Other***	***Total***
	US$	***US$***	***US$***	***US$***
Cash and balances with banks	**296,745**	**18,119**	**-**	**314,864**
Available-for-sale investments	**12,174,712**	**4,009,300**	**1,456,406**	**17,640,418**
Deferred payment sale receivables	**3,680,203**	**-**	**-**	**3,680,203**
Investment property	**21,087,271**	**-**	**4,495,649**	**25,582,920**
Other assets	**1,044,784**	**-**	**475,000**	**1,519,784**
Property and equipment	**5,130,137**	**-**	**-**	**5,130,137**
	43,413,852	**4,027,419**	**6,427,055**	**53,868,326**

	31 December 2009			
	Bahrain	*Kuwait*	*Other*	*Total*
	US$	*US$*	*US$*	*US$*
Cash and balances with banks	603,067	9,196	-	612,263
Available-for-sale investments	12,982,868	7,643,190	1,431,534	22,057,592
Deferred payment sale receivables	3,680,203	-	-	3,680,203
Investment property	22,226,283	-	5,345,121	27,571,404
Other assets	1,106,336	6,043,576	475,000	7,624,912
Property and equipment	7,098,715	-	-	7,098,715
	47,697,472	13,695,962	7,251,655	68,645,089

2 RISK MANAGEMENT (continued)

Credit risk (continued)

Industry sector of credit risk exposures:

	30-Jun-10			
	Banks and financial institutions US$	**Investment companies US$**	**Other US$**	**Total US$**
Cash and balances with banks	**314,864**	**-**	**-**	**314,864**
Available-for-sale investments	**15,373,345**	**694,372**	**1,572,701**	**17,640,418**
Deferred payment sale receivables	**-**	**3,680,203**	**-**	**3,680,203**
Investment property	**-**	**-**	**25,582,920**	**25,582,920**
Other assets	**900,996**	**-**	**618,788**	**1,519,784**
Property and equipment	**-**	**-**	**5,130,137**	**5,130,137**
	16,589,205	**4,374,575**	**32,904,546**	**53,868,326**

	31 December 2009			
	Banks and financial institutions US$	*Investment companies US$*	*Other US$*	*Total US$*
Cash and balances with banks	612,263	-	-	612,263
Available-for-sale investments	19,878,026	672,456	1,507,110	22,057,592
Deferred payment sale receivables	-	3,680,203	-	3,680,203
Investment property	-	-	27,571,404	27,571,404
Other assets	900,995	-	6,723,917	7,624,912
Property and equipment	-	-	7,098,715	7,098,715
	21,391,284	4,352,659	42,901,146	68,645,089

The Bank does not have any unfunded exposures.

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2 RISK MANAGEMENT (continued)

Credit risk (continued)

Individual counterparties where the exposure is in excess of the 15% individual obligor limit:

	30 June 2010 US$	*31 December 2009 US$*
Counterparty # 1 - Individual	**-**	11,455,214
Counterparty # 2 - Individual	**5,673,064**	5,673,633
Counterparties - Closely Related	**14,359,552**	20,853,278
	20,032,616	37,982,125

Past due and impaired financing contracts

	30-Jun-10			
	Banking and financial institutions US$	**Investment companies US$**	**Others US$**	**Total US$**
Past due but not impaired islamic financing contracts	**887,733**	**3,680,203**	**-**	**4,567,936**
Impaired financing contracts	**15,312,239**	**6,125,125**	**10,794,590**	**32,231,954**
	16,199,972	**9,805,328**	**10,794,590**	**36,799,890**

	31 December 2009			
	Banking and financial institutions US$	*Investment companies US$*	*Others US$*	*Total US$*
Past due but not impaired islamic financing contracts	887,733	3,680,203	-	4,567,936
Impaired financing contracts	15,312,239	6,125,125	10,108,903	31,546,267
	16,199,972	9,805,328	10,108,903	36,114,203

Ageing of past due and impaired financing contracts

	30-Jun-10			
	Banking and financial institutions US$	**Investment companies US$**	**Others US$**	**Total US$**
1 year - 3 years	**4,497,788**	**150,371**	**9,919,590**	**14,567,749**
Over 3 years	**11,702,184**	**9,654,957**	**875,000**	**22,232,141**
	16,199,972	**9,805,328**	**10,794,590**	**36,799,890**

2 RISK MANAGEMENT (continued)

Credit risk (continued)

Ageing of past due and impaired financing contracts (continued)

	31 December 2009			
	Banking and financial institutions US$	*Investment companies US$*	*Others US$*	*Total US$*
1 year – 3 years	15,312,239	6,125,125	9,233,903	30,671,267
Over 3 years	887,733	3,680,203	875,000	5,442,936
	16,199,972	9,805,328	10,108,903	36,114,203

Movement in specific provision during the period

	30-Jun-10			
	Banking and financial institutions US$	***Investment companies US$***	***Others US$***	***Total US$***
Balance at the beginning of the period	**15,312,239**	**6,125,126**	**3,590,327**	**25,027,692**
Impaired charge during the period	**-**	**-**	**6,729,263**	**6,729,263**
Balance at the end of the period	**15,312,239**	**6,125,126**	**10,319,590**	**31,756,955**

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

Past due exposures by geographical area:

	30 June 2010		*31 December 2009*	
	Past due islamic financing contract US$	***Specific impairment provision US$***	*Past due islamic financing contract US$*	*Specific impairment provision US$*
Bahrain	**4,567,936**	**-**	887,733	-
Kuwait	**31,356,954**	**31,356,954**	34,351,469	24,627,692
Other countries	**1,283,536**	**808,535**	1,283,536	808,535
Total	**37,208,426**	**32,165,489**	36,522,738	25,436,227

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2 RISK MANAGEMENT (continued)

Market risk

The total market risk weighted assets and regulatory capital requirements related to market risk are as follows:

	30 June 2010				
	Gross US$	***Risk assets US$***	***Capital requirements US$***	***Maximum capital requirement during the period US$***	***Minimum capital requirement during the period US$***
Equity position	**3,415,076**	**3,597,875**	**539,681**	**571,799**	539,681
Foreign exchange position	**7,503,335**	**7,503,335**	**1,125,500**	**1,556,392**	1,125,500

	31 December 2009				
	Gross US$	*Risk assets US$*	*Capital requirements US$*	*Maximum capital requirement during the year US$*	*Minimum capital requirement during the year US$*
Equity position	5,611,582	4,710,839	706,626	1,192,928	617,892
Foreign exchange position	13,273,011	13,273,011	1,990,952	4,380,506	1,990,952

Equity price risk
Equity price risk is the risk that the fair value of equity investments decreases as a result of fluctuations in the respective stock market indices. As at 30 June 2010, the Bank had trading investments and Available for sale investments listed on local and overseas stock exchanges. Based on the values at 30 June 2010, a change in the quoted price of plus or minus 20% would change the value of trading investments by plus or minus US$ 0.683 million (31 December 2009: US$ 1.122 million) with a corresponding increase or decrease in statement of income.

Based on the values at 30 June 2010, a change in the quoted price of plus or minus 20% would change the value of available for sale investments by plus or minus US$ 3.136 million (31 December 2009: US$ 4.016 million) with a corresponding increase or decrease in statement of equity.

Foreign currency risk
Foreign currency risk is the risk that the value of a financial instrument will fluctuate due to adverse changes in foreign currency rates. Certain investments and other financial assets and liabilities are in foreign currencies and give rise to foreign currency risk.

2 RISK MANAGEMENT (continued)

Market risk (continued)

Foreign currency risk (continued)
The Bank has following net foreign currency exposures at 30 June 2009:

Currency	***30 June 2010 US$***	*31 December 2009 US$*
Bahraini Dinar	**41,292,087**	49,970,729
Kuwaiti Dinar	**7,503,335**	13,273,011
United Arab Emirates	**4,495,649**	5,345,121
	53,291,071	68,588,861

Sensitivity Analysis
The following figures demonstrates the sensitivity of the statement of income to a 5% possible movement of the currency rates against the US Dollar (functional and reporting currency) based on the above positions with all other variables held constant.

	30 June 2010 US$ (+/-)	*30 June 2009 US$ (+/-)*
Kuwaiti Dinar	**357,302**	1,390,637

Operational risk

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

Bank's capital charge for Operational Risk using Basic Indicator Approach is as follows:

	Average gross income US$	***Risk weighted assets US$***	***Capital US$***
30 June 2010	**21,936,210**	**41,130,394**	**3,290,432**
31 December 2009	21,936,210	41,130,394	3,290,432

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

	(Unaudited) 30 June 2010	*(Audited) 31 December 2009*
Gross Income - US$	**21,936,210**	21,936,210
Amount of non-Shari'a-compliant income - US$	**-**	296
Number of Shari'a violations identified and reported during the period	**None**	None

2 RISK MANAGEMENT (continued)

Operational risk (continued)

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

	30 June 2010		*31 December 2009*	
	Publicly traded US$	***Privately held US$***	*Publicly traded US$*	*Privately held US$*
Investment in shares	**15,224,686**	**1,753,296**	19,652,965	1,764,107
Investment in managed funds	**-**	**662,435**	-	640,520
	15,224,686	**2,415,731**	19,652,965	2,404,627

Additionally the Bank has the following cumulative realised gains or losses arising from sales or liquidations, total unrealised gains and losses recognised in the statement of financial position but not through the statement of income, and any unrealised gains and losses included in Tier 1 and Tier 2 capital:

	30 June 2010 US$	*31 December 2009 US$*
Cumulative realised gains (losses) arising from sales or liquidations	**(490)**	6,530
Total unrealised gains (losses) recognised in the statement of financial position but not through statement of income	**2,308,468**	3,411,701
Unrealised gains (losses) included in Tier 1 Capital	**(497,720)**	(5,974)
Unrealised gains (losses) included in Tier 2 Capital	**1,262,784**	1,537,953

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

	30 June 2010		*31 December 2009*	
	Risk weighted assets US$	***Capital requirements US$***	*Risk weighted assets US$*	*Capital requirements US$*
Investment in shares	**12,697,257**	**1,904,589**	16,496,985	2,474,548
Investment in managed funds	**637,898**	**95,685**	610,380	91,557
	13,335,155	**2,000,274**	17,107,365	2,566,105

2 RISK MANAGEMENT (continued)

Liquidity risk

Liquidity risk is defined as the risk that funds will not be available to meet liabilities as they fall due. The maturity profile of assets and liabilities as at 30 June 2010 based on contractual maturity is as follows:

	Upto 1 month US$	*1 to 3 months US$*	*3 months to 1 year US$*	*1 to 3 years US$*	*Over 3 years US$*	*No fixed maturity US$*	*Total US$*
Assets							
Cash and balances with banks	314,864	-	-	-	-	-	314,864
Investments	-	-	-	-	-	21,055,494	21,055,494
Deferred payment sale receivables	-	-	-	-	-	3,680,203	3,680,203
Investment property	-	-	-	-	-	25,582,920	25,582,920
Other assets	-	11,412	23,400	107,476	-	1,377,495	1,519,783
Property and equipment	-	-	-	-	-	5,130,137	5,130,137
	314,864	11,412	23,400	107,476	-	56,826,249	57,283,401
Liabilities							
Due to a financial institution	-	-	-	-	-	3,670,202	3,670,202
Murabaha payable	-	-	-	-	-	3,229,064	3,229,064
Other liabilities	30,157	23,871	177,203			193,802	425,033
	30,157	23,871	177,203	-	-	7,093,068	7,324,299
Net	284,707	(12,459)	(153,803)	107,476	-	49,733,181	49,959,102
Cumulative	284,707	272,248	118,445	225,921	225,921	49,959,102	
Off- balance sheet items							
Restricted investment accounts	-	-	-	-	-	16,083,351	16,083,351
	-	-	-	-	-	16,083,351	16,083,351

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2 RISK MANAGEMENT (continued)

Liquidity risk (continued)

The maturity profile of assets and liabilities as at 31 December 2009 based on contractual maturity is as follows:

	Upto 1 month US$'000	*1 to 3 months US$'000*	*3 months to 1 year US$'000*	*1 to 3 years US$'000*	*Over 3 years US$'000*	*No fixed maturity US$'000*	*Total US$'000*
Assets							
Cash and balances with banks	612,263	-	-	-	-	-	612,263
Investments	-	-	-	-	-	27,669,174	27,669,174
Deferred payment sale receivables	-	-	-	-	-	3,680,203	3,680,203
Investment property	-	-	-	-	-	27,571,404	27,571,404
Other assets	-	10,038	59,512	134,292	1,499	7,419,571	7,624,912
Property and equipment	-	-	-	-	-	7,098,715	7,098,715
	612,263	10,038	59,512	134,292	1,499	73,439,067	74,256,671
Liabilities							
Due to a financial institution	-	-	-	-	-	3,670,202	3,670,202
Murabaha payable	-	-	-	-	-	3,229,064	3,229,064
Other liabilities	31,804	101,148	132,007	-	-	184,092	449,051
	31,804	101,148	132,007	-	-	7,083,358	7,348,317
Net	580,459	(91,110)	(72,495)	134,292	1,499	66,355,709	66,908,354
Cumulative	580,459	489,349	416,854	551,146	552,645	66,908,354	
Off- balance sheet items							
Restricted investment accounts	-	-	-	-	-	16,228,225	16,228,225
	-	-	-	-	-	16,228,225	16,228,225

3 LITIGATION AND CLAIMS

In 2004, the Bank entered into a sale and purchase agreement with a local financial institution to purchase shares of a related party on behalf of another relat party. The net amount due to the financial institution was US$ 3,670,202. In accordance with the terms of the agreement, the Bank pledged certain of investments with a carrying value of US$ 3,635,160 as at 30 June 2010 (31 December 2009: US$ 4,306,622) . Subsequently, the agreement was terminated the financial institution due to disputes with the Bank and as a result, the pledged investments have been retained by the financial institution. In the opinion of t Bank's lawyers and management, the agreement was wrongfully terminated and following the financial institution's refusal to settle the matter amicably, t Bank has filed a legal case in the Bahrain courts against the financial institution for wrongful possession of investments. As a result, the court has taken custo of the shares under dispute. The related party on whose behalf the transactions was entered has provided a manager's cheque for an equal amount which h been deposited with the court. This amount is included under Deferred payment sale receivables.

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

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