BMB INVESTMENT BANK

ANNUAL REPORT
FOR THE YEAR ENDED
31 DECEMBER 2009

The legal name of BMB Investment Bank is Bahrain Middle East Bank (B.S.C.)

Profile

- Established in 1982, Bahrain Middle East Bank (B.S.C.) ("BMB" or the "Bank") was initially set-up as an exempt joint stock company with Commercial Registration Number 12266. The Bank operates under a Conventional Wholesale Banking license granted by the Central Bank of Bahrain ("CBB").

- The Bank was originally incorporated for a fixed term of 25 years ending 2007, but the Bank's term was subsequently extended up until 2032 pursuant to a resolution passed by the ordinary shareholders and as approved by the Ministry of Industry and Commerce in Bahrain. In August 2005, the Bank amended its Memorandum and Articles of Association to convert from an Exempt Company, "E.C.", to a Bahrain Shareholding Company, "B.S.C." and as part of this process acquired an indefinite corporate life.

- The Bank conducts its operations from a single office.

- The Bank is listed on the Bahrain Stock Exchange under Reuters code BMEB.BH.

Business Activities

- The Bank' is primarily engaged in investment banking, asset management and proprietary trading. The core activity is in third party managed private equity fund investments.

Global Network

- BMB currently has a wide range of business alliances with leading investment banks, commercial banks and private equity asset managers primarily in Western Europe and the United States of America. It works with these partners to develop innovative investment products which offer superior returns to its clients and shareholders.

Shareholders

- Al Fawares Holding Company ("Al Fawares"), a Kuwaiti Private Holding Company, is BMB's major shareholder with 64.6% equity stake. No other single shareholder owns over 10% of the Bank's issued and fully paid up shares. The balance of BMB's shares are held by over 13,000 shareholders, primarily throughout the Gulf region.

Management

- The Bank is managed by a Board composed of 7 directors with broad industry experience. 4 directors are independent.

- In March 2009, Mr. Akbar Habib, former Group Chief Executive Officer of Oman National Investment Corporation Holding ('ONIC'), was appointed CEO of the Bank and charged with taking the Bank into a new era of focus and strategic direction.

<u>The Existing Business</u>

The Bank's existing business is primarily focused on proprietary investments in third party managed private equity funds.

This activity is supplemented by two additional lines of business:

i. Proprietary trading: where the focus is on identifying underlying trends and taking short term tactical trading positions as opposed to day trading.
ii. Customer business: where the emphasis is on a shared vision and collective investment in value creation; where BMB and its clients commit their funds alongside one another and share risk and rewards together.

Over the last 15 years, the Bank's existing business activity has produced superior returns having yielded an average 2.75 multiple on exit for both its own book and its clients'. Since 1988, the Bank has maintained a strong relationship with top quartile private equity fund managers, both directly and through private equity fund distributors. Drawing from its own fundamental macro trend analysis, BMB's strategy is to seek out unquoted equity funds and direct investments which meet stringent criteria for investment for both itself and its investors. Importantly, the Bank's investment placement strategy is based upon a risk sharing philosophy; where the Bank invests alongside its investor.

The criteria for selecting fund managers are stringent and include (amongst others):

- A proven track record over a number of years and economic cycles.
- A strong institutional backing.
- A strategy of taking controlling interest.
- A strict pricing discipline in the acquisition process and, for the most part, must not be sourcing transactions through the auction process.
- A pre-determined exit strategy.

Below is a more depth description of the Bank's revenue generating departments.

The Way Forward

Following a comprehensive review in 2009, the Bank's Board of Directors and Senior Management devised a New corporate plan and vision for 2015. This is summarised as follows:

Vision

"To be The Niche Investment Bank in the region"

Objectives

- Diversify and expand business via:
  - Offering a range of products/diversifying markets.
  - Secure sustainable income streams that are neutral to market volatility and thereby:
  - Strengthen profitability and financial position
- Emerge as a recognised regional player by 2015

Guiding Principles

- Integrity and Transparency
- Discipline
- Commitment
- Partnership
- Customer Orientation
- Innovation

Simplified key implementation steps

- Increase the Bank's share capital by no less than USD 75 million over the coming year. It forms the basis of enabling the Bank implement its new strategic initiatives.

- Leverage existing expertise in Private Equity fund investments and network of alliances and relationships to expand business lines across:
  i. Proprietary Investments
  ii. Asset Management
  iii. Corporate Finance & Advisory
  iv. Treasury & Capital Markets

- Increase annuity-like fee based income. A key part of this strategy is expanding assets under management.

- Broaden its geographical focus to cover the GCC/wider MENA region.

- Target clients with specialist needs that are being under-served by the market; and where BMB can carve a niche in providing investment products, portfolio management services and financial advisory.

- Focus on direct private equity investments – particularly special/distressed situations. Build value through active disciplined management, establishing the track record as a turn around specialist.

- Build institutional capacity/know how by attracting experienced personnel so that BMB can develop its own value added products for its clients.

- Drive growth not only organically but also through acquisitions.

- Leverage its lines of business and existing/prospective client contacts to expand overall business.

Chairman's and Chief Executive Officer's Report to the Shareholders

On behalf of the board of directors, we are pleased to put forth the financial statements for BMB for the period ended 31 December 2009, and provide an insight into those initiatives undertaken amidst challenging times and those intended over the short to medium-term

2009 - A Year in Review

The global financial crisis of 2009 caused havoc across all global economic activities and the world's financial markets. The crises which erupted with the Lehman Brothers bankruptcy towards late 2008, continued its knock-on effects throughout much of 2009; leaving no financial service provider immune or unscattered from its effects. BMB was no exception.

Accordingly, BMB whose main investment activities were in the Western hemisphere, Europe and the US through its private equity fund investments was directly impacted. Like all other asset classes, the Private Equity space was severely impacted, leading to significant reductions in valuations, a complete freeze in investment activities and an absolute halt in sales realizations. This resulted in the Bank recording serious losses, though much of which temporary in nature.

Opportunity to Regroup and Reorganize

While the crises saw the failure of some of the largest banks, it also created a vacuum and an opportunity for specialized investment banking services in the region; an opportunity BMB quickly moved to exploit. Led by a new management team, BMB embarked on several new initiatives which included:

- Develop a new corporate strategy and vision for the Bank which was completed by May.

- Right sizing in terms of achieving a proper balance between the Bank's current position and its future ambitions. This exercise achieved over 40% cost savings; full benefits of which are likely to be seen starting 2010.

- Review of efficiency and effectiveness of all the Bank's key processes, an exercise that lead to a complete revamping of all departments. In addition, the Bank is currently in the process of implementing a new IT system; which is expected to translate into further efficiency improvements and cost savings to the Bank, on completion.

- Testing of the Bank's entire Private Equity Portfolio and Direct Investments for those uncertain and doubtful, a prudent measure undertaken to provide stakeholders clear visibility in terms of the Bank's assets and financial status. Having fully completed the exercise, the Bank's books are now clean and transparent as a stakeholder would appreciate.

- Sizeable reduction of the Bank's Private unfunded Private Equity fund commitments to US$25 million at end-December 2009 from US$ 58 million at end-December 2008. The exercise was carried amidst challenging conditions and the Bank was successful in achieving its desired objective with minimal costs.

- Despite severe challenges and adverse market conditions, the Bank managed to honour all commitments during the period, for itself as well as on behalf of customers, and others to the tune of US$ 18 million. This, by its very own, is an extra-ordinary achievement.

Financial Performance

For the financial year 2009, the Bank reported net loss of US$ 33.5 million (2008: US$14.3 million). At the backdrop of an absolute halt in Private Equity Fund exits, BMB's core revenue generative source, this was due to:

- US$17.9 million in impairment provisions undertaken as part of its balance sheet cleaning up process. Much of these related to its Private Equity Fund Investments. Of the US$17.9 million, US$12.3 million related to none other than the transfer of accumulated negative fair values, previously recognized in equity, through to the income statement on the basis of being prolonged; with prolonged being defined by a period of one year. New impairments for the period amounted to US$ 5.6 million.

- Comprehensive loss for the period, net of any fair value transfers to the income statement, amounted to US$19.3 million versus US$ 28.4 million in losses in 2008.

- In addition, the Bank incurred additional losses on non-performing investments and the sale of its three sizeable unfunded fund commitments, amounting to US$ 8 million.

- Operating expense for the period amounted to US$ 9.2 million (2008: US$ 11.1 million); a 17% drop from 2008.

Resulting from the above, net equity of the Bank fell to US$ 23.7 million from US$ 43 million at end-2008.

- However, reflecting the valuation improvements on its Private Equity Fund portfolio as well as efforts of its cleaning up process, the Bank's fair value reserves increased to US$ 9.7 million at end-2009 from a negative US$ 5.7 million at end-2008 (and negative US$ 7.9 million at end-March 2009). This is a near 60% improvement.
- Capital adequacy continues to remain sound at 14.9% at end-2009

Outlook

- The Bank has come a long way in terms of managing its affairs through the crisis. The outlook now appears promising as evidenced by its improved liquidity status and improvement in Fair Value in its Private Equity Fund investments.

- The implementation of the new strategy is now pending the shareholders commitment to increase the Bank's share capital to US$ 100 million, i.e. the minimum as stipulated by the Central Bank of Bahrain. This would enable and facilitate the Bank embark on its new journey of building sustainable value for all stakeholders.

- On the Private Equity portfolio front, the second half of 2009 showed improvements in valuations; which were gradually creeping back with the Bank recognizing fair value gains of nearly US$ 2 million; much of which towards latter part of the year.

- Improvements in the Private Equity Fund space is also supported by an leading industry specialist research group that highlighted that the Private Equity valuations in the secondary market have increased by nearly 80% from period March to December. The Bank's Private Equity valuations improved by almost 60% to 1.25x cost at end-2009 from 0.8x at end-June 2009.

- This trend clearly demonstrates that the PE space recovering, though slowly but surely. This was also solidified by several General Partners who expect their exits to be no less than 2 times on cost; which translates significant expectations for the Bank and a positive outlook for its liquidity situation.

Appreciation

We would like to take this opportunity to make a special note, that the Bank would not been able to manage its affairs through this challenging time, if not for the assistance, guidance and support of the Social Insurance Organization and the Central Bank of Bahrain, which we are grateful for their positive stance and co-operation extended to the Bank.

We also like to express our gratitude to our clients for remaining loyal amidst difficult times and are optimistic that, in time, the Bank should be in a position to reward them in due course.

Last but not the very least, our sincere appreciation to the Staff and Management for their commitment, dedication and efforts which has made it possible for us to view the future with hope and optimism.

Wilson S. Benjamin
Chairman

Akbar A. Habib
Chief Executive Officer

28 February 2010

Board of Directors and Board Committees

Board of Directors (the "Board")

Mr. Wilson S. Benjamin	Chairman, Non-Executive Director
Sheikh Abdulla Ali K. Al Sabah	Vice Chairman, Non-Executive Director
Dr. Awadh Kh. Al-Enezi	Member, Independent Non-Executive Director
Mr. Ebrahim A. S. Bu Hendi	Member, Independent Non-Executive Director
Mr. Karunaker Nampalli	Member, Non-Executive Director
Mr. Alwaleed Kamal	Member, Independent Non-Executive Director
Mr. Mazen I. Abdulkarim	Member, Independent Non-Executive Director

Executive Committee ("The Exco")

Sheikh Abdulla Ali K. Al Sabah	Chairman
Mr. Wilson S. Benjamin	Vice Chairman
Mr. Alwaleed Kamal	Member
Mr. Akbar A. Habib	Non-voting member

Audit Committee

Dr. Awadh Kh. Al-Enezi	Chairman
Mr. Ebrahim A. S. Bu Hendi	Vice Chairman
Mr. Karunaker Nampalli	Member

Notes:

(1) Designation of Directors as "Executive", "Non-Executive" and "Independent" is in conformity with the definitions and materiality thresholds in Volume 1 Module HC of the Central Bank of Bahrain's Rulebook.

(2) As the representatives of Al Fawares Holding on the Bank's Board Mr. Benjamin, Sheikh Abdulla A. K. Al Sabah and Mr. Nampalli are not considered "Independent Directors" as per the regulations of the Central Bank of Bahrain.

(3) No member of management serves on the Board of Directors. Therefore, the Bank has no "Executive Directors".

(4) For a description of the roles and responsibilities of the Board and its committees, see the Corporate Governance section in this report.

Board of Directors - Profile

Mr. Wilson S Benjamin (Director since March 2000)
Chairman of the Board of Directors and Vice Chairman of the Executive Committee.

Prior to his election as Chairman of the Board of BMB in March 2006, Mr. Benjamin was the Vice Chairman of the Bank. Since 1992, he has been the President and Chief Executive Officer of Al-Fawares Holding Company, where he is responsible for Al-Fawares investments and participation in the management of certain of its portfolio companies.

Mr. Benjamin is also the Chairman of the Board of Directors and Chief Executive Officer of ATO Ram 2 Ltd., where he is responsible for managing ATO's operations and its investments in public and private companies in the United States, Europe and the Gulf Cooperation Council. He is also a board member of Authentium, a company in the security software industry based in U.S. Mr. Benjamin received a B.Sc. in Business Administration from Al-Hikma University in Baghdad, Iraq.

Sheikh Abdulla Ali K. Al Sabah (Director since May 2005)
Vice Chairman of the Board of Directors and Chairman of the Executive Committee

Prior to his election as Vice Chairman in March 2006, Sheikh Abdulla was a member of the Board of Directors. Sheikh Abdulla is the Chairman & Managing Director of Al Fawares Holding for Financial Investments, a subsidiary of Al Fawares Holding Company, where he is responsible for Al Fawares investments in Egypt and Africa; Executive Vice President, Al Fawares Holding Company; Chairman of Lotus Air, a charter company in Egypt; General Manager of Universal Media in Kuwait and a board member of Authentium, a company in the security software industry based in the U.S. He also serves on the Boards of many other companies in Kuwait and the U.S. He has a Master’s in Finance from George Washington University.

Dr. Awadh Kh. Al-Enezi (Director since October 1999)
Director and Chairman of the Audit Committee (since May 2005)

A PhD graduate of Bath University, U.K. in 1991 and the University of New York in 1993, Dr. Al-Enezi is a lecturer at the University of Kuwait and is Cultural Attaché at the Embassy of the State of Kuwait in Cairo. A recipient of numerous awards, he has published several studies dealing with the socio-economic culture in Kuwait. He is an active board member of several institutions.

Mr. Ebrahim A. S. Bu Hendi (Director since May 2005)
Director and Vice Chairman of the Audit Committee (since May 2005)

Over thirty years of banking/treasury experience gained through working with Citibank, Chase Manhattan, Paribas and National Commercial Bank, Saudi Arabia. The last ten years were at Bank of Bahrain & Kuwait as AGM – Treasury, Investment and overseas branches. He is a board member and Chairman of the Audit Committee of Bahrain Commercial Facilities Company since March 2007. Mr Bu Hendi has an MBA from Sheffield Hallam University, U.K.

Mr. Karunaker Nampalli (Director since July 2006)
Director and Member of the Audit Committee (since August 2006)

Thirty-two years of banking experience in India and the GCC, in operations, trade finance, project finance, corporate banking, credit and client relationship management, including most recent positions at Burgan Bank and Kuwait International Bank in Kuwait. During his career he has been active in staff training, both in terms of preparing manuals and reference materials for training, as well as conducting seminars.

Mr. Nampalli is a graduate of Osmania University and holds a Post Graduate Diploma of Export-Import Management from Bharatiya Vidya Bhavan, Delhi. He is also a Certified Associate of the Indian Institute of Bankers.

Mr. Nampalli is working with Al Fawares Holding Company as Finance Controller since April 2006.

Mr. Alwaleed Kamal (Director since January 2007)
Director and Member of the Executive Committee (since April 2008)

Over twenty-four years of experience in investment, commercial banking and consulting. Mr. Kamal held various positions in Citibank from 1985 in cash management and treasury, and in BMB Investment Bank from 1997 in wealth management and marketing. Since 2003, he has served as a director and senior consultant in Impact W.L.L., a regional firm specializing in consulting and advisory work for financial institutions, corporates and government agencies. Mr. Kamal holds an MBA from the University of Hull in the U.K.

Mr. Mazen Ibrahim Abdulkarim (Director since April 2007)
Director

Over fifteen years of banking, private equity and investment experience gained through working in major financial centres such as London, Hong Kong, New York and Bahrain. Mr. Abdulkarim currently runs a family office and a proprietary investment portfolio. He is also a board member of Esterad Investment Company BSC, Bahrain.

In Bahrain, he served in various institutions such as Arab Banking Corporation, Bank of Bahrain & Kuwait and Investcorp. He later joined Merrill Lynch International Bank in London as a Financial Consultant. His most recent assignment was with Cayenne Asset Management in London, which manages an Irish listed hedge fund and a listed closed end investment trust on the London Stock Exchange. He holds a B.Sc.with honours in Finance from Bentley College, U.S.

Organisational Structure and Brief Overview of Activities

The Bank is organised into functional departments as described below.

Investment Department

The Investment Department is responsible for all aspects of managing the Bank's private equity fund portfolio (from origination through final realisation of investments) and for trading in listed equities and related derivatives. The Head of the Department is a voting member of the Bank's Risk Management Committee ("RMC") and the Management Committee ("MC").

Group Treasury

BMB's Treasury is responsible for all trading of FX, money market and capital market activity of the Bank. The Department is also responsible for devising, implementing and managing the Bank's FX, interest rate and funding strategy as well as the placement of the Bank's liquid funds. The Head of the Department is responsible for (a) the generation of profitable transactions and (b) developing, maintaining and enhancing the Bank's relationships with other financial institutions and financial market counterparties and as well effectively managing the execution of the responsibilities assigned to the Department. He is also voting member of the RMC and the MC.

Investor Marketing Department

Investor Marketing is charged with developing, maintaining and enhancing the Bank's relationship with its institutional and high net worth individual clients. The Department is responsible for the marketing of all investment products offered by the Bank to clients as well as account opening and other legal documentation, the conduct of initial and ongoing customer due diligence on clients and all communications with clients including the resolution of client requests and complaints.

Corporate Finance Department

The department was created in 2008 with a view of carrying out specialised advisory services for clients. The department is expected to be fully launched in 2010. The department also overlooks the Bank's activities pertaining to direct private equity investments.

Finance Control

Finance Control is responsible for implementing the Bank's Accounting Policy, ensuring the integrity of internal and external financial reports, the preparation of such reports, and co-ordination with Internal Audit and the Bank's external auditors in their conduct of any financial statement related audit work. The Department also prepares various internal management reports, the annual budget, and various other reports as requested by the Board, the CEO or external parties such as the Central Bank of Bahrain (CBB). The Group Finance Controller is responsible for managing the Department and is a voting member of the RMC and MC.

Risk Management

Risk Management is responsible for identifying and quantifying risk exposures, recommending appropriate limits and monitoring their usage, and as well developing recommendations for appropriate detailed risk control policies and procedures for consideration by the RMC. The Department prepares a variety of daily and other periodic risk reports, including stress tests, for senior management, the RMC and the Board of Directors (BOD). In addition, Risk Management manages problem or past-due assets. The Head of Risk Management is charged with ensuring the proper functioning of the Department. He is also a non-voting member of the RMC, serves as the Deputy Money Laundering Reporting Officer and is a voting member of the MC.

Operations/ IT and Human Resources

Operations is responsible for ensuring that entries into the Bank's general ledger are processed accurately, in conformity with the Bank's Accounting Policy. The Department also manages the Bank's payments and receipts as well as administrative aspects associated with the maintenance of correspondent and brokerage accounts. A dedicated unit within the Department performs accounting and administrative services related to the Bank's client business.

Information Technology is charged with ensuring the proper operation, maintenance and development of the Bank's hardware and software, including centralized and distributed computing equipment. The Department also develops proprietary software for the Bank and maintains and enhances it as required.

Human Resources is responsible for all aspects of the Bank's personnel management, including recruitment, the Bank's Human Resource Policy and Procedures, performance evaluation, salary, bonus and benefit administration. The Department manages the Bank's messengers, receptionist and the Bank's centralised safe custody.

The Head of Operations/IT and HRA is responsible for ensuring that the departments under his charge efficiently conduct their assigned duties. He is a voting member of the MC.

Internal Audit

Internal Audit is responsible for ensuring that the Bank's operations are conducted according to the highest standards by providing an independent, objective assurance function and by advising on best practice. Through a systematic and disciplined approach, Internal Audit helps the Bank accomplish its objectives by evaluating and improving the effectiveness of risk management, control and governance processes. With the agreement of the CBB, BMB has outsourced its Internal Audit function to an international accounting firm.

Compliance

Compliance is responsible for implementing the Bank's Compliance Policy as approved by the Board of Directors and developing and implementing an annual Compliance Programme. This includes advising the CEO, senior managers and department heads of the various laws and regulations applicable to the Bank, training staff and following up with individual Bank departments to ensure that the Bank is in compliance with such applicable regulations. The Department is also responsible for the Bank's Business Continuity Plan. The Head of the Department is responsible for ensuring that the Department properly discharges its responsibilities. He is also a voting member of the MC.

In addition, the Head of Department has been appointed as the Bank's Money Laundering Reporting Officer ("MLRO").

Corporate Communications

Corporate Communications is responsible for the management of the Bank's external communications with shareholders, other stakeholders and market participants. It is therefore responsible for the maintenance of the Bank's website, the preparation, printing and dissemination of financial reports as well as the preparation and publication of press releases and other official communications. The Department also manages the Bank's brand identity and certain administrative functions, e.g. corporate travel. With the CEO, the Head of Corporate Communications acts as one of the two approved official spokesman of the Bank with the media. The Head of the Department is a voting member of the MC and is responsible for managing the Department.

The Bank's senior managers, defined as those reporting directly to the Chief Executive Officer, are:

Key Management Personnel

Mr. Akbar A. Habib
Chief Executive Officer

Mr. Habib joined BMB in March 2009. He has over twenty years of experience in banking and financial services and was previously the Group Chief Executive Officer of Oman National Investment Corporation (ONIC) where he is credited with the highly successful restructuring and repositioning of the group. His previous assignment and experience was also in the area of investment management with institutions such as Central Bank of Oman, Civil Services Pension Fund, Oman International Bank. Served on the Board of numerous Financial Institutions across the GCC.

Mr. S.V. Uppiliappan - Head of Investments
B.A. in Economics from University of Madras, India ; ACA from the Institute of Chartered Accountants of India and AICWA from the Institute of Cost & Works Accountants of India.

Mr. Uppiliappan joined BMB as Portfolio Manager in 2009. He is a Chartered Accountant from India and held senior positions in Investment Analysis, Financial Management and Portfolio Management in various countries for more than 20 years. Before joining BMB he was working with Injaz Mena Investments in Abu Dhabi as Portfolio Manager heading their Capital Markets Division. He has got a successful track record in portfolio management in GCC and Global markets. He has lectured extensively on various topics in Financial & Portfolio Management in professional forums.

Mr. P.K. Nambiar - Head of Information Technology
MSc Mathematics & Statistics from University of Kerala, PMP from Project Management Institute USA, Oracle Certified Professional from Oracle University, Diploma in Organization & Methods from O&M Society of India & UK.

Joined BMB Investment Bank as an IT consultant and was made Head of Information Technology in May 2009. Mr. Nambiar has almost forty years experience in all aspects of IT and brings to BMB extensive management skills and an in-depth knowledge of application systems, software development, project management and IT Infrastructure expertise. Prior to joining BMB Mr. Nambiar was head of IT at Gulf International Bank

Mr. Azzam Ahamat - Chief Financial Officer
Associate Member of the Association of Chartered Certified Accountants (ACCA UK) and Chartered Institute of Management Accountants (CIMA UK)

Mr. Ahamat joined BMB in March 2008. He oversees the Finance Control Department and has over 9 years experience across Corporate Finance and Valuation assignments, Ratings/Capital Markets and Risk. Prior to joining BMB, Mr. Ahamat served at Fitch Ratings Colombo where he was responsible for most Corporate Ratings carried out by the Agency in the country. Prior to working at Fitch, Mr. Ahamat served at Ernst & Young Colombo.

Mr. Thaer Ali Rabea - Head of Compliance
BA Advanced Accounting and Auditing from Poona University and an MBA from Glamorgan University (UK)

Mr. Rabea joined BMB in August 2008 and has over nineteen years experience in the areas of internal audit, operations, back office, accounting and credit. Prior to joining BMB Mr. Rabea was Head of Compliance at CrediMax and before that was at Shamil Bank and HSBC.

Brief Description of Business Activities

BMB's main activities are:

- investment banking
- private equity fund investments
- private placements and structured products
- asset management and funds distribution, and

We carry out these activities through dedicated specialist business units.

Investment banking

This activity consists of originating and structuring investments. It is conducted by our Investment and our Corporate Finance Departments.

Private equity fund investments

Since 1988, the Bank has developed strong relationships with premier private equity fund managers, both directly and through private equity fund distributors. Drawing on our own fundamental macro trend analysis, we seek out unquoted equity funds and direct investments which meet our stringent investment criteria. These investments are both for the Bank's own account and for clients.

Our primary focus is on fund managers who pursue a strategy of taking a controlling interest in high quality investments with a solid financial history. The fund managers selected by BMB must be able to demonstrate both a proven track record over a number of years and economic cycles, as well as strong institutional backing. They must have a strict pricing discipline, make investments with a pre-determined exit strategy and for the most part must not merely be sourcing transactions through the auction process.

On a more limited basis, the Bank invests directly in unlisted firms (direct private equity). The Bank employs a thorough quantitative and qualitative analysis to assess potential investments. In addition the Bank focuses on transactions where other professional financial firms with sufficient relevant experience as well as human and financial resources will take an active role in the investment.

Our Investment Department manages BMB's private equity fund investments and our Corporate Finance Department manages direct private equity investments.

Private placements, structured products and investor marketing

BMB continues to selectively raise equity on a private placement basis for mid-size companies and new ventures. In 4Q08, in partnership with a major US investment bank, BMB launched a seven-year capital protected note whose coupon is based upon the performance of the Asia Pacific Performance Fund, a fund of managed portfolios focused on public equity in the Asian markets, excluding Japan and Australia.

Our Corporate Finance Department, Investments Department and executive management originate transactions drawing on BMB's network of contacts. After a satisfactory internal review and structuring, the Bank's Investor Marketing Department places transactions with the Bank's customers.

Our Investor Marketing Department distributes structured products and private equity transactions to our investor base. This group also markets other specially developed products, including private equity funds, listed funds and hedge funds which are designed to meet our clients' needs.

Our relationship with clients is based upon our knowledge of each client's investment objectives and risk parameters. This detailed understanding enables us to focus product development and marketing efforts to more effectively meet our clients' needs. It also facilitates the cross-selling of other products and establishment of long-term client relationships.

Investor Marketing is supported by a dedicated Client Operations Unit within our Operations Department which provides a full range of accounting, reporting and support services.

Asset management and funds distribution

This activity consists of marketing investment products to BMB's individual and institutional clients and the management of BMB proprietary funds, including BMB's private equity fund of funds, BMB Technology & Telecommunications Company.

Our Investor Marketing Department has responsibility for marketing. To further enhance our abilities in administration and operations the Bank created a new middle office function, housed within our Investment Department to centralise tasks previously performed in our Corporate Finance Department, Investment Department and Finance Control Department.

Corporate Governance and Risk Management Framework

For a description of the legal entity structures composing the BMB Group, please refer to Note 1 to this financial report, as well as the Basel II Pillar 3 disclosures included as an appendix to this financial report.

BMB conducts its business activities under a written corporate governance framework which sets forth the goals, roles and responsibilities of members of the Board of Directors and bank management, including well defined reporting lines and structures. At the department level the Bank employs detailed policies and procedures, segregation of duties and dual controls to implement its corporate governance goals. The corporate governance framework also includes a Disclosure Policy which is designed to ensure the disclosure of accurate, complete and transparent information to stakeholders on a timely basis and to provide through its website at least five years historical financials and two years of press releases.

Under this framework, the Board is ultimately responsible for the governance and performance of the Bank. The Board discharges that responsibility through (a) setting the strategic direction of the Bank by approving an appropriate business strategy, including the identification, acceptance, monitoring and management of risks (b) establishing a robust corporate governance system, which includes risk limits, internal controls, policies and procedures and a system to foster compliance with applicable laws and as well as professional standards and ethics by itself and Bank staff and monitoring the same for implementation, (c) reviewing its own and the Bank management's performance and (d) reporting the Bank's results in a fair and transparent manner.

To assist it in the discharge of its duties, BMB's Board has created two committees: the Executive Committee and the Audit Committee. These Committees undertake tasks defined in their Charters on behalf of the Board, though in all cases the Board subsequently reviews and approves their actions.

The Executive Committee acts in place of the Board in case of urgent matters. It is also responsible for (a) managing the Bank's risk strategy and limits, (b) assessing the performance of Board members and senior executives of the Bank, including the latter's compensation, (c) major capital resource acquisition and allocation, (d) recruitment of board members and, as appropriate, senior executives for the Bank, including succession planning and (e) other tasks as assigned by the Board. Accordingly, the Executive Committee acts in the capacity of the Board's Remuneration and Nomination Committee.

The Audit Committee is charged with overseeing the integrity of the Bank's financial reporting, including the choice of accounting policies, reasonableness of any estimates or assumptions used in the preparation of the Bank's financials and thus the completeness and transparency of these reports. As part of its duties, the Audit Committee directly oversees the work performed by the Bank's external auditors and internal auditors. Through these activities, the Committee monitors the appropriateness of Bank's policies and procedures and other internal controls and their implementation. The Committee also monitors compliance with local laws, including Insider Trading regulations, Anti-Money Laundering regulations, the Bank's Disclosure Policy, the Bank's Code of Ethics and Code of Conduct. As per the Bank's policy, the Chairman of the Audit Committee must be an Independent Non Executive Director.

The composition of the Board, membership in Board committees, a brief description of each Board member's qualifications and regulatory classification is provided on pages 7, 8and 9.

In the discharge of its duties the Board reserves some rights and responsibilities for itself and delegates others to Bank management.

Bank management's role is to implement the Board's strategy within the authorities delegated to it. This involves primarily the day to day management of the Bank's affairs, including the conduct of business along with oversight of the Bank's various operating and monitoring systems.

To assist executive management in the discharge of its duties, executive management has created two committees: the Risk Management Committee and the Management Committee.

The Bank manages its credit and market risks, as well as its assets and liabilities, primarily through the Risk Management Committee ("RMC"). The RMC is composed of the Chief Executive, the Head of Risk Management Department ("RMD"), the Head of Treasury, the Head of the Investment Department, the Head of Investor Marketing Department and the Group Finance Controller. The Head of RMD is a non voting member. As well, whenever a voting member is presenting a transaction for consideration by the RMC, he or she is not allowed to vote on that transaction.

The Bank's Management Committee is composed of members of the RMC, the functional department heads and the Group Compliance Officer. It serves as a forum for the discussion of the Bank's overall strategy, product development, marketing and other significant business issues. As required, working groups composed of Management Committee members are formed to study specific issues and recommend actions for executive management approval.

In addition, several other parties play important roles in corporate governance and control at BMB: the Bank's external auditors, its internal auditors, its Compliance Officer, Money Laundering Reporting Officer and Risk Management Department.

The Bank's independent auditors, PricewaterhouseCoopers, have unhindered access to the Audit Committee, Executive Committee, and the Board of Directors, with or without members of management being present to discuss their audit findings and any other matter which should be brought to the attention of the Board.

The Bank's internal audit function (a) reviews policies and procedures for adequacy as well as compliance with applicable regulations and laws and (b) assesses the implementation of and adherence to policies and procedures by the Bank using a risk based approach. Internal audit reports directly to the Audit Committee of the Board of Directors, who approve the yearly internal audit plan, and all audit reports independent of the Bank's management. Beginning in 2006, the Bank outsourced its internal audit function to an international accounting firm after receiving Central Bank of Bahrain approval.

To monitor its compliance with local laws and regulations, the Bank has appointed a Compliance Officer who also serves as the Bank's Money Laundering Reporting Officer ("MLRO") for financial crimes regulations. The Bank has appointed the Head of Risk Management to serve as Deputy MLRO in the absence of the MLRO. Additionally, the Compliance Officer acts as Disclosure Compliance Officer for Central Bank and Bahrain Stock Exchange disclosure requirements.

Summary of Key Financial performance
The key financial ratios from 31 December 2005 - 2009 are summarised as follows:

Financial Summary 2005-2009
(all figures in thousands of US dollars)

	2009	2008	2007	2006	2005
Income Statement					
Net (loss)/ profit	(33,536)	(14,313)	24,617	21,115	6,165
Balance Sheet					
Total assets	75,870	100,493	180,879	172,666	168,411
Total debt	21,600	21,600	52,100	53,100	68,300
Total shareholders' equity	23,661	42,978	71,436	46,427	27,248
Off Balance Sheet					
Undrawn investment commitments	35,277	77,713	31,895	35,611	23,037
Funds under management	29,418	35,721	41,320	41,980	43,107
Key Ratios					
Return on average shareholders' equity (%)	-	-	41.8%	57.3%	-
Financial leverage (times)	1.9:1	1.1:1	1.4:1	2.6:1	4.9:1
Capital adequacy (%)	14.9	22.8	31.4	21.2	13.2
Net liquid position (US$ million)	(5)	(15)	(24)	(38)	(35)

The effects of prior period adjustments have not been reflected for periods earlier than 2005.

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF
BAHRAIN MIDDLE EAST BANK (B.S.C.)

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Bahrain Middle East Bank (B.S.C) (the Bank) and its subsidiaries (together, the Group) which comprise the consolidated statement of financial position as at 31 December 2009 and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the consolidated financial statements

The Directors are responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

PRICEWATERHOUSECOOPERS

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF
BAHRAIN MIDDLE EAST BANK (B.S.C.) (continued)

Opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2009, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to Note 2 to the consolidated financial statements which indicates that the Group has incurred a net loss of US$ 33.5 million for the year ended 31 December 2009 and, as of that date, (i) the accumulated losses exceeded the Group's issued share capital by US$ 9.9 million; and (ii) the Group's short-term liabilities exceeded its short-term assets by US$ 0.3 million. These conditions, along with other matters as set forth in note 2 to the consolidated financial statements, indicate the existence of a material uncertainty which may cast significant doubt about the Group's ability to continue as a going concern.

Report on regulatory requirements

Further, in accordance with the requirements of the Bahrain Commercial Companies Law and the Central Bank of Bahrain Law, we report that we have obtained all the information that we considered necessary for the purpose of our audit; the Bank has maintained proper books of accounts and the consolidated financial statements and the financial information contained in the Directors' and Chief Executive's report are in agreement therewith; and except for the non-compliance with the Central Bank of Bahrain's directive to increase the Bank's capital by US$ 100 million by 31 December 2009 as set out in Note 2 to the consolidated financial statements, nothing has come to our attention which causes us to believe that the Bank has breached any of the applicable provisions of the Bahrain Commercial Companies Law, the Central Bank of Bahrain Law, the terms of its banking license or its Memorandum and Articles of Association which would materially affect its activities or its financial position as at 31 December 2009.

PricewaterhouseCoopers

28 February 2010
Manama, Kingdom of Bahrain

BAHRAIN MIDDLE EAST BANK (BSC)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)
AT 31 DECEMBER 2009
(Expressed in thousands of United States Dollars)

	2009	2008
ASSETS		
Cash and short term funds (Note 4)	3,425	3,688
Trading securities (Note 5)	1,885	12,260
Available-for-sale investment securities (Note 6)	45,260	49,816
Held-to-maturity investment securities (Note 7)	4,624	9,537
Loans and advances (Note 8)	872	901
Instalment sale receivable (Note 9)	15,682	17,299
Property, plant and equipment (Note 10)	543	504
Other assets (Note 11)	3,579	6,488
TOTAL ASSETS	75,870	100,493
LIABILITIES		
Deposits from customers (Note 12)	23,925	26,493
Securities sold under repurchase agreements (Note 13)	-	817
Derivative Financial Instruments (Note 5b)	-	1,735
Revolving loan facility (Note 14)	11,600	11,600
Other liabilities (Note 15)	6,684	6,870
Subordinated loan (Note 16)	10,000	10,000
TOTAL LIABILITIES	52,209	57,515
EQUITY		
Share capital (Note 17)	54,955	54,955
Fair value reserve (Note 18)	9,745	(5,698)
Other reserves (Note 18)	(41,039)	(6,279)
TOTAL EQUITY	23,661	42,978
TOTAL LIABILITIES AND EQUITY	75,870	100,493

These consolidated financial statements were approved by the Board of Directors on 28 February 2010 and signed on its behalf by:

Wilson S. Benjamin
Chairman

Akbar A. Habib
Chief Executive Officer

Notes 1 to 36 form an integral part of these financial statements

BAHRAIN MIDDLE EAST BANK (BSC)

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2009
(Expressed in thousands of United States Dollars)

	2009	2008
(Loss)/income from investments (Note 19)	(7,976)	2,749
Foreign exchange translation income/(loss) (Note 20)	1,841	(1,569)
Fees and commission income (Note 21)	308	841
Other income/(loss)	68	(106)
	(5,759)	1,915
Interest income (Note 22)	1,364	1,976
Interest expense (Note 22)	(2,012)	(3,051)
NET INTEREST EXPENSE	(648)	(1,075)
TOTAL (LOSS)/INCOME FROM OPERATIONS	(6,407)	840
Impairment provisions (Note 23)	(17,943)	(4,003)
General and administrative expenses (Note 24)	(9,186)	(11,062)
OPERATING LOSS	(33,536)	(14,225)
Net income from assets sold	-	10
Loss before taxation	(33,536)	(14,215)
Taxation	-	(98)
LOSS FOR THE YEAR	(33,536)	(14,313)
LOSS PER SHARE (Note 17)		
Basic	US$ (0.15)	US$ (0.07)
Diluted	US$ (0.15)	US$ (0.07)

These consolidated financial statements were approved by the Board of Directors on 28 February 2010 and signed on its behalf by:

Wilson S. Benjamin
Chairman

Akbar A. Habib
Chief Executive Officer

Notes 1 to 36 form an integral part of these financial statements

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2009
(Expressed in thousands of United States Dollars)

	2009	2008
Loss for the year	(33,536)	(14,313)
Other comprehensive income/(loss)		
Net fair value income/(loss) on available-for-sale investment securities (Note 6)	2,059	(16,799)
Fair value reserve transferred to income statement	12,283	3,761
Exchange translations adjustment on fair value reserve (Note 6)	1,101	(3,909)
Exchange translations on retained earnings of foreign subsidiaries	(1,224)	2,802
OTHER COMPREHENSIVE INCOME/(LOSS)	14,219	(14,145)
TOTAL COMPREHENSIVE LOSS FOR THE YEAR	(19,317)	(28,458)

Notes 1 to 36 form an integral part of these financial statements

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2009
(Expressed in thousands of United States Dollars)

			Other reserves					
	Share capital	Fair value reserve	Retained earnings	Legal reserve	General reserve	Proposed stock dividends reserve	Total other reserves	Total
At 1 January 2008	52,338	11,249	(18,599)	16,310	7,521	2,617	7,849	71,436
Stock dividends approved	2,617	-	-	-	-	(2,617)	(2,617)	-
Total comprehensive loss for the year	-	(16,947)	(11,511)	-	-	-	(11,511)	(28,458)
At 31 December 2008	54,955	(5,698)	(30,110)	16,310	7,521	-	(6,279)	42,978
At 1 January 2009	54,955	(5,698)	(30,110)	16,310	7,521	-	(6,279)	42,978
Total comprehensive income/(loss) for the year	-	15,443	(34,760)	-	-	-	(34,760)	(19,317)
At 31 December 2009	54,955	9,745	(64,870)	16,310	7,521	-	(41,039)	23,661

Notes 1 to 36 form an integral part of these financial statements

BAHRAIN MIDDLE EAST BANK (BSC)

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2009
(Expressed in thousands of United States Dollars)

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating loss	(33,536)	(14,225)
Adjustments:		
Taxes paid	-	(98)
Impairment provisions (Note 23)	17,943	4,003
Depreciation and amortisation	215	147
Loss/(profit) on sale of fixed assets	(24)	60
Net changes in:		
Trading securities	9,811	(1,984)
Held-to-maturity investment securities	4,698	4,836
Available-for-sale investment securities	2,836	2,306
Loans and advances	29	(848)
Accrued interest receivable	(22)	39
Accrued interest payable	1,130	(626)
Other assets	2,930	2,784
Other liabilities	(1,311)	442
Deposits from customers	(2,568)	(10,060)
Financial liabilities held for trading	(1,735)	1,735
Change in exchange rates related to retained earnings of overseas subsidiaries	(1,224)	2,802
Foreign exchange movements on investments and others	92	977
NET CASH USED IN OPERATING ACTIVITIES	(736)	(7,710)
CASH FLOWS FROM INVESTING ACTIVITIES		
Amount received against instalment sale receivable	1,617	1,540
Property, plant and equipment (Note 10)	(260)	(405)
Proceeds from sale of fixed assets	30	10
Net cash flow from freehold land and building sold	-	18,047
NET CASH PROVIDED BY INVESTING ACTIVITIES	1,387	19,192
CASH FLOWS FROM FINANCING ACTIVITIES		
Net changes in:		
Bank deposits	-	(10,015)
Securities sold under repurchase agreement	(817)	(2,883)
Medium term loan	-	(28,500)
Revolving loan facility	-	(2,000)
Prior year dividends claimed and paid	(5)	(21)
NET CASH USED IN FINANCING ACTIVITIES	(822)	(43,419)
EFFECT OF EXCHANGE RATE CHANGES IN CASH AND CASH EQUIVALENTS	(92)	(977)
Net decrease in cash and cash equivalents	(263)	(32,914)
Cash and cash equivalents at the beginning of the year	3,622	36,536
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR (NOTE 4)	3,359	3,622

Notes 1 to 36 form an integral part of these financial statements

1 GENERAL INFORMATION

INCORPORATION AND PRINCIPAL ACTIVITY

Bahrain Middle East Bank (B.S.C.) (the "Bank", "BMB" or "BMB Investment Bank") is a Bahraini Shareholding Company with limited liability and is incorporated in the Kingdom of Bahrain. The registered office of the Bank is: BMB Centre, Building 135, Road 1702, Block 317, Diplomatic Area, Manama, Kingdom of Bahrain.

On 9 April 2007 the Central Bank of Bahrain issued a Conventional Wholesale Banking license to BMB.

The Bank is listed on the Bahrain Stock Exchange under BMEB.BH.

The Group comprises the Bank and its subsidiaries (Note 28).

The principal activities of the Group are the provision of investment banking, private banking, treasury services, trading and investment, asset management and funds distribution.

REGULATION AND SUPERVISION

BMB is regulated by the Central Bank of Bahrain ("CBB").

The approval of and notification to CBB is required for major changes to strategy and/or corporate plan, changes to senior management, the establishment of new subsidiaries and branches and the appointment/election of members of the Board of Directors.

2 SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The Group's consolidated financial statements have been prepared in accordance with and comply with International Financial Reporting Standards (IFRS). The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of available-for-sale financial assets, all derivative contracts and financial assets at fair value through profit and loss and financial liabilities held for trading.

The consolidated financial statements comprise the consolidated statement of financial position, the consolidated income statement and consolidated statement of comprehensive income showing as two statements, the consolidated statement of changes in shareholders' equity, the consolidated statement of cash flows and the notes to the consolidated financial statements.

The consolidated financial statements are presented in United States Dollars. The figures shown in the financial statements are stated in thousands United States Dollars.

During the financial year ended 31 st December 2009, the Group incurred net losses of US$ 33.5 million. This was, in part, due to the transfer of US$ 12.3 million cumulative negative fair value movements to the income statement as impairment provisions arising on certain private equity fund investments. Comprehensive loss for the year ended 31 December 2009 amounted to US$ 19.3 million, owing to which, shareholders' equity fell to US$ 23.7 million at 31 December 2009 from US$ 43.0 million at 31 December 2008. As a result, the Group's accumulated losses exceeded its issued share capital by US$ 9.9 million. At 31 December 2009, the Group's current liabilities exceeded its current assets by no more than US$ 0.3 million.

On 4 October 2009, the Central Bank of Bahrain directed the Bank to increase its issued share capital to US$ 100 million by 31 December 2009. While this requirement is yet to be met, efforts are currently being made to address this requirement by no later than 31 December 2010.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Although the above matters may indicate the existence of material uncertainty that may cast significant doubt on the Group's ability to continue as a going concern, the Bank's Board of Directors and management are confident that the initiatives and events already concluded and other ongoing activities that will take place during 2010, will address the capital and funding requirements of the Group. Initiatives and events already concluded and/or occurred to date include: (a) rescheduling of the revolving loan facility and quasi government term deposit which results in liquidity savings of US$15.6 million for 2010, arising as a result of postponement of original repayments (refer to Note 14, Note 12 and Note 30); (b) sizeable reduction in off-balance sheet proprietary Fund commitments to US$25.6 million at 31 December 2009 from US$ 58.7 million at 31 December 2008; and (c) improvements in Private Equity Market outlook and likelihood of realizations in 2010. Initiatives currently underway include (a) efforts to increase the Bank's share capital through a new issue of shares to meet the Central Bank of Bahrain's requirements; and (b) potential access to asset backed lending programmes that are supported by general improvements in liquidity markets and significant improvements in secondary market pricing of Private Equity Fund investments.

Taking into account the above factors, the Group's consolidated financial statements as at 31 December 2009 and for the year then ended have been prepared on a going concern basis. In the event the ongoing efforts to increase the Bank's share capital and/or raise finance through asset backed lending programmes are unsuccessful, then the Group's ability to continue as a going concern could become uncertain. In such an eventuality, the Group may not be able to meet its commitments, realize some of its assets at their carrying values and discharge some of its liabilities in the normal course of business.

2.2 Critical accounting estimates and judgements in applying accounting policies

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. Changes in assumptions may have a significant impact on the financial statements in the period the assumptions changed. Management believes that the underlying assumptions are appropriate and that the Group's financial statements therefore fairly present the financial position and result as at 31 December 2009. Other than the basis of preparation as set out in note 2.1 above, the areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are set out below.

Valuation of unquoted equity fund investments held as available-for-sale investment securities

Unquoted equity fund investments held as available-for-sale investment securities are stated at their fair values, based upon the asset values of individual investments within the funds, as well as overall fund performance as set out in the fund managers' latest available reports, expected repayment of management fees, where applicable, and the future prospects for the underlying investments. Until receipt of the fund manager's next report, the Group makes adjustments to the fair value of unquoted equity fund investments based on fund manager's communication and historical experience, as well as sales and new investment transactions occurring in the interim (Note 6).

Impairment of available-for-sale equity investments

The Group applies the principles and guidance provided by IAS 39 in making a determination if an available-for-sale equity investment is impaired. In addition to the general impairment tests provided by IAS 39, this standard includes two other general objective tests for impairment of equity instruments carried at fair value. The first are significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates and which indicate the cost of the investment in the equity instrument may not be recovered. The second is a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost. Such determinations require the application of significant judgement. In making the determination about a possible impairment, the Group evaluates many factors, including, where appropriate, the normal volatility in share price.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.2 Critical accounting estimates and judgements in applying accounting policies (continued)

Held-to-maturity investments

The Group follows the IAS 39 guidance on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. A key element in classifying such instruments as held-to-maturity is both the Group's intent and ability to hold such instruments to maturity. Making such a determination requires significant judgement about the Group's future financial condition and position. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to hold these investments to maturity other than for the specific circumstances – for example, selling an insignificant amount close to maturity - it will be required to reclassify the entire category as available-for-sale. In such a case, the investments would, therefore, be measured at fair value not amortised cost.

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

The following standards and amendments to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after 1 January 2009.

Standard	Content	Applicable for financial years beginning on /after
IFRS 7	Improving disclosures about financial instruments	1 January 2009
IAS 1	Presentation of financial statements	1 January 2009
IFRS 8	Operating segments	1 January 2009
IAS 23	Borrowing costs	1 January 2009

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

IAS 1 (revised), 'Presentation of financial statements'
A revised version of IAS 1 was issued in September 2007. It prohibits the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity in a statement of comprehensive income. All 'non-owner changes in equity' are required to be shown in a performance statement. Entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the statement of income and statement of comprehensive income). The Group has elected to present two statements: statement of income and statement of comprehensive income. Comparative information has been re-presented so that it also conforms to the revised standard. According to the amendment of IAS 1 in January 2008, each component of equity, including each item of other comprehensive income, should be reconciled between carrying amount at the beginning and the end of the period. Since the change in accounting policy only impacts presentation aspects, there is no impact on retained earnings.

IFRS 8, 'Operating segments'.
IFRS 8 was issued in November 2006 and excluding early adoption would first be required to be applied to the Group's accounting period beginning on 1 January 2009. The standard replaces IAS 14, 'Segment reporting', with its requirement to determine primary and secondary reporting segments. Under the requirements of the revised standard, the Group's external segment reporting will be based on the internal reporting to the chief operating decision-maker, which makes decisions on the allocation of resources and assess the performance of the reportable segments. No new segments have been identified by Management on adoption of this standard.

IAS 23 (Amendment), 'Borrowing costs' (effective from 1 January 2009).
A revised version of IAS 23 was issued in March 2007. The amendment requires an entity to capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to get ready for use or sale) as part of the cost of that asset. The option of immediately expensing those borrowing costs will be removed.

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

IAS 39 (Amendment), 'Financial instruments: Recognition and measurement' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008.

- This amendment clarifies that it is possible for there to be movements into and out of the fair value through profit or loss category where a derivative commences or ceases to qualify as a hedging instrument in cash flow or net investment hedge.
- The definition of financial asset or financial liability at fair value through profit or loss as it relates to items that are held for trading is also amended. This clarifies that a financial asset or liability that is part of a portfolio of financial instruments managed together with evidence of an actual recent pattern of short-term profit-taking is included in such a portfolio on initial recognition.

- The current guidance on designating and documenting hedges states that a hedging instrument needs to involve a party external to the reporting entity and cites a segment as an example of a reporting entity. This means that in order for hedge accounting to be applied at segment level, the requirements for hedge accounting are currently required to be met by the applicable segment. The amendment removes the example of a segment so that the guidance is consistent with IFRS 8, 'Operating segments', which requires disclosure for segments to be based on information reported to the chief operating decision maker.

- When re-measuring the carrying amount of a debt instrument on cessation of fair value hedge accounting, the amendment clarifies that a revised effective interest rate (calculated at the date fair value hedge accounting ceases) are used.

The following standards, amendments and interpretation, effective in 2009, but was not relevant for the Group's operations:

Standard / interpretation	**Content**	**Applicable for financial years beginning on /after**
IFRS 2	Share based payment – Vesting conditions and cancellations	1 January 2009
IAS 32 and IAS 1	Puttable financial instruments and obligations arising on liquidation	1 January 2009
IFRIC 16	Hedges of a net investment in a foreign operation	1 October 2008
IFRIC 13	Customer loyalty programmes	1 July 2008

IFRS 2, 'Share-based payment' – Vesting conditions and cancellations
The IASB published an amendment to IFRS 2, 'Share-based payment', in January 2008. The changes pertain mainly to the definition of vesting conditions and the regulations for the cancellation of a plan by a party other than the company. These changes clarify that vesting conditions are solely service and performance conditions. As a result of the amended definition of vesting conditions, non-vesting conditions should now be considered when estimating the fair value of the equity instrument granted. In addition, the standard describes the posting type if the vesting conditions and non-vesting conditions are not fulfilled. This is not relevant to the Group's operation as there is no share based payments.

IAS 32 and IAS 1, 'Puttable financial instruments and obligations arising on liquidiation'
The IASB amended IAS 32 in February 2008. It now requires some financial instruments that meet the definition of a financial liability to be classified as equity. Puttable financial instruments that represent a residual interest in the net assets of the entity are now classified as equity provided that specified conditions are met. Similar to those requirements is the exception to the definition of a financial liability for instruments that entitle the holder to a pro rata share of the net assets of an entity only on liquidation.

IFRIC 16, 'Hedges of a net investment in a foreign operation'
This interpretation clarifies the accounting treatment in respect of net investment hedging. This includes the fact that net investment hedging relates to differences in functional currency not presentation currency, and hedging instruments may be held anywhere in the Group.

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

IFRIC 13, 'Customer loyalty programmes'
IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple element arrangement. The consideration receivable from the customer is allocated between the components of the arrangement using fair values. IFRIC 13 is not relevant to the Company operations as the Company does not have any loyalty programmes.

Standards and interpretations issued but not yet effective

The following standards and interpretations have been issued and are mandatory for the Group's accounting period beginning on or after 1 July 2009 or later period and are expected to be relevant to the Group:

Standard/ interpretation	Content	Applicable for financial years beginning on /after
IFRS 1 and IAS 27	Cost of an investment in a Subsidiary, jointly-controlled entity or associate	1 July 2009
IFRS 3	Business combinations	1 July 2009
IAS 27	Consolidated and separate financial statements	1 July 2009
IAS 39	Financial instruments: Recognition and measurement – eligible hedged items	1 July 2009
IFRIC 17	Distribution of non cash assets to owners	1 July 2009
IFRIC 13	Transfers of assets from customers	1 July 2009
IFRIC 9	Financial instrument part 1: Classification and measurement	1 January 2013

IFRS 1 and IAS 27, 'Cost of an investment in a subsidiary, jointly-controlled entity or associate'
The amended standard allows first-time adopters to use a deemed cost of either fair value or the carrying amount under previous accounting practice to measure the initial cost of investments in subsidiaries, jointly controlled entities and associates in the separate financial statements. The amendment also removes the definition of the cost method from IAS 27 and requires an entity to present dividends from investments in subsidiaries, jointly controlled entities and associates as income in the separate financial statements of the investor.

IFRS 3, 'Business combinations'
The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the income statement. There is a choice, on an acquisition-by-acquisition basis, to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed.

IAS 27, 'Consolidated and separate financial statements'
The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost; any remaining interest in the entity is re-measured to fair value, and a gain or loss is recognised in profit or loss.

IAS 39, 'Financial instruments: Recognition and measurement – Eligible hedged items'
The amendment 'Eligible hedged items' was issued in July 2008. It provides guidance for two situations. On the designation of a one-sided risk in a hedged item, IAS 39 concludes that a purchased option designated in its entirety as the hedging instrument of a one-sided risk will not be perfectly effective. The designation of inflation as a hedged risk or portion is not permitted unless in particular situations. This will not give rise to any changes to the Group's financial statements.

IFRIC 17, 'Distribution of non-cash assets to owners'
IFRIC 17 was issued in November 2008. It addresses how the non-cash dividends distributed to the shareholders should be measured. A dividend obligation is recognised when the dividend was authorised by the appropriate entity and is no longer at the discretion of the entity. This dividend obligation should be recognised at the fair value of the net assets to be distributed. The difference between the dividend paid and the amount carried forward of the net assets distributed should be recognised in profit and loss. Additional disclosures are to be made if the net assets being held for distribution to owners meet the definition of a discontinued operation. The application of IFRIC 17 has no impact on the financial statements of the Group.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

IFRIC 18, 'Transfers of assets from customers'
IFRIC 18 was issued in January 2009. It clarifies how to account for transfers of items of property, plant and equipment by entities that receive such transfers from their customers. The interpretation also applies to agreements in which an entity receives cash from a customer when that amount of cash must be used only to construct or acquire an item of property, plant and equipment, and the entity must then use that item to provide the customer with ongoing access to supply of goods and/or services. The Group is not impacted by applying IFRIC 18.

IFRS 9, 'Financial instruments part 1: Classification and measurement'
IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets. Key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flows represent only payments of principal and interest (that is, it has only 'basic loan features'). All other debt instruments are to be measured at fair value through profit or loss.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

While adoption of IFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted.

The Group is considering the implications of the standard and the timing of its adoption.

2.4 Basis of consolidation

The consolidated financial statements include the assets, liabilities and results of the operations of the Group. Subsidiary companies (Note 28), which are those companies (and other entities) in which the Group directly or indirectly has power to exercise control over financial and operating policies, have been consolidated, except for companies that have been acquired for a temporary period and are held exclusively with a view to resale in the near future which are not consolidated.

All intra-Group balances and transactions have been eliminated.

2.5 Foreign currencies

The United States Dollar is the functional currency of the Bank and also the currency in which the Bank's share capital is denominated. Accordingly, the financial information has been prepared in United States Dollars

The assets and liabilities of foreign subsidiaries are translated into United States Dollars at the rates of exchange prevailing at the balance sheet date. The income statements of foreign subsidiaries are translated into United States Dollars at the rates of exchange prevailing on the dates of the transactions or at the average rate of exchange for the year. The exchange differences arising on translation are dealt with in shareholders' equity.

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Income and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

All translation differences on revaluation of debt securities and other monetary financial assets measured at fair value are included in foreign exchange income and losses, whereas translation differences on revaluation of non-monetary items such as equities and funds held for trading are reported as part of the trading income and loss. The translation differences on revaluation of available-for-sale equities and funds are included in the fair value reserve in equity, unless the investments are impaired whereby foreign currency differences are taken to income.

2.6 Financial instruments – recognition and measurement

Financial assets

IAS 39 requires classification of financial assets into the following four categories:

(i) financial assets at fair value through profit and loss;
(ii) loans and receivables;
(iii) held-to-maturity; and
(iv) available-for-sale.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The accounting policies for each category are as follows:

Financial assets at fair value through profit and loss

This category has two sub-categories; financial assets held for trading, and those designated at fair value through profit or loss at inception. The Group classifies a financial asset in this category if it was acquired principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin or is part of a portfolio for which there is evidence of a recent actual pattern of short-term profit-taking. These financial assets are initially recognised at cost and subsequently re-measured at fair value. All related realised and unrealised gains and losses are included in net trading income.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. These assets are initially recognised when cash is advanced to the borrowers and are carried at amortised cost, and derecognised when the rights to receive cash flows from them have expired or the Group has transferred substantially all risks and rewards of ownership.

Held-to-maturity

Fixed maturity investments having fixed or determinable payments and where the Group has both the positive intent and the ability to hold such investments to maturity are classified as held-to-maturity. Such investments are carried at amortised cost less provision for impairment in value. Amortised cost is calculated using the effective interest rate method. Were the Group to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available-for-sale.

Available-for-sale

Non-trading financial assets not falling within the definition of held-to-maturity or loans and receivables which are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices are classified as available-for-sale investments. Such assets are initially recognised at cost and re-measured at fair value, unless fair value cannot be reliably measured. Any changes in fair values of such assets subsequent to initial recognition are reported as movements in fair value reserve until the investment is sold, collected or otherwise disposed of, or the financial assets are considered impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement.

2.7 Recognition on trade-date

Purchases and sales of financial assets at fair value through profit and loss, held-to-maturity and available-for-sale are recognised on trade-date – the date on which the Group commits to purchase or sell the asset.

2.8 Financial liabilities

Financial liabilities are classified either as held for trading or other than held for trading. Liabilities held for trading are those that are held principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin and are carried at fair value. Liabilities held other than for trading are carried at amortised cost.

2.9 Derivative financial instruments and hedging

Derivative instruments are measured at fair value and are deemed held for trading unless they are highly effective hedging instruments and are designated as such. Derivatives that do not qualify as hedging instruments are measured at fair value and changes in the fair value are recorded in the income statement.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement along with the corresponding change in fair value of the hedged asset or liability that is attributable to that specific hedged risk.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised as a separate component of equity. Where the forecasted transaction or firm commitment results in the recognition of an asset or of a liability, the income or loss previously deferred in equity is included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in equity are transferred to the income statement when the hedged firm commitment or forecasted transaction affects the income statement.

2.10 Provisions for impairment

A provision is made in respect of a financial asset that is impaired if its carrying amount is greater than its estimated recoverable amount. Provisions for assets carried at amortised cost are calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

2.11 Trading equities and funds

Trading equities are stated at market value and realised and unrealised income or losses are included in the income statement.

Trading funds are stated at the year-end market valuation supplied by the investment managers. Unrealised income or losses and profits or losses on sale of investments in trading funds are included in income or loss from investments.

Dividend income is recognised in the income statement when declared by the investee company.

2.12 Other equities and funds

Unquoted equity investments held as available-for-sale are stated at fair value or at cost less impairment if the fair value cannot be reliably measured. The fair value is determined after examining various factors including the future prospects of the investee companies.

Unquoted equity fund investments held as available-for-sale are stated at their fair values, based upon the asset values of individual investments within the funds, as well as overall fund performance provided by the fund manager's latest available report, expected repayment of management fees, where applicable, and the future prospects for the underlying investments.

Until receipt of the fund manager's next report, the Bank makes adjustments to the fair value of unquoted equity fund investments based on fund manager's communication and historical experience, as well as sales and new investment transactions occurring in the interim.

Income is recognised in the income statement when contract for sale has been executed.

Dividend income is recognised in the income statement when declared by the investee company.

2.13 Government and Government Agency bonds

Government and Government Agency bonds held for trading purposes are stated at market value. Realised and unrealised income or losses are recorded as income or losses from sovereign debt and bonds and included in the income statement.

Government and Government Agency bonds acquired on the date of their issue are considered as loans and receivables and are carried at amortised cost using the effective interest rate method. Income or losses are recognised upon sale and recorded as income or losses from sovereign debt and bonds and included in the income statement.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.13 Government and Government Agency bonds (continued)

Available-for-sale Government and Government Agency bonds are stated at market value. The premium paid or discount received is amortised over the remaining period to maturity of the assets acquired using the effective interest rate method and reflected in the income statement. Unrealised income or losses from changes in fair value are recorded in the fair value reserve in equity. Upon sale or disposal of a Government or Government Agency bond, the related accumulated fair value adjustments in equity are recorded as income or losses from sovereign debt and bonds included in income or loss from investments.

2.14 Other bonds

Other bonds held for trading purposes are recorded at market value. Realised and unrealised income and losses are included in the income statement.

Other bonds held-to-maturity are stated at amortised cost. The premium paid or discount received is amortised over the remaining period to maturity of the bonds, using the effective interest rate method.

2.15 Loans and advances

Loans and advances are initially recognised at fair value and subsequently measured at amortised cost and stated net of impairment provisions which are charged to the income statement.

Fees and commission received are amortised over the period of the loan.

2.16 Instalment sale receivable

The instalment sale receivable is carried at amortised cost less provisions for impairment.

2.17 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Property, plant and equipment are depreciated on a straight-line basis over their estimated useful original lives as follows:

Equipment	2-8 years

In the event that the carrying value of an item of property, plant and equipment is higher than its recoverable amount, then its carrying value is immediately written down to its recoverable amount.

2.18 Securities purchased/sold under agreements to resell/repurchase (“Repo agreements”)

Repo agreements involve the buying or selling of Government securities, Government Agency bonds, other bonds and trading funds under agreements to resell or repurchase these securities. Repo agreements are treated as financing transactions and are stated at the amounts at which the securities, bonds and funds will subsequently be resold or repurchased as specified in the respective agreements as adjusted for accrued interest, using the effective interest rate method.

2.19 Provision

Provision for legal claims is recognised when the Bank has a present obligation as a result of a past event and it is probable that the outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

2.20 Directors’ remuneration

Directors’ remuneration is recognised as a liability when approved.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.21 Share capital - Share issue costs

Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds.

2.22 Dividends

Dividends are recognised as a liability in the period in which they are approved by the shareholders.

2.23 Treasury shares

Own shares reacquired by the Bank and held at the balance sheet date are designated as treasury shares. These shares are shown as a one line deduction from the Bank's shareholders' equity. The income and losses on the sale of treasury shares are recognised in shareholders' equity.

2.24 Fees and commission income

Fees and commission income is recognised in the income statement on an accrual basis. Fees received upon prepayment of loans are taken to income when received. Underwriting and placement fees are taken to income when earned. Performance fees are taken to income on sale of the investment when the IRR hurdle rate of an investment has been achieved.

2.25 Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except for those classified as held for trading or designated at fair value through profit or loss, is accrued and recognised within 'interest income' and 'interest expense' in the income statement.

Interest income from loans and advances is accrued based on contractual interest rates, using the effective interest rate method.

Interest income on Government and Government Agency bonds, other bonds and instalment sale receivable are recognised on an accrual basis using the effective interest rate method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group includes all transaction costs and all other premiums or discounts.

Once a financial asset or a Group of similar financial assets have been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

2.26 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.27 Employee compensation costs

Employee benefits

Employee benefits and entitlements to annual leave, holiday, air passage and other short-term benefits are recognised when they accrue to employees. The Group's contributions to defined contribution pension plans are charged to the income statement in the year to which they relate. In respect of these plans, the Group has a legal and constructive obligation to pay the contributions as they fall due and no obligation exists to pay the future benefits. In respect of end of service benefits, to which certain employees of the Group are eligible, provisions are made in accordance with the labour law requirements of the applicable jurisdiction.

2.28 Taxation

Liability towards taxation is calculated in accordance with the tax laws of the applicable country and recognised using the liability method. Currently, there is no corporate taxation in Bahrain.

2.29 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker is the person or group that allocates resources to and assesses the performance of the operating segments of an entity. The Group has determined the Group executive board as its chief operating decision maker. All transactions between business segments are conducted on an arm´s length basis, with intra-segment revenue and costs being eliminated in head office. Income and expenses directly associated with each segment are included in determining business segment performance.

2.30 Cash and cash equivalents

Cash and cash equivalents comprise cash and short-term funds and deposits with banks.

2.31 Subordinated loans

Subordinated loans are initially recognised at fair value and subsequently carried at amortised cost. Interest expense is accrued on contractual interest rates.

3 CLASSIFICATION OF FINANCIAL INSTRUMENTS

2009

	Held-for-trading US$000	Loans and receivables US$000	Held-to-maturity US$000	Available-for-sale US$000	Financial liabilities at amortised cost US$000	Total US$000
Cash and short term funds	-	3,425	-	-	-	3,425
Trading securities	1,885	-	-	-	-	1,885
Available-for-sale investment securities	-	-	-	45,260	-	45,260
Held-to-maturity investment securities	-	-	4,624	-	-	4,624
Loans and advances	-	872	-	-	-	872
Instalment sale receivable		15,682	-		-	15,682
Total financial assets	**1,885**	**19,979**	**4,624**	**45,260**	**-**	**71,748**
Deposits from customers	-	-	-	-	23,925	23,925
Revolving loan facility	-	-	-	-	11,600	11,600
Other liabilities	-	-	-	-	1,342	1,342
Subordinated loan	-	-	-	-	10,000	10,000
Total financial liabilities	**-**	**-**	**-**	**-**	**46,867**	**46,867**

3 CLASSIFICATION OF FINANCIAL INSTRUMENTS (CONTINUED)

2008

	Held-for-trading US$000	Loans and receivables US$000	Held-to-maturity US$000	Available-for-sale US$000	Financial liabilities at amortised cost US$000	Total US$000
Cash and short term funds	-	3,688	-	-	-	3,688
Trading securities	12,260	-	-	-	-	12,260
Available for sale investment securities	-	-	-	49,816	-	49,816
Held-to-maturity investment securities	-	-	9,537	-	-	9,537
Loans and advances	-	901	-	-	-	901
Instalment sale receivable	-	17,299	-	-		17,299
Total financial assets	**12,260**	**21,888**	**9,537**	**49,816**	**-**	**93,501**
Deposits from customers	-	-	-	-	26,493	26,493
Securities sold under repurchase agreements	-	-	-	-	817	817
Financial liabilities held for Trading	1,735	-	-	-	-	1,735
Revolving loan facility	-	-	-	-	11,600	11,600
Other liabilities	-	-	-	-	212	212
Subordinated loan	-	-	-	-	10,000	10,000
Total financial liabilities	**1,735**	**-**	**-**	**-**	**49,122**	**50,857**

4 CASH AND SHORT TERM FUNDS

Cash and short term funds comprise:

	2009 US$000	2008 US$000
Money at call with banks	3,359	3,622
Balances with Central Bank	66	66
Total cash and short term funds	3,425	3,688

Balances with the Central Bank of Bahrain are not available for use in the Group's day-to-day operations and hence has not formed a part of cash & cash equivalents.

5 TRADING SECURITIES

Trading securities comprise:

	2009 US$000	2008 US$000
Trading equities and funds		
- Quoted equities	1,885	703
- Managed funds	-	23
Total trading equities and funds	1,885	726
Debt securities (a)		
- Government loans	-	620
- Corporate and Notes	-	10,065
Total Debt securities	-	10,685
Total trading derivatives (b)	-	849
Total trading securities	1,885	12,260

(a) Debt securities comprise

	Government Loans		Corporate Bonds		Listed Capital Protected Note	
	2009 US$000	2008 US$000	2009 US$000	2008 US$000	2009 US$000	2008 US$000
Americas	-	536	-	2,756	-	7,309
Rest of the World	-	84	-	-	-	-
Total debt securities	-	620	-	2,756	-	7,309

5 TRADING SECURITIES (CONTINUED)

(b) Derivatives financial instruments

The Group utilised derivative instruments for trading purposes in 2009 and 2008 but there were no outstanding instruments as at 31 December 2009.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Group's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable and thus the aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time. The fair values of derivative instruments held are set out in the following table:

	Contract notional amount		Fair values: Assets		Fair values: Liabilities	
	2009	2008	2009	2008	2009	2008
	US$000	US$000	US$000	US$000	US$000	US$000
Derivatives – held for trading						
Equity derivatives:						
Equity options	-	300	-	-	-	-
Foreign exchange derivatives:						
Currency forwards	-	25,002	-	796	-	(1,662)
Currency futures	-	5,385	-	53	-	(73)
Total			-	849	-	(1,735)

Derivative financial instruments with negative fair value are classified as financial liabilities held for trading.

6 AVAILABLE-FOR-SALE INVESTMENT SECURITIES

Available-for-sale investment securities comprise:

	2009	2008
	US$000	US$000
Other Equities and Funds		
(i) Unquoted equity fund investments – at fair value	44,421	44,639
(ii) Unquoted equity investments – at fair value	427	3,659
(iii) Unquoted equity investments – at cost less impairment	412	1,518
Total available-for-sale investment securities	45,260	49,816

As previously stated in Note 2, the determination of fair value for unquoted equity funds investment and unquoted equity investments held as available-for-sale involves significant estimates and judgment on the part of the Bank's management and such determinations made are estimates, not absolute or certain values. The effect of a 5% variation in fair values determined as at 31 December 2009 would have the following impact on the Bank's results for the year ended 31 December 2009 and/or the Bank's equity as of that date:

- A shift of ±5% in management's fair value estimates for "other equities and funds" investments held as available-for-sale and not impaired as at 31 December 2009 would impact "other equities and funds" as well as fair value reserve within equity by ±US$ 2.2 million, respectively, as at that date.
- A shift of ± 5% in management's fair value estimate for "other equities and funds" investments held as available-for sale and impaired at 31 December 2009, would increase/decrease "other equities and funds" by US$ 858,000 with a corresponding opposite movement in profit for the year and equity by US$ 858,000, respectively.

6 AVAILABLE-FOR-SALE INVESTMENT SECURITIES (CONTINUED)

The type and segmental distribution break up for other equities and funds are as follows:

	Diversified		Technology		Others		Total	
	2009	2008	2009	2008	2009	2008	2009	2008
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
(i) Unquoted equity funds - at fair value								
Buy Out Funds:								
Asian	21	21	-	-	-	-	21	21
European	3,255	3,912	-	-	-	-	3,255	3,912
Italian	2,028	1,850	-	-	-	-	2,028	1,850
UK	-	88	-	-	-	-	-	88
UK & Continental Europe	5,585	5,986	-	-	-	-	5,585	5,986
US	2,768	2,127	-	-	-	-	2,768	2,127
US & European	15,879	13,375	-	-	-	-	15,879	13,375
	29,536	27,359	-	-	-	-	29,536	27,359
Venture Capital Funds:								
European	-	-	847	1,616	-	-	847	1,616
India	-	-	6,669	1,235	-	-	6,669	1,235
US	-	-	1,119	5,615	-	-	1,119	5,615
US & European	-	-	622	1,169	-	-	622	1,169
	-	-	9,257	9,635	-	-	9,257	9,635
Fund of Funds:								
US & European	1,692	2,107	3,936	5,538	-	-	5,628	7,645
Subtotal	31,228	29,466	13,193	15,173	-	-	44,421	44,639
(ii) Unquoted equity - at fair value								
Financial	-	-	-	-	-	-	-	-
Private Equity Financial intermediaries	-	3,290	-	-	-	-	-	3,290
Leisure	-	-	-	-	260	199	260	199
Others	-	-	-	-	167	170	167	170
Subtotal	-	3,290	-	-	427	369	427	3,659
(iii) Unquoted equity – at cost								
Technology/ Telecommunications		-	412	1,518	-	-	412	1,518
Subtotal		-	412	1,518	-	-	412	1,518
Total available-for-sale investment securities	31,228	32,756	13,605	16,691	427	369	45,260	49,816

6 AVAILABLE-FOR-SALE INVESTMENT SECURITIES (CONTINUED)

At 31 December 2009, the Bank had undrawn investment commitments to private equity funds of US$ 35.3 million (31 December 2008: US$ 77.7 million, Note 32). Of these, the Group's proprietary commitments amounted to US$ 23.2 million and the rest were on account of its sub-participants. Under the term of the agreements with these equity fund managers, the Group is irrevocably committed to invest funds upon notice from investment managers, except for certain excused investments. Excused investments include those prohibited by local law and, in certain cases, investments contrary to Shari'ah principles where the Bank is a co-investor with its clients who apply Shari'ah principles to their investment activity.

Movements in available-for-sale investment securities were as follows:

	2009 US$000	2008 US$000
At 1 January	49,816	73,264
Net fair value (loss)/gain on available-for-sale investments	2,059	(16,799)
Additions	5,675	10,681
Disposals	(8,510)	(12,987)
Fair value transferred to income statement on disposals	-	3,761
Impairment provisions (Note 23)	(4,881)	(4,195)
Foreign exchange movements	1,101	(3,909)
At 31 December	45,260	49,816

7 HELD-TO-MATURITY INVESTMENT SECURITIES

Held-to-maturity investment securities comprise:

	2009 US$000	2008 US$000
Student Loans	236	212
CDOs	-	4,937
Government bonds	4,388	4,388
	4,624	9,537

Movements in held-to-maturity investment securities were as follows:

	Government Bonds		Student loans		CDO's		Total	
	2009 US$000	2008 US$000	2009 US$000	2008 US$000	2009 US$000	2008 US$000	2009 US$000	2008 US$000
At January 1	4,388	4,388	212	292	4,937	9,501	9,537	14,181
Amortised costs	-	-	-	-	278	244	278	244
(Provisions) / writeback for the year (Note 23)	-	-	-	-	(215)	192	(215)	192
Disposals (repayments received/sold)	-	-	-	-	(5,000)	(5,000)	(5,000)	(5,000)
Foreign exchange movements	-	-	24	(80)	-	-	24	(80)
At 31 December	4,388	4,388	236	212	-	4,937	4,624	9,537

7 HELD-TO-MATURITY INVESTMENT SECURITIES (CONTINUED)

In 2009, the Group consented to the Issuer's request for early redemption of the CBOI Class A Senior Secured Note 2001-4 which was included within CDO's above. The Group accepted receipt of Underlying US Treasury Strip 15/11/2011 (USD 5 million nominal) as full consideration and settlement (by way of security) of amounts due in respect to CBOI Class A Senior Secured Note. The US Treasury Strip was classified in the Trading Securities category, and was sold during the year.

8 LOANS AND ADVANCES

The composition of the loans and advances is as follows:

	2009	2008
	US$000	US$000
Americas	872	872
Rest of the world	-	29
Total loans and advances	872	901

Loans and Advances includes bridge loan to Authentium Inc, a related party (refer to note 27).

9 INSTALMENT SALE RECEIVABLE

During 1995, the bank entered into an agreement to sell its investment in land in the State of Kuwait on an instalment sale basis for US$ 43,200,000. As security, the Bank obtained a first mortgage on the land and any subsequent enhancements to the property. Under the terms of the instalment sale transaction, the Bank had no liability with regard to any future costs. During 1998, the Bank entered into a revised agreement with the customer to release the first mortgage on the land and replace it with a guarantee from a bank in Kuwait.

In June 2001, the Bank released the guarantee from the bank in Kuwait that secured the instalment sale receivable. In consideration for the release of the guarantee, the Bank obtained the right to set off the interest and principal amounts due under a US$ 20,000,000 subordinated debt agreement dated 20 June 2001.

In June 2005, the US$ 20,000,000 subordinated loan, which provided credit support to the instalment sale receivable, was converted to equity. The Bank has obtained a corporate guarantee to secure this receivable.

10 PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment comprise:

	2009	2008
	US$000	US$000
At 1 January		
Cost	6,937	6,718
Accumulated depreciation	(6,433)	(6,402)
Net book amount	504	316
Year ended 31 December		
Opening net book amount	504	316
Additions	260	405
Depreciation charge	(215)	(147)
Disposals	(6)	(70)
Closing net book amount	543	504
At 31 December		
Cost	6,571	6,937
Accumulated depreciation	(6,028)	(6,433)
Net book amount	543	504

11 OTHER ASSETS

Other assets comprise:

	2009 US$000	2008 US$000
Accrued interest receivable	626	604
Management fees receivable	284	255
Receivable from investment fund managers	1,806	3,318
Prepayments	237	268
Other	626	2,043
Total other assets	3,579	6,488

Provisions for impairment

Other assets are stated after deducting provisions for impairment, which are as follows:

	2009 US$000	2008 US$000
At 1 January		317
Amounts written off	-	(317)
At 31 December	-	-

12 DEPOSITS FROM CUSTOMERS

Deposits from customers comprise:

	Current		Non-current		Total	
	2009 US$000	2008 US$000	2009 US$000	2008 US$000	2009 US$000	2008 US$000
Customer participation in funds	3,554	275	8,185	12,694	11,739	12,969
Government entities, corporates and individuals	3,768	13,524	8,418	-	12,186	13,524
Total deposits from customers	7,322	13,799	16,603	12,694	23,925	26,493

Customer participation in funds represents amounts received from customers to be invested in private equity funds marketed by BMB and amounts from private equity realizations received by the Bank and not yet distributed to customers. These funds, although treated as part of customer deposits, are retained by the Bank until drawdowns are made by private equity fund managers or paid to the customers as part of realised distributions. Customer deposits carry market rates of interest for the period until drawdown or payment. Customer participation in funds includes US$ 1,081,830 (31 December 2008: US$ 2,888,200) in deposits held on behalf of BMB Technology and Telecommunications Fund (Note 32).

In December 2009, the Bank successfully concluded negotiations with a quasi government depositor in respect of rescheduling its repayments on deposits aggregating US$ 12,186,000. As at 31 December 2009, the negotiated terms included a quarterly principal repayment of US$ 1 million on 5 April 2010 and quarterly repayments thereafter of US$ 2 million starting from 5 October 2010 to 5 July 2011, and a final repayment of US$ 3,186,000 on 5 October 2011. These deposits carry floating rates of interest and are based on 3 months LIBOR.

13 SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

Securities sold under repurchase agreements (“Repos”) comprise the following:

	2009 US$000	2008 US$000
Repos on other bonds	-	817

14 REVOLVING LOAN FACILITY

	2009 US$000	2008 US$000
Revolving loan facility	11,600	11,600

The revolving loan facility represents the balance outstanding on a US$ 20 million liquidity facility granted by the Central Bank of Bahrain. The facility was first granted in June 2003. Repayments were originally due to commence in September 2009 but were subsequently rescheduled on 14 January 2010. As per the new terms, principal repayments commence on 15 September 2010 as follows: US$1 million (September 2010), US$1 million (December 2010) and US$ 2 million each in March, July and September 2011 and a final repayment of US$3.6 million in December 2011.

Certain of the Bank’s investments are pledged against this revolving loan facility. Interest is fixed.

15 OTHER LIABILITIES

Other liabilities comprise:

	2009 US$000	2008 US$000
Accrued interest payable	1,342	212
Unclaimed dividends	3,237	3,366
Employee leaving indemnity (Note 26)	354	987
Accrued expenses	1,074	1,656
Other	677	649
	6,684	6,870

16 SUBORDINATED LOAN

Initially granted in June 2001, the subordinated debt facility is payable on 30 December 2011. Interest is based on 1 year Libor,

17 SHARE CAPITAL

Share capital comprises:

	2009 Number 000	2009 Amount US$000	2008 Number 000	2008 Amount US$000
Authorized				
Ordinary shares of US$0.25 each	2,000,000	500,000	2,000,000	500,000
Issued and fully paid				
Ordinary shares of US$0.25 each				
At 1 January	219,819	54,955	209,352	52,338
Stock dividend	-	-	10,467	2,617
At 31 December	219,819	54,955	219,819	54,955

17 SHARE CAPITAL (CONTINUED)

A distribution of each class of equity security, setting out the number of holders and percentage in the following categories at 31 December:

	2009			2008		
Ordinary shares	No. of Shares	No. of Shareholders	% of Total Outstanding Shares	No. of Shares	No. of Shareholders	% of Total Outstanding Shares
Less than 1%	7,173,004	13,128	3.26%	7,173,004	13,128	3.26%
1% up to less than 5%	8,193,882	1	3.73%	8,193,882	1	3.73%
5% up to less than 10%	62,545,696	4	28.45%	62,545,696	4	28.45%
10% up to less than 20%	-	-	-	-	-	-
20% up to less than 50%*	141,906,308	2	64.56%	141,906,308	2	64.56%
50% and above	-	-	-	-	-	-
	219,818,890	13,135	100%	219,818,890	13,135	100%

* Reflects ownership of Al Fawares Holding Co.

Treasury shares

At 31 December 2009, the Bank owned 1 of its own shares (31 December 2008: 1 share). This share is treated as a deduction from the shareholders' equity.

Earnings per share

Earnings per share are computed as below:

	Basic		Diluted	
	2009	2008	2009	2008
Loss for the year	US$(33,536,000)	US$(14,313,100)	US$ (33,536,000)	US$(14,313,100)
Weighted average number of shares	219,818,889	217,302,248	219,818,889	217,302,248
Loss per share	US$ (0.15)	US$ (0.07)	US$ (0.15)	US$ (0.07)

18 RESERVES

The Group's reserves analyzed in the consolidated statement of changes in equity comprise:

Legal reserve

Legal reserve comprises amounts set aside in accordance with the Bahrain Commercial Companies Law 2001, which requires that the Bank should make an annual transfer of a minimum of 10% of net profit for the year to a non-distributable legal reserve until such reserve equals 50% of its paid up share capital.

General reserve

General reserve comprises amounts set aside as a voluntary reserve from the profits of the Bank, upon the recommendation of the Board of Directors, and approved by the shareholders at the Ordinary General Meeting. This reserve is distributable.

Retained earnings

Retained earnings represent distributable profits after transfer of amounts to statutory and general reserves.

Dividends

Dividends are recognised as a liability once they have been ratified at the Ordinary General Meeting and the required regulatory approval has been obtained. At the meeting on 29 March 2008, a stock dividend of 5% for the year 2007 was proposed and approved.

18 RESERVES (CONTINUED)

Fair value reserve

Fair value reserve represents unrealised fair value movements on investment securities classified as available-for-sale. Income and losses arising from changes in the fair value of available-for-sale assets are recognised in the fair value reserve in equity.

19 LOSS /INCOME FROM INVESTMENTS

(Loss)/income from investments comprises:

	2009 US$000	2008 US$000
Trading		
Loss from managed funds	-	(412)
Loss from quoted equities	(214)	(1,241)
Income/(loss) from other bonds – corporate	167	(256)
Loss from sovereign debt and bonds	(44)	(333)
Loss from derivatives - Government bond futures	-	(286)
Income/(loss) from derivatives - equity options	20	(156)
Dividend income	-	132
	(71)	(2,552)
Available-for-sale		
(Loss)/income from available-for-sale investment securities	(7,905)	5,396
Held-to-maturity		
Loss from other bonds – structured products	-	(95)
Total (loss)/income from investments	(7,976)	2,749

20 FOREIGN EXCHANGE TRANSLATION INCOME/(LOSS)

Foreign exchange income/(loss)comprises:

	2009 US$000	2008 US$000
Foreign exchange income/(loss)	761	(172)
Foreign exchange derivatives (non-hedging)		
Income/(loss) from foreign exchange futures	213	(530)
Income/(loss) from foreign exchange forwards	867	(867)
Total foreign exchange translation income/(loss)	1,841	(1,569)

21 FEES AND COMMISSION INCOME

Fees and commission income comprises:

	2009 US$000	2008 US$000
Performance fees	2	177
Management fees	306	263
Placement fees	-	401
Total fees and commission income	308	841

22 NET INTEREST EXPENSE

Net interest expense comprises:

	2009 US$000	2008 US$000
Interest income:		
Instalment sale receivable	798	877
Government bonds and other bonds	427	602
Placement with banks	60	450
Loans and advances	79	47
Total interest income	1,364	1,976
Interest expense:		
Loan facilities	(1,624)	(1,703)
Customers deposits	(353)	(1,082)
Securities sold under repurchase agreements	(35)	(200)
Deposits from banks	-	(66)
Total interest expense	(2,012)	(3,051)
Net interest expense	(648)	(1,075)

23 IMPAIRMENT PROVISIONS

The specific provision charge comprises:

	2009 US$000	2008 US$000
Trading securities written off	564	-
Impairment on available-for-sale investment securities	17,164	4,565
Impairment/ (writeback) on held-to-maturity investment securities	215	(192)
Amounts released from available-for-sale investment securities	-	(370)
	17,943	4,003

24 GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses comprise:

	2009 US$000	2008 US$000
Salaries and other personnel expenses (Note 25)	5,773	7,700
Occupancy and equipment	1,021	1,068
Legal and professional	1,312	1,153
Other	1,080	1,141
Total general and administrative expenses	9,186	11,062

25 EMPLOYEE BENEFITS

Employee retirement benefits

The costs associated with contributions made by the Bank towards the pension scheme for Bahraini nationals administered by the Government of the Kingdom of Bahrain amounted to US$ 136,613 (31 December 2008: US$ 134,700). The Kingdom of Bahrain pension scheme is a defined contribution plan, and accordingly, the Bank has a legal and constructive obligation to pay the contributions as they fall due and no obligation exists to pay the future benefits.

26 EMPLOYEE BENEFITS (CONTINUED)

The expatriate employees of the Group based in Bahrain are paid leaving indemnity in accordance with the Kingdom of Bahrain labour laws. The movement in leaving indemnity liability is summarised below:

	2009 US$000	2008 US$000
At 1 January	987	965
Accruals for the year	193	420
Paid during the year	(826)	(398)
At 31 December (Note 15)	354	987

	2009 Number	2008 Number
Employees at 31 December	41	81

27 RELATED-PARTY TRANSACTIONS AND BALANCES

The Bank considers Directors and key management personnel as related parties. Transactions entered during the year and balances at the year end are set out below.

(a) Key management personnel of the Group are those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly. Key management personnel comprise members of the Board of Directors and the senior management.

	Directors and key management personnel 2009 US$000	Directors and key management personnel 2008 US$000
Loans		
At 1 January	851	661
Advanced during the year	112	420
Repayments during the year	(943)	(230)
At 31 December	20	851
Administration charges for the year	3	8

No loans were advanced to any director of the Bank during the year 2009 (2008: Nil).

No provisions have been recognised in respect of loans given to related parties (2008: Nil).

The above loans are included as part of other assets.

The loans made to key management personnel are repayable monthly up to a period of three years. Amounts are interest free. Majority of these loans are fully secured.

At 31 December 2009 deposits from customers included deposits from Directors and their related parties amounting to US$ 249,640 (31 December 2008: US$ 282,672)

27 RELATED-PARTY TRANSACTIONS AND BALANCES (CONTINUED)

	Directors and key management personnel 2009 US$000	Directors and key management personnel 2008 US$000
Deposits		
At 1 January	542	376
Received during the year	161	918
Repaid during the year	(310)	(768)
Interest capitalized during the year	4	16
At 31 December	397	542
Interest expense on deposits for the year	4	16

Key management compensation

Compensation to key management personnel, including directors, was as follows:

	2009 US$000	2008 US$000
Salaries and other short-term employee benefits	1,398	1,984
End of service benefits	61	1,231
	1,459	3,215
Directors' fees	57	63

(b) The Bank considers Al Fawares Holding Co. (the "Parent Company") and entities controlled or significantly influenced by Al Fawares Holding Co. as being related parties.

Guarantee

The Bank has received a corporate payment guarantee from Al Fawares Holding Co. with regard to the instalment sale receivable (Note 9).

Fellow associated companies

Al Fawares Holding Co. is considered as having significant influence in Authentium Inc., a company incorporated in Delaware, USA, as it has the power to participate in the framework and operating policy decisions of Authentium Inc., but has no control over those policies.

As at 31 December 2009, the Bank's investment in Authentium Inc. totalled US$ 0.7 million, included in available-for-sale investment securities, in addition to US$ 0.9 million included in loans and receivables. The respective amounts for 2008 are US$ 0.7 million and US$ 0.9 million.

The terms of the bridge loan agreement are as follows:

- 1st tranche drawn in 2008: This carries a fixed rate of interest. The principal and interest amounts are payable at maturity in July 2010 and can be converted at the lenders option into equity.

- 2nd tranche can be drawn (unspecified date) provided certain milestones are met by the company.

28 INVESTMENTS IN SUBSIDIARIES

Listing of subsidiaries

The principal subsidiaries of the Bank at 31 December were as follows:

Subsidiaries	Ownership interest 2009	2008	Country of incorporation	Nature of business
BMB Investment Company (Jersey) Limited	100%	100%	Jersey	Investment holding
Adhari Limited	100%	100%	Cayman Islands	Investment holding
BMB Property Services	100%	100%	Bahrain	Building Management
BMB Finance Limited	100%	100%	Cayman Islands	Investment holding
BMB-H Investment Company Limited	100%	100%	Channel Islands	Investment holding
BMB-H Investment Trading Limited	100%	100%	Cayman Islands	Investment holding
Universal Merchant Holdings NV	100%	100%	Netherlands Antilles	Investment holding
BMB Netherlands Antilles NV	100%	100%	Netherlands Antilles	Investment holding
BMB Curacao Netherlands NV	100%	100%	Netherlands Antilles	Investment holding
Universal Finance Holding NV	100%	100%	Netherlands	Investment holding
European Universal Finance NV	100%	100%	Netherlands	Investment holding
Beverages Limited	100%	100%	Channel Islands	Investment holding
Qassari Limited – LDC	100%	100%	Cayman Islands	Investment holding
Umm Shoum Limited – LDC	100%	100%	Cayman Islands	Investment holding
Bu Zaidan Limited – LDC	100%	100%	Cayman Islands	Investment holding
BMB SP Holdings Limited	100%	100%	Channel Islands	Investment holding
BMB New Era Ventures - I LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – II LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – III LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – IV LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – V LDC	100%	100%	Cayman Islands	Investment holding
BMB Ventures Limited	100%	100%	Cayman Islands	Investment holding
T&T Beverages Limited (T&T)*	93.9%	93.9%	United Kingdom	Softdrinks
T&T Beverages Limited II**	100%	100%	United Kingdom	Softdrinks

* Effective 25 April 2006, T&T Beverages Limited was put into voluntary liquidation.

** In January 2009, T&T Beverages Limited II was liquidated.

28 INVESTMENTS IN SUBSIDIARIES (CONTINUED)

T&T Beverages Limited II was created to hold certain intellectual property rights of T&T. It did not engage in operations, and was liquidated in January 2009.

With the exception of T&T Beverages, which is in liquidation, and BMB Property Services, the Bank's other subsidiaries are used solely to hold investments and do not engage in independent operations.

At 31 December all subsidiary companies were consolidated in the financial statements.

29 LEGAL CLAIMS

Share issuance – 1982

The Bank and the Bank of Bahrain and Kuwait (BBK) were co-defendants in a litigation in Kuwait arising in connection with the issuance of the original shares of BMB in 1982. In May 2002, the Court of First Instance in Kuwait ruled in favour of the Bank and its co-defendant. In April 2003, while the case was appealed by the plaintiff and the Appellate Court upheld the judgement of the Court of First Instance in favour of the Bank. In August 2003, the Kuwaiti litigant filed a suit in Bahrain. After a number of hearings in the Courts of Bahrain, on 23 June 2009 the High Civil Court passed judgement in favour of the Plaintiff with no liability to the Bank. However, BBK has filed an appeal against the judgement; several hearings have taken place at the Appeal Court and at the hearing held on 18 January 2010, the Court closed the case for judgement to be issued on 15 March 2010.

Based on the nature of this action and a previous favourable decision in its favour in a similar case in Bahrain, the Bank believes that this case will be decided in its favour and, accordingly, no provision has been made in the financial statements.

Labour complaints filed with the Ministry of Labour

Three former employees of the Bank have filed labour complaints with the Ministry of Labour. After discussions between the three individual parties and the Ministry of Labour, as no settlement had been reached, the Ministry of Labour transferred the three cases to the Labour Court.

On 25 October 2009 the Labour Court examined two of the cases: at the hearing on 21 December 2009, both cases were adjourned until 02 March 2010. On 28 October 2009 the Labour Court examined the third case: at the hearing on 02 February 2010, the case was adjourned to 25 March 2010.

Leased land - 2009

On 2 July 2009, a civil case was filed against the Bank and BMB Property Services (a subsidiary) by a former lessor for non-settlement of dues. Several hearings have taken place in the Court and on 10 February 2010 the case was adjourned to 10 March 2010. The Bank believes that any damages awarded will not be material within the overall context of these financial statements.

30 FINANCIAL RISK MANAGEMENT

In the normal course of its business, the Bank is exposed to various risks, related to the nature of the activities in which it engages. The principal sources of risk are credit risk, market risk, interest rate risk, currency risk, liquidity risk, private equity risk, operating risk and legal risk.

30 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

At BMB, the management of financial and other risks is based on the establishment of an appropriate risk governance structure, comprising:

- clearly defined exposure and risk limits by geography, sector and counter party
- internally, a collectively decisioning structure composed of independent departments and other departmental heads
- specialised task force for day to day monitoring and management of liquidity risk
- investment evaluation criteria based on quantitative and qualitative approaches
- robust operating policies and procedures, including those for specific allocation of risk limits to individual obligors and/or transactions
- ongoing review of exposures, excesses and risks by an independent department
- assessment of regulatory compliance by an independent department
- periodic internal audits of the control environment

Risk limits are at the heart of this process. BMB begins by setting maximum exposure limits as a percentage of capital for major lines of business. Within these macro limits, sublimits are set by geography, obligor type/credit grade, instrument, tenor, etc. For trading activities additional limits such as VaR, duration, maximum intraday and interday exposures, “stop losses”, etc. are applied as well. Individual transactions then take place within these sublimits.

In addition to the existence of various risk limits, overall risk discipline is maintained by the requirement that the Bank (a) maintains a Basel II Capital Adequacy Ratio in excess of the regulatory required minimum and (b) considers the impact on the Bank’s liquidity position of any major transaction(s) or new business initiative.

Risk management at BMB begins at the Board of Directors level. The Board of Directors exercise oversight and final approval of the risk management process at BMB. It operates through two Board Committees, the Executive Committee and the Audit Committee. With input provided by the Bank’s Risk Management Committee, the Executive Committee proposes the overall risk management strategy of the Bank. Based on the recommendations of the Executive Committee, the Board of Directors approves the aggregate levels of risk the Bank can assume as well as reviewing and approving the Bank’s risk management policies, risk limits and risk control framework. Among its duties, the Audit Committee is charged with reviewing and approving the Bank’s policies and procedures as well as overseeing both the internal and external audits of the Bank, including matters related to anti money laundering and terrorism finance.

The Board delegates certain authority to the Executive Committee and the executive management of the Bank to implement the risk control decisions of the Board. To carry out these responsibilities, executive management operates through a Risk Management Committee (the “RMC”).

The RMC is chaired by the Chief Executive Officer and comprises members of senior management. It serves as the Bank’s credit committee, asset/liability management committee and investment approval committee. In addition it prepares and submits to the Board detailed risk control policies and procedures as well as country, asset class and individual counterparty limits for Board approval. On an ongoing basis, the RMC monitors the environment in which the Bank operates and the risks to which it is exposed and adjusts the Bank’s operations as appropriate.

The Risk Management Department (“RMD”) plays a key role in this process. The RMD is independent of the Bank’s trading and business areas and reports directly to the Chief Executive Officer. It is responsible for identifying and quantifying risk exposures, recommending appropriate limits and monitoring usage of them. As part of its duties, the RMD prepares a variety of daily risk reports, including stress tests, for senior management and the RMC. In addition, the RMD manages problem and past-due assets.

Internal Audit, which is independent of both operations and the Bank’s business units, also assists in the risk management process. In particular, Internal Audit is charged with a periodic review of the effectiveness of BMB’s policies and internal controls – a review which is independent of the Bank’s executive management.

As a further step in mitigating risks, the Bank follows a policy of diversification in its activities and seeks to minimize the risk exposure to particular geographical regions, counterparties, instruments and types of business.

30 FINANCIAL RISK MANAGEMENT (CONTINUED)

In identifying and monitoring risk exposures, BMB uses a variety of quantitative tools as well as qualitative approaches to measure risks at the “macro” level. The Bank seeks to judiciously balance the use of these two approaches rather than rely on a single approach.

The following sections review the principal risks to which the Bank is exposed in the normal course of its business and how it manages those risks.

Credit risk

Credit risk is the risk of loss arising as a result of the inability or unwillingness of a counterparty to meet its obligations to the Bank. The Risk Management Department, under the oversight of RMC, has the responsibility for establishing credit risk standards and implementing the Bank’s credit risk management process.

BMB uses the Standardised Approach under the Basel II Framework for measuring and managing its credit risk.

The Bank estimates the probability of default through its risk grading system which employs a ten-grade scale, with “1” representing a risk which has the least probability of default (equivalent to AAA rating) and “10” representing a defaulted obligation (equivalent to rating below CCC-). Risk grading is based on (a) quantitative factors (historical and prospective, such as cash flow, profitability, asset quality and tenor of risk), (b) qualitative factors (such as management quality, market share and competitive position) and other factors, including country risk, the type of transaction, tenor and credit mitigation. Where ratings from an External Credit Assessment Institution, recognised by the Central Bank of Bahrain, are available, BMB considers these as part of its ratings process.

All obligors and countries are risk graded. All lines of credit, counterparty, country and trading limits are subject to annual reaffirmation by the Board of Directors. The limits are also reviewed more frequently, as necessary to ensure consistency with the Bank’s trading and investment strategies or to take into account latest market developments.

Given the nature of the Bank’s business, the Bank uses nominal balance sheet amounts, including accrued interest and other receivables, as its measure of exposure. Credit risks for a given economic entity (including its subsidiaries and affiliates) are aggregated as the measure of exposure and are managed at that level. Credit standards are defined in the Bank’s Credit Policies and Procedures Manual and include a sound process for evaluating obligor, transaction and product risks, as well as concentration risk, etc.

In order to ensure a common approach to risk control, the Bank uses the same credit procedure when entering into trading activities, including FX and derivatives, as it does for traditional lending products. Master netting agreements and collateral arrangements, as well as limits and the tenors of transactions, are employed to further control risks.

Overall, the Bank management considers that its policies and procedures constitute a reasonable approach to managing the credit risk in the activities it is engaged in.

With respect to specific assets, the following summarises key credit risk issues:

- Cash and deposits are placed with major OECD and regional banks
- Government bonds comprise bonds received in settlement of an outstanding past due loan
- Other bonds are either secured by US Government securities, or are AA- rated except for a small amount of securitized student loans (UK)
- The instalment sales receivable is supported by an appropriate security package

30 FINANCIAL RISK MANAGEMENT (CONTINUED)

BMB is not engaged in retail business and, therefore, does not use credit "scoring" models. Nor has the Bank securitized any of its assets and, therefore, has no recourse obligations under such transactions. BMB does not have any exposure to "highly leveraged institutions" as defined by the Financial Stability Task Force.

Concentration of credit risk arises when a number of obligors or counterparties are engaged in similar business activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Accordingly, such concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or region.

The following tables summarize the Group's geographical and industry sector exposures and any potential risk concentrations arising therefrom. Maximum credit risk exposures are detailed without considering the effects, if any, of collateral or other credit mitigation techniques on the Group's assets, liabilities and off-balance sheet items.

(a) Geographical sector

	North America		Europe		Rest of the world		Total	
	2009	2008	2009	2008	2009	2008	2009	2008
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Assets								
Cash and short term funds	2,454	1,634	464	1,440	507	614	3,425	3,688
Trading securities	673	9,106	330	1,900	882	1,254	1,885	12,260
Available-for-sale investment securities	16,668	17,699	28,155	24,829	437	7,288	45,260	49,816
Held-to-maturity investment securities		4,937	236	212	4,388	4,388	4,624	9,537
Loans and Advances	872	872				29	872	901
Instalment sale receivable					15,682	17,299	15,682	17,299
Other assets	1,475	2,724	610	1,055	1,494	2,709	3,579	6,488
Total assets subject to risk	**22,142**	**36,972**	**29,795**	**29,436**	**23,390**	**33,581**	**75,327**	**99,989**
Property, plant and equipment	-	-	-	-	543	504	543	504
Total assets	**22,142**	**36,972**	**29,795**	**29,436**	**23,933**	**34,085**	**75,870**	**100,493**
Off-balance sheet credit and investment instruments	**13,203**	**24,406**	**20,474**	**51,707**	**2,500**	**2,500**	**36,177**	**78,613**

30 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

(b) Industry sector

(i) **As at 31 December 2009**

	Banking/ Finance 2009 US$000	Govern-ment 2009 US$000	Technology/ Telecoms 2009 US$000	Diversified 2009 US$000	Others 2009 US$000	Total 2009 US$000
Assets						
Cash and short term funds	3,359	66	-	-	-	3,425
Trading securities	716	-	784	-	385	1,885
Available-for-sale investment securities	-	-	13,605	31,228	427	45,260
Held-to-maturity investment securities		4,388	-	-	236	4,624
Loans and advances	-	-	872	-	-	872
Instalment sale receivable	-	-	-	-	15,682	15,682
Other assets	1,475	-	610	1,494	-	3,579
Total assets subject to credit risk	**5,550**	**4,454**	**15,871**	**32,722**	**16,730**	**75,327**
Property, plant and equipment	-	-	-	-	543	543
Total assets	**5,550**	**4,454**	**15,871**	**32,722**	**17,273**	**75,870**
Off-balance sheet credit and investment instruments	**-**	**-**	**9,421**	**25,856**	**900**	**36,177**

(ii) **As at 31 December 2008**

	Banking/ Finance	Govern-ment	Technology/ Telecoms	Diversified	Others	Total
Total assets subject to credit risk	**14,775**	**10,128**	**20,106**	**33,382**	**21,598**	**99,989**
Total assets	14,775	10,128	20,106	33,382	22,102	100,493
Off-balance sheet credit and investment instruments	**-**	**-**	**10,695**	**67,018**	**900**	**78,613**

30 FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk

Market risk is defined as potential adverse changes in the fair value or future cash flows of a trading position or portfolio of financial instruments resulting from the movement of market variables, such as interest rates, currency rates, equity and commodity prices, market indices as well as volatilities and correlations between markets.

As its primary tool, the Bank measures its market risk exposure using the Standardised Approach prescribed by the Basel Committee and the Central Bank of Bahrain.

As noted above, market risk arises from changes in various market variables, including interest rate and foreign exchange risk. The tables on the following pages provide information on the Bank's interest rate and foreign currency risk exposures.

Interest rate risk

Interest rate risk is the risk that changes in market interest rates will affect (a) the fair value of financial instruments ("fair value interest rate risk") and/or (b) the future cash flows associated with financial instruments subject to periodic repricing ("cash flow interest rate risk"). The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through a variety of means, such as the daily risk analysis reports from the market risk model which assist the management in measuring and monitoring the Bank's exposure to interest rate risk.

30 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

The Bank's interest rate sensitivity position, based on the contractual repricing or maturity dates, whichever dates are earlier, is as follows:

2009

	Up to 1 month US$000	1 – 3 months US$000	3 – 6 months US$000	6 – 12 months US$000	1 – 5 years US$000	Over 5 years US$000	Non-interest bearing US$000	Total US$000
Cash and short term funds	66	-	-	-	-	-	3,359	3425
Trading securities	-	-	-	-	-	-	1,885	1885
Available-for-sale investment securities	-	-	-	-	-		45,260	45,260
Held-to-maturity investment securities	236					4,388		4,624
Loans and advances	-	-	-	872	-	-	-	872
Instalment sale receivable	-	-	1,696	-	7,646	6,340	-	15,682
Property, plant and equipment	-	-	-	-	-	-	543	543
Other assets	117	442	526	99	2,152	-	243	3,579
Total assets	**419**	**442**	**2,222**	**971**	**9,798**	**10,728**	**51,290**	**75,870**
Deposits from customers	23,157	-	-	-	-	-	768	23,925
Revolving loan facility	11,600	-	-	-	-	-	-	11,600
Other liabilities	509	158	-	1,315	257	3,237	1,208	6,684
Subordinated loan	-	-	-	-	10,000	-	-	10,000
Shareholders' equity	-	-	-	-	-	-	23,661	23,661
Total liabilities and shareholders' equity	**35,266**	**158**	**-**	**1,315**	**10,257**	**3,237**	**25,637**	**75,870**
Total interest rate sensitivity gap	(34,847)	284	2,222	(344)	(459)	7,491		

2008

	Up to 1 month US$000	1 – 3 months US$000	3 – 6 months US$000	6 – 12 months US$000	1 – 5 years US$000	Over 5 years US$000	Non-interest bearing US$000	Total US$000
Total assets	**552**	**2,820**	**2,065**	**8,438**	**12,960**	**17,715**	**55,943**	**100,493**
Total liabilities and shareholders' equity	**39,217**	**-**	**66**	**1,183**	**10,256**	**3,366**	**46,405**	**100,493**
Total interest rate sensitivity gap	(38,665)	2,820	1,999	7,255	2,704	14,349		

30 FINANCIAL RISK MANAGEMENT (CONTINUED)

The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is an historical rate for a fixed rate instrument carried at fair value. The effective interest rate by major currencies for each of the monetary financial instruments which bear interest is as follows:

2009

	Effective interest rate %		
	US$	GBP	EUR
Assets			
Government bonds	5.8	-	-
Other bonds	-	1.3	-
Loans and advances	8.0	-	-
Instalment sale receivable	4.8	-	-
Liabilities			
Customer deposits	1.7	0.3	0.3
Revolving loan facility	3.4	-	-
Subordinated loan	12.3	-	-

2008

	Effective interest rate %		
	US$	GBP	EUR
Assets			
Government bonds	5.8	-	-
Other bonds	4.5	3.3	-
Loans and advances	8.0	-	-
Instalment sale receivable	4.8	-	-
Liabilities			
Customer deposits	2.8	3.1	3.4
Securities sold under repurchase agreements	1.4	-	-
Revolving loan facility	4.6	-	-
Subordinated loan	12.0	-	-

(a) The effective interest rates are computed based upon a weighted average of the rates applicable to several individual instruments held at 31 December.
(b) The effective interest rate for customer deposits has been computed excluding non-interest bearing accounts of US$ 768,000 (31 December 2008: US$ 223,000).
(c) Statutory deposit held at the CBB is not included in the above.

Key to currencies:

US$ - United States Dollar
GBP - Great Britain Pound
EUR - Euro

30 FINANCIAL RISK MANAGEMENT (CONTINUED)

Currency risk

The Group is exposed to effects of fluctuations in the prevailing foreign currency exchange rates on its financial positions and cash flows. The table below summarises the Group's exposure to foreign currency exchange rate risk US$ equivalent.

At 31 December 2009

	US$ US$000	EUR US$000	GBP US$000	Others US$000	Total US$000
Assets:					
Cash and short term funds	2,757	134	74	460	3,425
Trading securities	673	173	157	882	1,885
Available-for-sale investment securities	18,769	21,954	3,360	1,177	45,260
Held-to-maturity investment securities	4,388	-	236	-	4,624
Loans and advances	872	-	-	-	872
Instalment sale receivable	15,682	-	-	-	15,682
Property, plant and equipment	543	-	-	-	543
Other assets	2,574	235	181	589	3,579
Total financial assets	**46,258**	**22,496**	**4,008**	**3,108**	**75,870**
Liabilities:					
Deposits from Customers	18,274	3,968	1,673	10	23,925
Revolving loan facility	11,600	-	-	-	11,600
Other liabilities	5,148	1	74	1,461	6,684
Subordinated loan	10,000	-	-	-	10,000
Total financial liabilities	**45,022**	**3,969**	**1,747**	**1,471**	**52,209**
Net on-balance sheet financial position	**1,236**	**18,527**	**2,261**	**1,637**	**23,661**
Off-balance sheet commitments	**10,140**	**24,780**	**1,257**	**-**	**36,177**
At 31 December 2008					
Total financial assets	67,966	21,739	5,644	5,144	100,493
Total financial liabilities	50,634	4,287	1,747	847	57,515
Net on-balance sheet financial position	**17,332**	**17,452**	**3,897**	**4,297**	**42,978**
Off-balance sheet commitments	**21,066**	**11,290**	**46,257**	**-**	**78,613**

30 FINANCIAL RISK MANAGEMENT (CONTINUED)

Pricing Risk

The Group is exposed to equity securities pricing risk as its investments are classified as held for trading. The Group's trading portfolio comprises of equity instruments quoted on stock exchanges. If market prices increased/decreased by 5%, with all other variable held constant, the loss for the year and equity would have been US$ 94,250 higher/lower than that reported (2008:36,300).

Liquidity risk

Liquidity risk is primarily the risk that the Bank will be unable to meet its payment obligations as they fall due and/or to replace funds when they are withdrawn ("liability liquidity risk"). It also represents the risk that the Bank will be unable to realize its assets in a timely fashion for prices close to their carrying values ("asset liquidity risk").

In its investing activities, BMB seeks to diversity its assets across instruments and markets and to avoid obligor concentrations which could constitute asset liquidity risk. This is particularly the case for our investments in unlisted private equity funds where BMB has consciously implemented a strategy of reducing the Bank's average individual investment size.

Liquidity is managed on a daily basis and senior management closely monitors significant daily changes to the liquidity position. In evaluating the liquidity position, the Bank also takes into account the possible call of un-drawn commitments in its investment portfolio.

30 FINANCIAL RISK MANAGEMENT (CONTINUED)

The table below presents the assets and liabilities of the Group based on remaining contractual maturities at the balance sheet date. The amounts disclosed in the table are the contractual undiscounted cash flows where the Group manages the inherent liquidity risk based on expected undiscounted cash inflows.

2009

	Within 1 month US$000	1–3 months US$000	3–6 months US$000	6–12 months US$000	1–5 years US$000	5–10 years US$000	10–20 years US$000	Total US$000
Assets								
Cash and short term funds	3,425	-	-	-	-	-	-	3,425
Trading securities	1,885	-	-	-	-	-	-	1,885
Available-for-sale investment securities	423	142	1,118	2,212	32,967	8,398	-	45,260
Held-to-maturity investment securities	127	-	-	127	-	-	4,624	4,878
Loans and advances	-	-	-	971	-	-	-	971
Instalment sale receivable			2,457	-	9,829	6,946	-	19,232
Other assets	117	442	-	242	2,152	-	-	2,953
Total assets	**5,977**	**584**	**3,575**	**3,552**	**44,948**	**15,344**	**4,624**	**78,604**
Liabilities								
Deposits from customers	2,407	-	-	4,915	16,674	-	-	23,996
Revolving loan facility	39	34	-	2,000	9,600	-	-	11,673
Other liabilities	509	158	-	1,315	256	3,237	-	5,475
Subordinated loan	-	-	-	1,238	11,216	-	-	12,454
Total liabilities	**2,955**	**192**	**-**	**9,468**	**37,746**	**3,237**	**-**	**53,598**
Net liquidity gap	**3,022**	**392**	**3,575**	**(5,916)**	**7,202**	**12,107**	**4,624**	**25,006**

30 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

2008

	Within 1 month US$000	1–3 months US$000	3–6 months US$000	6–12 months US$000	1–5 years US$000	5–10 years US$000	10–20 years US$000	Over 20 years US$000	Total US$000
Assets									
Cash and short term funds	3,688	-	-	-	-	-	-	-	3,688
Trading securities	11,647	620	-	-	-	-	-	-	12,267
Available-for-sale investment securities	801	-	1,093	4,362	35,027	8,533	-	-	49,816
Held-to-maturity investment securities	127	-	-	127	5,000	-	-	4,600	9,854
Loans and advances	29	-	-	-	1,011	-	-	-	1,040
Instalment sale receivable	-	-	2,457	-	12,286	9,403	-	-	24,146
Other assets	271	64	-	1,257	4,292	-	-	-	5,884
Total assets	**16,563**	**684**	**3,550**	**5,746**	**57,616**	**17,936**	**-**	**4,600**	**106,695**
Liabilities									
Deposits from customers	14,943	39	25	75	11,578	-	-	-	26,660
Securities sold under repurchase agreements	817	-	-	-	-	-	-	-	817
Financial liabilities held for trading	1,735	-	-	-	-	-	-	-	1,735
Revolving loan facility	3,748	4,000	4,000	-	-	-	-	-	11,748
Other liabilities	331	-	66	1,171	256	3,366	-	-	5,190
Subordinated loan	-	-	-	1,229	10,000	-	-	-	11,229
Total liabilities	**21,574**	**4,039**	**4,091**	**2,475**	**21,834**	**3,366**	**-**	**-**	**57,379**
Net liquidity gap	**(5,011)**	**(3,355)**	**(541)**	**3,271**	**35,782**	**14,570**	**-**	**4,600**	

30 FINANCIAL RISK MANAGEMENT (CONTINUED)

The Bank's net liquidity position is summarised as follows:

	2009 US$000	2008 US$000
Detail		
Inter-bank placements and cash	3,425	3,688
Trading securities	1,885	726
Other liquid bonds	-	10,065
Derivative financial instruments	-	849
Total liquid assets	5,310	15,328
Customer deposits maturing within 12 months	(7,322)	(15,082)
Repos on other bonds	-	(817)
Derivative financial instruments	-	(1,735)
Revolving loan facility	(2,073)	(11,748)
Subordinated loan	(1,238)	(1,229)
Total liquid liabilities	(10,633)	(30,611)
Net liquid position	(5,323)	(15,283)

Following the reschedulement of both the revolving loan and the quasi government term deposit (Note 12 and Note 14, respectively), the Group's net liquidity saving for 2010, on account of postponed repayments, amounts to US$ 15.6 million.

Private equity risk

BMB invests in private equity with the intent of later sale of these investments at a profit to third parties, either through a sale to another business ("trade sale") or an initial public offering ("IPO"). Private equity risk is the risk that the Bank will not be able to sell its investments at a profit within the intended time period. This risk arises from three factors. The first relates to the specific investment itself: that it does not develop a sustainable business or its line of business is not attractive to other investors. The second factor relates to macro trends in markets for IPO's and mergers and acquisition activity. The state of these markets affects both the price and timing of any "exit" from an investment. Third, as these investments typically are realised over the medium term and are not traded on organised exchanges, they have limited liquidity.

BMB uses the Standardised Approach under the Basel Framework for measuring and managing its private equity risk, which is considered a part of its "Banking Book".

The Bank manages risks at the specific investment level in the following ways. Firstly, it invests primarily in independently managed third party funds whose managers have a demonstrated successful track record. Based on its own experience and analysis of the private equity industry, BMB believes that the quality of the fund manager is a key risk mitigant. Secondly, the Bank seeks to diversify its investments across fund managers, different stages in the investment cycle (various stages of venture capital, buy-out, etc.), geographical locations and industries. The goal is to reduce exposure to any one investment. At 31 December 2009, the Bank has effectively invested in over 340 companies.

30 FINANCIAL RISK MANAGEMENT (CONTINUED)

Trends in macro economic events and their effects on the IPO and trade sale market are largely out of the control of the Bank. BMB seeks to mitigate its exposure to these risks by selecting managers who have demonstrated a solid track record over the entire economic cycle and by diversification of investments. Diversification is also the key tool for dealing with the inherent limited liquidity of this asset class. In addition, from time to time, the Bank approaches leading investment banks to determine realistic market opportunities for the securitisation of private equity assets.

As a result of a recent review, the Bank has decided to focus on private equity fund investment and minimize direct private equity investments. Refer to also Note 6.

Operating and legal risk

Operating risk is the risk of loss arising from errors that can be made in instructing payments or settling transactions, breakdown in technology and internal control systems.

In 2008, BMB started to use the Basic Indicator Approach under the Basel II Framework for measuring and managing its operating risk.

Currently, the Bank conducts its business from a single location. BMB is an investment bank and does not operate a retail or commercial banking franchise. Accordingly, the number of client relationships and volume of transactions at BMB are lower than at such institutions. The nature of transactions differ as well, given the Bank's focus on investment in unlisted private equities for its own and its clients' account. These factors mitigate to some extent the operational risks to which the Bank is exposed, both in terms of volumes of transactions and the liquidity of the assets underlying these transactions (e.g. the Bank does not offer cash deposit/withdrawal services, ATMs, credit cards, etc.).

BMB operations are conducted according to well-defined procedures. These procedures include a comprehensive system of internal controls, including segregation of duties and other internal checks, which are designed to prevent either inadvertent staff errors or malfeasance prior to the release of a transaction.

The Bank also engages in subsequent monitoring of accounting records, periodic reconciliation of cash and securities accounts and other checks to enable it detect any erroneous or improper transactions which may have occurred.

Legal risk includes the risk of non-compliance with applicable laws or regulations, the illegality or unenforceability of counterparty obligations under contracts and additional unintended exposure or liability resulting from the failure to structure transactions or contracts properly. Legal risks are mitigated through legal counsel review of transactions and documentation, as appropriate. Where possible, the Bank uses standard formats for transaction documentation.

To protect BMB from involvement in money laundering or terrorist finance activities, the Bank has designed and implemented a comprehensive set of policies and procedures. Adherence to the Bank's policies and procedures is reinforced through periodic staff training and internal and external reviews, as well as internal and external review by auditors.

To further mitigate operational and legal risks, the Bank purchases a variety of insurance.

31 CAPITAL MANAGEMENT

The primary purpose of the Bank's capital management is to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value.

To manage its capital, BMB employs a risk adjusted measure of capital adequacy (a Capital Adequacy Ratio or "CAR") based on the local regulatory implementation of the Basel Committee on Banking Supervision's capital adequacy guidelines. During 2008, BMB used the standards in the Basel II Framework and for the year 2007 and prior, used the Basel 1988 Accord and 1996 Amendment for Market Risks.

31 **CAPITAL MANAGEMENT (CONTINUED)**

The BMB Group manages its capital:

1) to comply at all times with the Capital Adequacy Ratio set by the Group's regulator, the Central Bank of Bahrain
2) to ensure that the Bank has sufficient capital to enable it to absorb diminutions in the value of its assets or unexpected losses while continuing to function as a "going concern"
3) to maintain a sound capital base that allows the Bank to take advantage of opportunities to develop and grow its business

The Group's executive management monitors the Bank's capital adequacy on a daily basis using the CAR. Reports on the Bank's capital adequacy are filed quarterly with the Central Bank of Bahrain.

In determining its Capital Adequacy Ratio, the Bank calculates risk adjusted assets which are then divided by regulatory capital rather than the equity capital appearing in the Bank's balance sheet.

Regulatory equity capital is composed of three elements:

Tier 1 Capital is the nominal value of paid in capital, audited retained earnings and accumulated reserves arising from the appropriation of current and past years' income and/or retained earnings less any treasury stock, minority interests or negative fair value reserves. Local regulations require that certain investments or exposures be deducted from Tier 1 capital. As at 31 December 2009 and 31 December 2008, BMB did not have any exposures or investments requiring such deductions.

Tier 2 Capital consists of the qualifying portion of subordinated loan and unrealised gains arising on fair valuation. Under Central Bank of Bahrain regulations, the aggregate amount of Tier 2 capital eligible for inclusion in the CAR is limited to no more than 100% of Tier 1 Capital.

Effective 1 January 2008 the Bank implemented Basel II Framework as per the CBB regulation. Using the Basel II Standardised Approaches for credit and market risk and the Basic Indicator Approach for operational risk, BMB's Basel II Capital Adequacy Ratio as 31 December 2009 stood at 14.9% as compared to 22.8% as at 31 December 2008.

31 CAPITAL MANAGEMENT (CONTINUED)

Capital base and risk weighted assets

	At year-end 2009 US$000	At year-end 2008 US$000
Tier 1 capital		
Share capital	54,955	54,955
Legal reserves	16,310	16,310
General and other reserves	7,521	7,521
Retained earnings	(64,870)	(30,110)
Revaluation (loss) reserves – available-for-sale investments	-	(5,698)
Total qualifying Tier 1 capital	13,916	42,978
Tier 2 capital		
Revaluation reserves – available-for-sale investments	4,386	-
Subordinated loan	4,000	6,000
Total qualifying Tier 2 capital	8,386	6,000
Total regulatory capital	22,302	48,978
Risk weighted assets		
On-balance sheet	125,222	155,085
Off-balance sheet	24,077	59,577
Total risk weighted assets	149,299	214,662
Capital Adequacy Ratio	14.9%	22.8%

Further to the CAR requirement as set out above, in 2009 the Central Bank of Bahrain instructed the Bank to increase its capital to US$ 100 million by 31 December 2009. This requirement has not been met at 31 December 2009, and the Bank is currently planning to meet this requirement by 31 December 2010.

32 OFF-BALANCE SHEET ITEMS

Credit-related financial instruments include commitments to extend credit and to participate in investments, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Bank's customers.

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed dates or other termination clauses and require the payment of a fee. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

Standby letters of credit, guarantees and acceptances commit the Bank to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

Undrawn investment commitments comprise contractual commitments to investments made in other equities and funds. These amounts are called by fund managers, generally for a period of between four and six years. Undrawn investment commitments also include commitments to quoted equities where the settlement date is after the balance sheet date.

32 OFF-BALANCE SHEET ITEMS (CONTINUED)

The outstanding off-balance sheet items at 31 December were as follows:

	2009 US$000	2008 US$ 000
Undrawn investment commitments in other equities and funds (Note 6)	35,277	77,713
Undrawn loan commitments	900	900
Funds under management	29,418	35,721
Discretionary accounts	91,808	93,266

Undrawn investment commitments in other equities and funds include US$ 12.1 million (31 December 2008: US$ 19 million), which the Bank has sold to clients and for which it has received binding commitments from them, the majority of which are secured by deposits with the Bank.

BMB Technology and Telecommunications Investment Company was the only fund under management as at 31 December 2009. Discretionary accounts include funds managed on behalf of customers pertaining to sub-participation in other private equity funds, unquoted equities and other debt instruments.

33 FAIR VALUE OF FINANCIAL INSTRUMENTS

The table below compares the estimated fair values of on-balance and off-balance sheet financial instruments with their respective book amounts as of 31 December 2009 and 2008. As set out in Note 2 to the financial statements, certain of the Bank's financial instruments are accounted for under the historical cost convention as modified by the revaluation of available-for-sale financial assets, all derivative contracts and financial assets and financial liabilities held for trading which may differ from the fair value for which the asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Consequently differences can arise between the book amounts and the fair value estimates.

2009	Book amount US$000	Fair value US$000	Over/(under) book amount US$000
Assets			
Held-to-maturity investment security	4,624	3,437	(1,187)
Loans and advances	872	872	-
Instalment sale receivable	15,682	15,682	-
Net shortfall of fair value over book amount			(1,187)

2008	Book amount US$000	Fair value US$000	Over/(under) book amount US$000
Assets			
Held-to-maturity investment security	9,537	6,761	(2,766)
Loans and advances	901	901	-
Instalment sale receivable	17,299	17,299	-
Net shortfall of fair value over book amount			(2,766)

33 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The total shortfall in fair value of US$ 1,187,000 (2008: US$ 2,766,000) is not relevant except in a forced sale situation since the Bank has the intention to hold these Held-to-maturity investment securities until maturity when it would recover full nominal amounts. However, in the event these held to maturity investment securities are sold, the impact on the income statement and equity would be US$1,187,000.

The total fair value of Held-to-maturity investment security is based on quoted market prices at the balance sheet date.

The fair value of loans and advances, is based on amounts estimated to be received upon maturity.

The fair value of the instalment sale receivable is shown at cost, which approximates the value calculated using the discounted cash flow method.

No fair value adjustment is appropriate for off-balance sheet financial instruments with contractual amounts representing credit risk as specific provisions are made in respect of individual transactions where a potential loss, if any, has been identified.

The estimated fair value of the following assets and liabilities is not significantly different from the corresponding book amounts as the items are short term in nature:

- Cash and short term funds
- Other assets
- Deposits from customers
- Securities sold under repurchase agreements
- Other liabilities

The estimate fair values of the revolving loan facility and subordinated loan are not significantly different from book amounts as these liabilities are primarily repriced on a quarterly basis.

Fair value hierarchy

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, unobservable inputs reflect the Group's market assumptions. These two types of inputs have created the following fair value hierarchy:

Level 1- Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – Valuation techniques based on observable inputs, either directly or indirectly. This category includes instruments valued using quoted market prices in active market for similar instruments, quoted prices for identical or similar instruments in markets that are considered less than active, or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3 – Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation.

This hierarchy requires the use of observable market data when available. The Group considers relevant and observable market prices in its valuations where possible.

33 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The table below analyses financial instruments measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised

	Level 1	Level 2	Level 3	Total
31 December 2009				
Trading securities				
- Trading equities and funds	1,885	-	-	1,885
- Debt securities	-	-	-	-
- Trading derivatives	-	-	-	-
Available-for-sale investment securities				
- Unquoted equity fund investments at fair value	-	-	44,421	44,421
- Unquoted equity investments at fair value	-	-	427	427
Total Assets	1,885	-	44,848	46,733
Financial liabilities held for trading	-	-	-	-
Total Liabilities	-	-	-	-

	Level 1	Level 2	Level 3	Total
31 December 2008				
Trading securities				
- Trading equities and funds	726	-	-	726
- Debt securities	10,685	-	-	10,685
- Trading derivatives	849	-	-	849
Available-for-sale investment securities				
- Unquoted equity fund investments at fair value	-	-	44,639	44,639
- Unquoted equity investments at fair value	-	-	3,659	3,659
Total Assets	12,260	-	48,298	60,558
Financial liabilities held for trading	1,735	-	-	1,735
Total Liabilities	1,735	-	-	1,735

Refer Note 6 for the movements on the Bank's investments categorised as Level 3. During 2008 and 2009, there were no transfers within the fair value hierarchy levels.

34 SEGMENT INFORMATION

The Group's business segments are broken down by key business activities and those with clearly identifiable revenue streams and expenses. These include "Trading", "Investments" and "Other". The segmentation is in line with that internally reported to the Chief Operating decision maker, the Chief Executive Officer, and IFRS 8 Segmental Reporting.

(a) Business Segments

The Group's main business activities can be broadly broken down into trading, investment activity which is mainly made up of its investments in Private Equity Funds, and other operations.

Segment	Activity
Trading	Investments in listed equities and funds and other derivative instruments
Investment	Investments Private Equity, both fund and direct and bonds.
Other operations	Investor marketing, building rental income etc

34 SEGMENT INFORMATION (CONTINUED)

	Trading activity US$000	Investing activity US$000	Other operations US$000	Total US$000
2009				
Loss from investments	(71)	(7,905)	-	(7,976)
Foreign exchange translation income	1,841	-	-	1,841
Fees and commission income	-	-	308	308
Other income	-	-	68	68
Net interest (expense)/income	3	(651)	-	(648)
Total income/(loss) from Operations	1,773	(8,556)	376	(6,407)
Impairment provisions	(564)	(17,379)	-	(17,943)
General and administrative expenses	(1,744)	(5,689)	(1,753)	(9,186)
Operating loss	(535)	(31,624)	(1,377)	(33,536)
Taxation	-	-	-	-
Net (loss)/income for the year	(535)	(31,624)	(1,377)	(33,536)
OTHER INFORMATION				
Segment assets	1,885	72,579	1,406	75,870
CONSOLIDATED TOTAL ASSETS	1,885	72,579	1,406	75,870
Segment liabilities	-	45,525	6,684	52,209
TOTAL LIABILITIES			6,684	
Shareholders' equity				23,661
CONSOLIDATED TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY				75,870

34 **SEGMENT INFORMATION (CONTINUED)**

2008	Trading activity US$000	Investing Activity US$000	Other operations US$000	Total US$000
Income/(loss) from investments	(2,552)	5,301	-	2,749
Foreign exchange (loss)	(1,569)	-	-	(1,569)
Fees and commission income	-	-	841	841
Other (loss)	-	-	(62)	(106)
Net interest (expense)/income	30	(1,105)	-	(1,075)
Total income/(loss) from operations	(4,091)	4,196	779	840
Impairment provisions	-	(4,003)	-	(4,003)
General and administrative expenses	(3,973)	(2,610)	(4,479)	(11,062)
Total operating expenses	(3,973)	(6,613)	(4,479)	(15,065)
Net (loss)/income from operations	(8,064)	(2,417)	(3,700)	(14,225)
Net income from assets sold	-	10	-	10
Net (loss)/income before taxation	(8,064)	(2,407)	(3,700)	(14,215)
Taxation	-	(98)	-	(98)
Net (loss)/income for the year	(8,064)	(2,505)	(3,700)	(14,313)
OTHER INFORMATION				
Segment assets	12,260	86,448	1,785	100,493
CONSOLIDATED TOTAL ASSETS	12,260	86,448	1,785	100,493
Segment liabilities	1,735	48,910	6,870	57,515
TOTAL LIABILITIES			6,870	
Shareholders' equity				42,978
CONSOLIDATED TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY				100,493

34 SEGMENT INFORMATION (CONTINUED)

(b) **Geographical Segments**

	North America		Europe		Rest of the World		Total	
	2009	2008	2009	2008	2009	2008	2009	2008
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Income								
Total operating income	(1,978)	1,599	(5,262)	(4,669)	833	3,910	(6,407)	840
Assets								
Total assets	22,142	37,508	29,795	29,436	23,933	33,549	75,870	100,493

Although the Group's two main business segments are managed on a worldwide basis, they operate in two main geographical areas. The Group's exposure to credit risk is concentrated in these areas:

North America - United States of America and Canada
Europe - Primarily Western Europe

35 POST BALANCE SHEET EVENT

On the 14 January 2010, the Bank concluded a rescheduling agreement with the Central Bank of Bahrain with respect to the revolving loan facility. As part of the amendment, the facility was extended up to December 2011. The new repayment schedule is given under Note 14.

36 RECLASSIFICATIONS

During the current year the Group has reclassified certain items in the financial statements to improve presentation. Such reclassifications do not have any impact on net equity or profit or loss of the Group in prior years.

BMB Investment Bank

Annexure to 2009 Annual Financial Statements

Basel II - Pillar 3 Disclosures

Table of Contents

1. INTRODUCTION

This Annexure contains the BMB Group's Basel II Pillar 3 disclosures for the Fiscal Year ended 31 December 2009 in conformity with the requirements of the Central Bank of Bahrain's Rulebook Number 1- Module PD as well as certain other additional information which the Bank believes will be useful to readers in interpreting this material and in understanding BMB's approach to risk management. The disclosures are part of Basel II Pillar 3 and are based on paragraphs 820 through to 826 of the Basel Committee on Banking Supervision's ("BCBS") "International Convergence of Capital Measurement and Capital Standards" (June 2006 edition) (the "Basel II Framework"). The Central Bank of Bahrain's disclosure requirements as set out in Module PD and are available at www.cbb.gov.bh and the BCBS's Basel II Framework is available at www.bis.org.

This document discusses BMB's risk management strategies, processes, structures, mitigation strategies and their effectiveness. Risks covered include those related to Basel II Pillar 1 (credit risk, market risk, and operational risks) and to Pillar 2 risks (Interest Rate Risk in the Banking Book (IRRBB), liquidity risk, legal, and all other residual risks). The Bank considers this Annexure and the information it contains a critical part of its efforts in fostering transparency and disclosure of the performance and condition of the Bank to stakeholders.

The disclosures in this Annexure supplement the disclosures within the Bank's 2009 Annual Report ("accompanying financial statements"). Where information has been disclosed in the 2009 Annual Report, that information is cross referenced here and only supplemental information is presented in this Annexure. For completeness this Annexure must be read together with the accompanying financial statements. The Bank's previous Basel II Pillar 3 disclosure was for the half-year ending 30 June 2009 and is available at its website, www.bmb.com.bh.

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2. SCOPE OF APPLICATION

2.1 Legal Entity

The name of the top corporate entity in the group to which this disclosure applies is Bahrain Middle East Bank, BSC ("BMB"). The Note 1 to the accompanying 2009 Annual Report provides detailed information on the history, formation, corporate and legal status, banking license and stock listing of the Bank, including detailed information on the organizational structure, lines of business and corporate governance which are contained in the Management Discussion and Analysis section of the report.

2.2 Consolidation

A list of the Bank's subsidiaries is provided in Note 28 to the 2009 Annual Report. With the exception of BMB Property Services ("BMBPS"), which is an operating company involved in property management and T&T Beverages, which is in liquidation, all of the Bank's other subsidiaries are passive investment holding companies. BMB Group subsidiaries do not engage in banking or other regulated financial services. As such, they are therefore not subject to bank or other financial supervision or regulation independent of that to which the Bank is subject by virtue of its license.

All of BMB's subsidiaries are fully consolidated in the preparation of the Bank's financial statements as described in Note 2 "Preparation of Financial Statements" and "Basis of Consolidation" in the accompanying financial statements. There is no material difference between the basis of consolidation used for financial statement and regulatory purposes, except for the calculation of the regulatory Capital Adequacy Ratio ("CAR") where certain elements of equity are assigned to different capital tiers and assets are risk-weighted using certain risk factors as specified in the Basel II Framework and further described in Note 31 of the accompanying financial statements.

2.3 Restrictions or Other Impediments on Transfer of Funds or Regulatory Capital

As none of the Bank's subsidiaries are regulated financial institutions, there is no regulatory impediment to the transfer of retained earnings to the Bank. However, as separate legally incorporated entities, the transfer of paid in capital and mandatory reserves would require shareholder action. As the sole shareholder (either direct or indirect) in these entities, the Bank has the power to undertake the legal processes for the transfer of such capital. None of the Bank's subsidiaries are registered and domiciled in jurisdictions which impose exchange controls or other restrictions on the cross border transfer of funds.

2.4 Aggregate Regulatory Surplus Capital of Insurance Subsidiaries

BMB does not have any subsidiary engaged in the insurance business.

2.5 Aggregate Regulatory and Other Capital Deficiencies and Deductions

Since none of the Bank's subsidiaries are regulated financial institutions, they are not subject to standalone capital requirements in excess of their paid in capital. On a legal and accounting basis none of the Bank's subsidiaries has a deficit in its legal or accounting capital, except for T&T Beverages, which is in liquidation. For the purposes of the Bank's implementation of Basel II under CBB regulations, none of the capital of any of the Group's subsidiaries is required to be deducted from regulatory capital.

3. CAPITAL STRUCTURE

3.1 Capital Instruments

All of the Bank's equity capital consists of one class of common equity. Note 17 to the 2009 Annual Report provides full details on the aggregate value of common equity shares, the number of shares outstanding, and par value. The Bank has not issued any innovative, complex or hybrid capital instruments in the year under review, nor does it have any such capital instruments outstanding.

3.2 Tier 1 Capital

Tier 1 Capital is the nominal value of paid in capital, audited retained earnings and accumulated reserves arising from the appropriation of current and past years' income and/or retained earnings less any treasury stock, minority interests, or negative fair value reserves. Local regulations require that certain investments or exposures be deducted from Tier 1 capital. The aggregate amount of Tier 1 Capital as at 31 December 2009 was US$ 13.9 million. An analysis of the components of Tier 1 Capital is provided below.

3.3 Tier 2 Capital

Tier 2 Capital consists of the qualifying portion of subordinated loans and unrealised gains arising on changes in the fair value of assets and liabilities. Under Central Bank of Bahrain regulations, the aggregate amount of Tier 2 Capital eligible for inclusion in the CAR is limited to no more than 100% of Tier 1 Capital. The aggregate amount of Tier 2 Capital as at 31 December 2009 was US$ 8.4 million. An analysis of the components of Tier 2 Capital is provided in Note 31 to the accompanying financial statements.

3.4 Tier 3 Capital

The Bank had no Tier 3 Capital as at 31 December 2009.

3.5 Deductions from Regulatory Capital

As at 31 December 2009, there were no deductions from eligible Tier 1 Capital. Since BMB uses the Standardised Approach for both Credit and Market Risk, there are no IRB model based deductions.

3.6 Total Eligible Capital

As at 31 December 2009, the aggregate amount of regulatory Capital (Tier 1, Tier 2 and Tier 3) was US$ 22.3 million. Note 31 to the 2009 accompanying financial statements provide details of the year-end amount for 2009.

Table 1: Capital Requirements

	Average for the year 2009 US$000	At year-end 2009 US$000	Average for the year 2008 US$000	At year-end 2008 US$000
Tier 1 capital				
Share capital	54,955	54,955	54,955	54,955
Legal reserves	16,310	16,310	16,310	16,310
General and other reserves	7,521	7,521	7,521	7,521
Retained earnings	(52,003)	(64,870)	(21,459)	(30,110)
Revaluation (loss) reserves – available-for-sale investments	(147)	-	-	(5,698)
Total qualifying Tier 1 capital	26,636	13,916	57,327	42,978
Tier 2 capital				
Revaluation reserves – available-for-sale investments	-	4,386	1,467	-
Subordinated loan	4,754	4,000	-	6,000
Total qualifying Tier 2 capital	4,7545	8,386	1,467	6,000
Total regulatory capital	31,390	22,302	58,794	48,978
Risk weighted assets				
On-balance sheet	132,295	125,222	215,517	155,085
Off-balance sheet	49,570	24,077	33,659	59,577
Total risk weighted assets	181,865	149,299	249,176	214,662
Capital Adequacy Ratio	17.3%	14.9%	23.6%	22.8%

4. RISK MANAGEMENT AT BMB

4.1 Role of the Board

Risk management at BMB begins at the Board of Directors level. The Board of Directors exercises oversight and final approval of the risk management process at BMB. The Board operates through two Committees, the Executive Committee and the Audit Committee. In terms of the Bank's Risk Charter, the Board Executive Committee is the highest authority responsible for evaluating and proposing business and risk strategies, plans and policies of the Bank to the Board. Based on the recommendations of the Executive Committee, the Board of Directors approves the aggregate levels of risk the Bank can assume, as well as reviewing and approving the Bank's risk management policies, risk limits and risk control framework.

4.2 Risk and Governance

The Bank believes that corporate governance plays a critical role in risk management. In view of this, the Bank subscribes to corporate governance best practices as prescribed by Basel Committee on Banking Supervision in its publication "Enhancing Corporate Governance for Banking Organizations". These include:

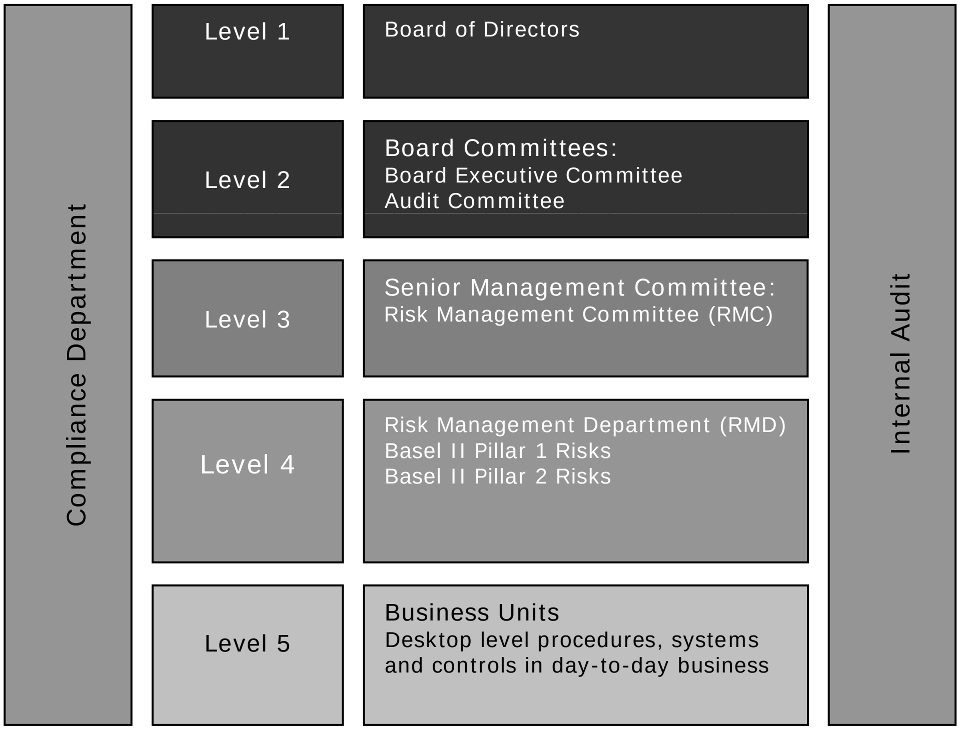
- Establishing strategic objectives and a set of corporate values that are communicated throughout the Bank,
- Setting and enforcing clear lines of responsibility and accountability throughout the organisation,
- Ensuring that the Board members are qualified for their positions, have a clear understanding of their role in corporate governance and are not subject to undue influence from management or outside concerns,
- Ensuring that there is appropriate oversight by the Board of Directors and senior management,
- Effectively utilising the work conducted by internal and external auditors, in recognition of the important control function they provide,
- Ensuring that compensation policy and systems are consistent with the Bank's ethical values, objectives, strategy and control environment, and
- Conducting corporate governance in a transparent manner.

4.3 Risk Management Framework

At BMB, the risk management framework is based on an appropriately robust risk governance structure, comprising:

- Establishment of an effective corporate governance framework with clearly documented Board, Senior Management and Committee responsibilities and where applicable, delegated authorities for risk management oversight,
- Detailed Basel II compliant risk management policies, including a clearly articulated Capital Management Policy and Capital Adequacy Assessment Plan (CAAP) which allows the Bank to evaluate risks against regulatory and economic capital requirements,
- Clearly documented risk management policies and procedures for the identification, measurement and control of risks,
- Robust operating policies and procedures, including those for specific allocation of risk limits to individual obligors and/or transactions,
- Criteria for risk acceptance based on risk and return as well as other factors,
- Clearly defined trading limits, counterparty limits, product limits, risk exposure limits and geographic limits,
- The use of quantitative models and qualitative approaches to assess and manage risks,
- Portfolio diversification and, where possible, other risk mitigation techniques,
- Ongoing review of exposures and risks by an independent department, including stress testing and frequent reporting,
- A Risk Management Committee, composed of key members of senior management, charged with the authorization and approval of certain activities and transactions,
- An independent professionally-staffed Risk Management Department responsible for day to day management of risks in the Bank,
- An independent professionally-competent Compliance Department responsible for managing the Bank's compliance and regulatory risks, and
- Periodic internal audits of the control environment by Internal Audit.

Figure 1.0: Risk and Governance Framework



4.4 Board Executive Committee

The Board Executive Committee (EXCO) is composed of three Board members and the Bank's Chief Executive Officer in a non-voting role and the committee is responsible for ensuring adequate Board risk management oversight. BMB's EXCO plays an integral part in the risk management and governance processes. The Committee is responsible for reviewing and approving risk management policies, procedures, limits and systems as recommended by the Risk Management Committee (RMC). In addition the Committee acts a Board level Credit Committee when approving credit facilities. Further to the above the EXCO also acts as the Bank's Nomination and Remuneration Committee to ensure that the Board has the right balance of skills, experience and diversity and that compensation of the Board and the Bank staff is consistent with the Bank's goals and objectives.

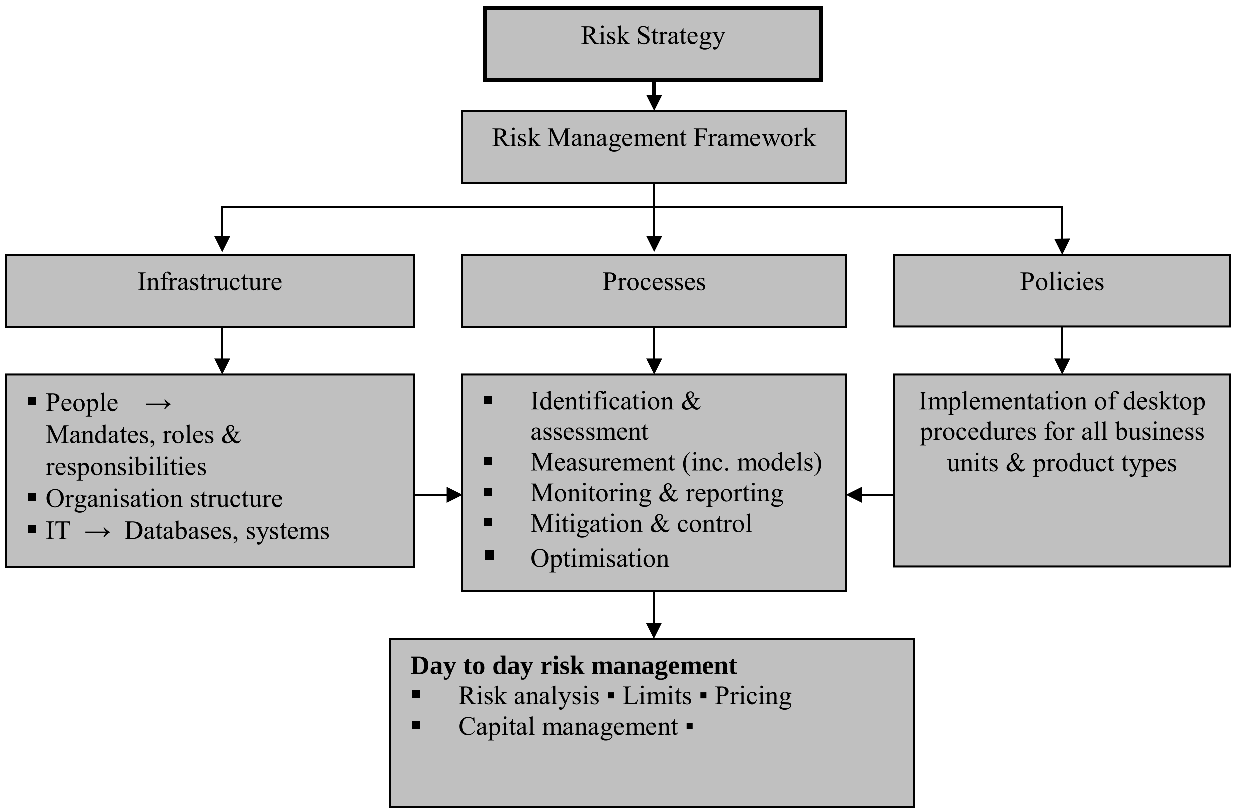
4.5 Board Audit Committee

The Audit Committee is composed of three Board members and is primarily responsible for ensuring the integrity of the Bank's financial reporting process, oversight of the internal audit function, monitoring compliance with the Bank's Code of Ethics and Code of Conduct, oversight of the Bank's Compliance Department and monitoring compliance with the Bank's Insider Trading Policy among other duties. The Committee is also responsible for reviewing and approving the Bank's policies and for ongoing oversight of the integrity of the internal control environment at BMB.

4.6 Risk Management Committee

The RMC is composed of the Bank's Chief Executive Officer as the Chairman, members of senior management including the Head of Risk Management, the Group Financial Controller, the Head of Treasury, the Head of Investment and the Head of Investor Marketing. The Committee is responsible for ensuring senior management oversight of risk management activities including the identification, assessment, monitoring and control of risk, recommending limits to the Board, reviewing policies and procedures, oversight of asset and liability management and approval of proposed investments. In this capacity, the Committee serves as the Bank's Credit Committee, Asset/Liability Management Committee (ALCO), and Investment Approval Committee. On an ongoing basis, the RMC monitors the environment in which the Bank operates and the risks to which it is exposed and recommends to the Board adjustments in the Bank's strategy or business, as appropriate.

Figure 2.0: Risk Management Framework



4.7 Risk Management Department

BMB's Risk Management Department ("RMD") is headed by a Head of Risk Management who reports to the Chief Executive Officer and whose appointment is approved by EXCO and the CBB in line with the requirements of CBB's Rulebook no. 1- Module HC. The Head of Risk Management Department is a non-voting member of the Bank's RMC. As a department completely independent of and separate from the Bank's lines of business, RMD plays a key role in the Bank's risk management processes. RMD is responsible for implementing the Bank's risk management framework, policies, procedures, monitoring limit usage, the identification, assessment, control and mitigation of risk. RMD also manages problem or past-due assets. In identifying and monitoring risk exposures, BMB uses a variety of quantitative tools as well as qualitative approaches to measure risks at the "macro" level. The Bank believes that judiciously balancing the use of these two approaches provides a more robust risk control regime rather than relying on just a single approach.

4.8 Compliance Risks and Anti-Money Laundering

The Bank has an independent Compliance Department, headed by a Head of Compliance who is responsible for managing compliance, regulatory and anti-money laundering risks. The Compliance Department in its functions, works closely with and under the oversight of the Board Audit Committee. The Bank's Compliance Charter sets forth the objectives, roles and responsibilities of the Compliance Department. Further to the above the Head of Compliance Department also acts as the Bank's Money Laundering Reporting Officer ("MLRO") in line with CBB regulations.

4.9 Internal Audit and Independent Review

The Bank's Internal Audit function, which is independent of both operations and business units, is charged with maintaining the integrity of the internal control environment through conducting risk-based internal audits. In line with international best practice, Internal Audit reports administratively to the Chief Executive and functionally to the Board Audit Committee. The Department operates under a formal Charter which documents its goals, its role, responsibility and rights within the Bank. With the concurrence of the CBB, BMB has outsourced its Internal Audit function to an international accounting firm.

4.10 Financial Risk Management

In the normal course of its business, the Bank is exposed to various financial risks, related to the nature of the activities in which it engages and these risks include:

- Private equity investment risk
- Market risk
- Credit risk
- Interest rate risk
- Currency risk
- Liquidity risk

Risk limits are at the heart of risk management processes at BMB. BMB's Risk Management Committee and Board Executive Committee (EXCO) are actively involved in the establishment of trading and exposure risk limits. RMD is responsible for monitoring usage of limits. In managing credit, investment and market currency, liquidity and interest rate risks the Bank relies on a framework of limits which includes; stop loss limits, geographic limits, country limits, trading limits, settlement risk limits, futures contract limits, tenor limits, single-stock exposure limits and counterparty limits. The limits serve the following purposes:

4.10.1 Loss Limits

Stop loss limits at BMB are used to limit losses on trading portfolios composed of financial instruments including equities and futures positions. Stop loss limits are triggered initially by deviations in market price from original cost. Thereafter, the limits are triggered by deviations from market price as a way of protecting profits.

4.10.2 Geographic and Country Limits

Geographic and Country limits are designed to limit exposures to certain geographical and geo-economic zones.

4.10.3 Trading Limits

Trading limits are designed to limit the Bank's exposure to asset classes and instruments as well as the quantum of exposure to individual obligors or issuers in its trading portfolio. These are implemented and monitored based on cost and are complemented with stop loss limits.

4.10.4 Futures and Options Contract Limits

Futures and options contract limits are used to limit the size of the futures trading portfolio and effectively the Bank's market risk appetite. Contract limits effectively limit the quantum of potential exposure arising from the underlying asset's price movement.

4.10.5 Tenor Limits

Tenor limits are used to manage maturity related risks within the fixed income portfolio. Tenor limits also assist in limiting liquidity risks arising from long maturity instruments.

4.10.6 Stock Limits

Single stock limits are used to limit trading equity risk exposure to a single stock and are designed to ensure diversification of equity specific risk within the Bank's portfolio.

4.10.7 Counterparty Limits

Counterparty limits are used to limit credit exposure to a single counterparty arising from placement activities, foreign exchange trading and associated settlement risks.

4.10.8 Macro Risk Controls

In addition to the above-mentioned risk management limits, further risk management discipline is maintained by the following risk controls maintained at a "macro" level which require that the Bank:

(a) Maintain its actual Capital Adequacy Ratio above both its internal target as well as CBB minimum requirements,
(b) Consider the impact on the Bank's liquidity position of any major transaction(s) or new business initiative, and
(c) Comply with its own internal risk management policies as well as CBB regulatory requirements.

4.11 Risk Management Policies

The cornerstone of the Bank's risk control framework and the heart of its Basel II policies is its Risk Charter which sets forth the overall risk management framework at BMB and guiding principles on which all risk management activities at BMB are based. The Charter is accompanied by a detailed set of policies which articulate the processes and policies for the identification, measurement, control, specification of the types and nature of limits to be utilised, reporting of various risks, including where applicable stress testing and the use of models as follows:

(a) Credit Risk Policy for all aspects of credit risk including counterparty and country risk,
(b) Investment Risk Policy for all aspects of the Bank's Banking Book investment activity, including private equity, debt securities, etc,
(c) Market Risk Policy for all aspects of market risk inherent in the Bank's Trading Book, including a system of nominal transaction and model specifications,
(d) Operational Risk Policy for all aspects of operational risk in the Bank, including the establishment of Key Risk Indicators, limits and thresholds, Risk and Control Self Assessments (RCSA's) and operational loss risk reporting, and
(e) Asset and Liability Management Policy for managing on a global basis the Bank's liquidity and interest rate risks in both its Banking and Trading Books.

Completing the policy architecture is the Bank's Capital Management Policy which establishes the Bank's policies, procedures and methodology for managing its capital on both a regulatory and economic basis. With respect to the latter, this Policy sets forth the Bank's Capital Adequacy Assessment Process ("CAAP"). The first stage of the CAAP is the development of a five-year strategic plan detailing the Bank's projected economic scenarios, financial performance, income statement and balance sheet. This is followed by the allocation of capital to the Bank's lines of businesses, specific products and risks which include both Pillar I and Pillar 2 risks. The third stage is the assessment on an ongoing and forward-looking basis of the Bank's Capital Adequacy. This stage includes a formal system with targets and trigger levels for Pre-emptive Corrective Action (PCA) in the event of deviations in the Bank's ratio.

5. CAPITAL MANAGEMENT FRAMEWORK

Under the CBB's capital adequacy guidelines, credit, market and operational risks are translated into total risk weighted assets using a variety of scaling factors against nominal amounts or other risk measures. Then a similar process is applied to the Bank's capital under which the various elements of capital are assigned to different capital tiers as outlined above and a total regulatory capital amount determined. The Capital Adequacy Ratio ("CAR") is calculated by dividing total risk weighted assets by total regulatory capital resulting in a risk adjusted measure of Capital Adequacy.

5.1 Basel II Methodologies

In implementing the above mentioned CBB directive, BMB uses the Standardised Approach for allocating credit and market risk capital and the Basic Indicator Approach (BIA) for Operational Risks. As the Bank has no operating branches outside the Kingdom of Bahrain, it is subject only to the capital requirements of the CBB, which currently requires all financial institutions in Bahrain to maintain a minimum 12.0% CAR on a consolidated basis.

Table 3: Basel II Methodologies

Pillar 1 Risk	Basel II Methodology
Credit Risk	Standardised Approach
Market Risk	Standardised Approach
Operational Risk	Basic Indicator Approach

5.2 Internal Capital Adequacy Assessment Plan ("CAAP")

The Second Pillar of Basel II, Supervisory Review Process (SRP), requires Banks to have an internal process for calibrating risks and Capital Adequacy. The SRP is principally designed to ensure that Banks have adequate capital resources. In early 2008, the CBB issued a draft guideline to Banks, providing guidance in developing and implementing a Capital Adequacy assessment processes as part of the SRP. In line with the guideline the Bank developed a Capital Management Policy which establishes the framework for the CAAP. The Capital Management Policy was approved by the Board and provides for the documentation of the Bank's internal capital adequacy assessment framework, based on the Bank's five-year strategic plan. The Bank's Capital Management Policy in line with CBB guidance, is designed to achieve the following objectives:

1. Allocate capital to each of the Bank's business units and products on a risk adjusted basis, including a methodology for assessing risk based performance,
2. Determine that the Bank is adequately capitalized both on a regulatory and an economic basis against the risks to which it is exposed as follows:
    a. For regulatory capital, Pillar 1 and Pillar 2 risks,
    b. For economic capital, Pillar 1 and Pillar 2 as well those risks not formally quantified under the Basel II Framework,
3. Ensure that the Bank has sufficient capital to enable it to absorb diminutions in the value of its assets or unexpected losses while continuing to function as a "going concern" both on a current and a look forward basis,
4. Maintain a sound capital base that allows the Bank to take advantage of opportunities to develop and grow its business,
5. Establish an early warning system to prompt appropriate action for changes in Capital Adequacy, and
6. Ensure compliance at all times with the capital adequacy ratio set by the Bank's regulator.

The CAAP allows the Bank to set its own internal target CAR within a reasonable buffer from the CBB minimum capital requirements. The integrity of the CAAP is validated in a number of ways which include, stress testing of various risk factors and an internal review of the CAAP assumptions. The documented CAAP is expected to be approved by the Board in 2010. In 2010 the Bank plans to increase its core capital by way of a rights issue and the capital infusion is expected to significantly increase the Bank's risk taking capacity.

6.0 BASEL II PILLAR 1 CAPITAL REQUIREMENTS

6.1 Credit Risk Capital

The Group applies the Standardised Approach to the measurement of all Credit Risk in its Banking Book. The capital requirements for each of the Standardised Portfolios as at 31 December 2009 is as follows:

Table 4: Credit Risk Capital Requirements –Standard Portfolios

	Net exposure US$000	Risk weighted amount US$000	Capital requirement US$000
Sovereigns	4,454	4,388	527
Public Sector Enterprises			
Banks Portfolio	3,359	672	81
Corporate Portfolio	40,867	40,867	4,904
Regulatory Retail Portfolio			
Residential Retail Portfolio			
Equity Portfolio	45,260	57,800	6,936
Others	4,123	4,123	495
Total	98,063	107,850	12,943

6.1.1 Internal Rating Based Disclosures

As stated above, the Bank uses the Standardised Approach for credit risk capital requirements and does not therefore have any Internal Rating Based Approach credit exposures.

6.1.2 Securitisation

In the period under review the Bank did not participate in securitisation activities in relation to credit synthesis. The Bank therefore does not have recourse obligations under securitisation transactions.

6.1.3 Capital Requirement – Equity Exposures in the IRB Approach

The Bank does not have any equity exposure in its Banking Book measured under the IRB Approach.

6.2 Operational Risk Capital

For purposes of Basel II the Bank uses the Basic Indicator Approach (BIA) for calculating capital charges for its Operational Risk. The Operational Risk capital charge as at 31 December 2009 was as follows;

Table 5: Operational Risk Capital Requirements

USD 000	31 Dec 2009	Average 2009	31 Dec 2008	Average 2008
Operational Risk Capital Charge	1,430	1,430	1,732	1,732
Operational Risk Weighted Assets	11,918	11,918	14,438	14,438

6.3 Market Risk Capital

Market risk is the risk of loss in on or off-balance-sheet positions arising from movements in market prices on financial instruments**.** For purposes of Basel II Pillar I, the Bank measures its market risk using the Standardised Approach and calculates market risk capital charges for the following Market Risk components:

1. Equity exposure risk
2. Interest rate exposure risk
3. Foreign currency exposure risk
4. Commodity exposure risk

The Bank's market risk capital charge is largely composed of foreign currency risk arising from the Bank's foreign exchange exposure on private equity investments denominated mainly in sterling and euros, interest rate risk arising on the bond portfolio, currency and bond futures. The capital requirement for market risk using the Standardised Approach as at 31 December 2009 was as follows:

Table 6: Market Risk Capital Requirements

USD	31 Dec 2009	Maximum	Minimum	Average
Equity risk	272,686	293,193	31,217	107,077
FX risk	1,825,615	4,407,778	1,693,577	2,179,069
Interest rate risk	219,209	481,686	125,593	242,749
Total	2,317,209	4,969,081	1,984,401	2,524,981

* *Figures under maximum and minimum columns are single-day highest and lowest points respectively.*

7. BASEL II PILLAR 1 RISK MANAGEMENT FRAMEWORK

7.1 Operational Risk Management

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. It includes legal risk but excludes strategic and reputational risk. Operational risks arise from errors that can be made in effecting payments or settling transactions, breakdown in technology and internal control systems. BMB is an investment bank and does not operate a retail or commercial banking franchise. Accordingly, the number of client relationships and volume of transactions at BMB are substantially lower than at such institutions. The nature and number of transactions differ given the Bank's focus on investing in unlisted private equities for both its own account and its clients'. These factors mitigate to some extent the operational risks to which the Bank is exposed both in terms of volumes of transactions and the liquidity of the assets underlying these transactions.

7.1.1 Operational Risk Controls and Mitigation

BMB's operations are conducted according to well-defined policies and procedures codified in the operating manuals of Bank departments. These procedures include a comprehensive system of internal controls, including segregation of duties, dual control and other internal checks, which are designed to prevent either inadvertent staff errors or malfeasance prior to the release of a transaction. The Bank also engages in subsequent monitoring of accounting records, daily reconciliation of cash and securities accounts and other procedures to enable it detect any erroneous or improper transactions which may have occurred. To further mitigate residual operational risk the Bank uses insurance contracts.

7.1.2 Business Continuity Risks

The Bank has a well developed and established Business Continuity Plans (BCP) which incorporates development and testing of a fully functional Business Continuity site. The Business Continuity Plan mitigates risks arising from crisis events and disasters and allows the Bank to continue its operations seamlessly in a disaster scenario. The Bank's BCP was developed in line with CBB requirements on Business Continuity.

7.1.3 Legal Risks

Legal risk arises from the potential that unenforceable contracts, lawsuits, or adverse judgments can disrupt or otherwise negatively affect the operations or condition of the Bank. The Bank uses external legal counsel for its legal documentation, agreements and contracts. The Bank works closely with external legal counsel to ensure legal documentation and contracts conform with applicable regulations and are in the best interests of the Bank. To further mitigate the legal risks arising from non-compliance with regulatory requirements the Bank has an independent Compliance Department headed by a Compliance Officer who is part of the Bank's senior management.

7.2 Credit Risk Management

BMB's principal line of business is placement of private equity investments, and, as such, the Bank is not involved in the granting of credit facilities. Further, BMB is not engaged in retail business and therefore does not use credit "scoring" models. However, the Bank is exposed to counterparty credit risk through its money market trading activities. In this respect credit risk is the risk of loss arising from the inability or unwillingness of a counterparty to meet its obligations to the Bank. The Risk Management Department**,** under the oversight of RMC, has the responsibility for establishing credit risk standards and implementing the Bank's credit risk management process. The Bank considers that its policies and procedures constitute a reasonable approach to managing the credit risk in the activities it is engaged in. With respect to specific assets, the following summarizes key credit risk issues:

1. Cash and deposits are placed with major Organisation of Economic Cooperation and Development (OECD) and regional banks,
2. Government and Government Agency bonds mainly comprise bonds received in settlement for an outstanding past due loan,
3. The Instalment Sale Receivable (ISR), which is in the Bank's books, resulted from the workout more than a decade ago of a credit facility granted by the Bank and is a performing asset with appropriate security package in place, and
4. A modest loan portfolio composed of loans (see Note 8 in the accompanying financial statements).

7.2.1 Internal Risk Grading

All obligors and countries are risk graded. All lines of credit, counterparty, country and trading limits are subject to periodic review and some on a specific case by case basis. The limits are also reviewed more frequently as necessary to ensure consistency with the Bank's trading and investment strategies or to take into account the latest market developments. The Bank seeks to mitigate its exposure to losses through a variety of techniques such as investing in senior instruments (those with legal priority), transaction structuring and collateral or other security. Given the nature of the Bank's business, the Bank uses nominal balance sheet amounts including accrued interest and other receivables as its measure of Credit Risk exposure.

7.2.1 Internal Risk Grading (continued)

Credit risks for a given economic entity (including its subsidiaries and affiliates) are aggregated as the measure of exposure and are managed at that level. For internal credit risk management the Bank estimates the probability of default through its risk grading system which employs a ten-grade scale, with "1" representing a risk which has the least probability of default (equivalent to AAA rating) and "10" representing a defaulted obligation (equivalent to rating below CCC-). Risk grading is based on (a) quantitative factors (historical and prospective such as cash flow, profitability, asset quality and tenor of risk), (b) qualitative factors (such as management quality, market share and competitive position) and other factors, including country risk, the type of transaction, tenor, and credit mitigation. Where ratings from an External Credit Assessment Institution, recognized by the CBB, are available, BMB considers these as part of its internal rating process.

Table 7: BMB Rating Translation Methodology

Fitch	Moody's	S&P	CI	BMB Rating
AAA	Aaa	AAA	AAA	1
AA+	Aa1	AA+	AA+	2
AA AA-	Aa2 Aa3	AA AA-	AA AA-	3
A+ A	A1 A2	A+ A	A+ A	4
A- BBB+ BBB	A3 Baa1 Baa2	A- BBB+ BBB	A- BBB+ BBB	5
BBB-	Baa3	BBB-	BBB-	6
BB+ BB BB-	Ba1 Ba2 Ba3	BB+ BB BB-	BB+ BB BB-	7
B+ B B-	B1 B2 B3	B+ B B-	B+ B B-	8
CCC+ CCC CCC-	Caa1 Caa2 Caa3	CCC+ CCC CCC-	CCC+ CCC CCC-	9
Below; CCC-	Caa3/NP	CCC-	CCC-	10

The process by which BMB transfers External Credit Assessment Institutions (ECAI) public issuer ratings onto comparable assets in its Banking Book is described in the table above. Where an obligor or counterparty is rated by two ECAIs, BMB uses the higher risk weight (more adverse rating) to determine the applicable risk weighting. Where an obligor or counterparty is rated by three or more ECAIs, BMB uses the two lowest (most favourable ratings) and selects the higher risk weight (more adverse rating) of the two to determine the applicable risk weighting.

7.2.2 External Credit Assessment Institutions

In its Credit Risk Management process, the Bank uses the following ECAIS: Capital Intelligence (CI), Fitch Ratings, Moody's and Standard and Poor's. The Bank currently does not hold any financial assets subject to an ECA guarantee or insurance. ECAI ratings are used to determine applicable credit grades for money market placements, foreign exchange trading limits, country exposure limits and rated bonds.

7.2.3 Provisions for Past Due and Impaired Assets

A past due loan is one on which the obligor of the loan has failed to make a payment of principal or interest within 90 days of its due date. A provision is made in respect of a financial asset that is impaired if its carrying amount is greater than its estimated recoverable amount. Provisions for assets carried at amortised cost are calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate. By comparison, the recoverable amount of an instrument measured at fair value is the present value of expected future cash flows discounted at the current market rates of interest for similar financial assets. Unquoted equity investments, included in other equities and funds, and CDO's, included in other bonds, are stated after deducting impairment provisions.

"**Provision for Impairments**" **Note 23** to the accompanying financial statements provides a detailed breakdown of provisions for impairments on financial assets. As noted therein, due to the nature of its asset portfolio, the Bank determines provisions for impairment on an asset by asset basis. Accordingly, the Bank does not use statistical methods to determine provisions.

7.2.4 Off-Balance Sheet Items

The Bank's off-balance sheet items consist primarily of commitments to various private equity funds representing the undrawn portion of the Bank's commitment for future investments which may be made by these funds. Undrawn investment commitments comprise contractual commitments to make investments in quoted equities and in other equities and funds as amounts are called by fund managers. The Bank's commitments for its private equity investments and other funds are generally drawn down over a period of six years (see Note 32 of the accompanying financial statements).

7.2.5 Credit Risk Mitigation

For the years 2009 and 2008, none of the credit risk mitigation techniques employed by the Bank qualified under Basel II for credit risk mitigation.

7.2.6 Collateral and Netting

The Group attempts to manage its credit risk exposure through diversification in its equity investments and in its capital markets and trading activities. Where possible, collateral and other security are obtained. In order to ensure a common approach to risk control, the Bank uses the same credit procedures when entering into trading activities, including foreign exchange and derivatives, as it would for traditional lending products. Master netting agreements and collateral arrangements as well as limits and the tenors of transactions are employed to further control risks. The Bank does not engage in netting of assets against liabilities in its financial statement presentation. The Bank does enter into certain bi-lateral master agreements with counterparties with respect to trading activities including repurchase agreements. The only Basel II eligible collateral used by the Bank for risk mitigation purposes is cash collateral. While other forms of collateral are occasionally accepted, the Bank does not assign them any risk mitigation for CAR calculation purposes in line with the requirements of Basel II. As of 31 December 2009, the only collateral taken by the Bank were cash deposits taken from clients in respect of their commitments to private equity funds in the amount of US$10.7 million. In order to reduce and mitigate credit risk the Bank revised the cash deposits required from customers as mitigation for credit risk for funding private equity commitments.

7.2.7 Exposure to Highly Leveraged Institutions

The Bank does not have any exposure to "highly leveraged institutions" ("HLI's"). In determining which institutions are HLI's, the Bank is guided by the principles outlined in the Basel Committee on Bank Supervision's January 1999 publication, "Banks Interactions with Highly Leveraged Institutions", as well as the definition employed by the Financial Stability Task Force.

7.2.8 Counterparty Credit Risk

BMB allocates economic capital and sets limits to counterparties based on their risk as determined by BMB's internal grading system. As noted in Table 7 above, when a counterparty has an ECAI rating the Bank uses that rating as the basis for its internal grade. Given the Bank's pattern of trading, the overwhelming majority of lines it extends are to counterparties with ECAI ratings. In those cases where a counterparty does not have an ECAI rating, the Bank uses the methodology in its own internal grading system to determine an obligor grade. These obligor credit grades or risk weightings are then considered in the context of type of transaction, its tenor, and any risk mitigation arising from structure (e.g., irrevocably binding contractual netting arrangements) or security (collateral or guarantees) as a way of assigning risk to a particular transaction or transaction type. The resulting facility or transaction grade is used for the purpose of establishing lines and allocating economic capital.

7.2.8 Counterparty Credit Risk (continued)

The Bank is involved in the following forms of trading:

1. Interbank foreign exchange forward contracts – All the Bank's dealings are on an unsecured basis,
2. Futures Contracts – All the Bank's dealings are for instruments traded on major exchanges and are subject to margin requirements based on the instrument traded, and
3. Equity Derivatives – No margins or collateral is required or paid by the Bank. All equity derivate transactions are conducted over regulated exchanges.

As such the Bank is not involved in securing collateral from its counterparties. Accordingly, a change in the Bank's credit rating would not trigger a demand for collateral. The Bank has no trading activity or exposure to credit derivatives or similar instruments. Given the nature of its trading, the Bank has not sought nor has it received CBB approval to calculate alpha.

7.2.9 Main Types of Guarantors/Credit Derivative Counterparty

The Bank has not purchased any credit protection from third parties via credit derivatives or any other instruments. The Bank has received an irrevocable guarantee of payment from a private corporation in respect of the Instalment Sales Receivable ("ISR"). Note 9 "Instalment Sales Receivable" and Note 27 "Related Party Transactions" to the accompanying financial statements contain additional information. Because the guarantor does not have a public rating, under CBB regulations and Basel II requirements the corporate guarantee does not qualify for risk mitigation.

7.2.10 Risk Concentrations and Mitigation Taken

The amount of non cash collateral risk mitigation taken by the Bank is modest and specific transaction and circumstance-related. In the opinion of the Bank this does not constitute a risk concentration. Concentration of credit risk arises when a number of obligors or counterparties are engaged in similar business activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Accordingly, such concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or region. The Bank sets limits based on geographic regions, types of investment, risks involved. The Bank's Large Exposure Policy details the Bank's exposure limits and the policy is in compliance with CBB restrictions on concentration limits. The Bank's single largest exposure is the ISR which exceeds 10% of eligible capital as per the CBB's definition of large exposure. The ISR resulted from a loan restructuring agreement more than a decade ago and is mitigated by a corporate guarantee. BMB has obtained the CBB's authorisation not to treat the loan as large exposure for Basel II purposes. The table below summarizes the Group's gross and average gross credit exposures as at 31 December 2009 based on quarter end CBB prudential return reporting:

Table 8: Gross Exposures

	Gross exposure 31 December 2009 US$000	Average 31 December 2009 US$000
Cash and short term funds	3,425	4,330
Available-for-sale investment securities	45,260	45,219
Held to maturity investment securities	4,624	9,717
Loans and advances	872	1,275
Instalment sale receivable	15,682	16,086
Other assets	3,579	4,738
Total		81,365
Trading securities	1,885	771
Fixed assets	543	523
Total	**75,870**	**82,659**
Off-balance sheet credit and investment instruments	**36,177**	**65,267**

7.2.11 Geographical Exposures

The following tables summarize the Group's geographical and industry sector exposures, and any potential risk concentrations arising therefrom. Maximum credit risk exposures are detailed without considering the effects, if any, of collateral or other credit mitigation techniques on the Group's assets, liabilities and off-balance sheet items. BMB allocates geographic exposure based on the registered domicile/legal residence of the obligor or counterparty. As at 31 December 2009 the Bank's exposures were as follows:

Table 9: Geographical Exposures – as at 31 December 2009

	North America		Europe		Rest of the world		Total	
	2009	2008	2009	2008	2009	2008	2009	2008
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Assets								
Cash and short term funds	2,454	1,634	464	1,440	507	614	3,425	3,688
Trading securities	673	9,106	330	1,900	882	1,254	1,885	12,260
Available-for-sale investment securities	16,668	17,699	28,155	24,829	437	7,288	45,260	49,816
Held-to-maturity investment securities	-	4,937	236	212	4,388	4,388	4,624	9,537
Loans and Advances	872	872	-	-		29	872	901
Installment sale receivable					15,682	17,299	15,682	17,299
Other assets	1,475	2,724	610	1,055	1,494	2,709	3,579	6,488
Total assets subject to risk	**22,142**	**36,972**	**29,795**	**29,436**	**23,390**	**33,581**	**75,327**	**99,989**
Property, plant and equipment	-	-	-	-	543	504	543	504
Reconciliation to total assets	**22,142**	**36,972**	**29,795**	**29,436**	**23,933**	**34,085**	**75,870**	**100,493**
Off-balance sheet credit and investment instruments	**13,203**	**24,406**	**20,474**	**51,707**	**2,500**	**2,500**	**36,177**	**78,613**

7.2.12 Credit Exposure by Industry

The table below shows the Bank's credit exposures broken down by industrial classification. BMB allocates geographic exposure based on the registered domicile/legal residence of the obligor or counterparty.

Table 10: Credit Exposures by Industry

	Banking/ Finance 2009 US$000	Govern- ment 2009 US$000	Technology/ Telecoms 2009 US$000	Diversified 2009 US$000	Others 2009 US$000	Total 2009 US$000
Assets						
Cash and short term funds	3,359	66	-	-	-	3,425
Trading securities	716	-	784	-	385	1,885
Available-for-sale investment securities	-	-	13,605	31,228	427	45,260
Held-to-maturity investment securities	-	4,388	-	-	236	4,624
Loans and advances	-	-	872	-	-	872
Installment sale receivable	-	-	-	-	15,682	15,682
Other assets	1,475	-	610	1,494	-	3,579
Total assets subject to credit risk	**5,550**	**4,454**	**15,871**	**32,722**	**16,730**	**75,327**
Property, plant and equipment	-	-	-	-	543	543
Reconciliation to total assets	**5,550**	**4,454**	**15,871**	**32,722**	**17,273**	**75,870**
Off-balance sheet credit and investment instruments	**-**	**-**	**9,421**	**25,856**	**900**	**36,177**
(ii) **As at 31 December 2008**						
Total assets subject to credit risk	**14,775**	**10,128**	**20,106**	**33,382**	**21,598**	**99,989**
Total assets	14,775	10,128	20,106	33,382	22,102	100,493
Off-balance sheet credit and investment instruments	**-**	**-**	**10,695**	**67,018**	**900**	**78,613**

8. PRIVATE EQUITY INVESTMENT RISK

BMB invests in private equity with the intent of later sale of these investments at a profit to third parties either through a sale to another business (“trade sale”) or an initial public offering (“IPO”). Private equity risk is the risk that the Bank will not be able to sell its investments at a profit within the intended time period. This risk arises from three factors:

1) The first relates to the risk that the funded underlying business does not develop a sustainable business or its line of business is not attractive to other investors
2) The second factor relates to macro trends in markets for IPO’s and mergers and acquisition activity. The state of these markets affects both the price and timing of any “exit” from an investment and
3) The third factor is that these investments are typically realised over the medium term and are not traded on organized exchanges, hence they have limited liquidity.

BMB uses the Standardised Approach under the Basel II Framework for measuring and managing its private equity risk, which is considered a part of its Banking Book. The Bank manages risks at the specific investment level in the following ways. First, it invests primarily in independently managed third party funds whose managers have a demonstrated successful track record over the entire economic cycle. Second, the Bank seeks to diversify its investments across fund managers, different stages in the investment cycle (various stages of venture capital, buy-out, etc), geographical locations and industries. Diversification is also a key tool for dealing with the inherent limited liquidity of this asset class. The goal is to reduce exposure to any one investment. Trends in macro economic events and their effects on the IPO and trade sale market are largely out of the control of the Bank. In addition, from time to time, the Bank approaches leading investment banks to determine realistic market opportunities for the securitisation of private equity assets. As at 31 December 2009, the Bank was effectively invested in over 340 companies.

The Bank holds the equities in its Banking Book primarily for capital gains rather than current income, relationship or other reasons, and all of the equities held in BMB’s books are accounted for as Available for Sale Assets at fair value with any changes in fair value taken to the Fair Value Reserve in equity. The Bank uses two methods to value the equities in its Banking Book. The bulk of equities in the Bank’s Banking Book are unlisted or private equities. For private equity funds, the Bank relies on financial reports provided by the respective fund managers. Fund reports are generally received quarterly with the annual reports audited by major international accounting firms and prepared according to IFRS/IAS. The Bank determines its pro-rata share of an investment in a fund and adjusts for any transactions including asset realizations and further drawdowns from the date of the fund statement until the date of the preparation of the Bank’s own financials. This value is used as the carrying value with any required valuation adjustment passed directly to the fair value reserve in equity.

For direct private investments, the Bank also primarily relies upon the investee company’s financial statements as the source of information. Where these have been prepared using IFRS, the Bank uses the fair value in the investee company’s financials as the basis for its own valuation. Where fair values are not provided in the investee company financial reports, the Bank uses a variety of techniques focused primarily on determining impairment from original cost. Where fair value cannot reliably be determined, cost is used. As at 31 December 2009, the amount of direct private equity carried at cost was US$ 412,000 representing less than 1% of the total private equity portfolio. Note 6 to the accompanying financial statements provides further information. Note 2 of the accompanying financial statements contains additional information on the Bank’s valuation policies for private equity, including the determination of impairment. For the remaining equities in the Banking Book which are listed, the Bank uses market prices for valuation.

As part of the Bank’s restructuring plan the Bank plans on introducing additional income streams and reduce dependency on private equity exits for income. Consequently the Bank has made a deliberate strategy of limiting further commitments to private equity funds. In 2009 the Bank sold three of its funds on the secondary markets and in the process managed to reduce its commitments by approximately USD 32 million. A breakdown of the Bank’s total private equity commitments as at 31 December 2009 is shown in Note 32 to the accompanying financial statements.

9. BASEL II PILLAR 2 RISK MANAGEMENT FRAMEWORK

9.1 Reputational Risk

Reputational risk is the risk to the Bank's earnings and capital arising from negative perceptions by the Bank's stakeholders whether arising from events internal to BMB or external events. Reputational risk falls under Pillar 2 of the Basel II Framework. The Bank considers its reputation one of its most important assets. Consequently, the Bank's approach in managing reputation risk is multi-pronged, particularly given that under normal circumstances reputational risk is a secondary risk that only arises after the primary risk has materialised. The Bank has various tools it uses to mitigate reputational risk including the following measures;

- Implementing a transparent corporate governance framework with clearly defined responsibilities, board and senior management oversight and adequate segregation of functions,
- Implementing Code of Ethics and Code of Conduct which regulate staff, senior management and board members' conduct. The Codes require applicable persons to conduct all their business ethically and with a strong sense of integrity,
- Establishing an Operational Risk Control Framework that minimises operational risk losses and ensure a better integration of people, systems, internal controls, structures and minimises control failures,
- Proper implementing of Business Continuity Plans (BCP) to ensure the Bank can continue to operate in crisis events and minimise disruptions to the Bank's stakeholders ,
- Establishing an independent Compliance Department to monitor and control compliance and regulatory risks,
- Implementing robust Anti-Money Laundering (AML) risk controls to minimise money laundering risks, ensure compliance with regulatory requirements and by international AML best practice,
- Implementing an Insider Trading Policy that restricts the use of inside information in line with the requirements of the Bahrain Stock Exchange (BSE), and
- Establishing a Corporate Communications function whose responsibilities include managing the Bank's branding, marketing, and communication with external stakeholders as well as responding to media enquiries.

9.2 Strategic Business Risk

The Bank views strategic risk as the risk of the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of business decisions and/or lack of responsiveness to industry and economic developments. Strategic risk is a function of the compatibility of BMB's strategic goals, the business strategies developed to achieve those goals, the adequacy of resources deployed against these goals, and the quality of strategy implementation. The Bank has developed a five-year strategic business plan covering the period 2009 to 2013.

9.3 Liquidity Risk Management

Liquidity risk is primarily the risk that the Bank will be unable to meet its payment obligations as they fall due and/or to replace funding sources when they are withdrawn ("liability liquidity risk"). It also represents the risk that the Bank will be unable to realize its assets in a timely fashion for prices close to their carrying values ("asset liquidity risk"). BMB strives to minimise liability liquidity risk by diversifying its sources of funding across markets, instruments and counterparties, and by matching the maturity of liabilities to the maturity of assets in conjunction with the consideration of interest rate risk management. The Bank's ability to manage liquidity risk through funding diversification is presently constrained by the availability to the Bank of alternate funding sources and instruments. The Bank seeks to maintain liquid assets within its portfolio as well as short-term deposits with banks as a cash reserve. By the end of 2009 and beginning 2010, the Bank had managed to reschedule both its revolving facility and its quasi government term deposit repayments. Further to this the Bank in 2009 initiated plans for a capital raising program which is expected to be completed by the end of 2010. In its investing activities, BMB seeks to diversify its assets across instruments and markets and to avoid obligor concentrations which could constitute asset liquidity risk. This is particularly the case for our investments in unlisted private equity funds where BMB has implemented a strategy of reducing our average individual investment size. Liquidity is managed on a daily basis and senior management closely monitors significant daily changes to the liquidity position. In evaluating the liquidity position, the Bank also takes into account the possible call of un-drawn commitments in its investment portfolio. To manage the possibility of a large drawdown, by policy BMB will continue to invest in multiple funds and maintain its limit in a single fund. The fact that fund managers' drawdown commitments fairly evenly over an average period of six years rather than more quickly mitigates the risk of large drawdowns and large cashflow demands. In the short-term period there is likely to be a reduction in expected calls as private equity fund managers scale down planned investments because of the global recession.

BMB manages its liquidity within the overall scope of achieving its earnings objectives, complying with CBB regulatory requirements as well as internal risk limits. In setting liquidity risk appetite the Bank considers a number of economic and financial factors which include both local and foreign monetary and fiscal policies and their impact on interest rates, cost of funding and exchange rate changes, developments in the financial the financial sector as well as in general macro-economic environment. In 2009 the CBB has proposed to put in place a new liquidity risk management regulatory framework, the Bank expects to implement the said regulation, once finalised by the regulators. Further the Bank has put in place a budget for the acquisition of an Asset Liability Management software solution to automate liquidity risk reporting.

For an analysis of the Bank's maturity profile of assets and liabilities as at 31 December 2009 see Note 30 in the 2009 Annual Report. Refer also to note 1 to the accompanying financial statements that sets out the number of action plans the Bank has taken to address liquidity over the next 12 months.

9.3.1 Liquidity Contingency Plan

The Bank's Liquidity Management Strategy identifies liquidity crisis events and early warning indicators, allocates roles and responsibilities in a liquidity crisis and provides for the formation of a Liquidity Event Team ("LET") composed of critical members of the Bank's senior management. The LET will be responsible for planning, managing and controlling the Bank's response to the liquidity crisis event. Under the Liquidity Risk Management Strategy the Bank has various options for raising liquidity including orderly disposition of assets, securitisation and raising equity capital. In the year under review the Bank's LET has met on several occasions to address and plan for issues arising from liquidity risks.

10 Interest Rate Risk In The Banking Book (IRRBB)

The Bank's interest rate sensitive Banking Book consists of the following financial instruments sovereign bonds, Instalment Sale Receivable (ISR), deposits and medium term loans. A 200 basis point shift in interest rates would reduce the Bank's earnings by USD 910,500 as at 31 December 2009.

For an analysis of the Bank's interest rate sensitivity position as at 31 December 2009, based on contractual repricing or maturity dates, whichever dates are earlier, see Note 30 in the 2009 Annual report.