BMB INVESTMENT BANK

ANNUAL REPORT
FOR THE YEAR ENDED
31 DECEMBER 2008

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

A brief history of Bahrain Middle East Bank (B.S.C.)

Bahrain Middle East Bank (B.S.C.) (the "Bank" or "BMB") was established as an exempt joint stock company on 21 March 1982 with Commercial Register Number 12266. The Bank operates under a Conventional Wholesale Banking license granted by the Central Bank of Bahrain (the "CBB").

The Bank is principally engaged in investment banking, asset management and proprietary trading.

Originally the Bank was incorporated for a fixed term of 25 years ending in 2007. This was subsequently extended to 2032 pursuant to a resolution of the shareholders and the approval of Bahrain's Ministry of Industry and Commerce. 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.". As part of that process, BMB acquired an indefinite corporate life.

BMB's shares are listed on the Bahrain Stock Exchange under Reuters code BMEB.BH.

Until July 1999, the Bank's principal shareholder was Burgan Bank SAK of Kuwait, which held a 28.6% stake. Burgan Bank sold its shareholding in BMB in late 1999. As a result of that sale, Al Fawares Holding Co. (formerly Al Fawares Construction and Development) ("Al Fawares"), a private Kuwaiti company, became the Bank's major shareholder with a stake of about 18%. In August 2005, following a capital reorganisation and rights offering, Al Fawares increased its shareholding to 64.6%. No other single shareholder owns 10% or more of the Bank's shares. The balance of BMB's shares is held by over 13,000 shareholders, primarily throughout the Gulf region.

From 1982 to 1992, the Bank focused on international commercial banking activities with overseas operations in the USA, U.K., Netherlands, Switzerland and Hong Kong. A new management team was appointed in 1993, which implemented a new strategic direction by transforming BMB into a niche investment bank serving selected clients in the Gulf Co-operation Council ("GCC") countries and the Arab world. Determined to compete only in markets where it has a competitive edge, the Bank divested activities that did not meet with its focus on investment banking, treasury products and investor marketing.

BMB 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.

In April 2000, the Bank launched a rebranding campaign and is now known as BMB Investment Bank. BMB's legal name remains Bahrain Middle East Bank (B.S.C.).

CORPORATE STRATEGY

In 2008 after the conclusion of an extensive review of macro economic and market trends as well as the Bank's core competencies conducted by its senior managers and Board of Directors, the Bank adopted a revised corporate strategy articulated in the four following statements:

VISION

"We aspire to be the regional investor's bank of choice for alternative investments."

MISSION STATEMENT

We are a niche investment bank specialised in alternative investments and financial advisory. We offer innovative global products and services to individual, institutional and governmental clients from across the region. While maintaining the highest professional and ethical standards, we consistently deliver superior returns to our stakeholders without compromising maximisation of value for our shareholders.

CORE VALUES

Five key values are the basis for all our business activities:

1) Integrity
2) Loyalty and Commitment
3) Partnership
4) Excellence
5) Innovation

BUSINESS PRINCIPLES

Ten guiding principles direct the day to day conduct of our business:

1) Maximisation of shareholders' value
2) Genuine partnership with our clients and staff
3) Delivery of superior performance
4) Integrity, confidentiality and trust
5) Full transparency and professionalism
6) Robust corporate governance
7) Proactive risk management and compliance disciplines
8) Rigorous financial management and income diversification
9) Proactive and prudent decision-making
10) Continuous investment in people, processes and systems

DIRECTORS' AND CHIEF EXECUTIVE'S REPORT TO THE SHAREHOLDERS

On behalf of the Board of Directors, we are pleased to report to you on BMB's financial performance in fiscal year 2008, as well as provide an insight into our plans for the future.

2008 was definitely a year of challenge and change.

On the macro economic front, early in 2008 markets which had previously been fuelled by unprecedented liquidity, poor underwriting standards and over optimistic pricing of risk began to retreat. That retreat rapidly turned into a rout. The global recession which started in the second half of the year began to exhibit characteristics of a global depression. What began as a decline in the U.S. housing market due to the sub prime crisis metamorphosed into a financial crisis that transcended national boundaries and affected not just the financial sector but the real economy as well. Declines in real estate prices were followed in quick succession by the collapse or near bankruptcy of financial institutions, the seizure of funding markets, a sharp decline in equities and in commodity prices, weak retail sales, etc. All of these factors dampened activity leading to a large increase in unemployment, both in the U.S. and elsewhere in the world.

We had been watching excesses in the financial market since late 2006. Early in 2007 we correctly anticipated this turbulent financial storm, though frankly not its magnitude.

To prepare the Bank for the impending crisis, we took several interrelated measures to reduce asset price exposure and to strengthen the liability side of our balance sheet.

To reduce the Bank's exposure to market and other asset price risks, we took two key steps.

1. In late 2007, the Bank determined that it was opportunistic to sell its headquarters building, due to high prices available in the real estate market. The Bank utilised the proceeds from that sale to prepay its US$ 28.5 million syndicated term loan maturing in June 2008.

2. Recognizing that a financial downturn would put pressure on listed securities, we reduced our trading equities and funds portfolio from US$ 9.3 million at 31 December 2007 to US$ 0.7 million at 31 December 2008. An opportunistic sale in the third quarter which eliminated one large position was responsible for the bulk of the decline.

As a result of the above steps and reductions in other of our liabilities, we reduced our leverage from 1.4 at 31 December 2007 to 1.1 at 31 December 2008.

Turning to the liability side of our balance sheet, we moved to enhance our long term funding.

1. We negotiated an extension of the maturity of the US$ 10 million subordinated debt from December 2008 to December 2011.

2. We began discussions with the provider of our liquidity facility for an extension of the maturity and successfully concluded these in early January 2009 with an agreement to extend the maturity to June 2010.

3. We converted other institutional deposits totalling over US$ 13.1 million from short term to medium term deposits with phased repayments over the period ending in early April 2011.

Despite taking the above steps to restructure the balance sheet and to reduce the Bank's leverage, like all other financial institutions, we have also been negatively impacted by the global credit crunch and economic decline.

While BMB's assets continue to be of the highest quality, our private equity holdings have been negatively affected by the global economic crisis in three ways:

1. Market distress and accompanying depreciation in global asset prices have led to reductions in fair value to reflect current market conditions,

2. Weakness in Sterling and the Euro has resulted in foreign exchange translation losses thus reducing the US Dollar fair value of the investments held in these currencies, and

3. The global credit and liquidity crisis has slowed the pace of exits and reduced the multiples realised on sales. Credit markets are distressed and there is a dislocation in equity markets. Purchasers are having difficulty obtaining financing for the acquisition of companies. Floatations of companies by means of IPOs are almost non-existent. Consequently, there is an almost total suspension of the sale of private equity investments. Those that are taking place, if any, are at lower prices. These factors severely affected BMB's investment income and cash flow during the year.

Reflecting the impact of the above factors, for 2008 we reported a consolidated net loss of US $ 14.3 million as compared to a profit of US $ 24.6 million in 2007. As in past years, income from investments was the main driver of the Bank's results. In 2008 this income declined from US $ 23.2 million the year before to just US $2.7 million. With the US Dollar strengthening over the year, foreign exchange income also turned from a profit of US $ 1.9 million in 2007 to a loss of US $1.6 million in 2008. With fewer exits from private equity investments and lower multiples on those that were exited, performance fees declined leading to only US $0.8 million in fees and commission income in 2008 as compared to US $ 2.5 million the year before. With respect to expenses, we took US$ 4.0 million in provisions primarily related to our private equity portfolio as compared to provisions of US$ 3.5 million in 2007. General and administrative expenses of US $ 11.1 million were US $ 2.4 million over last year's US $ 8.7 million. This increase is comprised primarily of rental expenses for the Bank's operating premises following the sale of our building in December 2007 as well as certain one time expenditures incurred in connection with end of service benefits, the implementation of Basel II and legal expenses associated with the development of new investment products.

The loss for the year and negative adjustments to fair value related to private equity were primarily responsible for the decline in shareholders' equity from US $ 71.4 million to US $ 43.0 million. In accordance with IAS 39, the Bank carries its private equity investments as available-for-sale securities. This accounting standard requires that we carry the assets at fair value. Even though private equity securities are not traded on exchanges, most techniques used to determine their fair value are based on and thus affected by public market data inputs. While the fair value decline is reflective of current market conditions, we do not believe it reflects the inherent strength of our portfolio which is composed of long term assets to be realised over the long term. Indeed, one may well ask what "fair value" or "market value" means when there is severe market dislocation, liquidity is absent, distressed sellers are dumping assets and buyers have retreated to the sidelines.

Despite these factors, we remain confident. Our portfolio is well diversified with 526 companies giving an average investment size of some US $ 95.0 thousand. It is primarily invested in buy outs with a focus on middle market companies as we deliberately refrained from participating in mega buyout funds. As well, the fund managers we have chosen are top quartile managers with a demonstrated record of managing through economic cycles. Our own experience as an investor in this asset class for more than twenty years confirms our confidence: we have seen the value of our portfolio rebound from past economic downturns as the cycles have turned upwards. As well, a recent study by the World Economic Forum: "The Global Impact of Private Equity Report 2009" further supports our view. This asset class has a proven record of superior value extraction and creation when compared to public, family or governmental owned corporations.

The net loss, the decline in private equity fair value, the prepayment of the remaining US $ 28.5 million tranche of our US $ 75 million syndicated facility and other reductions in liabilities led total assets to decline to US $ 100.5 million in 2008 from US $ 180.9 million in 2007.

Notwithstanding these factors, we enter 2009 with a strong balance sheet which has been successfully tested and proven itself over the years. On both a nominal and risk adjusted basis, our capital position is sound. Our financial leverage ratio was 1.1 at 31 December 2008, compared to 1.4 at 31 December 2007 and, thus, the Bank is under levered. On a risk adjusted basis, our position is strong as well evidenced by a Capital Adequacy Ratio (CAR) of 22.8% at the end of December 2008.

Despite current market conditions, at BMB we take a long term view of markets and our business. As such, over the last year, the Board and executive management worked closely to develop a multi-year strategic plan designed to guide the Bank's activities over the next five years. The Plan has two key goals: (a) diversification of the Bank's activities, while retaining a focus on our expertise in alternative investments, and (b) broadening our client franchise.

As the first concrete steps to implement our plan, we expanded our placement team, including hiring a seasoned new department head. In the fourth quarter of the year we brought a new instrument to market – a capital protected note with a coupon based on Asian stock market performance. In 2009, we intend to follow up with the launch of additional new and innovative products which will expand our product range and customer base and, thus, position BMB for future growth.

For the disciplined investor with a long term view, like BMB, current distress in the markets offers opportunities. In anticipation that an economic recovery will begin some time in the latter part of 2009/ early 2010, we committed to additional private equity funds. As always, we have maintained our focus on partnering with top quartile fund managers with a proven track record over economic cycles, as well as ensuring that any new investments made will enhance rather than detract from our goal of a highly diversified private equity portfolio. We expect these funds to yield superior returns in 2012 and beyond.

2008 has also led to another change, a transition in our Executive Management. In November, Albert Kittaneh, who has ably served as the Bank's Chief Executive since 1993, informed the Board of his intention to resign and leave BMB in February 2009. The Board is in the final stages of selecting a replacement and will be announcing the new Chief Executive as soon as all formalities are completed.

As we move forward into 2009, we would like to thank those who were instrumental in supporting us during 2008 and express our sincere desire to continue working with them in the future.

We begin by thanking His Majesty the King, H.R.H the Prime Minister, H.R.H the Crown Prince, the Government of Bahrain, and the Central Bank of Bahrain for their wise stewardship and direction of the local economy. We would also like to express our gratitude to our financial partners - the investment and commercial banks, private equity fund managers, other finance industry professionals and clients with whom we conduct our business. Finally we would like to acknowledge our shareholders, Board of Directors and our staff whose dedication, talent and loyalty are key to our ability to execute our strategy.

In that regard, we would like to extend a special note of appreciation to Albert Kittaneh, who has made many contributions to the Bank during his tenure. We are pleased that he will remain as an advisor to the Board during 2009 to assist with the transition.

To all these parties, our most sincere thanks. We look forward to deepening these relationships in 2009 and beyond.

Wilson S. Benjamin
Chairman

Sheikh Abdulla A.K. Al Sabah
Vice Chairman

Albert I. Kittaneh
Chief Executive

25 February 2009

BMB 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. Albert I. Kittaneh	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) Early in 2008, Sheikh Ali Khalifa A. Al Sabah, who had served as a director since March 2000, advised the Board of his decision not to stand for re-election.
(2) At the Ordinary General Meeting of shareholders held on 29 March 2008 elections were held for the Board of Directors for the term ending in 2011. Al Fawares Holding (formerly Al Fawares Construction and Development Company) nominated Mr. Wilson Benjamin, Sheikh Abdullah A.K. Al Sabah and Mr. Karunaker Nampalli as their representatives on the Board. Shareholders elected the remaining four independent directors: Dr. A. K. Al-Enezi, Mr. Ebrahim Bu Hendi, Mr. Alwaleed Kamal, and Mr. Mazen Abdulkarim.
(3) 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.
(4) 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.
(5) No member of management serves on the Board of Directors. Therefore, the Bank has no "Executive Directors".
(6) For a description of the roles and responsibilities of the Board and its committees, see the Corporate Governance section in this report.

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, 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 1995, 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. Alwaleed Kamal (Director since January 2007)
Director and Member of the Executive Committee (since April 2008)

Over eighteen years of experience in investment and commercial banking with Citibank and BMB Investment Bank in cash management, treasury, and wealth management. At BMB Mr. Kamal was AGM and Head of Investor Marketing where he was responsible for building BMB's client business. 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. 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, authorised by the FSA and NASD after completing the accredited Chase Manhattan Credit Training Program. 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.

Mr. Albert I. Kittaneh
Chief Executive

Over thirty-five years of experience in investment and commercial banking with The Bank of New York, Manufacturers Hanover Trust, Chemical Bank, and BMB. He is also a board member of Oryx Capital International Ltd., Saudi Arabia and MAK Holdings (Lebanon). He has a BA in Economics from Fordham University and an MBA from Columbia University.

ORGANISATIONAL STRUCTURE

The Bank is organised into functional departments as described below.

Corporate Finance Department

A new department created in 2008, Corporate Finance is responsible for managing all aspects of the Bank's direct private equity investments.

Investment Department

Formerly named the Corporate Finance Department, the department's name was changed in 2008 with the creation of the new Corporate Finance 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 (an activity that was transferred from the Treasury Department). The Head of the Department is responsible for ensuring the Department fulfils its mission, including transaction generation. 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 the trading of FX, money market and capital markets debt securities. 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. The Head of the Department is responsible for ensuring the proper functioning of the Department, including enhancement of the Bank's client base. He is a voting member of the RMC and MC.

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 CE or external parties such as the 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 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 CE, 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 CE, 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, are:

Mr. Georges N. Zouein - Assistant General Manager and Group Treasurer
BA in Economics and Business Administration from Saint-Joseph University (Beirut) & DESS FINANCE (THESIS Islamic Banking) from University d'Evry, Paris.

Mr. Zouein joined BMB in 1996. He has over thirty-three years experience in trading and treasury activities with Banque du Liban et d'Outre Mer, Gimtex, Banque de Belelux (Groupe Indo-Suez/Banker's Trust), Brussels, UBAF (Paris) and BMB.

Ms. Haya S. Abuzeid – Executive Vice President and Head of Corporate Communications
BS in Communication from Boston University

Ms. Abuzeid joined BMB in 1997. She has over fifteen years experience in the communications and public relations field. Prior to joining BMB, Ms. Abuzeid was Press Secretary and Public Relations Coordinator at the Office of The Crown Prince at the Royal Palace in Jordan. She is responsible for all the Bank's branding, advertising, public relations and media activity.

Mr. Robert Moxon – Executive Vice President and Head of Investments
Institute of Bankers (AIB) – U.K.

Mr. Moxon rejoined BMB in 2005. He has over thirty years experience in Capital Markets, Treasury and Investments. Previously he ran BMB's Investment Department from 1994-2001. Prior to joining BMB in 1994, he worked for Citibank in Amsterdam and London. From 1990-1992 he was responsible for BP's European Treasury activities based in Brussels. During his interim period away from BMB, he worked for Dexion Capital (London).

Mr. Basil Salah – Senior Vice President and Head of Investor Marketing
BA Economics from University of Michigan and an MBA from New York University

Mr. Salah joined BMB in December 2008. Prior to joining BMB Mr. Salah was Vice President at Capintro Partners where he oversaw the marketing of alternative investment products as overall wealth management solutions for the firm's institutional and high net worth clients. Mr. Salah has worked at various investment banks throughout his career (Paine Webber & UBS) consulting clients on effective risk management strategies. He comes to BMB with an extensive client base including GCC and Levant institutional and high net worth clients.

Ms. Dania Haddad – Senior Vice President and Group Financial Controller
BA in Business Administration and Economics from Richmond University, U.K.

Ms. Haddad joined BMB in 1992 and worked in the Accounts/Operations Department before moving to Finance Control Department in 1999. With over fifteen years experience in banking, she held the position of Deputy Group Financial Controller at the Bank for several years before becoming Group Financial Controller in 2007.

Mr. Lloyd Kawara – Senior Vice President and Head of Risk Management
Bachelors in Business (Honours) from the University of Zimbabwe and M.Sc. in Finance & Investment from National University of Science and Technology, Zimbabwe.

Mr. Kawara joined BMB in May 2008 as Vice President, Risk Management and was promoted to Head of Department in September of the same year. Prior to joining BMB, Mr. Kawara worked for Riyad Bank in Saudi Arabia as a Risk Management Officer. Mr. Kawara is an Associate Member of the Chartered Institute of Management Accountants (CIMA) of the United Kingdom. He is also a member of the Chartered Alternative Investment Analyst Association (CAIA^{sm}) of the United States, a Regular Member of the CFA Institute and a Level 3 candidate in the CFA program. In addition he is also a certified Financial Risk Manager (FRM) from the Global Association of Risk Professionals (GARP) of the United States. Mr. Kawara is also a member of the Institute of Directors of South Africa.

Mr. Mihir Chatterjee - Senior Vice President and Head of Operations
ACA, AICWA, CIA, CISA
Chartered and Cost Accountant (India), Certified Internal Auditor (USA) and Certified Information Systems Auditor (USA)

Mr. Chatterjee joined BMB in April 2008. He has over 27 years experience in Internal Audit, IT Audit and IT Advisory services – mostly in the financial services sector in India, Bahrain, Qatar and Canada. Prior to joining BMB, he worked with KPMG for about 10 years in Bahrain, Qatar and Canada. He established the Information Risk Management Practice of KPMG in Bahrain and Qatar and was a Senior Manager responsible for its IT Assurance Advisory practice.

Mr. Thaer Ali Rabea – Vice President and Head of Compliance
BA Advanced Accounting and Auditing from Poona University and an MBA from Glamorgan University

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.

DESCRIPTION OF BUSINESS ACTIVITIES

BMB's main activities are:

- investment banking which forms the core of our activities
- asset management and funds distribution, and
- trading and investment

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

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 and structured products

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.

Asset management/funds distribution and funds management

This activity consists of marketing investment products to BMB's individual and institutional clients and the management of BMB proprietary funds, including BMB's US$70 million 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.

Investor marketing

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.

During 2008, the Bank continued to strengthen the capabilities of this Department through increases in staffing and targeted training. An experienced new head for the department was hired as well as two new vice presidents. Now with three vice presidents in the department dedicated to client marketing, both the breadth and depth of marketing has increased through more sharply focused geographic responsibilities.

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.

Publicly traded equities and private equities

During 2008, the Bank transferred equity trading activity from the Treasury Department to a newly established trading desk within the Investment Department to trade publicly listed equities and related financial instruments. Both the size and number of transactions are being kept at a controlled level through modest overall limits and diversification requirements. Additionally, the Investment Department manages the Bank's portfolio of listed equities, which primarily consists of listed equities resulting from the realization of private equity investments via IPOs.

Capital markets, foreign exchange

In 2008, BMB increased its activities in foreign exchange, capital markets and related derivative instruments. This activity, like public equity trading, is being kept at controlled levels. In the second half of the year, the Bank began to take positions designed to partially mitigate the effect of adverse foreign exchange movements on its foreign currency denominated assets.

CORPORATE GOVERNANCE

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. Details on how to obtain key documents comprising BMB's corporate governance framework are provided at the end of this section.

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 6, 7 and 8.

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 internationally reputed 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.

Finally, the Bank has an independent Risk Management Department, whose functions are discussed in detail under the Risk Management section within the Basel II Pillar 3 Disclosures appendixed to this financial report.

During 2008, in conjunction with the implementation of Basel II, the Bank enhanced its existing policies and procedures in two basic ways.

First, building upon existing policies, the Bank developed the following policies to serve as the overall architecture for risk management and corporate governance:

- Risk Charter
- Capital Management Policy
- Asset Liability Management Policy
- Credit Risk Policy
- Investment Risk Policy
- Market Risk Policy
- Operational Risk Management Policy
- Liquidity Risk Management Strategy

The Bank engaged the services of the consulting arm of a major international accounting firm to assist in this endeavour.

During the year, the Board of Directors reviewed and approved each of these policies.

Additional information on these policies and their implementation at BMB can be found in the Basel II Pillar 3 Disclosures which is an appendix to this financial report.

Second, the Bank reviewed its corporate governance framework documents listed below and amended these as required. Two new charters for Internal Audit and Compliance were also formally approved by the Board during the year. As well, the Bank reviewed and updated departmental policy and procedure manuals to ensure these embodied Basel II requirements and as well reflected appropriate practice.

As per the requirements of the CBB, each licensee in Bahrain is required to engage an accounting firm acceptable to the CBB to perform an analysis of the adequacy of each licensee's risk management systems and, Basel II policies and procedures and the practical implementation thereof. This review began at BMB during 4Q08 and is still in process as of year-end.

The Bank's corporate governance framework is set forth in a series of basic documents:

- Code of Ethics and Code of Conduct
- Corporate Governance Policies and Procedures
- Charter of the Board of Directors
- Directors' Roles and Responsibilities
- Charter of the Executive Committee of the Board of Directors
- Charter of the Audit Committee of the Board of Directors
- Charter of the Chairman of the Board of Directors
- Charter of the Chief Executive
- Charter of the Internal Audit Function
- Charter of the Compliance Function
- Disclosure Policy and Procedures

Copies of these documents are available on the Bank's website at http://www.bmb.com.bh/corporate/more.asp

SUMMARY OF FINANCIAL PERFORMANCE 31 DECEMBER 2004-2008

The key financial ratios from 31 December 2004 – 2008 are summarised as follows:

ILLUSTRATION 1
SUMMARY OF FINANCIAL DATA 2004-2008
(all figures in thousands of US dollars)

	2008	2007	2006	2005	2004
Net (loss)/ income from continuing operations	(14,313)	24,617	21,115	6,165	594
(Decline)/growth in net income (%)	(158.14%)	16.6%	242.5%	937.9%	104.7%
Total shareholders' equity	42,978	71,436	46,427	27,248	(27,777)
Total assets	100,493	180,879	172,666	168,411	182,004
(Loss)/return on average shareholders' equity (%)	(25.0%)	41.8%	57.3%	N/A	N/A
(Loss)/return on average assets (%)	(10.2%)	13.9%	12.4%	3.5%	0.3%
Operating expenses/total income (%)	N/A	36.9%	31.0%	48.2%	N/A
Average net (loss)/income per employee	(188)	359	319	95	9
Financial leverage (times)	1.1:1	1.4:1	2.6:1	4.9:1	N/A
Net liquid position (US$ million)	(15)	(24)	(38)	(35)	(107)

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

FINANCIAL REVIEW

The following section analyzes BMB's financial performance for the year ended 31 December 2008 compared to 2007.

INCOME STATEMENT

OVERVIEW OF FINANCIAL RESULTS

The following points summarize BMB's 2008 financial performance:

- The net loss for the year was US$ 14.3 million compared to a profit of US$ 24.6 million in 2007.
- Income from investments totalled US$ 2.7 million as compared to US$ 23.2 million in 2007.
- Losses from foreign exchange totalled US$ 1.6 million as compared to US$ 1.9 million profit in 2007.
- Fees and commission totalled US$ 0.8 million as compared to US$ 2.5 million in 2007.
- Net interest expense stood at US$ 1.0 million against US$ 3.9 million in 2007.
- Impairment provisions stood at US$ 4.0 million compared to US$ 3.5 million in 2007.
- Net income from assets sold totalled US$ nil compared to US$ 13.2 million in 2007.

Net loss

The Bank recorded a net loss of US$ 14.3 million for the year ended 2008. The loss was mainly generated in the second half of the year as a direct result of the global credit crunch, the lack of liquidity in the financial markets, and the insufficient interbank foreign exchange lines available.

Distressed macro economic factors adversely impacted the pace of realizations of private equity. This in turn affected performance fee income, due to lower number of realisations and lower exit prices. As the Bank was unable to fully manage exposures on its foreign currency denominated private equity holdings, the strengthening US dollar led to foreign exchange translation losses.

The main contributors of this loss were from operations: lower income from other equities and funds US$ 5.4 million (2007: US$ 24.0 million), loss from quoted equities and equity derivatives US$ 1.4 million (2007: US$ 1.3 million), loss from foreign exchange US$ 1.6 million (2007: US$ 1.9 million profit), loss from capital markets US$ 0.9 million (2007: nil), provisions of US$ 4.0 million (2007: US$ 3.5 million) and operating expenses increased to US$ 11.1 million (2007: US$ 8.7 million).

Income from investments

2008 witnessed instability within global financial markets, resulting in a freeze in the credit market and, hence, making private equity realizations both difficult and severely limited.

The Bank's income from investments amounted to US$ 2.7 million as compared to US$ 23.2 million in 2007. This decrease of US$ 20.5 million was mainly as a result of lower number of realisations and lower multiples within other equities and funds.

Although the Bank took a more active role in trading equities and funds, as well as in the capital markets and derivatives portfolio, the effects of the global turmoil and the loss of confidence in the financial markets negatively offset our portfolios. In anticipation of the impact of declining oil prices, and the deepening US recession, in 2nd and 3rd quarters we exited almost all our holdings in the GCC and US markets. Despite our cautious approach, the severity and volatility of the declines resulted in incurring losses on the portfolios.

The results of the Bank's various investment activities in 2008 are summarised in the table below:

ILLUSTRATION 2
ANALYSIS OF INCOME FROM INVESTMENTS

	2008 US$000	2007 US$000
(Loss)/income from managed funds – trading	(412)	5
(Loss) from quoted equities – trading	(1,241)	(1,295)
(Loss)/income from sovereign debt and bonds – trading	(333)	72
Income from other equities and funds – available-for-sale	5,396	23,923
(Loss)/income from other bonds – loans and receivables	(95)	1
(Loss) from other bonds - trading	(256)	-
(Loss) from derivatives - Government bond futures - trading	(286)	-
(Loss) from derivatives - equity derivatives – trading	(156)	(39)
Dividend income	132	506
Total income from investments	2,749	23,173

Foreign exchange loss

The foreign exchange loss amounted to US$ 1.6 million as compared to a profit of US$ 1.9 million in 2007. This loss was mainly generated from foreign exchange derivatives (US$ 1.3 million) as the Bank attempted to control the foreign exchange volatility on the Bank's foreign exchange exposures, in the continued absence of sufficient foreign exchange lines.

Fees and Commission

Fees and commission amounted to US$ 0.8 million as compared to US$ 2.5 million in 2007. The decrease of US$ 1.7 million was due to the following:

- **Performance fees** – very low investment realizations within private equity funds, where BMB earns fees from the profit sharing arrangements with its customers.
- **Management fees** – the continued decline in outstanding balances within BMB Tech fund.
- **Placement fees** – During 2008 the Bank reduced its placement activities with the onset of the subprime and credit crisis. However, this was more than offset by fees for 2007 marketing efforts which were only collected in 2008 after the transactions were closed.

Fees and commission are summarised in the following table:

ILLUSTRATION 3
ANALYSIS OF FEES AND COMMISSION

Detail	2008 US$000	2007 US$000	Increase/ (decrease) US$000	Increase/ (decrease) %
Performance fees	177	1,859	(1,682)	(90%)
Management fees	263	517	(254)	(49%)
Placement fees	401	82	319	389%
Others	-	18	(18)	(100%)
Total fees and commission	841	2,476	(1,635)	(66%)

Operating expenses (general and administrative)

Operating expenses amounted to US$11.1 million for the year 2008 compared to US$ 8.7 million in 2007. This increase is comprised primarily of rental expenses for the Bank's operating premises following the sale of our building in December 2007 as well as certain one time expenditures incurred in connection with end of service benefits, the implementation of Basel II and legal expenses associated with the development of new investment products.

Operating expenses are summarised in the following table:

ILLUSTRATION 4
ANALYSIS OF OPERATING EXPENSES (General and Administrative)

Detail	2008 US$000	2007 US$000	(Increase/) decrease US$000	(Increase/) decrease %
Staff costs	7,700	6,650	(1,050)	(16%)
Occupancy and equipment expense	1,068	347	(721)	(208%)
Legal and professional	1,153	615	(538)	(87%)
Other	1,141	1,124	(17)	(2%)
Total operating expenses	11,062	8,736	(2,326)	(27%)

Provisions for impairment

BMB takes provisions if a financial asset is impaired, that is, 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 rate of interest for a similar financial asset.

The required levels of investment provisions are determined after a careful review of the underlying economic factors and the investee company's past and future forecasted financial performance which may eventually impact the recoverable amount of the investment portfolio.

In 2008 the Bank provided for an exposure against a direct private equity investment (US$ 0.5 million). Also in 2008, the Bank made provisions of US$ 3.7 million against private equity fund investments as their fair values throughout the year of 2008 continued to be lower than cost. This was partially offset by a release of US$ 0.4 million within other equities and funds and a write back of US$ 0.2 million from other bonds.

In 2007, a net provision of US$ 3.5 million was made. This was mainly attributed by an investment which the Bank considered unrecoverable as the company went into Chapter 11 in the United States and a provision of US$ 3.7 million was made. This was partially offset by a writeback of US$ 0.2 million from other bonds.

BALANCE SHEET

Total assets

Total assets at 31 December 2008 stood at US$ 100.5 million compared to US$ 180.9 at 31 December 2007, a decrease of US$ 80.4 million or 44.4%.

The decrease was mainly a reflection of the Bank repaying its outstanding amount of US$ 28.5 million on its syndicated loan, bank and client deposits of US$ 20.0 million, repos and other borrowings of US$ 5.0 million and the negative net movements on our other equities and funds portfolio of US$ 23.4 million.

This was partially offset by the Bank realizing a large portion of its trading equities and funds portfolio and the decrease in receivables with other assets.

Cash and deposits with banks

Cash and deposits with banks decreased to US$ 3.7 million as compared to US$ 36.6 million in 2007, a decrease of US$ 32.9 million. This decrease was mainly due to the Bank repaying a large portion of its liabilities and the limited number of realisations from the private equity funds portfolio.

Trading equities and funds

With the reestablishment of the investment department in early 2008, the Bank's trading equities and fund portfolio was reactivated. The department took steps to realise medium sized positions at peak prices and ventured profitably into trading ETFs.

The GCC and Asian stock markets were no safe havens, as these markets also were not spared by the global financial crisis.

As a result of the above and the recession concerns within international stock markets, the Bank decreased its trading equities and funds portfolio to US$ 0.7 million, a drop of 92.2%, or a decrease of US$ 8.6 million as compared to US$ 9.3 million in 2007.

Other equities and funds

Other equities and funds (private equity) decreased to US$ 49.8 million from US$ 73.3 million in 2007. This decrease was mainly due to negative foreign exchange translations on the Bank's foreign currency denominated private equity fund investments, as the US dollar strengthened, and downward revaluations on our private equity funds portfolio, as a result of severely depressed equity and funding markets and growing signs of a serious economic downturn.

In addition to the above, the Bank realised a portion of its direct unquoted equities portfolio held at fair value at the beginning of the year in 2008 at advantageous prices, and wrote down a direct investment held at cost as it was considered unrecoverable, due to its liquidity position, in the 4th quarter.

After assessing all investments held within other equities and funds, the Bank released provisions of US$ 0.3 million.

Undrawn commitments for other equities and funds increased to US$ 77.7 million in 2008 from US$ 31.9 million in 2007, an increase of US$ 45.8 million. This increase represents 6 new commitments made during the year. Of the US$ 77.7 million in 2008 US$ 19.0 million (2007: US$ 5.0 million) represents undrawn investment commitments that the Bank sold to clients and for which it has received binding commitments. This amount is expected to increase by US$ 12.7 million in 2009 as the Bank plans to sell down from its position as at 31 December 2008.

It is estimated that these unfunded investment commitments, which include customers' portions of US$ 19.0 million, will be drawn down over the course of the next six years.

Other bonds

Also in 2008, the Bank increased its exposure in debt securities by a net US$ 5.4 million, as it reactivated its bond trading portfolio, purchasing corporate bonds and capital protected notes. These bonds and notes hold AA- credit ratings. This was partially offset by selling CDOs of US$ 5.0 million held as loans and receivables within the year.

Loans and advances

In the 3rd quarter of 2008, the Bank participated (US$ 0.9 million) in a loan extended to a company it holds as a direct investment, held at cost within other equities and funds.

In addition to the above, the valuation of our trading loans portfolio decreased by US$ 0.3 million for the year. As a result of the above, loans and advances increased by a net US$ 0.5 million to US$ 1.5 million as at 31 December 2008 from US$ 1.0 million in 2007.

Derivative financial instruments

Throughout the second half of 2008 the Bank attempted to use currency forwards and futures to offset part of the foreign exchange volatility on the Bank's foreign currency denominated assets, in the absence of sufficient foreign exchange lines extended to the Bank.

Other derivatives, such as equity options and bond futures, were traded and realised within the year for the respective trading portfolios.

The closing balances as at 31 December 2008 for derivative financial assets and liabilities stood at US$ 0.8 million and US$ 1.7 million respectively, both relating to foreign exchange. The comparable balances as at 31 December 2007 were almost nil and related to equity options only.

In December 2008, the Bank pledged a corporate bond as collateral to cover our margin account.

Instalment sale receivable

Instalment sale receivable reduced to US$ 17.3 million from US$ 18.8 million as at 31 December 2007, representing the contractual yearly repayment received in June 2008 of US$ 1.5 million.

Other assets

Other assets decreased to US$ 6.5 million from US$ 27.3 million as at 31 December 2008, a decrease of US$ 20.8 million. This decrease was mainly attributed to the proceeds received in 1st quarter 2008 for assets sold in December 2007, US$ 18.0 million, which was chiefly accounted for by the proceeds of the sale of the Bank's headquarters building. In addition, movements in receivables from investment fund managers decreased by US$ 3.2 million.

Deposits from Banks

Deposits from banks amounting to US$ 10.0 million were repaid in early 2008.

Customer deposits

Customer deposits as at 31 December 2008 reduced to US$ 26.5 million from US$ 36.6 million in 2007, a decrease of US$ 10.1 million. This decrease was mainly due to a repayment of US$ 4.6 million to Government entities, corporates and individuals, as well as amounts paid out on customer participation in funds deposits of US$ 5.5 million within the year.

In December 2008, the Bank entered into negotiations with a depositor included in Government entities, corporates and individuals, as at 31 December 2008 regarding a deposit agreement of US$ 13.1 million.

The drafted terms include a quarterly principal repayment of US$ 2.0 million, starting 5 October 2009 to 5 January 2011 and a final repayment of US$ 1.1 million on 5 April 2011.

Interest is expected to be paid monthly at Libor plus 200 basis points from 5 February 2009 to 5 October 2009. Thereafter, interest will be payable quarterly and set at a rate of Libor plus 100 basis points from 5 October 2009 to 5 April 2011.

This agreement was finalised and signed in January 2009.

Securities sold under repurchase agreements

Securities sold under repurchase agreements amounted to US$ 0.8 million as at 31 December 2008, compared to US$ 3.7 million as at 31 December 2007. The decrease of US$ 2.9 million represents the Bank's decision in the last quarter of 2008 to minimise its repo exposures as the financial market conditions, market prices and counterparty risks were very volatile.

Medium term loan

The Bank successfully prepaid the remaining balance on its US$ 75.0 million syndicated loan facility in the 1st quarter of 2008, US$ 28.5 million. This move provided the Bank with operational and strategic flexibility.

Revolving loan facility

In July 2008, the Bank signed an amended agreement extending the maturity date to 15 May 2009 with the following repayment schedule: US$ 2.0 million (September 2008), US$ 3.6 million (January 2009), US$ 4.0 million (March 2009) and US$ 4.0 million (May 2009). The instalment of US$ 2.0 million paid on the due date decreased the revolving loan balance from US$ 13.6 million as at 31 December 2007 to US$ 11.6 million as at 31 December 2008.

In early January 2009, the Bank signed a further amended agreement, extending the maturity date to June 2010 with the following repayment schedule: US$ 3.0 million (September 2009), US$ 3.0 million (January 2010), US$ 3.0 million (March 2010) and US$ 2.6 million (June 2010).

Subordinated loan

On 28 December 2008, the Bank signed an amended and restated agreement extending the maturity date to 30 December 2011 and revised the interest rate to 1 year Libor plus 10%.

Capital ratios

The guiding principle of the Bank is to maintain its regulatory risk based capital ratio in excess of the prescribed minimum of 12.0% by the Central Bank of Bahrain.

On 1 January 2008, the Kingdom of Bahrain implemented Basel II. The Bank uses Basel II Standardised Approaches for credit and market risk, as well as the basic indicator approach for operational risk, BMB's Basel II capital adequacy ratio as of this date stood at 22.8 % as compared to 24.0% as at 31 December 2007.

Previously as at 31 December 2007, the risk based capital ratios of the Bank included market risk weighted assets using the Standardised Approach and the credit risk weighted assets based on the BIS 1988 Capital Accord and stood at 31.36%.

ILLUSTRATION 6
CAPITAL BASE AND RISK WEIGHTED ASSETS

	Average for the year 2008 US$000	At year-end 2008 US$000	Average for the year 2007 US$000	At year-end 2007 US$000
Tier 1 capital				
Share capital	54,955	54,955	52,338	52,338
Legal reserves	16,310	16,310	14,464	16,310
General and other reserves	7,521	7,521	10,138	10,138
Retained earnings	(21,459)	(30,110)	(27,840)	(18,599)
Revaluation (loss) reserves – available-for-sale investments	-	(5,698)	-	-
Total qualifying Tier 1 capital	57,327	42,978	49,100	60,187
Tier 2 capital				
Revaluation reserves – available-for-sale investments	1,467	-	4,621	5,056
Fixed assets revaluation reserves	-	-	5,324	-
Subordinated loan	-	6,000	2,257	-
Total qualifying Tier 2 capital	1,467	6,000	12,202	5,056
Total regulatory capital	58,794	48,978	61,302	65,243
Risk weighted assets				
On-balance sheet	215,517	155,085	261,637	251,374
Off-balance sheet	33,659	59,577	23,663	20,374
Total risk weighted assets	249,176	214,662	285,300	271,748
Capital Adequacy Ratio	23.6%	22.8%	21.5%	24.0%

Earnings per share and price/earning ratio

The Group's earnings per share and price/earnings ratio were as follows:

ILLUSTRATION 7
REVIEW OF EARNINGS PER SHARE AND PRICE EARNINGS RATIO

Detail	2008	2007
Net (loss)/ profit	US$ (14,313,100)	US$ 24,616,500
Number of shares (fully diluted)	217,302,248	209,351,949
(Loss)/earnings per share	US$ (0.07)	US$ 0.12
BMB's year-end share price on the Bahrain Stock Exchange	US$ 0.21	US$ 0.49
Book value per share	US$ 0.20	US$ 0.34
Price/earnings ratio	(3.00)	4.08

BMB shareholdings of directors, their related parties and BMB senior management

The shareholdings of directors, their related parties and BMB senior management were as follows:

ILLUSTRATION 8
DIRECTORS AND SENIOR MANAGEMENT SHAREHOLDINGS

Detail	2008 Number	2007 Number
Directors and their related parties	143,167,114	136,349,632
Senior management	99,753	95,003
Total	143,266,867	136,444,635

ILLUSTRATION 9
SUMMARY OF PERFORMANCE BY BUSINESS SEGMENTS

The Group is organized into two major business segments, banking and manufacturing. The respective segmental operating results for the year 2008 were as follows:

	Banking		Manufacturing		Consolidated	
	2008 US$000	2007 US$000	2008 US$000	2007 US$000	2008 US$000	2007 US$000
Income from investments	2,749	23,173	-	-	2,749	23,173
Foreign exchange (loss)/income	(1,569)	1,923	-	-	(1,569)	1,923
Fees and commission income	841	2,476	-	-	841	2,476
Other (loss)/income	(62)	58	(44)	(20)	(106)	38
Net interest (expense)/income	(1,075)	(3,926)	-	4	(1,075)	(3,922)
Total income/(loss) from operations	884	23,704	(44)	(16)	840	23,688
Impairment provisions	(4,003)	(3,514)	-	-	(4,003)	(3,514)
General and administrative expenses	(11,062)	(8,736)	-	-	(11,062)	(8,736)
Total operating expenses	(15,065)	(12,250)	-	-	(15,065)	(12,250)
Net (loss)/income from operations	(14,181)	11,454	(44)	(16)	(14,225)	11,438
Net income from assets sold	10	13,179	-	-	10	13,179
Net (loss)/income before taxation	(14,171)	24,633	(44)	(16)	(14,215)	24,617
Taxation	(98)	-	-	-	(98)	-
Net (loss)/ income for the year	(14,269)	24,633	(44)	(16)	(14,313)	24,617

The banking segment represents BMB and all its subsidiaries excluding T&T Beverages Limited (T&T).

The manufacturing segment is represented by T&T only which is under voluntary liquidation since 25 April 2006.

The consolidated figures are arrived at after off-setting all intra-group transactions including T&T.

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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 balance sheet as at 31 December 2008 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the consolidated financial statements
Management is 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

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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 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

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 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 2008.

PricewaterhouseCoopers

Manama, Kingdom of Bahrain
26 February 2009

ONSOLIDATED BALANCE SHEET
AT 31 DECEMBER 2008
(Expressed in thousands of United States Dollars)

	2008	2007
ASSETS		
Cash and deposits with banks (Note 4)	3,688	36,602
Trading equities and funds (Note 5)	726	9,279
Government bonds (Note 6)	4,388	4,388
Other equities and funds (Note 7)	49,816	73,264
Other bonds (Note 8)	15,214	9,793
Derivative financial instruments (Note 9)	849	83
Loans and advances (Note 10)	1,521	967
Instalment sale receivable (Note 11)	17,299	18,839
Fixed assets (Note 12)	504	316
Other assets (Note 13)	6,488	27,348
TOTAL ASSETS	100,493	180,879
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Bank deposits (Note 14)	-	10,015
Customer deposits (Note 15)	26,493	36,553
Securities sold under repurchase agreements (Note 16)	817	3,700
Derivative financial instrument (Note 9)	1,735	-
Medium term loan (Note 17)	-	28,500
Revolving loan facility (Note 18)	11,600	13,600
Other liabilities (Note 19)	6,870	7,075
Subordinated loan (Note 20)	10,000	10,000
TOTAL LIABILITIES	57,515	109,443
Shareholders' equity		
Share capital (Note 21)	54,955	52,338
Fair value reserve (Note 22)	(5,698)	11,249
Other reserves (Note 22)	(6,279)	7,849
TOTAL SHAREHOLDERS' EQUITY	42,978	71,436
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	100,493	180,879

These consolidated financial statements were approved by the Board of Directors on 25 February 2009 and signed on its behalf by:

Wilson S. Benjamin
Chairman

Sheikh Abdulla A.K. Al Sabah
Vice Chairman

Albert I. Kittaneh
Chief Executive

Notes 1 to 40 form an integral part of these financial statements

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2008
(Expressed in thousands of United States Dollars)

	2008	2007
Income from investments (Note 23)	2,749	23,173
Foreign exchange (loss)/income (Note 24)	(1,569)	1,923
Fees and commission income (Note 25)	841	2,476
Other (loss)/income (Note 26)	(106)	38
	1,915	27,610
Interest income (Note 27)	1,976	2,705
Interest expense (Note 27)	(3,051)	(6,627)
NET INTEREST (EXPENSE)	(1,075)	(3,922)
TOTAL INCOME FROM OPERATIONS	840	23,688
Impairment provisions (Note 28)	(4,003)	(3,514)
General and administrative expenses (Note 29)	(11,062)	(8,736)
TOTAL OPERATING EXPENSES	(15,065)	(12,250)
OPERATING (LOSS)/PROFIT	(14,225)	11,438
Net income from assets sold (Note 34)	10	13,179
(LOSS)/PROFIT BEFORE TAXATION	(14,215)	24,617
TAXATION	(98)	-
(LOSS)/PROFIT FOR THE YEAR	(14,313)	24,617
(LOSS)/EARNINGS PER SHARE (Note 21)		
Basic	US$ (0.07)	US$ 0.12
Diluted	US$ (0.07)	US$ 0.12

These consolidated financial statements were approved by the Board of Directors on 25 February 2009 and signed on its behalf by:

Wilson S. Benjamin
Chairman

Sheikh Abdulla A.K. Al Sabah
Vice Chairman

Albert I. Kittaneh
Chief Executive

Notes 1 to 40 form an integral part of these financial statements

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2008
(Expressed in thousands of United States Dollars)

				Other reserves					
	Share capital	Fixed asset revaluation reserve	Fair value reserve	Retained earnings	Legal reserve	General reserve	Proposed stock dividends reserve	Total other reserves	Total
At 1 January 2007	52,338	7,098	3,580	(40,575)	13,848	10,138	-	(16,589)	46,427
Exchange translation adjustment	-	-	2,856	(179)	-	-	-	(179)	2,677
Fixed asset revaluation reserve transferred to income (Notes 12 and 22)	-	(7,098)	-	-	-	-	-	-	(7,098)
Net fair value gain on available-for-sale investments (Note 7)	-	-	13,583	-	-	-	-	-	13,583
Fair value reserve transferred to income statement (Note 7)	-	-	(8,770)	-	-	-	-	-	(8,770)
Profit for the year	-	-	-	24,617	-	-	-	24,617	24,617
Transfer to reserves (Note 22)	-	-	-	(2,462)	2,462	-	-	-	-
Proposed stock dividends (Note 22)	-	-	-	-	-	(2,617)	2,617	-	-
At 31 December 2007	52,338	-	11,249	(18,599)	16,310	7,521	2,617	7,849	71,436
At 1 January 2008	52,338	-	11,249	(18,599)	16,310	7,521	2,617	7,849	71,436
Exchange translation adjustment	-	-	(3,909)	2,802	-	-	-	2,802	(1,107)
Net fair value loss on available-for-sale investments (Note 7)	-	-	(16,799)	-	-	-	-	-	(16,799)
Fair value reserve transferred to income statement (Note 7)	-	-	3,761	-	-	-	-	-	3,761
Stock dividends approved	2,617	-	-	-	-	-	(2,617)	(2,617)	-
Loss for the year	-	-	-	(14,313)	-	-	-	(14,313)	(14,313)
At 31 December 2008	54,955	-	(5,698)	(30,110)	16,310	7,521	-	(6,279)	42,978

Notes 1 to 40 form an integral part of these financial statements

BAHRAIN MIDDLE EAST BANK (BSC)

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2008
(Expressed in thousands of United States Dollars)

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
(Loss)/profit from operations	(14,225)	11,438
Adjustments to reconcile (loss)/profit from operations to net cash (used in)/provided by operating activities:		
Taxes paid	(98)	-
Impairment provisions (Note 28)	4,003	3,514
Depreciation and amortisation	147	58
Loss/(profit) on sale of fixed assets	60	(9)
Net changes in:		
Trading equities and funds	8,553	(773)
Other equities and funds	2,306	6,713
Other bonds	(5,229)	78
Derivative financial instruments	970	(83)
Loans and advances	(554)	2,255
Accrued interest receivable	39	26
Accrued interest payable	(626)	76
Other assets	2,783	15,704
Other liabilities	442	(627)
Customer deposits	(10,060)	(11,042)
Change in exchange rates related to retained earnings of overseas subsidiaries	2,802	(179)
Foreign exchange movements on investments and others	977	(491)
NET CASH (USED IN)/PROVIDED BY OPERATING ACTIVITIES	(7,710)	26,658
CASH FLOWS FROM INVESTING ACTIVITIES		
Amount received against instalment sale receivable	1,540	1,471
Purchase of fixed assets (Note 12)	(405)	(202)
Proceeds from sale of fixed assets	10	9
Net cash flow from freehold land and building sold (Note 34)	18,047	670
NET CASH PROVIDED BY INVESTING ACTIVITIES	19,192	1,948
CASH FLOWS FROM FINANCING ACTIVITIES		
Net changes in:		
Bank deposits	(10,015)	10,015
Securities sold under repurchase agreement	(2,883)	-
Medium term loan	(28,500)	(15,200)
Revolving loan facility	(2,000)	-
Prior year dividends claimed and paid	(21)	(18)
NET CASH USED IN FINANCING ACTIVITIES	(43,419)	(5,203)
EFFECT OF EXCHANGE RATE CHANGES IN CASH AND CASH EQUIVALENTS	(977)	491
Net (decrease)/increase in cash and cash equivalents	(32,914)	23,894
Cash and cash equivalents at the beginning of the year	36,602	12,708
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR (NOTE 4)	3,688	36,602

Notes 1 to 40 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 32).

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.

The CBB's inspection team carries out periodic reviews of BMB and submits reports of their findings directly to the Bank's 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 land and building, available-for-sale financial assets, all derivative contracts and financial assets at fair value through profit and loss and financial liabilities held for trading.

2.2 Critical accounting estimates and judgements in applying accounting policies

The preparation of the Group's consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies.

Management makes estimates and assumptions that affect the reported amounts of assets and liabilities within the current year and next financial year based on historic experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The resulting carrying estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are set out below.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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 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 7).

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.

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 New accounting standards and IFRIC interpretations

Amendments and interpretations to published standards that are effective for the Group's accounting periods commencing 1 January 2008 are as follows:

(a) amendments to published standards that are mandatory for the Group from 1 July 2008:

IAS 39, 'Financial Instruments: Recognition and Measurement' (amendment) and IFRS 7, 'Financial Instruments: Disclosures' (amendment) - Reclassification of financial assets. The amendment permits an entity to reclassify non-derivative financial assets (other than those designated at FVTPL by the entity upon initial recognition) out of the FVTPL category in particular circumstances. The amendment also permits an entity to transfer from the available-for-sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available for sale) if the entity has the intention and ability to hold that financial asset for the foreseeable future. The Group did not reclassify any financial asset in 2008.

(b) Interpretations effective in 2008 but not relevant:

The following interpretations to published standards are mandatory for accounting periods beginning on or after 1 January 2008 but are not relevant to the Group's operations:

IFRIC 14, 'IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction', provides guidance on assessing the limit in IAS 19 on the amount of the surplus that can be recognised as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement.

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

IFRIC 11, 'IFRS 2 – Group and treasury share transactions', provides guidance on whether share-based transactions involving treasury shares or involving Group entities (for example, options over a parent's shares) should be accounted for as equity-settled or cash-settled share-based payment transactions in the stand-alone accounts of the parent in its subsidiaries.

IFRIC 12, 'Service concession arrangements'; and

IFRIC 13, 'Customer loyalty programmes'.

(c) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group.

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 or later periods, but the Group has not early adopted them:

- IAS 23 (Amendment), 'Borrowing costs' (effective from 1 January 2009). 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.

- IAS 1 (Revised), 'Presentation of financial statements' (effective from 1 January 2009). The revised standard will prohibit 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. All non-owner changes in equity will be required to be shown in a performance statement, but entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the income statement and statement of comprehensive income). Where entities restate or reclassify comparative information, they will be required to present a restated balance sheet as at the beginning comparative period in addition to the current requirement to present balance sheets at the end of the current period and comparative period. The Group will apply IAS 1 (Revised) from 1 January 2009

- IAS 36 (Amendment), 'Impairment of assets' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008. Where fair value less costs to sell is calculated on the basis of discounted cash flows, disclosures equivalent to those for value-in-use calculation should be made. The Group will apply the IAS 36 (Amendment) and provide the required disclosure where applicable for impairment tests from 1 January 2009.

- 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.

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

– 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. Currently, for segment reporting purposes, each subsidiary designates contracts with Group treasury as fair value or cash flow hedges so that the hedges are reported in the segment to which the hedged items relate. This is consistent with the information viewed by the chief operating decision-maker. After the amendment is effective, the hedge will continue to be reflected in the segment to which the hedged items relate (and information provided to the chief operating decision-maker), but the Group will not formally document and test this relationship.

– When remeasuring 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 Group will apply the IAS 39 (Amendment) from 1 January 2009. It is not expected to have an impact on the Group's income statement.

- IAS 1 (Amendment), 'Presentation of financial statements' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008. The amendment clarifies that some rather than all financial assets and liabilities classified as held for trading in accordance with IAS 39, 'Financial instruments: Recognition and measurement' are examples of current assets and liabilities respectively. The Group will apply the IAS 39 (Amendment) from 1 January 2009. It is not expected to have an impact on the Group's financial statements.

- There are a number of minor amendments to IFRS 7, 'Financial instruments: Disclosures', IAS 8, 'Accounting policies, changes in accounting estimates and errors', IAS 10, 'Events after the reporting period', IAS 18, 'Revenue' and IAS 34, 'Interim financial reporting', which are part of the IASB's annual improvements project published in May 2008 (not addressed above). These amendments are unlikely to have an impact on the Group's accounts and have therefore not been analysed in detail.

(d) The following standards and amendments to existing standards have been published and are not relevant to the Group beginning on or after 1 January 2009 or later periods:

- IFRS 2 (Amendment), 'Share-based payment' (effective from 1 January 2009). The amended standard deals with vesting conditions and cancellations. It clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. These features would need to be included in the grant date fair value for transactions with employees and others providing similar services; they would not impact the number of awards expected to vest or valuation thereof subsequent to grant date. All cancellations, whether by the entity or by other parties, should receive the same accounting treatment.

- IAS 32 (Amendment), 'Financial instruments: Presentation', and IAS 1 (Amendment), 'Presentation of financial statements' – 'Puttable financial instruments and obligations arising on liquidation' (effective from 1 January 2009). The amended standards require entities to classify puttable financial instruments and instruments, or components of instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation as equity, provided the financial instruments have particular features and meet specific conditions.

- IFRS 1 (Amendment) 'First time adoption of IFRS', and IAS 27 'Consolidated and separate financial statements' (effective from 1 January 2009). 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 replaces it with a requirement to present dividends as income in the separate financial statements of the investor.

2 **SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

- IAS 27 (Revised), 'Consolidated and separate financial statements', (effective from 1 July 2009). 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.

- IFRS 3 (Revised), 'Business combinations' (effective from 1 July 2009). 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 vale or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed..

- IFRS 5 (Amendment), 'Non-current assets held-for-sale and discontinued operations' (and consequential amendment to IFRS 1, 'First-time adoption') (effective from 1 July 2009). The amendment is part of the IASB's annual improvements project published in May 2008. The amendment clarifies that all of a subsidiary's assets and liabilities are classified as held for sale if a partial disposal sale plan results in loss of control. Relevant disclosure should be made for this subsidiary if the definition of a discontinued operation is met. A consequential amendment to IFRS 1 states that these amendments are applied prospectively from the date of transition to IFRSs

- IAS 23 (Amendment), 'Borrowing costs' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008. The definition of borrowing costs has been amended so that interest expense is calculated using the effective interest method defined in IAS 39 'Financial instruments: Recognition and measurement'. This eliminates the inconsistency of terms between IAS 39 and IAS 23.

- IAS 28 (Amendment), 'Investments in associates' (and consequential amendments to IAS 32, 'Financial Instruments: Presentation', and IFRS 7, 'Financial instruments: Disclosures') (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008. An investment in associate is treated as a single asset for the purposes of impairment testing. Any impairment loss is not allocated to specific assets included within the investment, for example, goodwill. Reversals of impairment are recorded as an adjustment to the investment balance to the extent that the recoverable amount of the associate increases.

- IAS 38 (Amendment), 'Intangible assets'(effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008. A prepayment may only be recognised in the event that payment has been made in advance of obtaining right of access to goods or receipt of services.

- IAS 19 (Amendment), 'Employee benefits' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008.

  – The amendment clarifies that a plan amendment that results in a change in the extent to which benefit promises are affected by future salary increases is a curtailment, while an amendment that changes benefits attributable to past service gives rise to a negative past service cost if it results in a reduction in the present value of the defined benefit obligation.
  – IAS 19 (Amendment), 'Employee benefits' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008.
  – The amendment clarifies that a plan amendment that results in a change in the extent to which benefit promises are affected by future salary increases is a curtailment, while an amendment that changes benefits attributable to past service gives rise to a negative past service cost if it results in a reduction in the present value of the defined benefit obligation.

- IFRIC 16, 'Hedges of a net investment in a foreign operation' (effective from 1 October 2008). IFRIC 16 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. The requirements of IAS 21, 'The effects of changes in foreign exchange rates', do apply to the hedged item.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.4 Basis of consolidation

The consolidated financial statements include the assets, liabilities and results of the operations of the Group. Subsidiary companies (Note 32), 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.

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.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 financials 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. Such assets are initially recognised at cost and remeasured 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 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.

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 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 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.

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.

Other bonds acquired at the date of issue are classified as loans and receivables carried at amortised cost, using the effective interest method. Income or losses are recognised upon the sale of the bonds.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 Fixed assets

Fixed assets are stated at cost as modified by revaluation less accumulated depreciation. Fixed assets, with the exception of freehold land, are depreciated on a straight-line basis over their estimated useful original lives as follows:

Building	25 years
Other fixed assets	2-8 years

Effective 30 September 2004, the Bank adopted a new policy to revalue its freehold land and building based on periodic, but at least once in every three years, valuations by an external independent valuer. Previously, land and building were carried at cost. Effective 30 September 2004, the estimated remaining useful life of the building was 20 years and the revalued amount was being depreciated over this period. As part of its policy, the Bank again revalued its land and building in December 2006 and the revalued amount of the building was being depreciated over its now useful life of 20 years from 1 January 2007. The Bank sold its headquarters building in 2007.

The net impact of revaluations is recognised in the fixed assets revaluation reserve included in shareholders' equity.

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.

2.21 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 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 fee 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.

2.27 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 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.29 Segment reporting

A segment is a distinguishable component of the Group that is engaged in either providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenue earned from external customers and whose revenues or assets are 10 percent or more of all the segments are reported separately.

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.

2.32 Medium term loan

The medium term loan was initially recognised at fair value and subsequently carried at amortised cost; the front-end fees paid on the loan was amortised over the life of the loan.

2.33 Bank deposits

Deposits from banks are initially recognised at fair value and subsequently carried at amortised cost.

3 **CLASSIFICATION OF FINANCIAL INSTRUMENTS**

2008

	Held-for-trading US$1000	Loans and receivables US$000	Held-to-maturity US$000	Available-for-sale US$000	Financial liabilities at amortised cost US$000	Non-financial assets and liabilities US$000	Total US$000
Cash and deposits with banks	-	3,688	-	-	-	-	3,688
Trading equities and funds	726	-	-	-	-	-	726
Government bonds	-	-	4,388	-	-	-	4,388
Other equities and funds	-	-	-	49,816			49,816
Other bonds	10,065	212	4,937	-	-	-	15,214
Derivative financial instruments	849	-	-	-	-	-	849
Loans and advances	620	901	-	-	-	-	1,521
Instalment sale receivable	-	17,299	-	-	-	-	17,299
Fixed assets	-	-	-	-	-	504	504
Other assets	-	6,221	-	-	-	267	6,488
Total assets	12,260	28,321	9,325	49,816	-	771	100,493
Bank deposits	-	-	-	-	-	-	-
Customer deposits	-	-	-	-	26,493	-	26,493
Securities sold under repurchase agreements	-	-	-	-	817	-	817
Derivative financial instruments	1,735	-	-	-	-	-	1,735
Medium term loan	-	-	-	-	-	-	-
Revolving loan facility	-	-	-	-	11,600	-	11,600
Other liabilities	-	-	-	-	211	6,659	6,870
Subordinated loans	-	-	-	-	10,000	-	10,000
Shareholders' equity	-	-	-	-	-	42,978	42,978
Total liabilities and shareholders' equity	1,735	-	-	-	49,121	49,637	100,493

3 CLASSIFICATION OF FINANCIAL INSTRUMENTS (CONTINUED)

2007

	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	Non-financial assets and liabilities US$000	Total US$000
Cash and deposits with banks	-	2,391	34,211	-	-	-	36,602
Trading equities and funds	9,279	-	-	-	-	-	9,279
Government bonds	-	-	4,388	-	-	-	4,388
Other equities and funds	-	-	-	73,264	-	-	73,264
Other bonds	-	5,292	4,501	-	-	-	9,793
Derivative financial instruments	83	-	-	-	-	-	83
Loans and advances	914	53	-	-	-	-	967
Instalment sale receivable	-	18,839	-	-	-	-	18,839
Fixed assets	-	-	-	-	-	316	316
Other assets	-	26,951	-	-	-	397	27,348
Total assets	10,276	53,526	43,100	73,264	-	713	180,879
Bank deposits	-	-	-	-	10,015	-	10,015
Customer deposits	-	-	-	-	36,553	-	36,553
Securities sold under repurchase agreements	-	-	-	-	3,700	-	3,700
Medium term loan	-	-	-	-	28,500	-	28,500
Revolving loan facility	-	-	-	-	13,600	-	13,600
Other liabilities	-	-	-	-	839	6,236	7,075
Subordinated loans	-	-	-	-	10,000	-	10,000
Shareholders’ equity	-	-	-	-	-	71,436	71,436
Total liabilities and shareholders’ equity	-	-	-	-	103,207	77,672	180,879

4 CASH AND DEPOSITS WITH BANKS

Cash and deposits with banks comprise:

	2008 US$000	2007 US$000
Money at call	3,622	2,325
Placements with banks	-	34,211
Balances with Central Bank	66	66
Total cash and deposits with banks	3,688	36,602

Balances with the Central Bank of Bahrain are not available for use in the Group’s day-to-day operations.

5 TRADING EQUITIES AND FUNDS

Trading equities and funds comprise:

	2008 US$000	2007 US$000
Quoted equities	703	8,469
Managed funds	23	810
Total trading equities and funds	726	9,279

6 GOVERNMENT BONDS

Government bonds comprise:

	2008 US$000	2007 US$000
Government bonds – Held-to-maturity	4,388	4,388

7 OTHER EQUITIES AND FUNDS

Other equities and funds comprise:

	2008 US$000	2007 US$000
Available-for-sale		
(i) Unquoted equity fund investments – at fair value	44,639	62,190
(ii) Unquoted equity investments – at fair value	3,659	9,933
(iii) Unquoted equity investments – at cost	1,518	1,141
Total other equities and funds	49,816	73,264

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 judgement 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 2008 would have the following impact on the Bank’s results for the year ended 31 December 2008 and/or the Bank’s financial position 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 2008 would impact “other equities and funds” as well as fair value reserve by ±US$ 2.2 million, respectively, as at that date.

For those investments where, as at 31 December 2008, the fair value was significantly below cost or where the fair value was below cost for a prolonged period, a shift of ±5% in management’s fair value estimates would result in a ± US$ 0.2 million change in “other equities and funds” at 31 December 2008 with an inverse change in the provision for impairment in the income statement for the year then ended by the same amount.

7 OTHER EQUITIES AND FUNDS (CONTINUED)

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

	Diversified		Technology		Others		Total	
	2008	2007	2008	2007	2008	2007	2008	2007
	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	125	-	-	-	-	21	125
European	3,912	4,904	-	-	-	-	3,912	4,904
Italian	1,850	1,836	-	-	-	-	1,850	1,836
UK	88	132	-	-	-	-	88	132
UK & Continental Europe	5,986	15,419	-	-	-	-	5,986	15,419
US	2,127	1,783	-	-	-	-	2,127	1,783
US & European	13,375	17,582	-	-	-	-	13,375	17,582
	27,359	41,781	-	-	-	-	27,359	41,781
Venture Capital Funds:								
European	-	32	1,616	-	-	-	1,616	32
India	-	-	1,235	-	-	-	1,235	-
US	-	-	5,615	9,367	-	-	5,615	9,367
US & European	-	-	1,169	2,677	-	-	1,169	2,677
	-	32	9,635	12,044	-	-	9,635	12,076
Fund of Funds:								
US & European	2,107	2,516	5,538	5,817	-	-	7,645	8,333
Subtotal	29,466	44,329	15,173	17,861	-	-	44,639	62,190
(ii) Unquoted equity - at fair value								
Financial	-	-	-	-	-	3,339	-	3,339
Private Equity Financial Intermediaries	3,290	6,158	-	-	-	-	3,290	6,158
Leisure	-	-	-	-	199	174	199	174
Others	-	-	-	-	170	262	170	262
Subtotal	3,290	6,158	-	-	369	3,775	3,659	9,933
(iii) Unquoted equity – at cost								
Technology/ Telecommunications	-	-	1,518	1,141	-	-	1,518	1,141
Subtotal	-	-	1,518	1,141	-	-	1,518	1,141
Total other equities and funds	32,756	50,487	16,691	19,002	369	3,775	49,816	73,264

7 OTHER EQUITIES AND FUNDS (CONTINUED)

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 the following fund manager's report is received, 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.

The fair values in respect of unquoted equity investments carried at an amount of US$ 1,518,000 (2007: US$ 1,141,000) could not be reliably determined. These unquoted equity investments are measured at cost less provisions for impairment.

At December 31 2008, the Bank had undrawn investment commitments to private equity funds of US$ 77,713,000 (31 December 2007: US$ 31,895,000) (Note 37). 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. Under contractual agreements with certain fund managers, failure to honour a non-excused investment drawdown request from a fund manager can result in the forfeiture of existing investments with that fund manager.

As disclosed in Note 18, certain of the Bank's private equity investments are pledged against the revolving loan facility. As at 31 December 2008, these investments had a carrying fair value of US$ 19.7 million (2007: US$ 20.7 million).

Movements in other equities and funds were as follows:

	2008 US$000	2007 US$000
At 1 January	73,264	75,690
Net fair value (loss)/gain on available-for-sale investments	(16,799)	13,583
Additions	10,681	9,220
Disposals	(12,987)	(15,934)
Fair value transferred to income statement on disposals	3,761	(8,770)
Impairment provisions (Note 28)	(4,195)	(3,381)
Foreign exchange movements	(3,909)	2,856
At 31 December	49,816	73,264

Unquoted equity investments are stated net of specific impairment provisions as follows:

	Unquoted Equity investments -at cost 2008 US$000	Unquoted Equity fund investments -at fair value 2008 US$000	Total 2008 US$000	Unquoted Equity investments -at cost 2007 US$000	Unquoted Equity fund investments -at fair value 2007 US$000	Total 2007 US$000
At 1 January	4,881	-	4,881	1,562	-	1,562
Charge for the year (Note 28)	505	4,060	4,565	3,381	-	3,381
Amounts released within the year (Note 28)	(370)	-	(370)	-	-	-
Amounts written off	(3,611)	-	(3,611)	(211)	-	(211)
Foreign exchange movements	(91)	-	(91)	149	-	149
At 31 December	1,314	4,060	5,374	4,881	-	4,881

8 OTHER BONDS

Other bonds comprise:

		Structured Products			
	Corporate	Listed Capital Protected Note	Student Loans	CDOs	Total
	US$000	US$000	US$000	US$000	US$000
31 December 2008					
Held for trading	2,756	7,309	-	-	10,065
Held-to-maturity - at amortised cost	-	-	-	4,937	4,937
Loans and receivables-at amortised cost	-	-	212	-	212
Total other bonds	2,756	7,309	212	4,937	15,214
31 December 2007					
Held-to-maturity - at amortised cost	-	-	-	4,501	4,501
Loans and receivables – at amortised cost	-	-	292	5,000	5,292
Total other bonds	-	-	292	9,501	9,793

Other bonds classified as held-to-maturity and loans and receivables had a fair value of US$ 4,906,000 and US$ 85,000 respectively (31 December 2007: US$ 4,470,000 and US$ 4,646,500 respectively).

All bonds held for trading as at 31 December 2008 had a rating of AA-.

CDOs maturing in 2011 amounting to US$ 4.9 million as at 31 December 2008 (2007: US$ 9.5 million) comprise the Group's investments in asset securitisation programmes. CDO bonds are secured by U.S. Government securities.

In the normal course of banking business, certain bonds are pledged to parties under repo agreements (Note 16). These bonds had a fair market value of US$ 0.9 million as at 31 December 2008 (2007: US$ 4.6 million).

Also, at 31 December 2008 certain corporate bonds were pledged as collateral against derivative margin accounts. These bonds had a fair market value of US$ 0.9 million (31 December 2007: Nil).

8 **OTHER BONDS (CONTINUED)**

Movements in other bonds classified as held-to-maturity and loans and receivables were as follows:

	Student loans		CDOs		Total	
	2008	2007	2008	2007	2008	2007
	US$000	US$000	US$000	US$000	US$000	US$000
At January 1	292	574	9,501	9,113	9,793	9,687
Amortised costs	-	-	244	204	244	204
Writeback for the year (Note 28)	-	-	192	184	192	184
Disposals (repayments received/sold)	-	(290)	(5,000)	-	(5,000)	(290)
Foreign exchange movements	(80)	8	-	-	(80)	8
At 31 December	212	292	4,937	9,501	5,149	9,793

Other bonds are stated after deducting impairment provisions as follows:

	2008	2007
	US$000	US$000
At 1 January	11,650	11,834
Writeback for the year (Note 28)	(192)	(184)
At 31 December	11,458	11,650

9 **DERIVATIVE FINANCIAL INSTRUMENTS**

The Group utilised derivative instruments for trading purposes in 2008.

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:

			Fair values			
	Contact notional amount		Assets		Liabilities	
	2008	2007	2008	2007	2008	2007
	US$000	US$000	US$000	US$000	US$000	US$000
Derivatives – held for trading						
Equity derivatives:						
Equity options	300	165	-	83	-	-
Foreign exchange derivatives:						
Currency forwards	25,002	-	796	-	(1,662)	-
Currency futures	5,385	-	53	-	(73)	-
Total			849	83	(1,735)	-

10 LOANS AND ADVANCES

(a) Composition

The composition of the loans and advances is as follows:

	Commercial		Government		Total	
	2008	2007	2008	2007	2008	2007
	US$000	US$000	US$000	US$000	US$000	US$000
Americas	872	-	536	791	1,408	791
Rest of the world	29	53	84	123	113	176
Total loans and advances	901	53	620	914	1,521	967

Commercial loans are stated at cost less impairment provisions. Government loans are held for trading and carried at market value.

(b) Movements in loans and advances

The movements in loans and advances portfolio were as follows:

	2008	2007
	US$000	US$000
At 1 January	967	3,222
Additions	872	136
Disposals	(13)	(2,535)
Fair value transferred to income statement	(354)	72
Foreign exchange movements	49	72
At 31 December	1,521	967

(c) Provisions for impairment on loans and advances

None of the above loans are impaired and, hence, no provisions for impairment have been deducted from loans and advances.

(d) Non-accrual loans

Non-accrual loans comprise distressed Government loans purchased from the secondary market and are held as trading assets.

	Less than 6 Months		6 months to one year		Over 3 years		Total	
	2008	2007	2008	2007	2008	2007	2008	2007
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Government								
Americas	-	-	-	-	536	791	536	791
Rest of the world	-	123	84	-	-	-	84	123
Total non-accrual loans	-	123	84	-	536	791	620	914

(e) Unrecognised contractual interest

	2008	2007
	US$000	US$000
At 1 January	3,169	3,450
Amounts written off	-	(975)
Amounts unrecognised within the year	424	435
Foreign exchange movements	198	259
At 31 December	3,791	3,169

11 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.

12 FIXED ASSETS

Fixed assets comprise:

2008	Freehold land and building	Other fixed assets	Total
	US$000	US$000	US$000
At 1 January 2008			
Cost/valuation	-	6,718	6,718
Accumulated depreciation	-	(6,402)	(6,402)
Net book amount	-	316	316
Year ended 31 December 2008			
Opening net book amount	-	316	316
Additions	-	405	405
Depreciation charge	-	(147)	(147)
Disposals	-	(70)	(70)
Closing net book amount	-	504	504
At 31 December 2008			
Cost/valuation	-	6,937	6,937
Accumulated depreciation	-	(6,433)	(6,433)
Net book amount	-	504	504

2007	Freehold land and building	Other fixed assets	Total
	US$000	US$000	US$000
At 1 January 2007			
Cost/valuation	12,599	6,664	19,263
Accumulated depreciation	-	(6,467)	(6,467)
Net book amount	12,599	197	12,796
Year ended 31 December 2007			
Opening net book amount	12,599	197	12,796
Exchange rate adjustments	-	2	2
Additions	27	175	202
Depreciation charge	(449)	(58)	(507)
Disposals	(12,177)	-	(12,177)
Closing net book amount	-	316	316
At 31 December 2007			
Cost/valuation	-	6,718	6,718
Accumulated depreciation	-	(6,402)	(6,402)
Net book amount	-	316	316

12 FIXED ASSETS (CONTINUED)

In October 2007, the Board of Directors decided to sell the freehold land and building. The Bank reclassified the freehold land and building from fixed assets to assets held for sale. In late December 2007, the Bank signed a definitive sale agreement and recognised a receivable of US$ 18.04 million (Notes 13 and 34), with payment to be made in first quarter 2008. Accordingly, in order to protect the interests of the lenders under the medium term loan and as per agreement with the buyer, the mortgage in the lenders' favour on the Bank's head office land and building remained in place during that period. As agreed, the lenders released the mortgage upon the full prepayment of the loan (US$ 28,500,000 in February 2008), which was funded by the sale proceeds received in February 2008 and an additional payment by the Bank for the remaining amount.

13 OTHER ASSETS

Other assets comprise:

	2008 US$000	2007 US$000
Accrued interest receivable	604	643
Management fees receivable	255	281
Receivables from assets sold (Note 34)	-	18,037
Receivable from investment fund managers	3,318	6,555
Prepayments	268	397
Other	2,043	1,435
Total other assets	6,488	27,348

Receivables from assets sold as at 31 December 2007 amounting to US$ 18.04 million represent proceeds receivable from the sale of the Bank's freehold land and building (Notes 12, 17 and 34). This amount was collected in February 2008.

Provisions for impairment

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

	Specific	
	2008 US$000	2007 US$000
At 1 January	317	-
Amounts charged for the year (Note 28)	-	317
Amounts written off	(317)	-
At 31 December	-	317

14 BANK DEPOSITS

Deposits from banks comprise:

	2008 US$000	2007 US$000
Bank deposits	-	10,015
Total bank deposits	-	10,015

15 CUSTOMER DEPOSITS

Customer deposits comprise:

	2008 US$000	2007 US$000
Customer participation in funds	12,969	19,028
Government entities, corporates and individuals	13,524	17,525
Total customer deposits	26,493	36,553

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$ 2,888,200 (31 December 2007: US$ 6,114,000) in deposits held on behalf of BMB Technology and Telecommunications Fund (Note 37).

In December 2008, the Bank entered into negotiations with a depositor included in Government entities, corporates and individuals regarding deposits aggregating US$ 13,119,000. As at 31 December, the negotiated terms include a quarterly principal repayment of US$ 2,000,000 starting 5 October 2009 to 5 January 2011 and a final repayment of US$ 1,119,000 on 5 April 2011. Interest is to be paid monthly at Libor plus 200 basis points from 5 February 2009 to 5 October 2009. Thereafter, interest will be payable quarterly and set at a rate of Libor plus 100 basis points from 5 October 2009 to 5 April 2011. This agreement on the terms set out above was signed on 15 January 2009.

16 SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

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

	2008 US$000	2007 US$000
Repos on other bonds (Note 8)	817	3,700

17 MEDIUM TERM LOAN

The Bank raised an unsecured medium term loan facility of US$ 75,000,000 on 21 December 1999, which was drawn on 18 January 2000. This loan carried interest at Libor plus 100 basis points and was repayable with a bullet repayment on 23 December 2002. The front-end fee paid 145 basis points. The fee, together with all costs associated with this facility, was amortised over the life of the loan facility.

On 14 December 2004, the Bank and the lenders signed an agreement to refinance this facility. The refinancing agreement became effective as of 28 July 2005, after the fulfilment of certain conditions precedent, including a US$ 5,000,000 principal down payment, a mortgage in favour of the lenders on the Bank’s head office, land and building and establishment of a pledged account in connection with a mechanism under which 50% of the Bank’s excess operating cash flow over a minimum cash balance threshold would be dedicated to debt service.

The refinancing carried interest at a rate of Libor plus 150 basis points. After the conversion on 30 August 2005 of US$ 16,800,000 of this facility under the Bank’s capital restoration plan, the loan balance was reduced to US$ 53,200,000 with principal repayments of US$ 9,500,000 (June 2006), US$ 15,200,000 (June 2007) and US$ 28,500,000 (June 2008). The instalments of US$ 9,500,000 (due June 2006) and US$ 15,200,000 (due June 2007) were paid.

17 MEDIUM TERM LOAN (CONTINUED)

In late December 2007, the Bank sold its head office land and building with payment to be made in first quarter 2008. Accordingly, in order to protect the interests of the lenders under the medium term loan and as per agreement with the buyer, the mortgage in the lenders' favour on the Bank's head office land and building remained in place during that period. As agreed, the lenders released the mortgage upon the full prepayment of the loan (US$ 28,500,000 in February 2008), which was funded by the sale proceeds received in February 2008 and an additional payment by the Bank for the remaining amount. A refinancing fee of 1% was paid and was amortised over the life of the loan to maturity.

18 REVOLVING LOAN FACILITY

	2008 US$000	2007 US$000
Revolving loan facility	11,600	13,600

On 30 December 2003, the Bank signed a US$ 20,000,000 three-year revolving facility secured by certain of the Bank's investments in private equity funds/investments (Note 7). This facility was designed to provide liquidity to the Bank with applicable interest of floating US$ Libor. By an amended agreement signed in December 2006, the facility was extended to 30 December 2007 with an interest rate of floating US$ Libor plus 25 basis points.

In December 2007, an additional amendment agreement was signed, extending the facility to 30 June 2008, with a revised interest rate of floating US$ Libor plus 80 basis points. This was extended to 17 July 2008 and then rolled over to 15 May 2009, with the following repayment schedule: US $2,000,000 (September 2008), US$ 3,600,000 (January 2009), US$ 4,000,000 (March 2009) and US$ 4,000,000 (May 2009). The instalment of US$ 2,000,000 was paid on the due date.

In January 2009, this agreement was amended and extended to 17 June 2010 with the following repayment schedule: US$ 3,000,000 (30 September 2009); US$ 3,000,000 (7 January 2010); US$ 3,000,000 (31 March 2010) and US$ 2,600,000 (17 June 2010). Collateral of 150% of the outstanding facility agreement will be required at all times (Note 7).

19 OTHER LIABILITIES

Other liabilities comprise:

	2008 US$000	2007 US$000
Accrued interest payable	212	839
Unclaimed dividends	3,366	3,387
Employee leaving indemnity (Note 30)	987	965
Accrued expenses	1,656	1,535
Other	649	349
Total other liabilities	6,870	7,075

20 SUBORDINATED LOAN

On 29 June 2001, the Bank raised a subordinated debt facility of US$ 10,000,000 repayable on 29 December 2006. The debt carried interest at 13% per annum, 8% payable annually and the difference payable when realization of profits on certain private equity investments of the Bank occurred.

On 1 November 2001, the interest payable on the above subordinated facility was amended to 8% per annum, 5% payable annually and the difference payable when realization of profits on certain private equity investments of the Bank took place (Notes 7 and 23). By an amended agreement, the facility was extended to December 2008.

On 28 December 2008, an additional amendment and restated agreement was signed, amending the maturity date to 30 December 2011, and revising the interest rate to one year Libor plus 10% per annum, with all other terms and conditions unchanged.

21 SHARE CAPITAL

Share capital comprises:

	2008		2007	
	Number 000	Amount US$000	Number 000	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	209,352	52,338	209,352	52,338
Stock dividend	10,467	2,617	-	-
At 30 September 2008/31 December 2007	219,819	54,955	209,352	52,338

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

	2008			2007		
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%	7,112,416	13,140	3.40%
1% up to less than 5%	8,193,882	1	3.73%	7,466,672	1	3.57%
5% up to less than 10%	62,545,696	4	28.45%	59,623,997	4	28.48%
10% up to less than 20%	-	-	-	-	-	-
20% up to less than 50%*	141,906,308	2	64.56%	135,148,865	2	64.55%
50% and above	-	-	-	-	-	-
	219,818,890	13,135	100%	209,351,950	13,147	100%

* Reflects ownership of Al Fawares Holding Co.

Treasury shares

At 31 December 2008, the Bank owned 1 of its own shares (31 December 2007: 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	
	2008	2007	2008	2007
Net (loss)/ income	US$(14,313,100)	US$ 24,616,500	US$ (14,313,100)	US$ 24,616,500
Weighted average number of shares	217,302,248	209,351,949	217,302,248	209,351,949
(Loss)/earnings per share	US$ (0.07)	US$ 0.12	US$ (0.07)	US$ 0.12

22 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.

Retained earnings

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

Dividends

Dividends are "recognised" 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.

Fair value reserve

Fair value reserve represents 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.

Fixed asset revaluation reserve

Effective 30 September 2004, the Bank adopted a policy to revalue its land and building once every three years. Such revaluation is to be undertaken by an independent external valuer. In accordance with International Financial Reporting Standards, depreciation is provided on a straight-line basis over the remaining estimated useful life of the building calculated on the revalued amount. The assets are presented in the financial statements at their revalued amounts, being the fair value at the revaluation date less any subsequent accumulated depreciation. Land is not subject to depreciation.

At 30 September 2004, the land and building were fair valued based on open market valuation method, at US$ 11,406,000 by a firm of independent professional valuers. The net impact of revaluation, US$ 5,056,000, was credited to a fixed asset revaluation reserve, as part of shareholders' equity. The building was depreciated over its estimated useful life of 20 years from 1 October 2004. As part of its established policy, the Bank again revalued its land and building in December 2006, by an independent valuer using the same valuation method, at US$ 12,600,000. the net impact of this revaluation, US$ 2,042,000, was credited to the fixed asset revaluation reserve. The building was being depreciated over its estimated useful life of 20 years from 1 January 2007. In October 2007, the fixed asset revaluation of US$ 7,098,000 was reversed as the Bank put the land and building up for sale and reclassified these assets as assets held for sale. In December 2007, the Bank sold these assets.

23 INCOME FROM INVESTMENTS

Income from investments comprises:

	2008 US$000	2007 US$000
Trading		
(Loss)/income from managed funds	(412)	5
Loss from quoted equities	(1,241)	(1,295)
Loss from other bonds – corporate	(256)	-
(Loss)/income from sovereign debt and bonds	(333)	72
Loss from derivatives - Government bond futures	(286)	-
Loss from derivatives -equity options	(156)	(39)
Dividend income	132	405
	(2,552)	(852)
Available-for-sale		
Income from other equities and funds	5,396	23,923
Dividend income	-	101
	5,396	24,024
Loans and receivables		
(Loss)/ income from other bonds – structured products	(95)	1
Total income from investments	2,749	23,173

24 FOREIGN EXCHANGE (LOSS)/INCOME

Foreign exchange (loss)/income comprises:

	2008 US$000	2007 US$000
Foreign exchange (loss)/ income	(172)	1,923
Foreign exchange derivatives (non-hedging)		
(Loss) from foreign exchange futures	(530)	-
(Loss) from foreign exchange forwards	(867)	-
Total foreign exchange (loss)/income	(1,569)	1,923

25 FEES AND COMMISSION INCOME

Fees and commission income comprises:

	2008 US$000	2007 US$000
Performance fees	177	1,859
Management fees	263	517
Placement fees	401	82
Others	-	18
Total fees and commission income	841	2,476

26 OTHER (LOSS)/INCOME

Other (loss)/income primarily comprises amounts relating to the liquidation of T&T Beverages Limited.

27 NET INTEREST EXPENSE

Net interest expense comprises:

	2008 US$000	2007 US$000
Interest income:		
Instalment sale receivable	877	948
Government bonds and other bonds	602	482
Placement with banks	450	1,197
Loans and advances	47	78
Total interest income	1,976	2,705
Interest expense:		
Loan facilities	(1,703)	(4,268)
Customers deposits	(1,082)	(2,072)
Securities sold under repurchase agreements	(200)	(209)
Deposits from banks	(66)	(78)
Total interest expense	(3,051)	(6,627)
Net interest expense	(1,075)	(3,922)

28 IMPAIRMENT PROVISIONS

The specific provision charge comprises:

	2008 US$000	2007 US$000
Charge for other equities and funds (Note 7)	4,565	3,381
Charge for other assets (Note 13)	-	317
Writeback for other bonds (Note 8)	(192)	(184)
Amounts released from other equities and funds (Note 7)	(370)	-
Total charge for impairment provisions	4,003	3,514

29 GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses comprise:

	2008 US$000	2007 US$000
Salaries and other personnel expenses (Note 30)	7,700	6,650
Occupancy and equipment	1,068	347
Legal and professional	1,153	615
Other	1,141	1,124
Total general and administrative expenses	11,062	8,736

30 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$ 134,700 (31 December 2007: US$ 73,200). 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.

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:

	2008 US$000	2007 US$000
At 1 January	965	1,074
Accruals for the year	420	280
Paid during the year	(398)	(389)
At 31 December (Note 19)	987	965

	2008 Number	2007 Number
Employees at 31 December	81	71

31 RELATED-PARTY TRANSACTIONS AND BALANCES

The Bank considers Directors and key management personnel as related parties. Transactions entered during the year and balances at 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.

31 RELATED-PARTY TRANSACTIONS AND BALANCES (CONTINUED)

	Directors and key management personnel 2008 US$000	Directors and key management personnel 2007 US$000
Loans		
At 1 January	661	685
Advanced during the year	420	69
Repayments during the year	(230)	(93)
At 31 December	851	661
Administration charges for the year	8	7

No loans were advanced to any director of the Bank during the year or in 2008 (2007: Nil).

No provisions have been recognised in respect of loans given to related parties (2007: 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 and bear an administration charge of 1% per annum (2007: 1% p.a.). The majority of these loans are fully secured.

	Directors and key management personnel 2008 US$000	Directors and key management personnel 2007 US$000
Deposits		
At 1 January	376	57
Received during the year	918	1,735
Repaid during the year	(768)	(1,420)
Interest capitalized during the year	16	4
At 31 December	542	376
Interest expense on deposits for the year	16	4

Key management compensation

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

	2008 US$000	2007 US$000
Salaries and other short-term employee benefits	1,984	2,680
End of service benefits	1,231	108
	3,215	2,788
Directors' remuneration	63	387

For the year ended 31 December 2007, Directors' remuneration included US$ 300,000 as a proposed payment. This was approved by the Ordinary General Meeting of shareholders held in March 2008.

31 RELATED-PARTY TRANSACTIONS AND BALANCES (CONTINUED)

(b) The Bank considers Al Fawares Holding Co. 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 11).

Fellow associated companies

Al Fawares Holding Co. is considered as having significant influence in Authentium Inc., a company incorporated in Delaware, 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 2008, the Bank's investment in Authentium Inc. totalled US$ 0.7 million, included in other equities and funds, in addition to US$ 0.9 million included in loans and receivables. The respective amounts for 2007 are US$ 0.7 million and nil.

The terms of the bridge loan agreement are as follows:

- 1st tranche drawn in 2008; bears an interest rate of 8% per annum. 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.

32 INVESTMENTS IN SUBSIDIARIES

Listing of subsidiaries

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

Subsidiaries	Ownership interest 2008	2007	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.

32 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.

33 LEGAL CLAIMS

Share issuance – 1982

The Bank and the Bank of Bahrain and Kuwait 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, the Appellate Court upheld the judgement of the Court of First Instance, ruling in the Bank's favour. The Kuwaiti litigant had the right to appeal to the Court of Cassation but did not file a challenge within the stipulated time and, hence, the litigation in Kuwait came to a final conclusion in the Bank's favour.

On 10 August 2003, the Kuwaiti litigant filed suit in Bahrain. The case is pending in the courts of Bahrain, having been adjourned several times, and a Court Expert has been appointed. At the hearing held on 20 November 2008 the case was adjourned once again to 2 April 2009 to hear the Expert's report.

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.

34 NET INCOME FROM ASSETS SOLD

Net income from assets sold comprises:

	2008 US$000	2007 US$000
Income		
Profit on sale of freehold land and building	-	12,959
Rental income	-	867
Service charge income	10	135
	10	13,961
Expenses		
Staff costs	-	222
Depreciation	-	449
Others	-	111
	-	782
Net income from assets sold	10	13,179

Net cash flow from assets sold:

	2008 US$000	2007 US$000
Net profit from assets sold	10	13,179
Additions:		
Depreciation	-	449
Net book amount – freehold land and building (Note 12)	-	12,177
Less:		
Proceeds (received)/not received from sale of freehold land and and building (Note 13)	18,037	(18,037)
Revaluation reserves released (Note 22)	-	(7,098)
Net cash flow provided by assets sold as at 31 December 2007	18,047	670

In the fourth quarter of 2007, the Bank derecognised freehold land and building from fixed assets to assets sold.

In late December 2007, the Bank signed a definitive sale agreement with the buyer.

35 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.

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

- procedures for identification and quantification of risks
- criteria for risk acceptance based on risk and return, as well as other factors
- clearly defined exposure and risk limits
- robust operating policies and procedures, including those for specific allocation of risk limits to individual obligors and/or transactions
- 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
- periodic internal audits of the control environment

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

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 anti 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 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. 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. During fiscal year 2008, external factors have limited the Bank's ability to fully implement this policy with respect to managing the foreign exchange exposure of the Bank's investments.

In identifying and monitoring risk exposures, BMB uses a variety of quantitative tools (including Value at Risk) as well as qualitative approaches to measure risks at the "macro" level. The Banks 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.

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

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.

The Bank seeks to mitigate its exposure to losses through a variety of techniques such as investment 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 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.

The Group attempts to manage its credit risk exposure through diversification of its equity investments, capital markets, trading and lending 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 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

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.

35 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

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	
	2008	2007	2008	2007	2008	2007	2008	2007
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Assets								
Cash and deposits with banks	1,634	721	1,440	31,803	614	4,078	3,688	36,602
Government bonds	-	-	-	-	4,388	4,388	4,388	4,388
Other equities and funds	17,699	26,588	24,829	36,717	7,288	9,959	49,816	73,264
Other bonds	14,043	9,501	1,171	292	-	-	15,214	9,793
Derivative financial instruments	-	83	849	-	-	-	849	83
Loans and advances	1,408	791	-	-	113	176	1,521	967
Instalment sale receivable	-	-	-	-	17,299	18,839	17,299	18,839
Other assets	2,724	3,953	1,055	2,987	2,709	20,408	6,488	27,348
Total assets subject to Risk	37,508	41,637	29,344	71,799	32,411	57,848	99,263	171,284
Trading equities and funds	-	273	92	6,505	634	2,501	726	9,279
Fixed assets	-	-	-	70	504	246	504	316
Reconciliation to total assets	37,508	41,910	29,436	78,374	33,549	60,595	100,493	180,879
Off-balance sheet credit and investment instruments	24,406	9,822	51,707	22,073	2,500	-	78,613	31,895

35 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

(b) Industry sector

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

	Banking/ Finance 2008 US$000	Govern-ment 2008 US$000	Technology/ Telecoms 2008 US$000	Diversified 2008 US$000	Others 2008 US$000	Total 2008 US$000
Assets						
Cash and deposits with banks	3,622	66	-	-	-	3,688
Government bonds	-	4,388	-	-	-	4,388
Other equities and funds	-	-	16,691	32,756	369	49,816
Other bonds	10,065	4,937	-	-	212	15,214
Derivative financial instruments	849	-	-	-	-	849
Loans and advances	-	620	872	-	29	1,521
Instalment sale receivable	-	-	-	-	17,299	17,299
Other assets	209	117	1,927	626	3,609	6,488
Total assets subject to credit risk	14,745	10,128	19,490	33,382	21,518	99,263
Trading equities and funds	30	-	616	-	80	726
Fixed assets	-	-	-	-	504	504
Reconciliation to 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

(ii) **As at 31 December 2007**

	2007 US$000	2007 US$000	2007 US$000	2007 US$000	2007 US$000	2007 US$000
Total assets subject to credit risk	36,844	15,010	20,880	55,466	43,084	171,284
Total assets	43,078	15,010	22,441	55,493	44,857	180,879
Off-balance sheet credit and investment instruments	-	-	6,368	25,527	-	31,895

35 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.

BMB also uses RiskMetrics™ Value at Risk ("VaR") model as a secondary market risk measurement and monitoring tool and also for stress testing of positions. VaR is a statistical risk measure which quantifies within a given confidence level the maximum expected fluctuation in the fair value of a portfolio within a specified time period. BMB calculates VaR for a 99% one-tailed confidence level for a one-day holding period based on market price changes during a previous one-year historical observation period. As such, the VaR parameters correspond to a maximum potential loss in one of one hundred trading days. The market data on which these calculations are made, including correlations and volatility, are provided by an independent third party vendor, RiskMetrics Group. Calculations are made both by risk factor and then for the Bank's entire market risk portfolio after consideration of correlations between asset classes which may result in diversification benefits or may reflect additional risk due to unfavourable co-movements between asset classes.

In addition to the estimation of daily VaR, the Bank conducts daily stress testing on its market risk portfolio for a variety of historical and simulated extreme market events. The Bank also performs stress tests on interest rate risk in its "Banking Book". The results of these stress tests are reported to senior management as part of the daily VaR reports.

During 2008 the Bank's trading activities were modest. Interest rate and foreign exchange exposures (the latter chiefly from foreign currency denominated private equity investments), as well as equity exposures from existing publicly traded equity investments, are considered by the VaR model as market exposures.

The total 1-day VaR for these risks, segregated by the sources of risk, at 31 December were as follows:

VaR by source of risk

	2008 US$000	2007 US$000
Sources of risk		
Equity price risk	50	119
Interest rate risk	169	95
Foreign exchange rate risk	53	515
Less: Diversification benefit	(106)	(160)
Total VaR	166	569

The total VaR is less than the sum of the VaR of the individual risk components, due to diversification benefits arising from correlation within and across the risk classes.

During the year, the daily average total one-day VaR, minimum total VaR and maximum total VaR were US$ 303,000 (2007: US$ 480,388), US$ 193,000 (2007: US$ 407,493) and US$ 719,600 (2007: US$ 596,083) respectively, estimated for 99 % confidence level for a one day holding period and a decay factor of 0.94.

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.

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

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.

35 **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:

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
Cash and deposits with banks	66	-	-	-	-	-	3,622	3,688
Trading equities and funds	-	-	-	-	-	-	726	726
Government bonds	-	-	-	-	-	4,388	-	4,388
Other equities and funds	-	-	-	-	-	-	49,816	49,816
Other bonds	212	2,756	-	7,309	-	4,937	-	15,214
Derivative financial instruments	-	-	-	-	-	-	849	849
Loans and advances	-	-	-	-	872	-	649	1,521
Instalment sale receivable	-	-	1,617	-	7,292	8,390	-	17,299
Fixed assets	-	-	-	-	504	-	-	504
Other assets	274	64	448	1,129	4,292	-	281	6,488
Total assets	552	2,820	2,065	8,438	12,960	17,715	55,943	100,493
Bank deposits	-	-	-	-	-	-	-	-
Customer deposits	26,270	-	-	-	-	-	223	26,493
Securities sold under repurchase agreements	817	-	-	-	-	-	-	817
Derivative financial instruments	-	-	-	-	-	-	1,735	1,735
Medium term loan	-	-	-	-	-	-	-	-
Revolving loan facility	11,600	-	-	-	-	-	-	11,600
Other liabilities	530	-	66	1,183	256	3,366	1,469	6,870
Subordinated loans	-	-	-	-	10,000	-	-	10,000
Shareholders' equity	-	-	-	-	-	-	42,978	42,978
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		

2007

	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	36,934	19,894	2,053	514	11,083	24,234	86,167	180,879
Total liabilities and shareholders' equity	62,254	29,851	1,889	10,000	-	4,352	72,533	180,879
Total interest rate sensitivity gap	(25,320)	(9,957)	164	(9,486)	11,083	19,882		

35 **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:

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	-	-

2007

	Effective interest rate %		
	US$	GBP	EUR
Assets			
Placements with banks	4.7	5.8	4.3
Government bonds	5.8	-	-
Other bonds	5.3	7.5	-
Loans and advances	-	-	-
Instalment sale receivable	4.8	-	-
Liabilities			
Bank deposits	-	-	4.4
Customer deposits	5.4	6.0	4.6
Securities sold under repurchase agreements			
Medium term loan	6.4	-	-
Revolving loan facility	5.4	-	-
Subordinated loans	8.0	-	-

(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$ 223,000 (31 December 2007: US$ 487,000).
(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

35 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 2008

	US$	EUR	GBP	Others	Total
	US$000	US$000	US$000	US$000	US$000
Assets:					
Cash and deposit with banks	2,163	497	628	400	3,688
Trading equities and funds	-	-	68	658	726
Government bonds	4,388	-	-	-	4,388
Other equities and funds	23,437	20,122	4,380	1,877	49,816
Other bonds	15,002	-	212	-	15,214
Derivative financial instruments	849	-	-	-	849
Loans and advances	872	283	29	337	1,521
Instalment sale receivable	17,299	-	-	-	17,299
Fixed assets	504	-	-	-	504
Other assets	3,452	837	327	1,872	6,488
Total financial assets	67,966	21,739	5,644	5,144	100,493
Liabilities:					
Customer deposits	20,530	4,275	1,678	10	26,493
Securities sold under repurchase agreement	817	-	-	-	817
Derivative financial instruments	1,735				1,735
Revolving loan facility	11,600	-	-	-	11,600
Other liabilities	5,952	12	69	837	6,870
Subordinated loan	10,000	-	-	-	10,000
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
At 31 December 2007					
Total financial assets	85,490	52,958	16,233	26,198	180,879
Total financial liabilities	92,346	14,419	2,411	267	109,443
Net on-balance sheet financial position	(6,856)	38,359	13,822	25,931	71,436
Off-balance sheet commitments	10,037	15,007	6,851	-	31,895

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

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").

BMB strives to minimize 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. The Bank seeks to maintain high quality marketable securities within its portfolio as well as sizeable short-term deposits with banks as a cash reserve. Over the past years, the Bank has strengthened its liquidity position by refinancing its US$ 75 million medium term facility, raising US$ 52.34 million in additional capital, extending the maturity of the US$ 20 million liquidity facility, extending the maturity on the US$ 10 million subordinated loan and agreeing a term repayment schedule for US$ 13.1 million in customer deposits (which was formalised in early 2009).

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 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.

35 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.

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									
Deposits with banks	3,688	-	-	-	-	-	-	-	3,688
Trading equities and funds	726	-	-	-	-	-	-	-	726
Government bonds	127	-	-	127	-	-	-	4,388	4,642
Other equities and funds	801	-	1,093	4,362	35,027	8,533	-	-	49,816
Other bonds	10,072	-	-	-	5,000	-	-	212	15,284
Derivative financial instruments	849	-	-	-	-	-	-	-	849
Loans and advances	29	620	-	-	1,011	-	-	-	1,660
Instalment sale receivable	-	-	2,457	-	12,286	9,403	-	-	24,146
Fixed assets	-	-	-	-	504	-	-	-	504
Other assets	271	64	-	1,257	4,292	-	-	-	5,884
Total assets	16,563	684	3,550	5,746	58,120	17,936	-	4,600	107,199
Liabilities									
Customer deposits	14,943	39	25	75	11,578	-	-	-	26,660
Securities sold under repurchase agreements	817	-	-	-	-	-	-	-	817
Derivative financial instruments	1,735								1,735
Revolving loan facility	3,748	4,000	4,000	-	-	-	-	-	11,748
Subordinated loan	-	-	-	1,229	10,000	-	-	-	11,229
Other liabilities	331	-	66	1,171	256	3,366	-	-	5,190
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	36,286	14,570	-	4,600	

Subsequent to the balance sheet date, as detailed in Note 15, the Bank agreed the extension of the maturity of US$ 11.2 million of deposits to the period 2010-2011. Similarly, as detailed in Note 18, the maturity of US$ 8.6 million of the Revolving Loan Facility was extended to 2010.

The Group will be able to meet any unexpected net cash outflows by selling securities it holds.

35 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

2007

	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									
Deposits with banks	36,648	-	-	-	-	-	-	-	36,648
Trading equities and funds	9,279	-	-	-	-	-	-	-	9,279
Government bonds	127	-	-	127	-	-	-	4,388	4,642
Other equities and funds	-	2,839	5,677	24,584	38,587	1,577	-	-	73,264
Other bonds	2	-	-	-	10,000	-	-	292	10,294
Derivative financial instruments	83	-	-	-	-	-	-	-	83
Loans and advances	53	914	-	-	-	-	-	-	967
Instalment sale receivable	-	-	2,457	-	12,286	9,403	-	-	24,146
Fixed assets	-	-	-	-	316	-	-	-	316
Other assets	2,326	19,894	856	397	3,232	-	-	-	26,705
Total assets	48,518	23,647	8,990	25,108	64,421	10,980	-	4,680	186,344
Liabilities									
Bank deposits	8,576	-	1,480	-	-	-	-	-	10,056
Customer deposits	22,073	797	797	3,107	10,117	-	-	-	36,891
Securities sold under repurchase agreements	3,717	-	-	-	-	-	-	-	3,717
Medium term loan	163	-	-	-	28,500	-	-	-	28,663
Revolving loan facility	64	-	13,600	-	-	-	-	-	13,664
Subordinated loan	-	-	800	10,400	-	-	-	-	11,200
Other liabilities	6	1,268	-	-	-	4,962	-	-	6,236
Total liabilities	34,599	2,065	16,677	13,507	38,617	4,962	-	-	110,427
Net liquidity gap	13,919	21,582	(7,687)	11,601	25,804	6,018	-	4,680	

Structured products (loans and receivables), included in other bonds, of US$ 5,000,000 classified within the maturity band of 1–5 years is a marketable security readily convertible to cash, secured by a U.S. Government security.

35 **FINANCIAL RISK MANAGEMENT (CONTINUED)**

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

	2008 US$000	2007 US$000
Detail		
Inter-bank placements and cash	3,688	36,602
Trading equities and funds	726	9,279
Other liquid bonds	10,065	5,000
Other assets	-	19,240
Derivative financial instruments	849	-
Total liquid assets	15,328	70,121
Bank deposits	-	(10,056)
Customer deposits maturing within 12 months	(15,082)	(27,138)
Medium term loan/due within 12 months	-	(28,663)
Repos on other bonds	(817)	(3,717)
Derivative financial instruments	(1,735)	-
Revolving loan facility	(11,748)	(13,664)
Subordinated loan	(1,229)	(11,200)
Total liquid liabilities	(30,611)	(94,438)
Net liquid position	(15,283)	(24,317)

Subsequent to the balance sheet date, as detailed in Note 15, the Bank agreed the extension of the maturity of US$ 11.2 million of deposits to the period 2010-2011. Similarly, as detailed in Note 18, the maturity of US$ 8.6 million of the Revolving Loan Facility was extended to 2010. As a result of these two actions, the Bank's net liquidity position improved to a positive US$ 4.5 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 2008, the Bank was effectively invested in over 526 companies.

35 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.

Note 7 discusses private equity.

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' accounts. 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.

36 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.

36 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. This is supplemented by use of RiskMetrics™ VaR program to assess market exposure and to perform stress tests of market positions and interest rate risk in the Banking Book. Reports on the Bank's capital adequacy are filed quarterly with the Central Bank of Bahrain.

As the Bank has no operating branches or subsidiaries outside the Kingdom of Bahrain, it is subject only to the capital requirements of the Central Bank of Bahrain, which currently requires all financial institutions in Bahrain to maintain a 12.0% CAR.

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 2008 and 31 December 2007, BMB did not have any exposures or investments requiring such deductions.

Tier 2 Capital consists of the qualifying portion of subordinated loans 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, as well as the Basic Indicator Approach for operational risk, BMB's Basel II Capital Adequacy Ratio as 31 December 2008 stood at 22.8% as compared to 24.0% as at 31 December 2007.

36 CAPITAL MANAGEMENT (CONTINUED)

Capital base and risk weighted assets

	Average for the year 2008 US$000	At year-end 2008 US$000	Average for the year 2007 US$000	At year-end 2007 US$000
Tier 1 capital				
Share capital	54,955	54,955	52,338	52,338
Legal reserves	16,310	16,310	14,464	16,310
General and other reserves	7,521	7,521	10,138	10,138
Retained earnings	(21,459)	(30,110)	(27,840)	(18,599)
Revaluation (loss) reserves – available-for-sale investments	-	(5,698)	-	-
Total qualifying Tier 1 capital	57,327	42,978	49,100	60,187
Tier 2 capital				
Revaluation reserves – available-for-sale investments	1,467	-	4,621	5,056
Fixed assets revaluation reserves	-	-	5,324	-
Subordinated loan	-	6,000	2,257	-
Total qualifying Tier 2 capital	1,467	6,000	12,202	5,056
Total regulatory capital	58,794	48,978	61,302	65,243
Risk weighted assets				
On-balance sheet	215,517	155,085	261,637	251,374
Off-balance sheet	33,659	59,577	23,663	20,374
Total risk weighted assets	249,176	214,662	285,300	271,748
Capital Adequacy Ratio	23.6%	22.8%	21.5%	24.0%

Prior to implementation of Basel II Framework by the CBB in 2008, the Bank calculated the Capital Adequacy Ratio using the Standardised Approach for market risk weighted assets and for the credit risk weighted assets based on the BIS 1988 Capital Accord and 1996 Market Risk Amendment.

37 OFF-BALANCE SHEET ITEMS

Credit-related financial instruments include commitments to extend credit, 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.

37 OFF-BALANCE SHEET ITEMS (CONTINUED)

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

	2008 US$000	2007 US$ 000
Undrawn investment commitments in other equities and funds (Note 7)	77,713	31,895
Undrawn loan commitments	900	-
Funds under management	35,721	41,320
Discretionary accounts	93,266	90,311

Undrawn investment commitments in other equities and funds include US$ 19,009,000 (31 December 2007: US$ 11,521,000), 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.

Undrawn loan commitments include US$ 28,000 which the Bank has sold to clients, for which it has received binding commitments from them.

BMB Technology and Telecommunications Investment Company was the only fund under management as at 31 December 2008. Discretionary accounts include funds managed on behalf of customers pertaining to sub-participation in other private equity funds, unquoted equities and other debt instruments.

38 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 2008 and 2007. 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.

2008	Book amount US$000	Fair value US$000	Over/(under) book amount US$000
Assets			
Government bonds	4,388	1,865	(2,523)
Other bonds carried at amortised cost	5,149	4,906	(243)
Loans and advances	1,521	1,521	-
Instalment sale receivable	17,299	17,299	-
Net shortfall of fair value over book amount			(2,766)

2007	Book amount US$000	Fair value US$000	Over/(under) book amount US$000
Assets	4,388	2,927	(1,461)
Government bonds	9,793	9,262	(531)
Other bonds carried at amortised cost	967	967	-
Loans and advances	18,839	18,839	-
Instalment sale receivable			
			(1,992)
Net shortfall of fair value over book amount			

38 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The total shortfall in fair value of US$ 2,766,000 (2007: US$ 1,992,000) is not relevant except in a forced sale situation since the Bank has the intention and the ability to hold these bonds to maturity when it would recover the nominal amounts.

The total fair value of Government bonds and other bonds is based on quoted market prices at the balance sheet date.

The fair value of loans and advances, excluding loans held for trading purposes, 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 deposit with banks
- Other assets
- Bank deposits
- Customer deposits
- Securities sold under repurchase agreements
- Other liabilities

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

39 SEGMENT INFORMATION

(a) Business Segments

The Group is organized into two business segments; banking and manufacturing. The banking segment has three sub-segments; trading, investment activity and other operations.

Trading activity – current investments in equities and funds and other derivative instruments.
Investment activity – investments in bonds, other equities and funds and hedging activity.
Other operations include investor marketing, building rental, etc.

Manufacturing: softdrinks.

Transactions between business sub-segments are on normal terms and conditions. The allocation of costs for each business segment is based on estimated time and relevant measurement criteria for each business segment.

39 **SEGMENT INFORMATION (CONTINUED)**

	Banking					
	Trading activity	Investing activity	Other operations	Total banking	Manufacturing	Total
	US$000	US$000	US$000	US$000	US$000	US$000
2008						
Income/(loss) from investments	(2,552)	5,301	-	2,749	-	2,749
Foreign exchange (loss)	(1,569)	-	-	(1,569)	-	(1,569)
Fees and commission income	-	-	841	841	-	841
Other (loss)	-	-	(62)	(62)	(44)	(106)
Net interest (expense)/income	30	(1,105)	-	(1,075)	-	(1,075)
Total income/(loss) from operations	(4,091)	4,196	779	884	(44)	840
Impairment provisions	-	(4,003)	-	(4,003)	-	(4,003)
General and administrative expenses	(3,973)	(2,610)	(4,479)	(11,062)	-	(11,062)
Total operating expenses	(3,973)	(6,613)	(4,479)	(15,065)	-	(15,065)
Net (loss)/income from operations	(8,064)	(2,417)	(3,700)	(14,181)	(44)	(14,225)
Net income from assets sold	-	10	-	10	-	10
Net (loss)/income before taxation	(8,064)	(2,407)	(3,700)	(14,171)	(44)	(14,215)
Taxation	-	(98)	-	(98)	-	(98)
Net (loss)/income for the year	(8,064)	(2,505)	(3,700)	(14,269)	(44)	(14,313)
OTHER INFORMATION						
Segment assets	12,260	86,448	-	98,708	-	98,708
Unallocated corporate assets	-	-	-	1,785	-	1,785
CONSOLIDATED TOTAL ASSETS	12,260	86,448	-	100,493	-	100,493
Segment liabilities	1,735	48,910	-	50,645	-	50,645
Unallocated corporate liabilities	-	-	-	6,870	-	6,870
Total liabilities	1,735	48,910	-	57,515	-	57,515
Shareholders' equity						42,978
CONSOLIDATED TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY						100,493

39 **SEGMENT INFORMATION (CONTINUED)**

	Banking					
	Trading activity US$000	Investing activity US$000	Other operations US$000	Total banking US$000	Manufacturing US$000	Total US$000
2007						
Income/(loss) from investments	(851)	24,024	-	23,173	-	23,173
Foreign exchange income	1,923	-	-	1,923	-	1,923
Fees and commission income	-	-	2,476	2,476	-	2,476
Other income/(loss)			58	58	(20)	38
Net interest (expense)/income	-	(3,926)	-	(3,926)	4	(3,922)
Total income/(loss) from operations	1,072	20,098	2,534	23,704	(16)	23,688
Impairment provisions	-	(3,514)	-	(3,514)	-	(3,514)
General and administrative expenses	(43)	(5,975)	(2,718)	(8,736)	-	(8,736)
Total operating expenses	(43)	(9,489)	(2,718)	(12,250)	-	(12,250)
Net income/(loss) from operations	1,029	10,609	(184)	11,454	(16)	11,438
Net income from assets sold	-	13,179	-	13,179	-	13,179
Net income/(loss) before taxation	1,029	23,788	(184)	24,633	(16)	24,617
Taxation	-	-	-	-	-	-
Net income/(loss) for the year	1,029	23,788	(184)	24,633	(16)	24,617
OTHER INFORMATION						
Segment assets	10,277	168,489	-	178,766	81	178,847
Unallocated corporate assets	-	-	-	2,032	-	2,032
CONSOLIDATED TOTAL ASSETS	10,277	168,489	-	180,798	81	180,879
Segment liabilities	-	102,225	-	102,225	143	102,368
Unallocated corporate liabilities	-	-	-	7,075	-	7,075
Total liabilities	-	102,225	-	109,300	143	109,443
Shareholders' equity						71,436
CONSOLIDATED TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY						180,879

39 SEGMENT INFORMATION (CONTINUED)

(b) Geographical Segments

	North America		Europe		Rest of the world		Total	
	2008	2007	2008	2007	2008	2007	2008	2007
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Income								
Total operating income	1,599	15,616	(4,669)	10,407	3,910	(2,335)	840	23,688
Assets								
Total assets	37,508	41,910	29,436	78,374	33,549	60,595	100,493	180,879

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

40 POST BALANCE SHEET EVENT

Revolving loan facility

In January 2009, the Bank signed an amended and restated agreement on the revolving loan facility. As part of the amendment, the facility was extended to June 2010 with the following repayments: US $3,000,000 (September 2009), US$ 3,000,000 (January 2010), US$ 3,000,000 (March 2010) and US$ 2,600,000 (June 2010) (Note 18).

Closure of subsidiary

In January 2009 T&T Beverages Limited II was liquidated (Note 32).

Customer deposits

In January 2009, the Bank signed a deposit agreement with depositors included in Government entities, corporates and individuals.

The drafted terms include a quarterly principal repayment of US$ 2,000,000 starting 5 October 2009 to 5 January 2011 and a final repayment of US$ 1,119,000 on 5 April 2011.

Interest is to be paid monthly at Libor plus 200 basis points from 5 February 2009 to 5 October 2009. Thereafter, interest will be payable quarterly and set at a rate of Libor plus 100 basis points from 5 October 2009 to 5 April 2011 (Note 15).

BMB Investment Bank

Annex: Basel II - Pillar 3 Disclosures

2008

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1. INTRODUCTION

This Annex contains the BMB Group's Basel II Pillar 3 disclosures for the Fiscal Year ending 31 December 2008 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 disclosure is part of Basel II Pillar 3 and is based on paragraph numbers 820 through to number 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 Rulebook is available at www.cbb.gov.bh and the BCBS Basel II Framework is available at www.bis.org.

This document discusses BMB's risk management strategies, processes, structures, risk 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 Annex and the information it contains a critical part of its efforts in fostering transparency and disclosure of the performance and condition of the Bank.

The disclosures in this Annex supplement the disclosures within the Bank's 2008 Annual Report (accompanying financial statements). Where information has been disclosed in the 2008 Annual Report, that information is cross referenced and only supplemental information is presented in this Annex. The Bank's previous Basel II Pillar 3 disclosure was for the half-year period ending 30 June 2008 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 section "A Brief History of BMB" and Note 1 to the accompanying 2008 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 32 to the 2008 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 36 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 21 to the 2008 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 2008 was US$ 43.0 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 2008 was US$ 6.0 million. An analysis of the components of Tier 2 Capital is provided in Note 36 to the accompanying financial statements.

3.4 Tier 3 Capital

The Bank had no Tier 3 Capital as at 31 December 2008, and as at 31 December 2007

3.5 Deductions from Regulatory Capital

As at 31 December 2008, 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 2008, the aggregate amount of regulatory Capital (Tier 1, Tier 2 and Tier 3) was US$ 49.0 million. Note 36 to the 2008 Annual Report provides details on average amounts for 2008 and 2007 as well as the year-end amount for 2007.

Table 1: Capital Requirements

	Average for the year 2008 US$000	At year-end 2008 US$000	Average for the year 2007 US$000	At year-end 2007 US$000
Tier 1 capital				
Share capital	54,955	54,955	52,338	52,338
Legal reserves	16,310	16,310	14,464	16,310
General and other reserves	7,521	7,521	10,138	10,138
Retained earnings	(21,459)	(30,110)	(27,840)	(18,599)
Revaluation (loss) reserves – available-for-sale investments	-	(5,698)	-	-
Total qualifying Tier 1 capital	57,327	42,978	49,100	60,187
Tier 2 capital				
Revaluation reserves – available-for-sale investments	1,467	-	4,621	5,056
Fixed assets revaluation reserves	-	-	5,324	-
Subordinated loan	-	6,000	2,257	-
Total qualifying Tier 2 capital	1,467	6,000	12,202	5,056
Total regulatory capital	58,794	48,978	61,302	65,243
Risk weighted assets				
On-balance sheet	215,517	155,085	261,637	251,374
Off-balance sheet	33,659	59,577	23,663	20,374
Total risk weighted assets	249,176	214,662	285,300	271,748
Capital Adequacy Ratio	23.6%	22.8%	21.5%	24.0%

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.

The Bank's corporate governance documents espousing the above listed best practices are available on its website: http://www.bmb.com.bh/corporate/more.asp

4.3 BMB rated one of the best for Corporate Governance

The Bank is proud to announce that in 2008, the Bank was rated number 6 out of a total of 581 listed financial and non-financial companies within the GCC in an evaluation of corporate governance systems conducted by The National Investor UAE ("TNI"), using a corporate governance rating methodology developed in conjunction with Hawkmah, the regional Institute for Corporate Governance, TNI evaluated 581 listed financial and non financial corporate entities within the GCC region.

The report, which is available at http://www.tni.ae/ir/Strategy%20Reports/TNI_BASIC_01Sep08.pdf rated listed companies based on 43 defined corporate governance parameters across 3 categories.

4.4 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

4.5 Board Executive Committee

The Board Executive Committee (EXCO) is composed of three Board members and the Bank's Chief Executive 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.

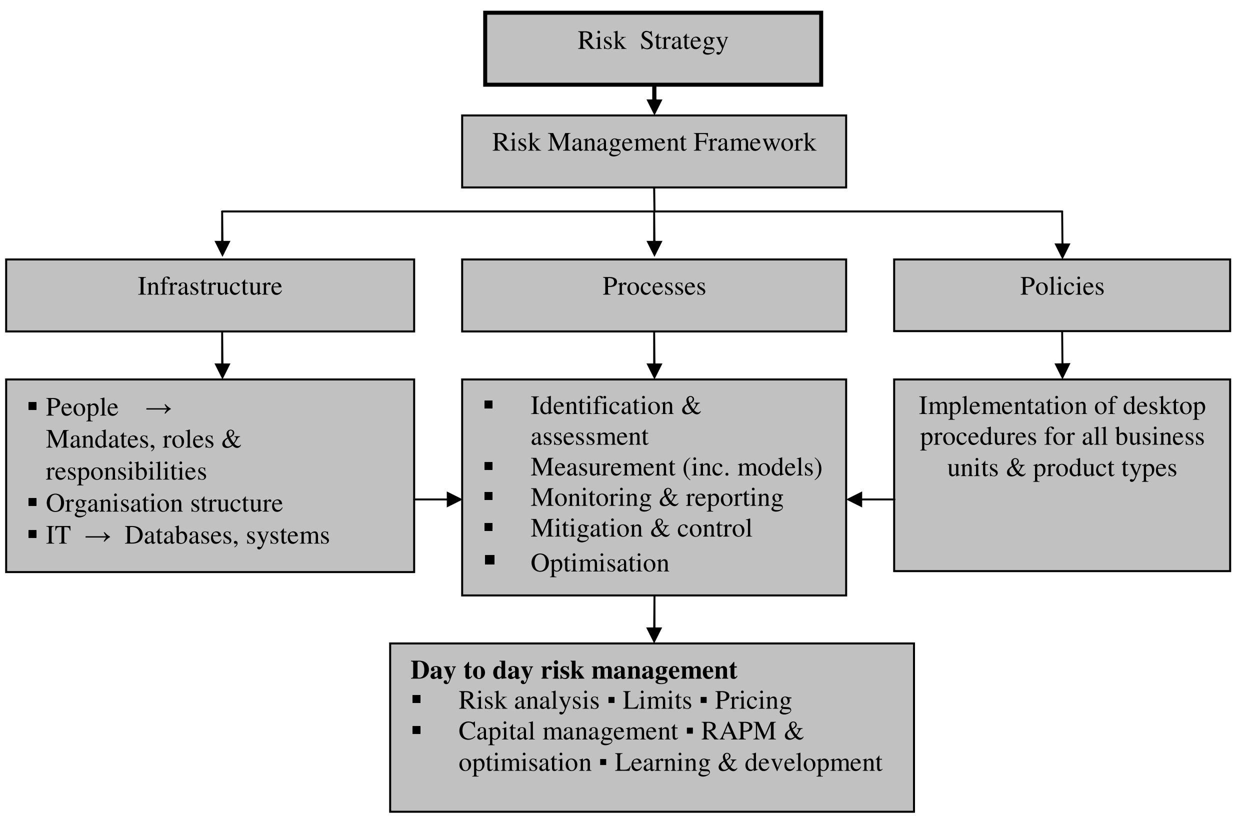
4.6 Board Audit Committee

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.

4.7 Risk Management Committee

The RMC is composed of the Bank's Chief Executive 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



4.8 Risk Management Department

BMB's Risk Management Department ("RMD") is headed by a Head of Risk Management who reports to the Chief Executive 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 is also responsible for preparing daily risk reports, including stress test reports, Value at Risk (VaR) reports, limit monitoring reports among various other reports. In addition, RMD also manages problem or past-due assets. In identifying and monitoring risk exposures, BMB uses a variety of quantitative tools including VaR 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.

4.9 Compliance Risks and Anti-Money Laundering

In the year under review the Bank enhanced its compliance management process by establishing an independent Compliance Department and recruiting a Compliance Officer to Head the Department, which oversees and manages the Bank's compliance, regulatory and money laundering risks. The Compliance Department in its functions, works closely with and under the oversight of the Board Audit Committee. The Department is also responsible for the Bank's Information Technology Compliance and in particular for developing and managing the Bank's Business Continuity Plan. The Bank's Compliance Charter sets forth the objectives, roles and responsibilities of the Compliance Department.

4.10 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.

4.11 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, VaR limits, settlement risk limits, futures contract limits, tenor limits, single-stock exposure limits and counterparty limits. The limits serve the following purposes:

4.11.1 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.

4.11.2 Geographic and Country Limits

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

4.11.3 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.

4.11.4 VaR Limits
VaR limits are used to monitor global market risk exposures in the Trading Book including interest rate, equity exposure, foreign currency and commodity risk factors.

4.11.5 Futures Contract Limits
Futures contract limits are used to limit the size of the futures Trading Book. Contract limits effectively limit the quantum of potential exposure arising from the underlying asset's price movement.

4.11.6 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.

4.11.7 Stock Limits
Single stock limits are used to limit trading equity risk exposure to a single stock.

4.11.8 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.

4.11.9 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.

4.12 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, economic or VaR based limits 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.

4.13 Market Risk Quantification

4.13.1 Value at Risk

In addition to the regulatory Market Risk calculations under Basel II, the Bank uses RiskMetrics Group's RiskManager™ software to compute aggregate measures of market risk using Value at Risk (VaR) and for stress testing. VaR is a statistical risk measure which quantifies, within a given confidence level, the expected loss within a portfolio within a specified time period. BMB calculates VaR for a 99% one-tailed confidence level for a one-day holding period, based on market price changes during a previous one-year historical observation period and using a decay factor of 0.94. As such, the VaR parameters correspond to a maximum potential loss in one of one hundred trading days. The market data, on which these calculations are made, including correlations and volatility, are provided by the RiskMetrics Group. Calculations are made both by risk factor and then for the Bank's entire market risk portfolio after consideration of correlations between asset classes, which may result in diversification benefits or may reflect additional risk due to unfavourable co-movements between asset classes. Hence, because of this imperfect correlation the total VaR is generally less than the sum of the VaR of the individual risk components, which results in diversification benefits. During 2008, the Bank's trading activities were modest. The Bank started scaling back its trading equities positions in early 2008, by the time the financial crisis reached its peak, the Bank had substantially reduced its equity exposure. In addition the Bank initiated foreign currency futures and forwards to mitigate the foreign exchange risk inherent in its private equity portfolio, which is carried in its Banking Book. The combination of the above activities has seen the Bank's market risk capital gradually declining in 2008.

As with the Basel II based risk measures, the majority of the Bank's market risk exposure under the VaR model also arises from the foreign exchange risk inherent in the bank's private equity investments which are predominantly denominated in Sterling and Euros. The total 1-day VaR for these risks, segregated by the sources of risk, at 31 December 2008 are as shown in the table below.

Table 2: Value At Risk

USD 000	31-Dec-08	Maximum	Minimum	Average
Equity VaR	50.37	224.01	44.12	157.16
Foreign Exchange VaR	53.00	616.75	53.00	423.11
Interest Rate VaR	168.67	171.01	54.09	85.57
Diversification Benefit	(106.21)	-	-	-
Global VaR	165.82	719.63	165.82	505.37

***Figures are based on 251 trading days. VaR figures under maximum and minimum columns are single-day highest and lowest points respectively. VaR computations are based on 1-day holding period, 99% Confidence Interval, 0.94 Decay Factor and Historical Simulation Methodology.**

4.13.2 Stress Testing

While VaR captures the Bank's market risk exposure under normal market conditions, stress testing is used to add insight to the possible outcomes under abnormal market conditions for a variety of historical and simulated extreme market events. In this respect stress testing complements VaR as it addresses some of the critical weaknesses of VaR. Stress tests produce information summarising the Bank's exposure to extreme, but possible, circumstances and offer a way of measuring and monitoring the portfolio against such extreme price movements. As such, stress testing addresses the large moves in key market variables of the kind that lie beyond day to day risk monitoring but could potentially occur. With the upgrade of its Risk Manager software to version 3, all of the Bank's stress tests are now based on a predictive algorithm, which simulates the effects of historical changes in a single risk factor across multiple risk portfolios based on historical cross correlations between the different risk types. The Bank currently runs a total of 15 different stress tests daily; these include historical crisis events, parallel yield curve changes, yield curve steepening, yield curve flattening and volatility changes among others. Historical stress tests are run using the historical simulation methodology, over a 25-day holding period and using decay factor of 0.94. The results of these stress tests are reported to executive management as part of the daily market risk reports.

4.13.3 Equity Exposure Risk

Equity risk is the risk of adverse impact on the Bank's income and economic value arising from adverse movements in equity prices. The Bank is exposed to equity exposure risk arising from its trading portfolio of equities listed in the GCC, India, UK/Europe and the US. The Bank has Board-approved geographic equity exposure limits based on cost as the first line of defence against equity risk. Further to these limits the Bank also uses stop loss limits to control losses on trading equities. The stop loss limits are triggered initially by deviations from original cost and then subsequently by deviations from market value. In addition, the Bank calculates 1-day and 10-day VaR at the 99% confidence interval using historical simulation for the equity exposures and the Bank manages equity risk within the context of VaR equity risk limits. Equity VaR usage is monitored by the Risk Management Department daily and reported to executive management for review and to the Board on a periodic basis. In addition, the Risk Management Department conducts stress testing against its equity exposures on a daily basis by simulating historical market stress events and the results of the stress tests are reported to executive management. The majority of the Bank's listed equity exposures are in the Trading Book and the Bank uses the Standardised Approach for calculating capital charges for equity risk exposures as part of its market risk capital charge under Basel II.

4.13.4 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"). Such risks arise from deliberate decisions on the part of the Bank relating from its view on future interest rates as well as the availability and cost of instruments to manage such risk. The Bank is also 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 uses VaR based limits as well as nominal limits (set as a percentage of regulatory capital) for a series of defined maturity time "buckets" to quantify and thus control this risk. In conformity with Basel II, the Bank considers not only the interest rate risk inherent in its Trading Book but as well that in its Banking Book utilizing VaR under current market and stress test scenarios. See Note 35 in the 2008 Annual Report for the interest rate gap analysis.

4.14 Global Financial Crisis

What started as a mortgage related crisis in the United States in late 2007 quickly evolved into a financial crisis in the US which quickly spread to other parts of the world, highlighting the globalization of the financial markets and the world economy. Weak credit underwriting standards in the US sub-prime mortgage market resulted in increasing defaults on mortgage payments which in turn resulted in traders of mortgage backed securities (MBS) being unable to value or trade in these MBS assets. Consequently, global credit markets froze, global banks were unable to access liquidity and funding, equity markets tumbled and asset price volatility spiked to unprecedented levels. Financial institutions that were highly leveraged and exposed to US sub-prime activity were affected the most.

The global financial crisis has highlighted the important role of proper risk management systems and strong corporate governance practices. We foresee the regulators responding appropriately to the financial crisis and the regulatory burden increasing rather than decreasing. The Bank's risk management architecture will continue to evolve to match the expected increase in the regulatory burden. For its part BMB has no exposure to the US sub-prime and MBS markets nor in any credit derivative transactions. However, the Bank anticipates that the state of the global markets and the anticipated economic slowdown will have an impact on the Bank in the following ways. First, the pace of private equity realizations will slow over the coming 12 to 24 months and the exit multiples achieved are likely to be lower. Second, these same macro factors are likely to adversely affect global trading opportunities thus limiting the Bank's trading activities and trading profits. Thirdly just like all other Banks, constraints on global liquidity are likely to impact the Bank's ability to develop additional funding sources. Going forward, as the global economy heads into a depression, prudent management of funding sources and leverage, proper management of capital resources and selective diversification of earnings will become critical.

5. CAPITAL MANAGEMENT FRAMEWORK

The Bank complies with Capital Adequacy Requirements as set by the Central Bank of Bahrain (CBB). Under this process, 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. The CBB required all Bahrain banking institutions to implement Pillar 1 of Basel II, which involves calculation of capital charges for market, credit and operational risks with effect from 1 January 2008.

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.

Table 3: Basel II Methodologies

Pillar 1 Risk	Basel II Methodology	Planned Migration
Credit Risk	Standardised Approach	-
Market Risk	Standardised Approach	Internal Models Approach by 31 January 2010
Operational Risk	Basic Indicator Approach	-

5.2 Independent Risk Management Review

In 2008 CBB issued a directive which requires that all banking institutions subject to its regulations undergo an independent risk management review to determine the state of the Bank's risk management systems with a view to establishing individual CARs for individual banks based on the results of the independent review. In compliance with the CBB requirement, BMB appointed an international accounting firm to conduct the independent risk management review, the results of which are expected in first quarter of 2009.

5.3 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 in October 2008 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 Bank's initial CAAP model allocates capital for credit risk using the Standardised Approach, for market risk using an internal 1-day VaR model and operational risk using the BIA. Private equity investment risk is incorporated under the credit risk Standardised Approach principally because private equity exposure represents the majority of the risk in BMB's Banking Book. At present there are not sufficiently robust and well tested models in existence to measure this risk. Also, regulator-accepted detailed historical data sets on private equity to be used in conjunction with such models do not exist. The Bank has developed quantitative methodologies for computing Pillar 2 risks which include strategic, liquidity, reputational, residual credit and concentration risk, and Interest Rate Risk in the Banking Book (" IRRBB'). For IRRBB the Bank uses the 200 basis point parallel yield curve change in interest rates as recommended by the BCBS and as required by CBB.

The CAAP allows the Bank to set its own internal target CAR within a reasonable buffer from the CBB minimum capital requirements. Once the above mentioned independent risk management review of BMB's compliance with the Basel II Framework is completed and the CBB establishes the specific CAR target for the Bank, BMB will review its internal CAR target and make any necessary adjustment. The integrity of the CAAP is validated in a number of ways which include, stress testing of various risk factors by the Risk Management Department and an internal review of the CAAP and assumptions used in the CAAP. The documented CAAP is expected to be approved by the Board in 2009.

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 2008 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	9,010	5,008	600
Public Sector Enterprises	-	-	-
Banks Portfolio	3,622	724	87
Corporate Portfolio	78,961	78,961	9,475
Regulatory Retail Portfolio	-	-	-
Residential Retail Portfolio	-	-	-
Equity Portfolio	49,816	73,555	8,827
Others	7,021	7,021	843
Total	148,430	165,270	19,832

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, acting as sponsor, liquidity facility provider, credit enhancement facility provider or swap provider. 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 2008 was as follows;

Table 5: Operational Risk Capital Requirements

USD 000	31 Dec 2008	Average 2008	31 Dec 2007	Average 2007
Operational Risk Capital Charge	1,732	1,732	1,992	1,992
Operational Risk Weighted Assets	14,438	14,438	16,601	16,601

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.

For purposes of computing market risk capital the Bank plans to migrate to the more advanced Internal Models Approach (IMA) under Basel II Pillar 1 in 2010. To prepare for this transition, the Bank upgraded to the latest version of RiskMetrics Group's Risk Manager^{TM} software used for calculating market risk statistics including Value at Risk (VaR). The upgraded version allows better portfolio risk management by way of additional risk statistics which help in detecting pockets of risk concentrations within a portfolio of market instruments. After obtaining 12 months of data using the latest upgraded version of Risk Manager^{TM}, the Bank intends to initiate formal back-testing of the VaR model in line with CBB requirements as well Basel Committee on Bank Supervision (BCBS) recommendations.

The capital requirement for market risk using the Standardised Approach as at 31 December 2008 was as follows:

Table 6: Market Risk Capital Requirements

USD 000	31 Dec 2008	Maximum	Minimum	Average
Equity risk	106.12	1,869.45	106.12	1,275.80
FX risk	2,338.08	4,659.79	2,338.08	3,978.96
Interest rate risk	352.01	425.62	34.21	118.08
Total	2,796.21			

* **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. In 2008 the Board approved a revised and updated Operational Risk Management Policy (ORP) which formally establishes the Operational Risk Management Framework. The ORP establishes operational risk appetite as the primary measure of the amount of operational risk the Bank is willing to accept. Operational risk appetite is quantified by way of threshold levels for identified key risk indicators and residual risk measures as well as loss event capturing and reporting thresholds. The Bank expects to have automated the operational risk assessment process, risk register database and Risk and Control Self-Assessments (RCSA's) by end of fiscal year of 2009.

7.1.2 Business Continuity Risks

In 2008 the Bank completed the development and establishment of its Business Continuity Plans (BCP) including the 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's Risk Management and Compliance Departments work closely with external legal counsel to ensure legal documentation conforms with applicable regulations and is designed to control legal risks. To further mitigate the legal risks arising from non-compliance with regulatory requirements the Bank established an independent Compliance Department headed by a Compliance Officer who is part of the Bank's senior management. As indicated above, reputational risk and strategic business risk are not formally quantified for CAR purposes under Pillar 1 of the Basel II Framework. However they do form part of the Pillar 2 framework and are quantified within the Bank's CAAP process.

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. A portion of the bond portfolio is secured by US Government securities,
4. 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
5. A modest loan portfolio composed of loans (see Note 10 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 annual review and approval 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 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. 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.

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 2** 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 37 of the accompanying financial statements).

7.2.5 Credit Risk Mitigation

For the years 2008 and 2007, 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 2008, 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$11.6 million.

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.

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 11 "Instalment Sales Receivable" and Note 31 "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 2008 based on quarter end CBB prudential return reporting:

Table 8: Gross Exposures

	Gross exposure 31 December 2008 US$000	Average 31 December 2008 US$000
Cash and deposits with banks	3,688	11,012
Government bonds	4,388	4,886
Other equities and funds	49,816	63,676
Other bonds	15,214	13,358
Derivative financial instruments	849	224
Loans and advances	1,521	1,388
Instalment sale receivable	17,299	17,684
Other assets	6,488	8,666
Total	99,263	120,893
Trading equities and funds	726	6,179
Fixed assets	504	527
Total	100,493	127,598
Off-balance sheet credit and investment instruments	59,577	40,879

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 the Bank's exposures were as follows;

Table 9: Geographical Exposures – as at 31 December 2008

	North America		Europe		Rest of the world		Total	
	2008	2007	2008	2007	2008	2007	2008	2007
	US$000	US$000	US$000	US$000	US$000	US$000	US$000	US$000
Assets								
Cash and deposits with banks	1,634	721	1,440	31,803	614	4,078	3,688	36,602
Government bonds	-	-	-	-	4,388	4,388	4,388	4,388
Other equities and funds	17,699	26,588	24,829	36,717	7,288	9,959	49,816	73,264
Other bonds	14,043	9,501	1,171	292	-	-	15,214	9,793
Derivative financial instruments	-	83	849	-	-	-	849	83
Loans and advances	1,408	791	-	-	113	176	1,521	967
Instalment sale receivable	-	-	-	-	17,299	18,839	17,299	18,839
Other assets	2,724	3,953	1,055	2,987	2,709	20,408	6,488	27,348
Total assets subject to risk	37,508	41,637	29,344	71,799	32,411	57,848	99,263	171,284
Trading equities and funds	-	273	92	6,505	634	2,501	726	9,279
Fixed assets	-	-	-	70	504	246	504	316
Reconciliation to total assets	37,508	41,910	29,436	78,374	33,549	60,595	100,493	180,879
Off-balance sheet credit and investment instruments	24,406	9,822	51,708	22,073	2,500	-	78,613	31,895

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

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

	Banking/ Finance 2008 US$000	Govern-ment 2008 US$000	Technology/ Telecoms 2008 US$000	Diversified 2008 US$000	Others 2008 US$000	Total 2008 US$000
Assets						
Cash and deposits with banks	3,622	66	-	-	-	3,688
Government bonds	-	4,388	-	-	-	4,388
Other equities and funds	-	-	16,691	32,756	369	49,816
Other bonds	10,065	4,937	-	-	212	15,214
Derivative financial instruments	849	-	-	-	-	849
Loans and advances	-	620	872	-	29	1,521
Instalment sale receivable	-	-	-	-	17,299	17,299
Other assets	209	117	1,927	626	3,609	6,488
Total assets subject to credit risk	14,745	10,128	19,490	33,382	21,518	99,263
Trading equities and funds	30	-	616	-	80	726
Fixed assets	-	-	-	-	504	504
Reconciliation to 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	78,614

(ii) **As at 31 December 2007**

	2007 US$000	2007 US$000	2007 US$000	2007 US$000	2007 US$000	2007 US$000
Total assets subject to credit risk	36,844	15,010	20,880	55,466	43,084	171,284
Total assets	43,078	15,010	22,441	55,493	44,857	180,879
Off-balance sheet credit and investment instruments	-	-	6,368	25,527	-	31,895

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 2008, the Bank was effectively invested in over 526 companies. As a result of a recent review, the Bank decided that within this asset class it will focus on private equity fund investments and invest only very selectively in direct private equity investments. Such investments will be made in modest amounts with a priority to those investments where the shareholder group includes professional institutional investors with appropriate experience and human and financial capital who will take an active role in the management and development of the investee company.

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, including fair values as per IAS 39. 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 IAS 39 methodology, 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. As a general rule, the Bank does not use internal models to assess fair value. Where fair value cannot reliably be determined, cost is used. As at 31 December 2008, the amount of private equity carried at cost was US$ 1.5 million representing less than 3% 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.

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. The plan underwent an internal review process and was approved by the Board. The plan will be reviewed on a continuous basis to take account of market and other economic developments. The Bank allocates capital for strategic risk under its CAAP framework.

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. Over the past years, the Bank has strengthened its liquidity position by refinancing and then repaying its US$ 75 million medium term facility, raising US$ 52.34 million in additional capital , extending the maturity of the US$ 20 million Revolving Loan Facility and on the US$ 10 million subordinated loan and on certain customer deposits. For an analysis of the Bank's maturity profile of assets and liabilities as at 31 December 2008 see Note 36 in the 2008 Annual Report.

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 2008 the Bank revised its Liquidity Risk Management Strategy by incorporating recommendations of the BCBS's paper on "Sound Practices for Managing Liquidity". In addition the strategy's objectives were broadened to include other factors that affect the Bank's funding capacity that include improving credit ratings and increased market access as well as the incorporation of liquidity stress tests among other factors. Within its CAAP, the Bank allocates capital for liquidity risk, with an implicit recognition of the cross-correlation between liquidity risk capital, strategic risk capital and reputational risk capital. This recognises the interdependence between the availability and management of liquidity and the ability to successfully execute the strategic plan.

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.

9.4 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. The Bank employs various analytical techniques to measure interest rate sensitivity within the Banking Book. Chief among these is the use of VaR which is used to measure the economic value of such a change on the Bank's equity for a standard interest rate shock and stress-testing earnings at risk and economic value of equity for a number of stressed interest rate scenarios including the yield curve steepening and flattening. A 200 basis point shift in interest rates would affect the Banking Book as at 31 December 2008 as follows, on a net basis and broken down by currency:

Table 11: IRRBB- 200 basis point economic value impact

USD 000 equivalent	200 basis points decline	200 basis points increase
Swiss Franc	-2.00	2.08
Euro	286.26	-309.60
British Pound	114.20	-122.38
United States Dollar	778.38	-779.09
TOTAL	1,176.84	-1,208.99

Under its CAAP, the Bank allocates capital for interest risk in the Banking Book using a 200 basis point parallel yield curve shock as required by CBB's guidelines on Pillar 2.