BANKING ON YOUR TRUST

FUTURE READY

ANNUAL REPORT 2010

بنك المستقبل
futurebank

Main Branch / Head Office
P.O. Box 785
City Centre Building 199
Road 203, Block 304
Manama Town
Government Avenue
Kingdom of Bahrain

Tel: +973 - 17505000
Fax: +973 - 17224402
Swift Code: FUBBBHBM

Muharraq Branch
P.O. Box 22309
Bldg 263, Road 311
Muharraq 203
Shaikh Khalifa bin Salman Avenue
Kingdom of Bahrain

Tel: +973 - 17322494
Fax: +973 - 17323644
Swift Code: FUBBBHBMMUH

Budaiya Road Branch
P.O. Box 70115
Shop No. 8 B
Country Mall
Budaiya Highway
Kingdom of Bahrain

Tel: +973 - 17596666
Fax: +973 - 17596111
Swift Code: FUBBBHBMSIT

Tehran Representative Office
No.25
Tandees Avenue
Africa Highway
Tehran
Islamic Republic of Iran

Tel: +9821 - 22053351/52
Fax: +9821 - 26201311

بسم الله الرحمن الرحيم

قد جعل الله لكل شيء قدراً

TABLE OF CONTENTS

BUSINESS PHILOSOPHY

The business philosophy of the Bank is characterised by its vision, mission & purpose statements as detailed below.

Vision

To be recognised as a Bank for its ability to build financial bridges connecting our customers and regional markets.

Mission

To maximise stakeholders' interests by becoming the partner of choice for all those who value personalised attention.

Purpose

To serve the community with care and conscience and make a tangible difference to lives.

FINANCIAL HIGHLIGHTS

	2010	2009	2008	2007	2006
Income and Expenses (BD millions)					
Net interest income	**14.4**	13.1	13.7	11.4	7.5
Other income	**1.0**	1.0	0.8	1.0	0.6
Total income	**15.4**	14.1	14.5	12.4	8.1
Operating expenses	**4.0**	3.5	3.3	2.6	2.0
Profit before provisions	**11.4**	10.6	11.2	9.8	6.1
Net provision / write-back	**(1.3)**	2.4	(0.5)	(1.0)	(0.0)
Impairment of goodwill	**(1.0)**	-	-	-	-
Net profit / (loss)	**9.1**	8.2	10.7	8.8	6.0
Financial Position (BD millions)					
Total assets	**524.3**	547.5	547.5	498.1	383.1
Net loans	**151.7**	118.4	113.1	83.3	65.6
Placements	**276.8**	358.9	381.0	340.8	302.4
Investments	**50.3**	12.4	8.8	10.2	5.5
Total deposits	**431.1**	470.3	478.2	434.0	334.5
Customer deposits	**131.7**	108.7	95.9	67.7	54.9
Shareholder's equity	**88.2**	73.7	63.3	58.2	46.0
Ratios (percentage)					
Profitability					
Net income / average equity	**11.3**	12.2	17.8	17.9	14.1
Net income / average assets	**1.7**	1.5	2.1	2.4	2.5
Operating expenses / total income	**26.1**	24.8	23.0	21.0	25.4
Earning per share (BD/USD)	**0.128**	0.152	0.237	0.209	0.162
Liquidity					
Customer deposits / net loan and advances	**86.8**	91.8	84.7	81.2	83.7
Loans and advances / total assets	**28.9**	21.6	20.7	16.7	17.1
Liquid assets / total assets	**38.3**	44.6	39.1	52.4	61.4
Capital Adequacy					
Capital adequacy	**25.7**	21.0	15.6	20.0	15.7
Equity / total assets	**16.8**	13.5	11.6	11.7	12.0

CHAIRMAN'S STATEMENT

The 2010 period has signified nothing less than another prominent year in the Bank's consistent journey towards enhanced profitability and growth

On behalf of the Board of Directors of Futurebank, it is with great pleasure that I present the audited financial results for the year ended 31 December, 2010. This period marked the seventh operational year for the Bank and proved to be a very challenging one.

Against the backdrop of the global financial crisis and the difficult regional environment, Futurebank managed to achieve positive financial results in line with its long term objectives of delivering consistent returns. In fact, it would be safe to say that the 2010 period has signified nothing less than another prominent year in the Bank's consistent journey towards enhanced profitability and growth.

Futurebank was established as a joint venture between three highly reputed financial institutions – Bank Saderat (Iran), Bank Melli (Iran) and Ahli United Bank (Bahrain). Aligned with its strategic mission, Futurebank aims to exploit the combined strength of the national economies which its constituents represent.

In light of the challenges posed by economic sanctions from Western Governments (US and EU) upon Iran, the Bank's management focused their energies on retaining a conservative and diligent approach to solidifying Futurebank's balance sheet, as well as strengthening the Bank's focus on growth opportunities within the Kingdom of Bahrain via an expansion of our local branch network. Furthering our stance in the Kingdom of Bahrain, construction of Futurebank's new Head Office in the Al Seef area has already progressed up to the 18th floor and plans are underway to populate this state-of-the-art property by mid-2012.

Futurebank has substantially invested in its infrastructure over the past few years. Development initiatives have primarily focused on improving the Bank's information technology capabilities, re-engineering its operations and strengthening the Bank's risk measurement and control measures. Towards this goal, Futurebank successfully witnessed the implementation of a state-of-the-art, new core-banking system in 2010. This new system will enable the Bank to offer a wider spectrum of retail and corporate products, launch new services and improve existing facilities for its customers, within an environment of measured and controlled risk.

Futurebank also remained committed to building upon its long term strategic goals, prudently extending its capabilities to match local market needs in a bid to increase its customer base in Bahrain. New initiatives were undertaken towards launching retail banking products and services targeted at local consumers, along with a foray into the "Sukuks" Islamic bond market, which retains vast potential as investor confidence returns and new issuers emerge in the Islamic finance industry. All these factors contributed towards augmenting the Bank's presence and business activities within the Kingdom of Bahrain.

In 2010, the Bank embarked upon notable strategic training programs, in addition to its ongoing in-house training, to augment the skill sets of its employees. These were undertaken in partnership with Tamkeen and Capital Knowledge; we believe that a committed and well-trained workforce is a key enabler in achieving our long term objectives.

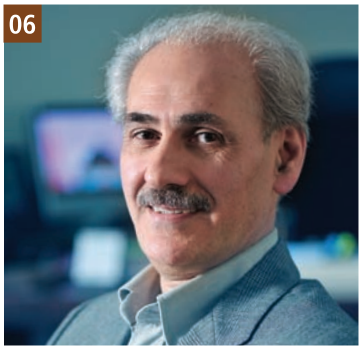
Futurebank's financial performance for the year 2010 also owes its success to the well-regulated operating environment in Bahrain, which remains one of most open economies within the GCC with a liberal attitude towards foreign investment. Bahrain's status as one of the GCC's most significant banking centres has also been upheld, as the Kingdom continues to position itself as the financial gateway to the wider region.

On behalf of our shareholders, the Board of Directors acknowledges with great appreciation the contributions of Futurebank's management and staff, who have worked tirelessly to maintain the highest standards of operational excellence across the Bank's operations. We also take this opportunity to thank our shareholders, customers and correspondents for their valuable association, while extending our gratitude to the authorities in Bahrain and Iran, particularly the Central Bank of Bahrain for their continued support.

By the grace of Allah the Almighty, the Board of Directors stand highly assured and confident about the steady pace of progress already achieved by the Bank, as well as the prudent manner in which Futurebank is being positioned to succeed well into the future. Banking on your trust, we will continue to strive to become an unrivalled resource, which compliments your needs and your aspirations.

Dr. Hamid Borhani
Chairman

BOARD OF DIRECTORS



BOARD COMMITTEE MEMBERS

01

Dr. Hamid Borhani
Chairman

Board Member since 2006
Vice Governor
Bank Markazi Jomhuri Islami Iran
PhD in Business Management & Accounting from Azad University. Over 30 years of banking experience holding various managerial & directorial positions in Bank Saderat Iran as: Chairman & Managing Director; BSI Board Member; BSI Regional Manager; Chairman of Bank Saderat PLC- London

02

Mr. Mahmoud Reza Khavari
Deputy Chairman

Board Member since 2009
Chairman and Managing Director,
Bank Melli - Iran
Chairman, Melli Bank PLC - UK
Chairman, Melli Bank - Moscow

03

Mr. A. Aziz Ahmed A. Malek
Deputy Chairman

Board Member since 2007
Non Executive Director,
Netlinks Consultancy
Telecommunications – Bahrain

04

Dr. Valiollah Seif
Director

Board Member since 2004
CEO, Karafarin Bank, Iran

05

Mr. Adel Al Mannai
Director

Board Member since 2007
Assistant General Manager,
The Arab Investment Co. SA.A.
(TAIC) - Bahrain

06

Mr. Gholam H. Zaferani
Director

Board Member since 2004
CEO & President,
Saman Bank Corporation - Iran

07

Mr. Gholam Souri
CEO & Managing Director

Board Member since 2004

08

Mr. Abbas Fatemi Torshezi
Deputy CEO & Deputy Managing Director

Board Member since 2004

09

Mr. Shahram Razavi
Deputy CEO & Director

(Up to October 2010)

GROUP MANAGEMENT

MR. GHOLAM SOURI
Chief Executive Officer & Managing Director

MBA in Banking from Iranian Banking Institution. Over 25 years of international banking experience holding various senior managerial positions in Bank Saderat Iran as: General Manager of International Division & Regional Office Dubai; General Manager, Bank Saderat Iran Branches. Joined the Bank in 2004. Appointed as CEO w.e.f. July 2010

MR. ABBAS FATEMI TORSHEZI
Deputy Chief Executive Officer & Deputy Managing Director
Risk, Finance & Operations

BA in English Language, Tehran University. Over 41 years of banking experience in Bank Melli Iran. Assistant Director of Bank Melli Iran, International Division, Tehran; Manager of Bank Melli Iran, Dubai Main Branch for 7 years. Joined the Bank in 2004.

MR. VISTASP BURJOR SOPARIWALLA
Head of Finance

B.Com, Chartered Accountant. Over 21 years of banking experience spanning Financial Control, Operations and Treasury Services holding successively senior managerial positions. Prior work experience primarily with BNP PARIBAS, Bank of Bahrain & Kuwait and Bahraini Saudi Bank. Joined the Bank in 2006.

MR. HOSSEIN REZAEE NICO
Head of Information Technology

Master's Degree in International Business from Wollongong University, Australia. Over 21 years of banking experience; Treasury & Trade Finance and Information Technology Systems at Bank Melli Iran, Dubai and Commercial Bank of Dubai, Dubai. Joined the Bank in 2006.

MR. K. SURESH KUMAR
Head of Corporate Banking

CAIIB from Indian Institute of Bankers, Mumbai. Over 25 years of banking experience mainly in Corporate Credit-Marketing, Appraisal, Risk & Remedial Management at United Bank of India, Oman International Bank, IDBI Bank and as Senior Vice President at Mizuho Corporate Bank. Joined the Bank in 2005.

MR. MOHAN SHENOY YARMAL
Head of Treasury & Investment

Master's Degree in Commerce (M.Com) from the University of Mysore, India. Over 33 years of wholesale banking experience holding various senior positions in Bank Saderat Iran, OBU, Bahrain. Joined the Bank since inception.

MR. MILIND VINAYAK KAMAT
Head of Risk

B.Com, Chartered Accountant. Over 24 years of banking experience holding various positions in various banks; Union Bank of India, Bank of Bahrain & Kuwait, Mumbai and as Vice President at Calyon Bank. Joined the Bank in 2005.

MR. JALIL AL-SHEHABI
Head of Compliance & MLRO

Advanced Banking Diploma. Over 29 years of banking experience holding various senior managerial positions mainly Banking Operations, Internal Control, Internal Audit and Compliance / MLRO at various Banks in Bahrain. Joined the Bank in March 2007.

MR. U.P.RAVIPRAKASH
Head of Internal Audit

B.Sc. in Maths from Chennai University, India, CAIIB from Indian Institute of Bankers. Over 27 years of banking experience mainly in Internal Audit, Corporate Banking/SME Credit and Retail Banking with State Bank of India. Held senior managerial positions in State Bank of India and worked as Assistant General Manager. Joined the Bank in November 2008.

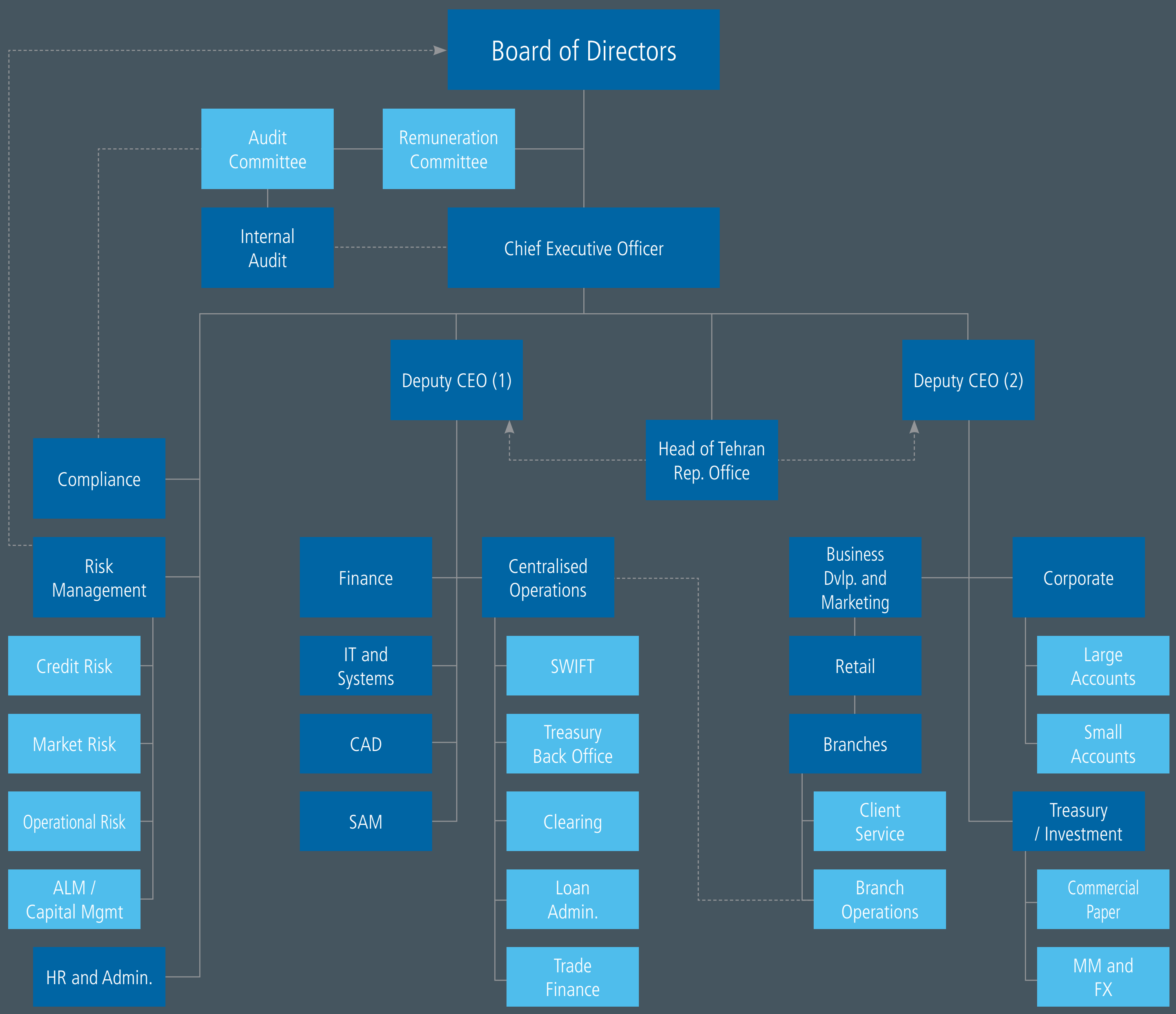
MRS. MAHA MURAD ALI
Head of HR & Administration

Diploma in HRP from the Chartered Institute of Personnel Development (CIPD), Advanced Diploma in Insurance, Diploma in Computer Engineering. Over 11 years of work experience, of which 5 years of experience was in the HR and Administration field and holding various managerial positions. Joined the Bank in 2005.

MR. MEHDI HABIBOLAH RASHIDI
Head of Tehran Representative Office

Master of Business Administration from Oklahoma State University, Oklahoma, USA. Over 30 years of international banking experience holding various managerial positions at Central Bank of Iran till May 2004. Foreign Exchange Expert and Director of Treasury Department in ECO Trade and Development Bank, Turkey. Joined the Bank in 2010.

ORGANISATION CHART



Futurebank's ongoing growth and development plans witnessed numerous new initiatives focused on furthering the skill sets of the Bank's employees, enabling them to effectively deliver world class standards of service to our customers

BOARD COMMITTEES

Board Audit Committee:
Mr. Gholam H. Zaferani – Chairman of Audit Committee
Mr. Gholam Souri – Up to July 2010, Mr. Abdulaziz Abdulmalek
Dr. Valiollah Seif – w.e.f. October 2010

Mr. Vistasp Sopariwalla – Corporate Secretary

Remuneration Committee:
Dr. Hamid Borhani, Mr. Mahmoud Reza Khavari, Mr. Abdulaziz Abdul Malek

TERMS OF REFERENCE OF THE VARIOUS COMMITTEES

BOARD COMMITTEES

Audit Committee

Assists the Board of Directors in discharging its responsibilities relating to the Bank's accounting policy, internal audit controls, compliance procedures, risk management functions. Ensures the integrity of the financial statements, reviews the performance of the internal audit function and liaises with external auditors and regulators.

Remuneration Committee

Sets the guidelines for performance evaluation, salary, bonus, managing the Bank's compensation arrangement and decision-making for executive management.

MANAGEMENT COMMITTEES

All the below mentioned meetings are chaired by the CEO and the Managing Director. All the meetings are held on a monthly basis, except for the Senior Management Committee meeting which is held on a fortnightly basis and the Senior Credit Committee meeting which is held on a weekly basis.

Senior Management Committee

Reviews and monitors progress on strategic initiatives, including regulatory, financial, operational and compliance issues.

Asset Liability Committee

Sets guidelines for the overall management of the liquidity risk and interest rate risk; determines the funding strategy of the Bank in order to maximise net interest income at minimal risk.

Senior Credit Committee

Implements the Credit Policy as authorised by the Board (inclusive of approval of the credit-related proposals) renewal of facilities, business services and reviews new credit-related products.

Risk Management Committee

Oversees the implementation, interpretation and follow-up of the risk policy and establishes guidelines for all lending activities to promote a sound risk culture within the Bank.

Information Technology Committee

Reviews and manages the overall IT strategy, with a focus on the projects under implementation and provides a forum for user-IT interface.

Disclosure Committee

Enables the Bank to adhere to the disclosure requirements and provides guidelines to be followed for the relevant disclosures required as per regulation.

MAJOR SHAREHOLDERS, VOTING RIGHTS & DIRECTORS' INTERESTS

Major Shareholders (5% and above)

Name	Nationality	No. of Shares
Ahli United Bank through its Trustee arrangements with Dana Trust	Bahraini	25,000,000
Bank Saderat Iran	Iranian	25,000,000
Bank Melli Iran	Iranian	25,000,000

Distribution schedule of each class of equity security, setting out the number of holders and percentage in the following categories:

Categories	No. of Shares	No. of Shareholders	% of Outstanding Shares
Less than 1%	------	------	------
1% up to less than 5%	------	------	------
5% up to less than 10%	------	------	------
10% up to less than 20%	------	------	------
20% up to less than 50%	75,000,000	3	100
50% and above	------	------	------
Total	**75,000,000**	**3**	**100**

Class of Equity

Class Type	No. of Holders	Voting Rights
Ordinary shares 75,000,000	3	75,000,000

Directors' Interest and details of shareholding by Directors and their related parties:
None of the Directors or their related parties had any shareholding in the Bank as at 31 December, 2010

CEO'S STATEMENT & MANAGEMENT REVIEW

In light of the foreseeable general economic climate, Futurebank is well poised to reap the benefits of the expected recovery as and when it materialises

In 2010, Futurebank recorded a net profit of BD 9.1 million, as compared to BD 8.2 million in the previous year. This significant increase of 10.4% reflects the successful implementation of the Bank's progressive growth and profitability strategies, which included numerous new initiatives and processes coming into effect throughout the year.

The Bank's balance sheet for the period under review reflected a volume of BD 524.3 million; this signifies a 4.2% decrease from the BD 547.5 million generated in the previous year. It is worthy to note that owing to the prudent practices of the Bank, the minor containment in the size of the Bank's balance sheet effectively registered better ROA figures for the year 2010, as compared to the year before.

In addition, Futurebank's Loans and Advances Portfolio increased by 28.1%, rising from BD 118.4 million in 2009 to BD 151.7 million in 2010. Customer Deposits also witnessed an incline of 21.1%, from BD 108.7 million at the end of the 2009 period to BD 131.6 million in 2010.

OPERATING ENVIRONMENT

Throughout the 2010 period, regional economies benefitted from stabilising oil prices and a recovery, albeit modest, from the depressed economic outlook which prevailed in the aftermath of the global economic downturn.

Bahrain remains one of the most open economies in the Middle East region, where the authorities have prioritised private investment particularly amongst other regional economies in the financial services sector. Over 390 licensed financial institutions reside in Bahrain, with the Government looking to attract foreign investment in key infrastructure and tourism projects. Within this context, Bahrain in particular was able to weather the worst of the global financial crisis due to its local real estate market's aversion to high levels of speculative activity. The regulatory authorities have sought to discourage speculative activities, with prudent fiscal and monetary policies which have proven to be largely successful.

In spite of the sanctions imposed on Iran by the US and the EU, the Bank decided to focus on its operations in Bahrain and other regional countries where a host of developments continued to foster growth. The SME sector in particular was identified as being an area for potential opportunity. A recent report by the World Bank indicates that bank loans to SMEs makes up only 2 per cent of the total bank lending in the GCC, while in non-GCC countries, this proportion rises to 14 per cent. The Bank has therefore focused its energy towards this segment, wherein future growth is envisaged.

In light of the foreseeable general economic climate, Futurebank is well poised to reap the benefits of the expected recovery as and when it materialises. The Bank, therefore, confidently proceeded to follow through on its expansion path, focusing on its core business market within the Kingdom of Bahrain.

OPERATIONAL ACHIEVEMENTS

In 2010, Futurebank focused on strengthening its operational stance within Bahrain and enhanced its services to meet the needs of its growing customer base. The Bank witnessed the expansion of its ATM network across Bahrain's most populated and commercially active locales. While the total count currently stands at 17, the total envisaged number of ATM outlets is to reach 25 by the end of 2011. This expansion strategy within Bahrain has led to greater awareness and enhanced visibility for Futurebank amongst its target markets and the Bahraini community at large.

With reference to the composition of Futurebank's portfolio, a management decision has been taken to diversify the Bank's assets in a bid to counterbalance any adverse effects of the sanctions imposed on Iran by the US and the EU. Thus, by transforming the composition of the portfolio, we continue to carry out this process steadfastly to meet the requirements of the Central Bank of Bahrain (CBB). Keeping this in mind, Futurebank successfully forayed into local and regional markets, wherein new loans were sanctioned not only in the SME sector, but new investments were realised in Government Treasury Bills and Sukuks.

The Bank commissioned Ernst and Young (E&Y), to conduct a thorough review of all Standard Operating Procedures (SOPs) in 2010, as a prerequisite for the proposed launch of a new Core Banking System. This task was aimed at setting clear definitions for the responsibilities and accountability at each authority level within the Bank.

During the year, Futurebank amended its provisioning policy to incorporate a minimum of 15 per cent provision on all NPA accounts, and a 100 per cent provision on all bad accounts, irrespective of the collateral, which led to a healthier and stronger balance sheet. The adoption of the ICAAP process is still under progress with E&Y, with new software being purchased which will stress even future projections for the calculation of ICAAP.

The ongoing construction of Futurebank's Head Office in the Al Seef area is yet another testament to our commitment to the Kingdom of Bahrain. The 18 storey tower has already reached its plinth height of 18 floors and is due for completion by mid-2012.

CORPORATE BANKING

Futurebank's corporate banking strategy is based on providing comprehensive and customised financial solutions to our corporate customers mainly in Bahrain, the GCC and Iran. The Bank offers various corporate banking products including Bahraini Dinar and foreign currency debt, working capital credit, structured financing, syndication and transaction banking products and services.

During 2010, the Bank continued providing high quality syndication facilities to its clients at competitive rates. The steady growth which the Bank has achieved during the year in its Loans & Advances Portfolio is mainly due to its enhanced expertise in syndicated loans and can also be credited to its participation in other prospective syndications.

Futurebank will continue to strengthen its focus on the SME sector, as indicated, envisioning future growth across this high-potential segment.

INFORMATION TECHNOLOGY

In line with Futurebank's strategic growth plans, a significant deployment of cutting edge technological tools was rolled out in 2010. The Bank has been continually committed to evolving its information technology framework to align with technological advancements taking shape across the region. Multiple projects were initiated in 2010 which brought about numerous changes in the Bank's IT infrastructure.

Futurebank was also one of the first banks in Bahrain to implement the CCTV security monitoring system, as mandated by the Central Bank of Bahrain (CBB). An all new cutting edge Core Banking software was successfully implemented at the end of 2010 and went live on January 1, 2011. This system enables the Bank to provide customers with a higher level of service with numerous value-added features.

I take this opportunity to congratulate the IT, Finance and Audit teams, in particular, for the successful implementation of this high-end project, alongside all the staff involved in this endeavour who committed their dedicated efforts throughout.

RISK MANAGEMENT

In 2010, Futurebank commissioned the services of Ernst and Young (E&Y), to aid with the restructuring of its Risk Department. Vast progress has been made on this front with an organisational chart aligned with a comprehensive set of risk mitigation policies already approved by the Bank's Board of Directors. The Bank's Risk Charter/ Risk Policy/ Credit Risk Policy are now envisaged to be duly fortified with appropriate amendments incorporated towards higher control of risks.

Furthermore, a new and separate Credit Department was established to further strengthen the Bank's credit process, wherein the Credit Analysis division from the Corporate Banking Department was realigned and transferred to form a new functional unit within the Credit Department.

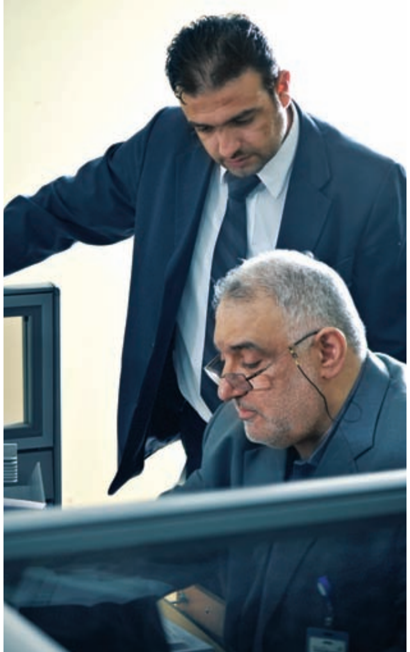
COMPLIANCE

A filtering and reporting tool is already in place at Futurebank to counter any sort of Anti-Money Laundering practices. This initiative will continue to be monitored for effectiveness and will be bolstered following the implementation of the Core Banking System software, should the need arise.

HUMAN RESOURCES

Futurebank's ongoing growth and development plans witnessed numerous new initiatives focused on furthering the skill sets of the Bank's employees, enabling them to effectively deliver world class standards of service to our customers.

In 2010, the Bank embarked upon supplementary strategic training programs,



in addition to our ongoing in-house training, to bolster staff skill sets. A strategic training program was undertaken in partnership with Tamkeen and Capital Knowledge, which are involved in the training of young Bahrainis. Staff training programs impacted all areas of the Bank's operations, and served to improve the acumen of both national and expatriate staff members.

FUTURE OUTLOOK

Looking ahead, Futurebank will continue to serve in the best interests of its customers and shareholders, enhancing the availability of its products and services, while striving to deliver premium retail products and services to a broader range of individual and corporate customers across the Kingdom of Bahrain. Whilst the existing US and EU sanctions pose a greater challenge for the Bank, in terms of its operational environment, Futurebank is swiftly developing a new three-year roadmap, which is envisioned to guide our strategic direction throughout the upcoming 2011- 2013 period.

As a token of its commitment to Bahrain, the Bank shall embark upon a significant drive to enable greater accessibility to its offerings, via new branch openings across the Kingdom in

2011. This reinforces our dedication to providing our customers with better accessibility to our unique brand of financial services. In tandem, we will also witness existing Futurebank branches being re-assessed for better visibility. Together with the expansion and improvement of our branch network in Bahrain, Futurebank's ATM network will undergo a similar revamp – with the installation of 5 new ATM stations planned for 2011. This resultant total of 25 ATMS is aimed at increasing our presence in the local market.

Futurebank's strategy of ensuring a premium selection of retail banking products and services will also be furthered in the near future, with planned increases to impact the Bank's Loans & Advances Portfolio within Bahrain. This surge is expected to mature not only through individual retail banking channels, but also via

the Bank's ongoing efforts to strengthen our relationships with corporate clients, within the highly lucrative local SME category.

The establishment of an investment vehicle, or SPVs, to enable our customers with a distinctly superior range of financial services is also on the agenda. This undertaking, once realised, would extend our capabilities to cover needs such as leasing for housing and equipment, exchanges houses and the import and export of food stuff.

With these initiatives occupying the course of our endeavours for the upcoming few years,

Futurebank is poised to reach its growth potential, as set out by the Board of Directors, and firmly on course to becoming an unrivalled resource for its customers in the Kingdom of Bahrain, who continue to honour us with their trust and loyalty.

Last but not least, I take this opportunity to express my sincere gratitude to all our staff members and colleagues for their untiring efforts and contributions towards bringing Futurebank to its current position and stature. I would also like to thank all the competent authorities in Bahrain for their guidance and support and of course our valued customers for their ongoing support and the confidence which they have entrusted in Futurebank.

Mr. Gholam Souri
Chief Executive Officer & Managing Director

FINANCIAL REVIEW

INCOME STATEMENT

Futurebank's strong operating performance has resulted in a record net profit of BD 9.1 million, registering an increment of 10.4 per cent over last year's net profit of BD 8.2 million. This exemplary growth is primarily attributed to the strong revenue growth witnessed by the Bank across all of its major business banking activities. Consequently, the Return on Average assets increased from 1.5 per cent in the previous year to 1.7 per cent in 2010.

Net Operating Income grew by 9.4 per cent from BD 14.1 million to BD 15.4 million. This robust financial performance reflected the Bank's continued growth across all principal business activities. The significant year-on-year increase in the Bank's profitability was attributable to increases in both interest and non-interest earnings, with containment over the growth in expenses during the year.

The Bank's net interest income at BD 14.4 million for the year as compared to BD 13.2 million in the previous year reflects an increase of 9.2 per cent over 2009. The main drivers for the increase in net interest income are strong growth in Loans & Advances and Customer Deposit despite lower yield on surplus liquidity deployed in money market and investments in a falling interest rate environment.

Taking a closer look at the markets which Futurebank operates in, margins remained under pressure, as the Bank's interest earnings were principally sustained on the strength of a higher loan portfolio, with increased focus on the local market and a selection of large corporate clients in Iran, seeking to finance major Iranian projects. This portfolio, along with the prudent utilisation of liquidity positions and the deployment of net available funds, resulted in a net interest margin of 2.8 per cent, as compared to 2.4 per cent in the previous year.

Moreover, fee and commission income together with other operating income witnessed a significant 35.7 per cent rise in 2010, on a year-on-year basis, with containment over the growth of expenses during the year. This was mainly derived from commission income, earned on the trade finance portfolio, together with fresh financing deals carried out by the Bank in conjunction with companies based in Iran. Some noteworthy corporate deals finalised within Bahrain with major clients also contributed to the fee income.

Despite all efforts, the overriding global turmoil witnessed during the last year caused the Bank to report a net loss of BD 0.3 million in foreign exchange for the current year. A similar loss of BD 0.06 million was realized in the previous year also. Together with foreign exchange losses, the Bank's non-interest income during 2010 represented a contribution of 7.0 per cent (BD 1.1 million) to total income, as compared to 6.8 per cent (BD 1.0 million) in the previous year.

Although the Bank's operating expenses increased from BD 3.5 million to BD 4.0 million, for a comparative 15.3 per cent increase over the previous year, they were mainly allocated to the rising costs of staffing the Bank's operations. Despite the increase, the cost to income ratio stood at only 26.1 per cent, as compared to 24.8 per cent in 2009 – notably one of the lowest figures in the industry and a true testament to the Bank's operational efficiency and ability to contain revenue expenditures.

Futurebank follows the International Accounting Standard (IAS) 39 for the provisioning requirements of its non-performing portfolio. Provisions for individually significant credit exposures are determined by discounting expected future cash flows. Following a more prudent approach, the Bank made a significant amendment to its provisioning policy to incorporate a minimum of 15 per cent provision on all non-performing exposures over BD 100 thousand classified as sub-standard and doubtful, besides making a 100 per cent provision on all non-performing exposures classified as bad accounts – irrespective of the collateral. This has led to a healthier and stronger financial position. Consequently, the Bank made specific provisions to the extent of BD 1.3 million in the current year, up from BD 0.8 million in the previous year. In addition to the specific provision the Bank also holds collective impairment provision of BD 0.9 million as recorded at the end of the current year (2009: BD 2.9 million). However, the provision coverage ratio as of year-end 2010 stood at 41.1 per cent when compared to 55.7 per cent recorded in the previous year. This is due to the fact that the Bank holds significant assets as collateral with regard to many of these facilities.

Keeping in line with IAS requirement, the Bank also recognized goodwill impairment to the extent of BD 1.0 million (2009: BD nil) during the current year.

BALANCE SHEET

The Bank's balance sheet has remained stable, registering only a minor decline of 4.2 per cent from BD 547.5 million shown in the previous year to BD 524.3 million. Throughout the year, Futurebank adopted a flexible approach to its asset mix which was instrumental in yielding better returns. The Bank's asset allocation model has continued to focus more on the Loans & Advances Portfolio and the bills discounted portfolio. Consequently, Loans & Advances comprised of 28.9 per cent of the balance sheet, up from 21.6 per cent in the previous year and the lucrative bills discounted under the Bank's Portfolio, now comprise 28.3 per cent of its balance sheet at year-end, as compared to 30.5 per cent in the previous year.

FINANCIAL REVIEW

The Bank's net loans and advances to customers rose from BD 118.4 million to BD 151.7 million. This BD 33.3 million increase shows a significant year-on-year gain of 28.1 per cent during the year, as compared to the previous year's 4.7 per cent only. During the year, the Bank continued to shift its focus on booking loans within the Bahraini and GCC markets, whilst maintaining a consistent flow to its primary market in Iran. This strategy will continue to be utilised to achieve further growth in loans and advances.

The Interbank Portfolio now comprises 24.5 per cent of the Bank's total assets, compared to 35 per cent in the previous year. At year-end the Bank's investment portfolio of BD 50.3 million (2009: BD 12.4 million) consisted of a further diversified mix of high yielding Iranian Government and Corporate Bonds, Treasury Bills and Sukuks. These investments are classified under the "Available for Sale" (AFS) and the "Held to Maturity" (HTM) category as per IAS 39. The Bank does not foresee any risks associated with these securities.

Interbank deposits continue to form major sources of funding for the Bank towards its Interbank Portfolio. The ratio of Interbank deposits to total liabilities and the shareholders fund stood at 57.1 per cent, as compared to 66 per cent in the previous year. For the year ended 2010, the loans to customer deposit ratio including medium term loan facilities availed by the Bank, stood at 79.2 per cent, compared to 75.2 per cent in the previous year, to reflect better utilisations.

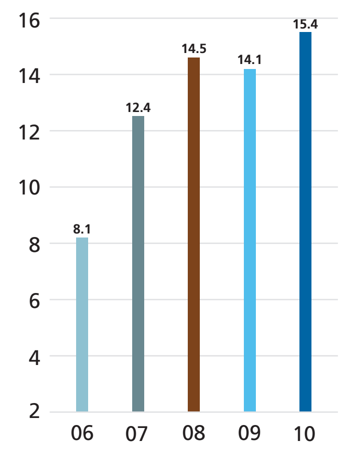
Customer deposits grew by BD 22.9 million or 21.1 per cent to BD 131.6 million by year-end 2010 from BD 108.7 million at the end of 2009 with all segments of business showing growth with emphasis on generating core low cost deposits.

Futurebank increased its capital base by way of a rights issue to the extent of BD 18.4 million in the first quarter of 2010. Thus despite the increased net profit earned by the Bank during the year, the return on average equity declined as compared to the previous year. Consequently, the return on average equity ratio stood at 11.3 per cent on a higher capital base for the full year, as compared to 12.2 per cent in the previous year 2009.

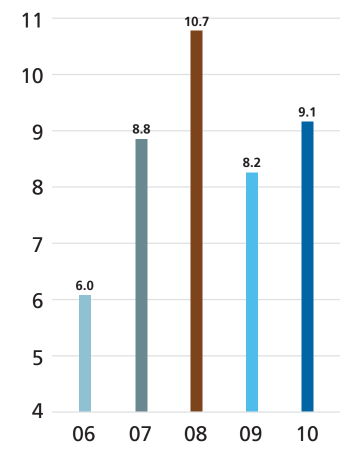
Equity before appropriation increased to BD 88.2 million at the end of 2010, up from BD 73.7 million at the end of the previous year. Equity to total assets accounted for 16.8 per cent of the total assets of the Bank, as compared to 13.5 per cent in the previous year.

The Kingdom of Bahrain is expected to grow at a moderate pace, benefitting from its balanced economic structure. Taking stock of the prevailing conditions, Futurebank will strengthen its focus towards sectoral funding and has been proactively ensuring the maintenance of strong liquidity and capital positions to grow and expand both its business and its customer base. Measures to ensure stringent adherence to the capital requirement regulations are in place, and compliance with the capital adequacy standards towards the new Basel-II requirement, along with its Pillar III disclosures are also being enforced. The Bank's capital adequacy ratio stood at a much higher figure of 25.7 per cent in 2010, as compared to 21 per cent in the previous year. This figure exceeds the minimum requirement of 12 per cent prescribed by the Central Bank of Bahrain (CBB) for banks operating within the Kingdom of Bahrain. The higher ratio achieved in the current year can partly be credited to the fresh infusion of capital to the extent of BD 18.4 million, which was contributed in equal proportion by existing shareholders. The above ratio is based on the guidelines issued by the CBB, in line with the Basel Committee standard for measuring risk weighted assets.

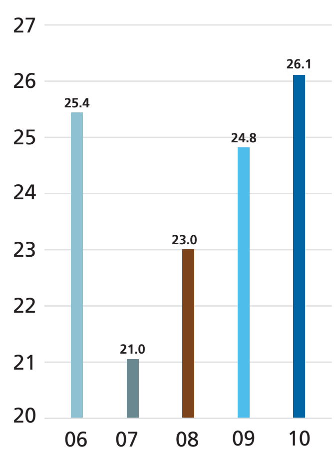
Total Income
BD millions



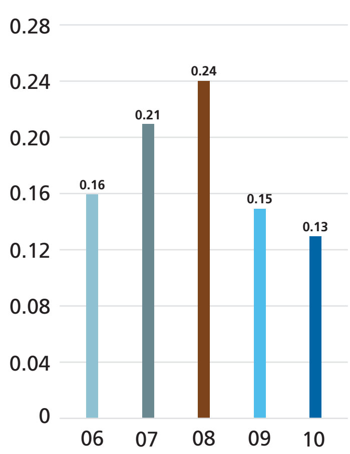
Net Profit
BD millions



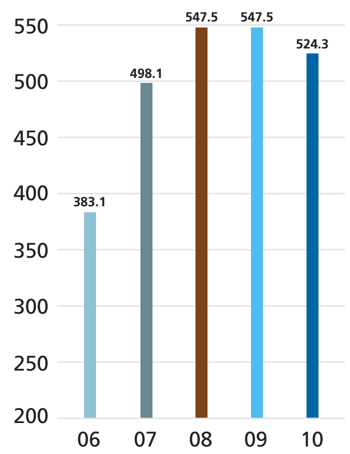
Cost / Income
Per cent



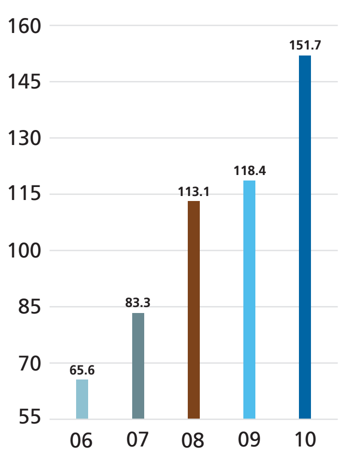
Earning per Share
BD / USD



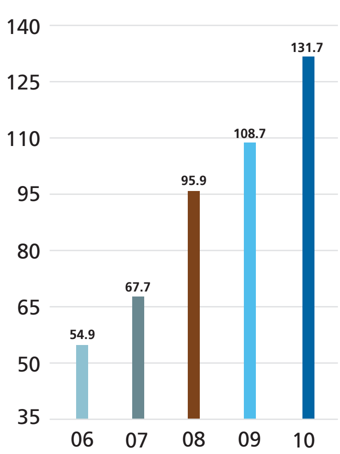
Total Assets
BD millions



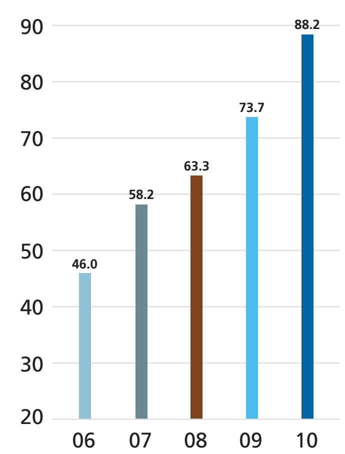
Loans & Advances
BD millions



Customer Deposits
BD millions



Shareholders' Equity
BD millions



INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF FUTUREBANK B.S.C. (c)

Report on the Financial Statements

We have audited the accompanying financial statements of Futurebank B.S.C. (c) ("the Bank"), which comprise the statement of financial position as at 31 December 2010 and the statements of comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The Bank's Board of Directors is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these 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 about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2010, its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Regulatory Requirements

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the financial statements and the content of the Chairman's report relating to these financial statements are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank, have occurred during the year ended 31 December 2010 that might have had a material adverse effect on the business of the Bank or on its financial position, and that the Bank has complied with the terms of its banking license.

Ernst + Young

29 January 2011
Manama, Kingdom of Bahrain

FINANCIAL STATEMENTS

STATEMENT OF COMPREHENSIVE INCOME Year ended 31 December 2010

	Note	2010 BD'000	2009 BD'000
Interest and similar income	5	24,704	26,567
Interest expense and similar charges	6	10,319	13,395
Net interest income		14,385	13,172
Net fees and commissions income	7	1,236	907
Net losses from foreign currencies		(326)	(55)
Gain (loss) on disposal of equipment		6	(11)
Other operating income		167	127
		1,083	968
OPERATING INCOME		15,468	14,140
Provision for loan losses - net	10	1,324	2,410
Impairment of goodwill	14	1,019	-
NET OPERATING INCOME		13,125	11,730
Staff expenses		2,382	2,068
Depreciation		259	260
Other operating expenses		1,403	1,179
OPERATING EXPENSES		4,044	3,507
PROFIT AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR		9,081	8,223

The attached notes 1 to 31 form part of these financial statements.

STATEMENT OF FINANCIAL POSITION At 31 December 2010

	Note	2010 BD'000	2009 BD'000
ASSETS			
Cash and balances with central banks	8	31,827	45,356
Due from banks	9	276,829	358,947
Loans and advances to customers	10	151,724	118,413
Non-trading investments	11	50,324	12,420
Other assets	12	5,704	5,414
Property and equipment	13	4,969	3,024
Goodwill	14	2,923	3,942
TOTAL ASSETS		524,300	547,516
LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks		239,494	312,820
Customers' deposits	15	131,653	108,726
Medium term loans	16	59,979	48,764
Other liabilities	17	4,996	3,458
Total liabilities		436,122	473,768
EQUITY			
Share capital	18	75,000	56,550
Statutory reserve	19	5,003	4,095
Retained earnings		8,175	13,103
Total equity		88,178	73,748
TOTAL LIABILITIES AND EQUITY		524,300	547,516

(Chairman)

(CEO & Managing Director)

The attached notes 1 to 31 form part of these financial statements.

STATEMENT OF CASH FLOWS Year ended 31 December 2010

	Note	2010 BD'000	2009 BD'000
OPERATING ACTIVITIES			
Profit for the year		9,081	8,223
Adjustments for non-cash items:			
Depreciation		259	260
Provision for loan losses - net	10	1,324	2,410
(Gain) loss on disposal of property and equipment		(6)	11
Impairment of goodwill	14	1,019	-
Operating profit before changes in operating assets and liabilities		11,677	10,904
Changes in operating assets and liabilities:			
Mandatory reserve deposit with Central Bank of Bahrain		(846)	392
Due from banks		22,045	(3,310)
Loans and advances to customers		(34,635)	(7,696)
Other assets		(290)	(1,298)
Due to banks		(73,326)	(37,682)
Customers' deposits		22,927	12,870
Other liabilities		1,538	(2,529)
Net cash used in operating activities		(50,910)	(28,349)
INVESTING ACTIVITIES			
Purchase of non-trading investments		(40,935)	(8,814)
Proceeds from maturity of non-trading investments		3,031	5,173
Purchase of property and equipment		(2,210)	(952)
Proceeds from disposal of equipment		12	1
Net cash used in investing activities		(40,102)	(4,592)
FINANCING ACTIVITIES			
Proceeds from rights issue	18	18,450	11,310
Medium term loans raised	16	11,215	16,908
Dividend paid	20	(13,101)	(9,048)
Net cash from financing activities		16,564	19,170
DECREASE IN CASH AND CASH EQUIVALENTS		(74,448)	(13,771)
Cash and cash equivalents at beginning of the year		290,573	304,344
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	21	216,125	290,573

The attached notes 1 to 31 form part of these financial statements.

STATEMENT OF CHANGES IN EQUITY Year ended 31 December 2010

	Share capital BD'000	Statutory reserve BD'000	Retained earnings BD'000	Total BD'000
Balance at 31 December 2008	45,240	3,273	14,750	63,263
Proceeds from rights issue (note 18)	11,310	-	-	11,310
Dividend paid during the year for 2008 (note 20)	-	-	(9,048)	(9,048)
Total comprehensive income for the year	-	-	8,223	8,223
Transfer to statutory reserve (note 19)	-	822	(822)	-
Balance at 31 December 2009	56,550	4,095	13,103	73,748
Proceeds from rights issue (note 18)	18,450	-	-	18,450
Dividend paid during the year for 2009 (note 20)	-	-	(13,101)	(13,101)
Total comprehensive income for the year	-	-	9,081	9,081
Transfer to statutory reserve (note 19)	-	908	(908)	-
Balance at 31 December 2010	**75,000**	**5,003**	**8,175**	**88,178**

The attached notes 1 to 31 form part of these financial statements.

FINANCIAL STATEMENTS

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

1 ACTIVITIES

Futurebank B.S.C. (c) ("the Bank") is a closed Bahrain Joint Stock Company incorporated on 1 July 2004 when the Bank acquired the Bahrain commercial branches of Bank Melli Iran (BMI) and Bank Saderat Iran (BSI) and the offshore banking unit of BSI. The Bank operates in the Kingdom of Bahrain under a retail banking license issued by the Central Bank of Bahrain and is engaged in commercial banking activities through its three branches in the Kingdom of Bahrain. The address of the Bank's registered office is P.O. Box 785, Manama, Kingdom of Bahrain.

The financial statements for the year ended 31 December 2010 were authorised for issue in accordance with a resolution of the Directors on 29 January 2011.

2 BASIS OF PREPARATION

Statement of compliance

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

Accounting convention

The financial statements are prepared under the historical cost convention. The financial statements have been presented in Bahraini Dinars (BD) being the functional currency of the Bank and all values are rounded to the nearest thousand BD (BD '000) except when otherwise indicated.

New and amended standards and interpretations

Amendments resulting from improvements in IFRSs to the following standards did not have any impact on the accounting policies, financial position or performance of the Bank:

IFRS 2 Share based payment: Group cash settled share-based payment transactions effective 1 January 2010.

IFRS 5 Non-current assets held for sale and discontinued operations effective 1 January 2010.

New standards and interpretations issued but not yet effective

IAS 32 Financial Instruments (Revised): Presentation - Classification of Rights Issues

The amendment to IAS 32 is effective for annual period beginning on or after 1 February 2010 and amended that definition of a financial liability in order to classify rights issues (and certain options or warrants) as equity instruments in cases where such rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, or to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. This amendment will have no impact on the Bank after initial application.

IAS 24 Related Party Disclosures

The amended standard is effective for annual periods beginning on or after 1 January 2011. It clarified the definition of a related party to simplify the identification of such relationships and to eliminate inconsistencies in its application. The revised standard introduces a partial exemption of disclosure requirements for government-related entities. The Bank does not expect any impact on its financial position or performance. Early adoption is permitted for either the partial exemption for government-related entities for the entire standard.

IFRS 9: Financial Instruments: Classification and Measurement

IFRS 9 was issued in November 2009 and replaces the parts of IAS 39 relating to the classification and measurement of financial assets. The standard is effective for annual periods beginning on or after 1 January 2013. The Bank is considering the implication of the standard, the impact on the Bank and the timing of its adoption by the Bank.

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

3 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

In the process of applying the Bank's accounting policies, management has used its judgement and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgements and estimates are as follows:

Going concern

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Furthermore, the Bank's management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

Impairment losses on loans and advances

The Bank reviews its problem loans and advances at each reporting date to assess whether an allowance for impairment should be recorded in the statement of income. In particular, judgement by the Bank's management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in possible future changes to such allowance.

Collective impairment provisions on loans and advances

In addition to specific allowances against individually significant loans and advances, the Bank also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This collective allowance is based on any deterioration in the internal rating of the loan or investment since it was granted or acquired. These internal ratings take into consideration factors such as any deterioration in country risk, industry and technological obsolescence as well as identified structural weaknesses or deterioration in cash flows.

Impairment of goodwill

The annual impairment testing of goodwill involves significant judgements and assumptions relating to the Bank's future operations and the economic environment in which it operates.

4 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of these financial statements are consistent with those followed in the preparation of the annual financial statements for the year ended 31 December 2009.

Foreign currency translation

Transactions in foreign currencies are initially recorded in the functional currency at the rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the statement of financial position date. All differences are taken to the statement of comprehensive income.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial instruments

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are initially measured at their fair value plus, any directly attributable incremental costs of acquisition or issue.

(i) Date of recognition

Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace are recognised on trade date, i.e. the date that the Bank commits to purchase or sell the asset.

(ii) Initial recognition and subsequent measurement

a) Available-for-sale investments

Available-for-sale investments are financial assets that are held for an indefinite period of time, but may be sold in response to need for liquidity or that are not classified as loans and receivables, held to maturity or at fair value through statement of comprehensive income.

Available-for-sale investments are initially recognised at fair value including any transaction cost and subsequently measured at fair value. All gains and losses are taken to the statement of comprehensive income.

b) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities and which the Bank has the intention and ability to hold to maturity. Held-to-maturity financial investments are initially recorded at fair value including transaction cost and are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in 'Interest and similar income' in the statement of comprehensive income. The losses arising from impairment of such investments are recognised in the statement of comprehensive income.

c) Due from banks and loans and advances to customers

Due from banks and loans and advances are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale. This accounting policy relates to the statement of financial position captions 'Due from banks' and 'Loans and advances to customers'. These are initially measured at fair value which is the cash consideration to originate the loan. After initial measurement, these are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in 'Interest and similar income' in the statement of comprehensive income. The losses arising from impairment of such loans and advances are recognised in the statement of comprehensive income as 'Provision for loan losses - net'.

d) Derivatives

Derivatives represent forward foreign exchange contracts. Derivatives are recorded at fair value and carried as assets when the fair value is positive and as liabilities when the fair value is negative. Changes in fair value of derivatives held for trading are included in the statement of comprehensive income.

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

e) Medium term loans

Medium term loans are stated at amortised cost using the effective interest rate method.

Derecognition of financial assets and financial liabilities

(i) Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Bank retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; or
- the Bank has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

(ii) Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expired.

Fair value

For investments quoted in an active market, fair value is calculated by reference to quoted bid prices. The fair value of forward exchange contracts is calculated by reference to forward exchange rates with similar maturities.

Impairment of financial assets

The Bank assesses at each statement of financial position date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults. If such evidence exists, any impairment loss, is recognised in the statement of comprehensive income.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of comprehensive income. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account and the corresponding amount recognised in the statement of income. If a future write-off is later recovered, the recovery is credited to the 'Provision for loan losses - net'.

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of financial assets (continued)

Impairment is determined as follows:

(a) for assets carried at amortised cost, impairment is based on estimated cash flows discounted at the original effective interest rate;

(b) for assets carried at fair value, impairment is the difference between cost and fair value; and

(c) for assets carried at cost, impairment is based on the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

In addition, a provision is made to cover impairment for specific groups of assets where there is a measurable decrease in estimated future cash flows.

Impairment of non-financial assets

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Bank makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets and then its recoverable amount is assessed as part of the cash-generating unit to which it belongs. Where the carrying amount of an asset (or cash-generating unit) exceeds its recoverable amount, the asset (or cash-generating unit) is considered impaired and is written down to its recoverable amount.

Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position, if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

(i) Interest and similar income

For all financial instruments measured at amortised cost, interest-income or expense is recorded at the effective interest rate.

(ii) Fees and commissions income

Credit origination fees are treated as an integral part of the effective interest rate of financial instruments and are recognised over their lives, except when the underlying risk is sold to a third party at which time it is recognised immediately. Other fees and commission income are recognised when earned.

(iii) Dividend income

Dividend income is recognised when the right to receive payment is established.

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment in value.

Depreciation is calculated using the straight-line method to write down the cost of equipment to their residual values over their estimated useful life of 5 years. Land is not depreciated.

An item of equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the statement of comprehensive income in the year the asset is derecognised.

Goodwill

Goodwill arising on acquisition is measured at cost, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is not amortised, but reviewed for impairment annually, or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the cash generating unit, to which the goodwill relates. Where the recoverable amount of the cash generating unit is less than the carrying amount, an impairment loss is recognised in the statement of comprehensive income.

Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and able to be reliably measured.

Employees' end of service benefits

The Bank provides end of service benefits to its expatriate employees. The entitlement to these benefits is based upon the employees' final salary and length of service, subject to the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

With respect to its national employees, the Bank makes contributions to the Social Insurance Organisation scheme calculated as a percentage of the employees' salaries. The Bank's obligations are limited to these contributions, which are expensed when due.

Cash and cash equivalents

Cash and cash equivalents comprise cash, balances with central banks (excluding mandatory reserve deposits), deposits with banks with original maturities of less than ninety days.

Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders. Interim dividends are deducted from equity when they are paid.

Dividends for the year that are approved after the statement of financial position date are dealt with as an event after the statement of financial position date.

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the statement of comprehensive income in 'Provision for loan losses - net'. The premium received is recognised in the statement of comprehensive income in 'Net fees and commissions income' on a straight line basis over the life of the guarantee.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of the new loan conditions. Once the term have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

5 INTEREST AND SIMILAR INCOME

	2010 BD'000	2009 BD'000
Loans and advances	19,877	21,448
Due from banks	1,611	3,583
Non-trading investments	3,216	1,536
	24,704	26,567

6 INTEREST EXPENSE AND SIMILAR CHARGES

	2010 BD'000	2009 BD'000
Due to banks	5,762	10,350
Customers' deposits	3,851	2,409
Medium term loans	706	636
	10,319	13,395

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

7 NET FEES AND COMMISSIONS INCOME

	2010 BD'000	2009 BD'000
Fees and commissions income	1,288	958
Fees and commissions expense	(52)	(51)
	1,236	907

8 CASH AND BALANCES WITH CENTRAL BANKS

	2010 BD'000	2009 BD'000
Cash	1,113	831
Balances with the Central Bank of Bahrain:		
Current account	312	776
Mandatory reserve deposit	3,751	2,905
Time deposit	23,400	32,700
Current account with the Central Bank of Iran	3,251	8,144
	31,827	45,356

Mandatory reserve deposit is not available for use in the day-to-day operations of the Bank.

9 DUE FROM BANKS

	2010 BD'000	2009 BD'000
Placements	128,397	191,716
Bills discounted	148,432	167,231
	276,829	358,947

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

10 LOANS AND ADVANCES TO CUSTOMERS

	2010 BD'000	2009 BD'000
Retail	14,134	11,500
Corporate	146,616	113,680
	160,750	125,180
Less: Provision for loan losses	(6,286)	(5,010)
Suspended interest	(2,740)	(1,757)
	151,724	118,413

The movements in provision for credit losses were as follows:

	2010			2009		
	Retail BD'000	Corporate BD'000	Total BD'000	Retail BD'000	Corporate BD'000	Total BD'000
At 1 January	596	4,414	5,010	362	2,295	2,657
Charge for the year	565	1,495	2,060	346	2,566	2,912
Recoveries	(93)	(643)	(736)	(76)	(426)	(502)
Net provision	472	852	1,324	270	2,140	2,410
Amounts written off	(46)	(2)	(48)	(36)	(21)	(57)
At 31 December	1,022	5,264	6,286	596	4,414	5,010
Specific provision	1,022	4,327	5,349	596	1,558	2,154
Collective provision	-	937	937	-	2,856	2,856
Total provision	1,022	5,264	6,286	596	4,414	5,010
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	2,559	19,400	21,959	2,346	9,812	12,158

The fair value of collateral that the Bank holds relating to loans individually determined to be impaired at 31 December 2010 amounts to BD 37.9 million (31 December 2009: BD 24.7 million). The collateral consists of cash, securities and properties. The Bank also obtains guarantee from banks and corporates.

11 NON-TRADING INVESTMENTS

	2010			2009		
Unquoted	Available for sale BD'000	Held to maturity BD'000	Total BD'000	Available for sale BD'000	Held to maturity BD'000	Total BD'000
Iranian Government bonds	13,859	1,023	14,882	10,033	2,377	12,410
Iranian Corporate bonds	19,993	-	19,993			
Treasury bills	14,929	-	14,929	-	-	-
Sukuk	510	-	510	-	-	-
Equity	10	-	10	10	-	10
	49,301	1,023	50,324	10,043	2,377	12,420

The Iranian Government bonds are denominated in Iranian Rials. The Iranian Corporate bonds are issued by Iranian companies and are denominated in Euro.

Treasury bills and Sukuk are issued by Ministry of Finance of the Kingdom of Bahrain and are denominated in Bahraini Dinars.

All investments are stated at cost as on maturity these are redeemable at their face value.

The held to maturity bond matured on 31 December 2010 and the proceeds which were received subsequent to the statement of financial position date were reinvested in another bond.

12 OTHER ASSETS

	2010 BD'000	2009 BD'000
Interest receivable	5,261	5,007
Sundry debtors and prepayments	186	382
Other	257	25
	5,704	5,414

13 PROPERTY AND EQUIPMENT

Property and equipment includes freehold land in the Seef District in the Kingdom of Bahrain of BD 1.3 million (31 December 2009: BD 1.3 million) and capital work in progress of BD 1.7 million (31 December 2009: nil) relating to the construction of the Bank's new Head Office premises. The Bank's management performed an impairment review of the land by seeking an independent professional valuation as of 31 December 2010. Based on such review no indication of impairment was observed.

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

14 GOODWILL

The goodwill had arisen from the Bank's acquisition of the offshore banking unit of BSI in Bahrain in 2004 (refer note 1). The Bank's management has allocated the goodwill entirely to a single Cash Generating Unit (CGU) - International Trade Finance and Treasury Unit.

The recoverable amount of the CGU was determined based on value in use calculation using cash flow projections from financial budgets approved by the Bank's senior management covering a five year period. The key assumptions used in the value in use calculation included a perpetuity growth rate of 0.5% and discount factor of 20.8%.

As the recoverable amount of the CGU was lower than its net book value by BD 1.02 million, the management recognised the goodwill impairment for this amount through the statement of comprehensive income.

The calculation of value in use for the CGU is sensitive to certain key assumptions such as growth rate, risk free rate, market risk premium and country risk premium.

15 CUSTOMERS' DEPOSITS

	2010 BD'000	2009 BD'000
Current and call accounts	22,596	12,170
Savings accounts	7,136	5,470
Term deposit accounts	101,921	91,086
	131,653	108,726

16 MEDIUM TERM LOANS

	2010		2009	
	Interest rate	BD'000	Interest rate	BD'000
Bank Saderat Iran (Euro 30 million) (repayable in bullet in January 2014)	Libor + 25 basis points	14,995	Libor + 25 basis points	16,255
Bank Melli Iran (Euro 30 million) (repayable in bullet in January 2014)	Libor + 25 basis points	14,995	Libor + 25 basis points	16,255
Bank Melli Iran (Euro 30 million) (repayable in bullet in August 2013)	Libor + 81 basis points	14,995	-	-
Bank Tejarat Iran (Euro 30 million) (repayable in bullet in January 2014)	Libor +125 basis points	14,994	Libor +125 basis points	16,254
		59,979		48,764

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

17 OTHER LIABILITIES

	2010 BD'000	2009 BD'000
Interest payable	1,560	1,665
Staff related accruals	741	678
Accounts payable	2,046	670
Other	649	445
	4,996	3,458

18 SHARE CAPITAL

	2010 BD'000	2009 BD'000
Authorised:		
100 million (31 December 2009: 75.4 million) ordinary shares of BD 1 each	100,000	75,400
Issued and fully paid:		
75 million (31 December 2009: 56.5 million) ordinary shares of BD 1 each	75,000	56,550

At the Extraordinary General Meeting held on 7 March 2010, the Bank's shareholders resolved to increase the paid up share capital from BD 56.6 million to BD 75 million through a rights issue of 18.5 million shares of BD 1 each (2009: paid up share capital increased from BD 45.2 million to BD 56.5 million through a rights issue of 11.3 million shares of BD 1 each).

19 STATUTORY RESERVE

As required by the Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the net profit for the year has been transferred to a statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve equates to 50% of the paid up share capital. This reserve is non distributable, except in circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

20 DIVIDEND PAID AND PROPOSED

	2010 BD'000	2009 BD'000
Dividend paid during the year:		
Final dividend for 2009 - Bahraini Fils: 232 per share (for 2008 - Bahraini Fils: 200 per share)	13,101	9,048

Following the approval of the 2009 proposed dividend by the Bank's shareholders at the Annual General Meeting on 3 February 2010, the dividend was paid.

	2010 BD'000	2009 BD'000
Proposed dividend:		
Proposed cash dividend for 2010 - Bahraini Fils: 108 per share (for 2009 - Bahraini Fils: 232 per share)	8,100	13,101

The proposed dividend will be submitted for formal approval of the Bank's shareholders at the Annual General Meeting subject to necessary regulatory approval.

21 CASH AND CASH EQUIVALENTS

	2010 BD'000	2009 BD'000
Cash and balances with central banks excluding mandatory reserve deposit	28,076	42,451
Due from banks with an original maturity of less than ninety days	188,049	248,122
	216,125	290,573

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

22 RELATED PARTY TRANSACTIONS

The Bank enters into transactions with shareholders, directors, senior management and their related entities in the ordinary course of business at normal commercial terms. All the loans and advances to related parties are performing and are free of any provision for possible credit losses.

Details of balances and transactions with related parties are as follows:

	2010 BD'000	2009 BD'000
Statement of financial position		
Shareholders and related parties		
Placements (included in due from banks)*	92,702	135,702
Loans and advances to shareholders (included in due from banks)*	90,998	97,704
Loans and advances to other related parties (included in loans and advances)**	6,442	9,124
Deposits from shareholders (included in due to banks)*	21,791	22,573
Medium term borrowings*	44,984	32,510
Directors and key management personnel		
Loans and advances	29	42
Deposits	265	109

	2010 BD'000	2009 BD'000
Statement of comprehensive income		
Shareholders and related parties		
Interest income from shareholders*	5,637	9,455
Interest income from other related parties**	442	683
Fees and commissions income from shareholders*	299	396
Fees and commissions income from other related parties**	59	48
Interest expense*	409	760

* These relate to two of the Bank's shareholders.

** These relate to two affiliates of the Bank's shareholders.

Key management compensation

The compensation for key management personnel, including executive directors, comprises the following:

	2010 BD'000	2009 BD'000
Salaries and other short term benefits	649	689
End of service benefits	26	25

In 2010 Directors' sitting fees amounted to BD 38.5 thousand (2009: BD 38.5 thousand).

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

23 COMMITMENTS AND CONTINGENT LIABILITIES

Credit-related commitments

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

Letters of credit, guarantees (including standby letters of credit) and acceptances commit the Bank to make payments on behalf of customers.

The Bank has the following credit related commitments:

	2010 BD'000	2009 BD'000
Commitments on behalf of customers:		
Acceptances	191	799
Letters of credit	2,328	3,769
Guarantees	3,890	3,569
	6,409	8,137

Other Commitments:

The Bank's commitments in respect of operating leases were as follows:

	2010 BD'000	2009 BD'000
Within one year	247	135
One to five years	151	82
	398	217

As of 31 December 2010 the Bank has a capital commitment of BD 4.2 million (2009: nil) for the construction of the Bank's new Head Office.

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

24 CAPITAL ADEQUACY

The primary objectives of the Bank's capital management are 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 maintain or adjust the capital structure, the Bank may adjust the amount of dividend payments to shareholders, or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

The risk asset ratio, calculated in accordance with the capital adequacy guidelines approved by the Central Bank of Bahrain, for the Bank is as follows:

	2010 BD'000	2009 BD'000
Capital base:		
Tier 1 capital	88,178	73,748
Goodwill	(2,923)	(3,942)
Total capital base (a)	85,255	69,806
Risk weighted assets (b)	332,230	332,254
Capital adequacy (a/b* 100)	25.7%	21.0%
Minimum requirement	12.0%	12.0%

Since 2008 the Bank has adopted the Basel II guidelines as adopted by the Central Bank of Bahrain for calculation of the capital adequacy ratio.

25 RISK MANAGEMENT

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk. It is also subject to operational risk.

Risk management framework

The risk management framework is summarised through the risk charter of the Bank which was approved by the Board of Directors in December 2007 and last reviewed in July 2010. The objective of the risk charter is to define the board framework consisting of policies and procedures for the management of credit, operational, market and liquidity risks. It also defines the roles and responsibilities of various committees, such as Board, Executive Committee, Management Committee, Asset Liability Committee (ALCO), Risk Committee, and the Risk Management Department. The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent committees responsible for managing and monitoring risks. The overall control for risks lies with the Risk Committee.

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

25 RISK MANAGEMENT (continued)

Audit Committee

The Audit Committee is responsible for ensuring the Bank's internal controls and systems are properly tested. The Audit Committee is also responsible for ensuring that Bank meets various regulatory guidelines and undertakes continuous disclosure in line with the accounting and regulatory standards.

Risk Management Committee

The Risk Management committee has overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for fundamental risk issues and manages and monitors relevant risk decisions. There are two sub-committees namely the Operational Risk sub-committee and the Credit Monitoring and Special Asset Management (SAM) sub-committee which monitor operational risk and credit risk respectively and report to the Risk Management Committee.

Risk Management Department

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure that independent reporting and control processes exist.

Asset Liability Management Committee

The asset Liability Management Committee (ALCO) is the management's governing committee mainly responsible for market and liquidity risks pertaining to on statement of financial position and off statement of financial position items by optimising liquidity constraints, profitability expectations, foreign exchange exposures, income and asset volatility and capital adequacy requirements.

Risk measurement and reporting systems

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Board of Directors, the Risk Committee, and the head of each business division. The report includes aggregate credit exposure, analysis of lending portfolio by sectors, ratings and security as well as country exposure. The liquidity and interest rate risk related ratios are reported and discussed in the monthly ALCO meetings. Senior Management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Board receives a comprehensive overview through a report from head of risk and other reports produced by Risk Management Department (RMD) such as ten largest watch listed borrower accounts, ten largest non-performing borrower accounts and computation of capital adequacy ratio for the quarters.

Risk mitigation

Significant risk mitigation techniques are applied in the area of credit and operational risk. The Bank actively uses collateral to reduce its credit risks.

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For commercial lending in Bahrain, charges over real estate properties; and
- For lending outside Bahrain (mainly Iran) collateral of shares listed on the Tehran Stock Exchange.

25 RISK MANAGEMENT (continued)

The Bank also obtains guarantees from parent companies for loans to their subsidiaries.

The Bank monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and also monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

Operational Risk is mitigated through a set of internal controls which are part of the Bank's Standard Operating Procedures (SOPs). The Bank has implemented dedicated software to monitor Key Risk Indicators (KRI) and loss events. The data is gathered by business coordinators and validated by respective supervisors before it is loaded into the software. Threshold breaches, if any, are reported to the operational risk sub-committee for suitable action. The entire operational risk management process was also recently reviewed by the Bank's internal audit function.

Excessive risk concentration

Concentrations arise when a number of 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. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

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

26 CREDIT RISK

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Bank manages credit risk by setting limits for individual borrowers, and groups of borrowers and for geographical and industry segments. The Bank also monitors credit exposures, and continually assesses the creditworthiness of counterparties. In addition, the Bank obtains security where appropriate (refer note 10) and collateral arrangements with counterparties and limits the duration of exposures.

(a) Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the statement of financial position. The maximum exposure is shown gross, before the effect of mitigation through the use of collateral but after impairment allowance, if any.

	Gross maximum exposure 2010 BD'000	Gross maximum exposure 2009 BD'000
Balances with central banks	30,714	44,525
Due from banks	276,829	358,947
Loans and advances to customers	151,724	118,413
Non-trading investments	50,314	12,410
Other assets	5,574	5,313
Total on balance sheet exposures	515,155	539,608
Commitments and contingent liabilities	6,409	8,137
Total credit risk exposure	521,564	547,745

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

26 CREDIT RISK (continued)

(b) Risk concentrations of the maximum exposure to credit risk

The distribution of assets (excluding goodwill), liabilities (excluding equity), and off-statement of financial position items by geographic region and industry sector was as follows:

	2010			2009		
	Assets BD'000	Liabilities BD'000	Credit related commitments BD'000	Assets BD'000	Liabilities BD'000	Credit related commitments BD'000
Geographic region:						
Domestic (Bahrain)	131,026	78,060	3,890	114,677	65,253	3,657
Iran and Middle East countries*	371,676	358,060	2,519	356,279	403,366	4,480
Europe	18,675	2	-	72,618	5,149	-
	521,377	436,122	6,409	543,574	473,768	8,137
Industry sector:						
Trading and manufacturing	47,637	7,729	2,778	24,093	727	4,825
Banks and financial institutions	364,118	304,912	3	444,415	365,491	-
Construction and real estate	64,914	283	2,688	54,983	73	2,533
Other	44,708	123,198	940	20,083	107,477	779
	521,377	436,122	6,409	543,574	473,768	8,137

* A substantial part of these exposures relate to Iran.

As of 31 December 2010, five largest customers accounted for 23% (31 December 2009: 23%) of the net loans and advances to customers.

26 CREDIT RISK (continued)

(c) Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank using internal credit ratings. The table below shows the credit quality by class of assets, based on the Bank's credit rating system.

	31 December 2010				
	Neither past due nor impaired				
	High grade BD'000	Standard grade BD'000	Past due but not impaired BD'000	Individually impaired BD'000	Total BD'000
Balances with central banks	30,714	-	-	-	30,714
Due from banks					
Placements	-	128,397	-	-	128,397
Loans and advances	-	148,432	-	-	148,432
Loans and advances to customers					
Retail	893	7,066	3,616	2,559	14,134
Corporate	23,914	78,797	24,505	19,400	146,616
Non-trading investments	50,314	-	-	-	50,314
	105,835	362,692	28,121	21,959	518,607

	31 December 2009				
	Neither past due nor impaired				
	High grade BD'000	Standard grade BD'000	Past due but not impaired BD'000	Individually impaired BD'000	Total BD'000
Balances with central banks	44,525	-	-	-	44,525
Due from banks					
Placements	-	191,716	-	-	191,716
Loans and advances	-	167,231	-	-	167,231
Loans and advances to customers					
Retail	2,942	5,251	961	2,346	11,500
Corporate	17,192	51,996	34,680	9,812	113,680
Non-trading investments	12,410	-	-	-	12,410
	77,069	416,194	35,641	12,158	541,062

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

26 CREDIT RISK (continued)

(d) Aging analysis of past due but not impaired loans per class of financial assets

31 December 2010

	Less than 30 days BD'000	31 to 60 days BD'000	61 to 90 days BD'000	Total BD'000
Loans and advances to customers				
Retail	265	3,289	62	3,616
Corporate*	15,657	8,848	-	24,505
	15,922	12,137	62	28,121

* Subsequent to the year end, BD 1 million (2009: BD 11.9 million) of the corporate Loans and Advances Portfolio have been transferred from the past due but not impaired loans category to high or standard grades upon collection of the related over dues.

31 December 2009

	Less than 30 days BD'000	31 to 60 days BD'000	61 to 90 days BD'000	Total BD'000
Loans and advances to customers				
Retail	12	488	461	961
Corporate	9,009	11,831	13,840	34,680
	9,021	12,319	14,301	35,641

The above past due loans and advances include those that are only past due by a few days.

(e) Carrying amount per class of financial assets whose terms have been renegotiated

	2010 BD'000	2009 BD'000
Loans and advances to customers		
Retail	30	43
Corporate	15,422	1,781
Total renegotiated loans	15,452	1,824

27 MARKET RISK

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates and equity prices.

27.1 Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. The Bank's management believe that the Bank is not exposed to material interest rate risk as a result of mismatches of interest rate repricing of assets and liabilities as the repricing of assets and liabilities occur at similar intervals.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates by major currencies, with all other variables held constant, of the Bank's statement of comprehensive income. The Bank's equity is not sensitive to changes in interest rates as at 31 December 2010 and 2009.

	31 December 2010		31 December 2009	
	Increase in basis points	Impact on net interest income BD'000	Increase in basis points	Impact on net interest income BD'000
US Dollars	100	23	100	99
Bahraini Dinar	100	249	100	323
Euro	100	(211)	100	(114)
Iranian Rials	100	256	100	124

The impact of a similar decrease in basis points will be approximately opposite to the impact disclosed above.

27.2 Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on positions by currency. Positions are monitored on a daily basis and strategies are used to ensure positions are maintained within established limits.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2010 and 2009. The analysis calculates the effect of a reasonably possible movement of the currency exchange rate against the BD with all other variables held constant on the statement of comprehensive income. A negative amount in the table reflects a potential net reduction in statement of comprehensive income, while a positive amount reflects a net potential increase.

	31 December 2010		31 December 2009	
Currency	Change in currency rate in %	Effect on profit 2010 BD'000	Change in currency rate in %	Effect on profit 2009 BD'000
Euro	10	780	10	(358)
Swiss Francs	10	(1)	10	(1)
Iranian Rials	8	2,171	8	1,027

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

28 LIQUIDITY RISK

Liquidity risk is the risk that the Bank will be unable to meet its liabilities when they fall due. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind, and monitors liquidity on a daily basis.

The Bank has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains a statutory deposit with the Central Bank of Bahrain equal to 5% of customer deposits denominated in Bahraini Dinars. The Bank also maintains limits on the ratio of net liquid assets to customer liabilities, set to reflect market conditions. Net liquid assets consist of cash, short term bank deposits and liquid debt securities available for immediate sale, less deposits for banks and other issued securities and borrowings due to mature within the next month. The liquidity profile of customer deposits has been determined on the basis of the effective maturities indicated by the Bank's deposit retention history.

The maturity profile of management's best estimate of expected maturities of the assets and liabilities at 31 December 2010 was as follows:

	Up to 1 month BD'000	1 to 3 months BD'000	3 to 6 months BD'000	6 months to 1 year BD'000	Total up to 1 year BD'000	1 to 3 years BD'000	Over 3 years BD'000	No fixed maturity BD'000	Total BD'000
Assets									
Cash and balances with central banks	28,076	-	-	-	28,076	-	-	3,751	31,827
Due from banks	123,520	64,529	42,169	46,611	276,829	-	-	-	276,829
Loans and advances to customers	8,888	6,917	7,719	41,165	64,689	57,120	29,915	-	151,724
Non-trading investments	50,314	-	-	-	50,314	-	-	10	50,324
Other assets	2,053	921	643	1,132	4,749	646	309	-	5,704
Property and equipment	-	-	-	-	-	-	-	4,969	4,969
Goodwill	-	-	-	-	-	-	-	2,923	2,923
Total assets	212,851	72,367	50,531	88,908	424,657	57,766	30,224	11,653	524,300
Liabilities									
Due to banks	42,114	118,226	12,522	66,632	239,494	-	-	-	239,494
Customers' deposits	10,260	9,904	-	-	20,164	111,489	-	-	131,653
Medium term loans	-	-	-	-	-	14,995	44,984	-	59,979
Other liabilities	3,496	723	87	316	4,622	188	186	-	4,996
Total liabilities	55,870	128,853	12,609	66,948	264,280	126,672	45,170	-	436,122
Net liquidity gap	156,981	(56,486)	37,922	21,960	160,377	(68,906)	(14,946)	11,653	
Cumulative liquidity gap	156,981	100,495	138,417	160,377	160,377	91,471	76,525	88,178	

28 LIQUIDITY RISK (continued)

The maturity profile of management's best estimate of expected maturities of the assets and liabilities at 31 December 2009 was as follows:

	Up to 1 month BD'000	1 to 3 months BD'000	3 to 6 months BD'000	6 months to 1 year BD'000	Total up to 1 year BD'000	1 to 3 years BD'000	Over 3 years BD'000	No fixed maturity BD'000	Total BD'000
Assets									
Cash and balances with central banks	42,451	-	-	-	42,451	-	-	2,905	45,356
Due from banks	177,947	70,541	55,005	55,454	358,947	-	-	-	358,947
Loans and advances to customers	10,731	15,283	5,773	36,253	68,040	24,504	25,869	-	118,413
Non-trading investments	10,033	-	-	2,377	12,410	-	-	10	12,420
Other assets	2,588	856	606	915	4,965	208	241	-	5,414
Property and equipment	-	-	-	-	-	-	-	3,024	3,024
Goodwill	-	-	-	-	-	-	-	3,942	3,942
Total assets	243,750	86,680	61,384	94,999	486,813	24,712	26,110	9,881	547,516
Liabilities									
Due to banks	122,989	90,054	48,449	51,328	312,820	-	-	-	312,820
Customers' deposits	8,322	8,048	-	-	16,370	92,356	-	-	108,726
Medium term loans	-	-	-	-	-	48,764	-	-	48,764
Other liabilities	2,131	555	216	232	3,134	324	-	-	3,458
Total liabilities	133,442	98,657	48,665	51,560	332,324	141,444	-	-	473,768
Net liquidity gap	110,308	(11,977)	12,719	43,439	154,489	(116,732)	26,110	9,881	
Cumulative liquidity gap	110,308	98,331	111,050	154,489	154,489	37,757	63,867	73,748	

NOTES TO THE FINANCIAL STATEMENTS At 31 December 2010

28 LIQUIDITY RISK (continued)

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2010 based on contractual undiscounted repayment obligations. Repayments which are subjected to notice are treated as if notice were to be given immediately.

	On demand BD'000	less than 3 months BD'000	3 to 6 months BD'000	6 to 12 months BD'000	1 to 3 years BD'000	Total BD'000
Financial liabilities						
As at 31 December 2010						
Due to banks	42,303	119,469	13,003	67,265	-	242,040
Customers' deposits	32,793	72,274	12,182	13,098	3,059	133,406
Medium term loans	-	754	754	1,509	66,307	69,324
	75,096	192,497	25,939	81,872	69,366	444,770
Contingencies and commitments	1,273	2,406	640	821	1,269	6,409
Total undiscounted financial liabilities	76,369	194,903	26,579	82,693	70,635	451,179
As at 31 December 2009						
Due to banks	123,435	91,104	49,001	51,756	-	315,296
Customers' deposits	21,780	69,067	8,715	10,064	80	109,706
Medium term loans	-	613	613	1,226	53,877	56,329
	145,215	160,784	58,329	63,046	53,957	481,331
Contingencies and commitments	1,417	3,016	2,632	100	972	8,137
Total undiscounted financial liabilities	146,632	163,800	60,961	63,146	54,929	489,468

29 LEGAL RISK AND CLAIMS

Legal risk is the risk arising from the potential that unenforceable contracts, lawsuits or adverse judgments can disrupt or otherwise negatively affect the operations of the Bank. The Bank has developed controls and procedures to identify legal risks and believes that losses will be avoided.

30 OPERATIONAL RISK

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

31 FAIR VALUE OF FINANCIAL INSTRUMENTS

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and saving accounts without specific maturity and variable rate financial instruments.

The estimated fair values of other financial assets and financial liabilities are not materially different from their carrying values as stated in the statement of financial position.

DISCLOSURES

PILLAR III QUALITATIVE DISCLOSURES - BASEL II 31 December 2010

RISK MANAGEMENT

Management of risk involves the identification, measurement, ongoing monitoring and control of all financial and non financial risks to which the Bank is potentially exposed. It is understood that risks cannot be eliminated but can be effectively controlled and mitigated. This involves continuous monitoring of the political, economic and market conditions as also the creditworthiness of the Bank's counterparts. To achieve this objective the Bank has decided to use the best management practices supported by skilled and experienced people and appropriate technology.

The Board of Directors of the Bank assumes ultimate responsibility for the risk management function through a comprehensive set of policies and strategies which are subject to periodic review. The Board defines the risk appetite of the Bank through such policies and strategies which ultimately provide necessary direction and framework for all activities undertaken by the Bank. The Senior Management, under the direct supervision of the Board, is responsible for establishing procedures for implementation of these policies and strategies.

The risk function at Futurebank was formally set up in September 2005. Within a short span of a little more than five years the Bank has managed to go into various areas of risk management. The overall risk management activity is enunciated through a Risk Charter which lays down the overall framework of strategies, infrastructure, policies and procedures. It also summarises the committee structure adopted by the Bank for management of risk. The Risk Management Committee (RMC) set up with the representation of Senior Management, reports to the Board of Directors. The RMC is chaired by the CEO and is responsible for implementation, interpretation and follow up of the risk policies. The terms of reference of the RMC broadly include the implementation of all policies relating to management of credit, market, liquidity and operational risks on an ongoing basis. There are three subcommittees to specifically monitor Operational Risk, Credit Risk (Performing loans) and SAM (Special Assets Management or Non-Performing loans) respectively. These subcommittees report to the RMC. The Head of Risk reports to the CEO with a dotted line to Board.

During 2009, based on Central Bank of Bahrain's (CBB) guidelines, a risk profiling audit of the Bank was conducted by an independent external auditor and the report was sent to the CBB. Based on the gaps identified in the report, the Bank had submitted a time bound action plan to the CBB. The Risk Management Department (RMD) follows up on this action plan and backlog, if any, is reported to the CBB and Board. During 2010 the organisation structure was modified in order to elevate the role of the Risk Management in the credit approval process. In addition, the credit analysis function is being shifted from front office to Credit Department.

The RMD is responsible for the day-to-day management of risk which includes setting up and maintenance of various limits, monitoring of these limits, reporting all excesses and anomalies to RMC and follow up with respective front office representatives for regularisation.

Internal audit assesses whether the policies and procedures are complied with and, if necessary, suggest ways of improving internal controls. A separate internal control function was set up under the Finance Department and looks after various internal control issues.

The risks associated with the Banks' business are broadly categorised into credit, market, liquidity and operational risks. These are discussed in following sections.

CREDIT RISK

Credit risk is the potential financial loss arising due to counterpart default or counterpart failure to perform as per agreed terms. The objective of credit risk management is to ensure that all credit exposures are undertaken and managed within the parameters defined in the credit risk policy and the risk reward relationship is maintained. The Bank is in the process of adopting a Risk-Adjusted Return On Capital (RAROC) model. In December 2007, the Bank adopted a comprehensive credit risk policy which was further augmented in December 2008. All credit activities of the Bank are guided by a set of principles and procedures as described in this policy document.

The credit approval process follows the well accepted principle of joint signatories under which the credit proposal is marketed by front office and processed by Credit Department. The approval levels are well defined with clear delegations in terms of amount and tenor. In case of relatively risk free exposures such as cash collateralised loans, sub-delegations are permitted under the policy.

The Bank has adopted an elaborate rating system separately for retail, corporate and Bank customers with appropriate weightage to quantitative and qualitative factors. Rating is mandatory for all credit decisions. The entire portfolio of the Bank has been segregated into three broad categories namely: the investment grade assets (Ratings A to D minus), the judgmental grade (Weak list E + and Watch list E) and

PILLAR III QUALITATIVE DISCLOSURES - BASEL II 31 December 2010

the classification grade assets (Ratings X, Y and Z) which are the Non Performing Assets (NPA). For external classifications, where available the Bank relies on FITCH ratings for counterparties and country risk.

Limits are also in place to monitor various credit concentrations by counterpart / group, country, sector, ratings, products etc. The day-to-day monitoring of individual borrowers or counterparty exposures is the responsibility of the respective business units. The Credit Administration unit ensures that credit facilities are released after proper approval and against proper documentation and is in charge of activating the customer limits. The Credit Risk Monitoring and Control unit under RMD ensures that limits and other parameters such as ratings, sector codes etc. are properly maintained in the system. It also monitors past dues, expired credits and any other exceptions and ensures proper classification of assets. The Bank's credit risk policy incorporates detailed guidelines on acceptability of various types of collaterals, haircuts, frequency of valuation and guidelines on selection of external valuers. Collaterals are valued on daily basis in case of shares and in case of Title Deeds with a minimum frequency of one year or more depending upon the volatility of the markets. The main types of guarantors currently accepted by the Bank are corporate and quasi-government entities. The creditworthiness of these guarantors is assessed by the Bank through the same credit rating model as used for borrowers.

A remedial unit is in place to manage the NPA accounts and follow up of loans on which legal action has been taken. The Bank follows the Basel II norm of 90 days default for classifying a loan as non performing / impaired category. Interest / other income is immediately suspended upon classification of an asset as NPA. The Bank follows IAS – 39 guidelines for making specific provisions in respect of its impaired assets. A collective impairment provision is held in addition to specific provision which is based on the Probability of Default (PD) of external rating agencies which are mapped to the Bank's internal rating categories on a best effort basis. All provisions are recommended by the Risk Department and approved by the Risk Committee.

The Bank has adopted a standardised approach for capital computation under credit risk.

LIQUIDITY, INTEREST & CURRENCY RISK (BANKING BOOK)

Liquidity risk is the risk of the Bank failing to meet its commitments unless it raises funds at unreasonable prices or is forced to sell its assets at whatever price. It arises out of funding mismatch.

At Futurebank the liquidity and interest risks are managed through the mechanism of Assets Liability Management Committee (ALCO). The Bank uses the maturity ladder (time buckets) approach for managing its liquidity. For interest rate risks the Bank considers the interest reset dates. The limits for each time bucket of the maturity ladder, the cumulative outflow of cash for each time bucket and limits on each gap as approved by the Board are reviewed and monitored by ALCO on monthly basis. No prepayment of loans are considered as key assumption for calculating interest rate risk in the banking book and the Bank has no deposit without fixed maturity. It is the Bank's policy to keep its assets in high quality liquid assets such as inter-bank placements to ensure that funds are available to meet maturing liabilities, undrawn facilities and deposit withdrawals. A substantial portion of the Bank's deposits are made up of retail, current and fixed deposit accounts which, though payable on demand or at short notice, have traditionally formed part of a stable deposit base and a source of stable funds. The Bank has also adopted a liquidity contingency plan which is subject to annual testing.

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. As the Bahraini Dinar is pegged to the US Dollar, the currency risk is minimised. The Board has approved limits for open positions which are monitored by the RMD on daily basis.

The Bank does not have trading portfolios and is therefore not exposed to interest, equity and / or currency risk on that count. The Treasurer is responsible for the day-to-day management of liquidity, interest and FX risk arising in the banking book with direct reporting to Senior Management and ALCO.

MARKET RISK

Market risk is defined as the risk of potential losses in the on and off balance sheet positions, arising out of adverse movements in interest rates, equity prices, exchange rates, commodity prices and derivatives. This risk arises from the asset–liability mismatch, changes in yield curve and changes in the volatilities in the market value of derivatives.

The magnitude of market risk carried on the balance sheet is minimal. At present the Bank does not trade in foreign exchange for its own account nor does it carry open positions except for its nostros. The Bank is also not trading in commodities.

PILLAR III QUALITATIVE DISCLOSURES - BASEL II 31 December 2010

The Bank currently holds no trading portfolio and therefore application of Value at Risk (VaR) techniques is not relevant for the time being. The Bank has invested certain amounts in Iranian Government Bonds and has adopted a stop loss policy to prevent loss arising in case of possible depreciation of Iranian Rial. In addition, the Bank is also indirectly exposed to loss on account of depreciation of Iranian Rial as it has granted loans designated in Bahraini Dinar in Bahrain against Iranian Rial deposits issued in Iran. The exchange risk is being monitored on a regular basis. In Bahrain, the Bank is indirectly exposed to the real Estate sector as major portion of its lending portfolio in Bahrain is secured by real estate mortgage.

The Bank is indirectly exposed to market risk on Iranian equities as major portion of its offshore credit portfolio is secured by listed Iranian stocks. A policy is in place to diversify this risk into various stocks to avoid concentrations, to obtain adequate cushion to protect against possible fall in prices, regular monitoring, with top up and sell down thresholds.

OPERATIONAL RISK

Operational risk is the risk of direct or indirect loss resulting from failed processes, technology, people or external events. It includes reputation risk. The Bank has put in place Standard Operating Procedures (SOPs) which comply with the high standards of internal control. In the process, the activities have been segregated into back office and front office in accordance with international best practice. During 2010, the SOPs were re-engineered in order to reflect the changes required through implementation of a new Core Banking Module.

The IT security processes were re-engineered and streamlined through an ISO audit. The Management Information System (MIS) is being strengthened with particular focus on exception management. The Internal Audit Department is considered the final layer of internal control and reports directly to the Board of Directors.

A business continuity plan is in place to ensure continuity of essential services to customers in case of occurrence of any calamity resulting in dirsruption of normal business activity. Similarly, a disaster recovery plan is also in place. The Bank has set up a disaster recovery site at one of its branches as a back up site in case of any disaster.

An operational risk management policy and procedure framework has been adopted which defines key operational risk areas, key control standards and key risk indicators in line with the Basel II recommendations. The Bank currently follows the basic indicator approach for operational risk. The Operational Risk subcommittee is in charge of implementation of the operational risk policy and reports to the RMC. The RMD implements operational risk procedures. Dedicated software is in place to monitor operational risk.

The Bank paid a nominal amount of BD 600 only as penalty during the year to Central Bank of Bahrain due to errors in Bahrain Credit Reference Bureau Records (BCRB).

CAPITAL ADEQUACY ASSESSMENT PROCESS AND PILLAR II RISKS (ICAAP)

The Bank follows a standardised approach for credit and market risks and the basic indicator approach for operational risk. A Capital Management Policy has been approved by the Board under which the Bank has defined threshold limits for capital adequacy ratio with a minimum capital requirement ratio of 12% (same as required by the CBB) and a maximum threshold level. Within this range, 3 trigger ratios are defined i.e. internal target ratio, lower trigger ratio, and ICAAP capital adequacy ratio to enable the Bank to assess the adequacy of the capital to support current and future activities. Action points are triggered in case of breach of any of the lower trigger ratios. The ICAAP capital adequacy ratio represents the capital position which the Bank will maintain as buffer over 12% to accommodate any capital requirements under Pillar II and effects of stress test on the level of capital required. In order to manage the Pillar II risks the Bank has adopted risk diversification policies by geographic, sector, rating classifications. Stress tests are performed at quarterly intervals and reported to the Board.

For example the geographic areas are broken into six categories under the country risk management policy based on country ratings. Exposure limits have been set up on each category. Similarly sector limits and rating wise limits have been defined under the credit risk policy to avoid concentration risk. Currently the geographic risk is concentrated to one country i.e. Iran apart from Bahrain.

The Bank follows the CBB's definition of large exposure limits and all credit approvals are based on adherence to the maximum limit of 15% of capital base except those specifically approved by the CBB. All large exposures are monitored by the RMD on a daily basis and a report is presented to the Risk Committee on a monthly basis. Certain sensitive exposures such as connected party exposure and Iran exposure are monitored on a daily basis.

Any credit obligation which remains unpaid on the due date is considered as past due on the next succeeding day. All past dues are closely monitored through daily and monthly reports. The rating model adopted by the Bank automatically downgrades an account to weak list (rating E+) or watch list (rating E) depending upon the length of the past dues. An account is downgraded to impaired asset if the past due status extends beyond 90 days. Provisions are made based on IAS 39 requirements.

In addition high value NPAs are subjected to quarterly revaluation of security based on 3 independent valuations and the Net Present Value (NPV) is based on 4 years discounting of the lowest value in order to ensure that all provisions are made on a conservative basis. The Bank has adopted a policy of minimum 20% provision on all NPAs irrespective of the availability of collaterals on cash flows. In addition, 100% provision is made in respect of any NPA with a gross exposure up to BD 100 thousand. The Bank also follows a cooling period of 6 months satisfactory performance before upgrading any asset to performing category.

A collective impairment provision is also maintained as additional cushion based on the PDs for each rating category. Since the Bank does not have its own PDs in the absence of adequate historical data, the PDs of external rating agencies have been mapped to the Bank's internal rating categories on a best effort basis.

In order to minimise potential legal risks, the Bank has adopted best practices in lending activities especially in the area of consumer lending which includes dissemination of information relating to products, tariffs etc. through various media including website, literature and documentation, complaint disposal mechanism, staff training etc. There were no material legal claims against the Bank as of 31 December 2010. A separate Compliance Department is functional which monitors the compliance risk.

The Bank has adopted a policy for conducting stress testing on various portfolios in order to determine additional capital requirements as part of its ICAAP. The Bank is in the process of calculating its ICAAP ratio based on its 3 year business plan approved by the Board.

PILLAR III - DISCLOSURES

In line with CBB guidelines the Bank has put in place a Disclosure Policy approved by its Board. The policy defines a framework for the disclosure obligations and a committee has been established which oversees the entire process.

DEPOSIT PROTECTION SCHEME

Deposits held with the Bank are covered by the Deposit Protection Scheme (the Scheme) established by CBB regulations concerning the establishment of a Deposit Protection Scheme and Deposit Protection Board. No liability is due until one of the member commercial banks associated with the Scheme is unable to meet its deposit obligations. The Bank has contributed to the Deposit Protection Fund during 2010 as per CBB guidelines.

TABLE OF CONTENTS

Pillar III Disclosures - Basel II

Pillar III Disclosures - Basel II for the year ended 31 December 2010

DISCLOSURE - 1 CAPITAL STRUCTURE

	BD '000	
NET AVAILABLE CAPITAL	Tier 1	Tier 2
Paid-up share capital	75,000	
Reserves:		
Statutory reserve	4,095	
Retained earnings brought forward	2	
Less: Goodwill	(2,923)	
Current profits	9,081	
NET AVAILABLE CAPITAL	85,255	0
TOTAL ELIGIBLE CAPITAL BASE (Tier 1 + Tier 2)		85,255

DISCLOSURE - 2 - A. CAPITAL REQUIREMENT FOR CREDIT, MARKET AND OPERATIONAL RISKS

	BD '000	
	Risk weighted assets*	Capital requirement
Claims on sovereign	3,251	390
Claims on public sector entities	9,697	1,164
Claims on banks	156,211	18,745
Claims on corporate	49,333	5,920
Regulatory retail portfolios	55	7
Mortgage	47,847	5,742
Past due exposure	12,277	1,473
Equity investments	15	2
Holding real estate	1,329	159
Other assets	9,344	1,121
TOTAL CREDIT RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH)	289,359	34,723
TOTAL OPERATIONAL RISK CAPITAL REQUIREMENT (BASIC INDICATOR APPROACH)	25,697	3,084
TOTAL MARKET RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH)**	17,175	2,061
TOTAL CAPITAL REQUIREMENT	332,231	39,868

* Exposures post credit risk mitigation and credit conversion.

** Market risk capital requirement only relates to foreign exchange risk.

Pillar III Disclosures - Basel II for the year ended 31 December 2010

DISCLOSURE - 2 - A. CAPITAL REQUIREMENT FOR CREDIT, MARKET AND OPERATIONAL RISKS (continued)

	BD '000	
	Risk weighted assets	Capital requirement
Maximum market risk	18,386	2,206
Minimum market risk	12,222	1,467

DISCLOSURE - 2 - B. CAPITAL ADEQUACY RATIOS

Tier 1 Capital Adequacy Ratio (Tier 1 capital / risk weighted exposures)	25.66%
Total Capital Adequacy Ratio (Total capital / risk weighted exposures)	25.66%

DISCLOSURE - 3 GROSS CREDIT RISK EXPOSURES BEFORE CREDIT RISK MITIGATION

	BD '000	
	As at 31 December 2010	Average monthly balance
Balances with central banks	30,714	56,545
Due from banks	276,829	268,960
Loans and advances to customers	151,724	141,793
Non-trading investments	50,314	29,233
Interest receivable and other assets	5,574	4,863
TOTAL FUNDED EXPOSURES	515,155	501,394
Contingent liabilities	6,409	5,221
Undrawn loan commitments	16,555	16,498
TOTAL UNFUNDED EXPOSURES	22,964	21,719
TOTAL CREDIT RISK EXPOSURE	538,119	523,113

The Bank has calculated the average monthly balance based on the month end balances for the year ended 31 December 2010.

Pillar III Disclosures - Basel II for the year ended 31 December 2010

DISCLOSURE - 4 GEOGRAPHIC DISTRIBUTION OF GROSS CREDIT RISK EXPOSURES

	BD '000			
	GCC countries	Iran and Middle East countries	Europe	Total
Balances with central banks	27,463	3,251	-	30,714
Due from banks	18	258,136	18,675	276,829
Loans and advances	80,610	71,114	-	151,724
Non-trading investments	15,439	34,875	-	50,314
Interest receivable and other assets	1,599	3,975	-	5,574
TOTAL FUNDED EXPOSURES	125,129	371,351	18,675	515,155
Contingent liabilities	3,890	2,519	-	6,409
Undrawn loan commitments	11,746	4,809	-	16,555
TOTAL UNFUNDED EXPOSURES	15,636	7,328	-	22,964
TOTAL CREDIT RISK EXPOSURE	140,765	378,679	18,675	538,119

DISCLOSURE - 5 SECTORAL CLASSIFICATION OF GROSS CREDIT RISK EXPOSURES

	BD '000		
	Funded	Unfunded	Total
Manufacturing	30,816	2,499	33,315
Construction	11,305	3,688	14,993
Financial	357,896	3	357,899
Trade	16,821	7,463	24,284
Personal / consumer finance	6,438	104	6,542
Commercial real estate financing	50,909	4,537	55,446
Government	5,652	-	5,652
Transport	16,921	1,547	18,468
Other	18,397	3,123	21,520
TOTAL CREDIT RISK EXPOSURE	515,155	22,964	538,119

Pillar III Disclosures - Basel II for the year ended 31 December 2010

DISCLOSURE - 6 RELATED PARTY TRANSACTIONS

The Bank enters into transactions with shareholders, directors, senior management and their related concerns in the ordinary course of business at commercial interest and commission rates. All the loans and advances to related parties are performing and are free of any provision for possible credit losses.

The balances in respect of related parties as of 31 December 2010 are as follows:

	BD '000
Shareholders and related parties	
Placements (included in due from banks)*	92,702
Loans and advances to shareholders (included in due from banks)*	90,998
Loans and advances to other related parties (included in loans and advances)**	6,442
Deposits from shareholders (included in due to banks)*	21,791
Medium term borrowings*	44,984
Directors and key management personnel	
Loans and advances	29
Deposits	265

	BD '000
Income statement	
Shareholders and related parties	
Interest income from shareholders*	5,637
Interest income from other related parties**	442
Fees and commissions income from shareholders*	299
Fees and commissions income from other related parties**	59
Interest expense*	409

* These relate to two of the Bank's shareholders.

** These relate to two affiliates of the Bank's shareholders.

Key management compensation

Compensation for key management, including executive directors, comprises the following:

	BD '000
Salaries and other short term benefits	649
End of service benefits	26
	675

Pillar III Disclosures - Basel II for the year ended 31 December 2010

DISCLOSURE - 7 CREDIT CONCENTRATION GREATER THAN 15% INDIVIDUAL OBLIGOR LIMIT

Total credit exposures in excess of 15% individual obligor limit (BD '000)	300,316

None of the individual exposures qualify for capital deductions from tier 1 and tier 2 capital.

DISCLOSURE - 8 RESIDUAL CONTRACTUAL MATURITY

	BD '000				
	Up to one month	One month to three months	Over three months to one year	Over one year to five years	Total
Balances with central banks	26,963	-	-	3,751	30,714
Due from banks	123,520	64,529	88,780	-	276,829
Loans and advances to customers	32,790	4,261	27,637	87,036	151,724
Non-trading investments	50,314	-	-	-	50,314
Interest receivable and other assets	2,787	2,787	-	-	5,574
TOTAL FUNDED EXPOSURES	236,374	71,577	116,417	90,787	515,155
Contingent liabilities	1,273	2,406	1,461	1,269	6,409
Undrawn loan commitments	1,941	2,841	9,273	2,500	16,555
TOTAL UNFUNDED EXPOSURES	3,214	5,247	10,734	3,769	22,964
TOTAL	239,588	76,824	127,151	94,556	538,119

Note: The Bank had no assets, liabilities or off balance sheet items with maturities exceeding five years.

DISCLOSURE - 9 SECTORAL BREAKDOWN OF IMPAIRED LOANS AND PROVISIONS

	BD '000				
	Impaired loans	Specific provision	Recoveries during the period	Written off during the period	Collective impairment provision*
Manufacturing	2,288	432	-	-	164
Construction	2,308	849	(3)	(1)	61
Finance	-	-	-	-	109
Trade	799	673	(124)	(3)	83
Personal / consumer finance	689	223	(14)	(44)	33
Commercial real estate financing	12,625	2,366	(378)	-	405
Transport	517	190	(60)	-	28
Other	2,733	616	(157)	-	54
TOTAL	21,959	5,349	(736)	(48)	937

Also refer to table 12 for geographic and sectoral disclosures of impaired and past due loans.

*The collective impairment provision does not relate to the impaired loans.

Pillar III Disclosures - Basel II for the year ended 31 December 2010

DISCLOSURE - 10 GEOGRAPHICAL DISTRIBUTION OF IMPAIRMENT PROVISIONS

	BD '000		
	GCC countries	Iran and Middle East countries	Total
Specific impairment provision	4,917	432	5,349
Collective impairment provision	605	332	937
TOTAL	5,522	764	6,286

DISCLOSURE - 11 MOVEMENT IN PROVISION FOR LOANS AND ADVANCES

	BD '000						
	Retail			Corporate			
	Specific	Collective	Total retail provision	Specific	Collective	Total corporate provision	Total
At 1 January 2010	596	-	596	1,558	2,856	4,414	5,010
Charge for the period	565	-	565	1,495	-	1,495	2,060
Recoveries	(93)	-	(93)	1,276	(1,919)	(643)	(736)
Net provision	472	-	472	2,771	(1,919)	852	1,324
Amounts written off	(46)	-	(46)	(2)	-	(2)	(48)
At 31 December 2010	1,022	-	1,022	4,327	937	5,264	6,286

The provision relates entirely to exposures to non-banks.

Pillar III Disclosures - Basel II for the year ended 31 December 2010

DISCLOSURE - 12 IMPAIRED LOANS - AGE ANALYSIS

i) By Geographical Region

	BD '000				
	Three months to one year	One to three years	Over three years	Total	%
GCC countries	12,630	4,087	2,953	19,670	90%
Iran and Middle East countries	-	2,289	-	2,289	10%
TOTAL	12,630	6,376	2,953	21,959	100%
	58%	29%	13%	100%	

ii) By Industry Sector

	BD '000				
	Three months to one year	One to three years	Over three years	Total	%
Manufacturing	-	2,288	-	2,288	10%
Construction	452	1,567	289	2,308	11%
Trade	-	99	700	799	4%
Personal / consumer finance	118	18	553	689	3%
Commercial real estate financing	10,266	1,756	603	12,625	57%
Transport	-	393	124	517	2%
Other	1,794	255	684	2,733	13%
TOTAL	12,630	6,376	2,953	21,959	100%
	58%	29%	13%	100%	

Pillar III Disclosures - Basel II for the year ended 31 December 2010

DISCLOSURE - 13 PAST DUE BUT NOT IMPAIRED LOANS - AGE ANALYSIS

i) By Geographical Region

	BD '000				
	Less than 30 days	31 to 60 days	61 to 90 days	Total	%
GCC countries	1,075	10,220	62	11,357	40%
Iran and Middle East countries	14,847	1,918	-	16,765	60%
TOTAL	15,922	12,138	62	28,122	100%
	57%	43%	0%	100%	

ii) By Industry Sector

	BD '000				
	Less than 30 days	31 to 60 days	61 to 90 days	Total	%
Manufacturing	4,469	-	-	4,469	16%
Construction	-	363	-	363	1%
Finance	4,125	1,918	-	6,043	22%
Trade	69	-	-	69	0%
Personal / consumer finance	265	2,572	62	2,899	10%
Commercial real estate financing	449	6,897	-	7,346	26%
Transport	6,253	-	-	6,253	22%
Other	292	388	-	680	3%
TOTAL	15,922	12,138	62	28,122	100%
	57%	43%	0%	100%	

DISCLOSURE - 14 RESTRUCTURED CREDIT FACILITIES

	BD '000
Balance of restructured credit facilities at 1 January 2010	1,824
Amount of loans restructured during the year	15,422
Restructured credit facilities repaid / settled	(1,794)
Balance of restructured credit facilities at 31 December 2010	15,452

Restructured credit facilities have no significant impact on the Bank's present and future earnings. The basic nature of concessions granted is extension of repayment period in order to suit the repayment ability of the customer.

Pillar III Disclosures - Basel II for the year ended 31 December 2010

DISCLOSURE - 15 ELIGIBLE FINANCIAL COLLATERAL AND GUARANTEES

	BD '000	
	Gross exposure	Eligible CRM
Cash	1,113	-
Claims on sovereign	186,842	-
Claims on public sector entities	46,350	36,653
Claims on banks	156,676	-
Claims on corporate	68,123	18,790
Regulatory retail portfolio	118	45
Mortgage	49,148	-
Past due exposure	14,003	1,726
Equity investments	10	-
Holding real estate	1,329	-
Other assets	9,344	-
TOTAL	533,056	57,214

DISCLOSURE - 16 INTEREST RATE RISK

	BD '000				
	Less than three months	Three months to one year	Over one year	Non-interest sensitive	Total
ASSETS					
Cash and balances with central banks	23,400	-	-	8,427	31,827
Due from banks	157,785	88,052	-	30,992	276,829
Loans and advances to customers	82,091	36,008	20,692	12,933	151,724
Non-trading investments	39,069	11,245	-	10	50,324
	302,345	135,305	- 20,692	52,362	510,704
LIABILITIES					
Due to banks	160,340	79,154	-	-	239,494
Medium term borrowings	59,979	-	-	-	59,979
Customers' deposits	74,476	24,803	2,642	29,732	131,653
	294,795	103,957	- 2,642	29,732	431,126
Total interest sensitivity gap	7,550	31,348	18,050	22,630	
Cumulative interest sensitivity gap	7,550	38,898	- 56,948		

Pillar III Disclosures - Basel II for the year ended 31 December 2010

DISCLOSURE - 17 SENSITIVITY ANALYSIS - INTEREST RATE RISK

	BD '000	
	Increase in basis points	Impact on net interest income
United States Dollar	200	46
Bahraini Dinar	200	498
Euro	200	(422)
Iranian Rials	200	512

The impact of a 200 basis point decrease in interest rates will be approximately opposite to the impact disclosed above.

DISCLOSURE - 18 EQUITY INVESTMENT

	BD '000	
	Gross exposure	Capital requirement
Privately held	10	2
TOTAL	10	2

DISCLOSURE - 19 GAINS (LOSSES) ON EQUITY INVESTMENTS

There were no realised or unrealised gains (losses) from equity investments during the year.