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I. Monetary Policy Developments

In the fourth quarter of 2006, the Central Bank of Bahrain initiated a comprehensive review of its monetary policy framework including policy instruments used, monetary policy management and the provision of information to the public.

The review and development process was conducted based on key principles. These include enhancing the interbank market, the reconciliation of policies and instruments with market mechanisms and open market principles, and increasing the level of transparency and information disseminated.

Based on the review, the following developments have been implemented:

Monetary Policy Instruments

Monetary policy instruments, in the form of short and long term facilities for banks have been identified. These include overnight and one-week deposits as well as overnight repos and secured lending. The interest rate on the one-week deposit facility was established as the key policy rate.

The timing of the above facilities has been determined after discussion with retail banks. With regard to overnight deposits, lending and repo facilities, the trading window has been set from 1:00 p.m. to 2:15 p.m. As for one-week deposits, the window will be open during the same time on Tuesdays. The timing of the facilities has been set in order to encourage more interbank transactions.

Reserve Requirements

The compulsory reserve requirement system currently in place has been under review. The system requires banks to deposit a proportion of
their Bahraini dinar deposits with the CBB depending on monetary and financial conditions.

**Interbank Rates**

In order to stimulate the interbank market and thus raising the efficiency of the market, the CBB in collaboration with a number of banks and Reuters developed a mechanism for calculating the interest rate between banks for one day to one year.

The resulting Bahrain Inter Bank Offer Rate (BHIBOR) interbank rates are published and updated on the Reuters page on a daily basis.

**Monetary Policy Management**

*Monetary Policy Committee*

The CBB has formed and assigned the responsibility of managing monetary policy to the Monetary Policy Committee (MPC). The MPC monitors economic and financial developments, liquidity developments and sets interest rates for the facilities provided by the CBB.

Since it was formed, the committee has held weekly meetings and reports its recommendations to H.E. the Governor on a weekly basis.

*Money Market Forum*

In order to facilitate communication and interaction with the banking sector in the money market, The Bahrain Money Market Forum was established in 2007. The Forum includes representatives of the CBB and a number of banks operating in the Kingdom. Since its establishment, the forum has been meeting on a quarterly basis.

**Consolidation of Operations in Local and Foreign Currency**

In its efforts to increase the effectiveness of the implementation of monetary policy, the CBB has consolidated Bahraini dinar and U.S. dollar operations in the Treasury unit of the Reserve Management Directorate.
Transparency and Dissemination of Information

The CBB has designed two pages displaying information on CBB facilities which are uploaded onto the Reuters system. One page displays interest rates on existing CBB facilities. The rates are updated on a daily basis at ten o’clock. The second page displays information on CBB bond issues by categories such as bid, price and coupon rate.

In light of domestic and global economic and financial developments, the CBB has taken a number of monetary policy decisions. The CBB lowered deposit interest rates three times during the months of November and December 2007, and twice during the month of January 2008. This led to a reduction in the one-week deposit facility interest rate from 5% to 3%. In January 2008, the CBB raised the reserve requirement from 5% to 7%.

Money Supply

Broad money, M2 reached BD 5,622.0 million at the end of 2007, thus recording an increase of BD 1,586.8 million (39.3%) over end-2006. This was due to an increase in private sector time and savings deposits by BD 1,288.3 million (46.9%) and in demand deposits by BD 270.0 million (25.5%). M3 increased by BD 1,703.9 million (34.8%) to reach BD 6,596.5 million.

Domestic Interest Rates

The weighted average BD time deposit rate (3-12 months) decreased from 4.40% at end-2006 to 3.47% at end-2007. Also, the weighted average saving rate decreased from 0.37% to 0.36%.

The weighted average interest rate on business loans fell from 7.97% at end-2006 to 6.91% at end-2007, and the interest rate on personal loans increased from 8.89% to 9.27%.
II. Banking Developments

The Consolidated Balance Sheet of the Banking System

The consolidated balance sheet for the banking system (retail and wholesale banks) increased to reach $245.8 billion by the end of 2007, compared to $187.3 billion at the end of 2006, an increase of $58.5 billion, or 31.2%. Wholesale banks represented 79.9% of the total balance sheet whilst retail banks represented 20.1%.

Assets

Domestic banking assets amounted to $37.5 billion at the end of 2007 compared to $27.6 billion at the end of 2006, registering an increase of $9.9 billion (35.9%).

Foreign assets amounted to $208.3 billion at the end of 2007 compared to $159.7 billion at the end of 2006, an increase of $48.6 billion (30.4%).

Net foreign assets rose from $6.4 billion at the end of 2006 to $6.7 billion at the end of 2007, increasing by $0.3 billion (4.7%).

Liabilities

Domestic liabilities rose to $44.2 billion at the end of 2007 compared to $34.0 billion at the end of 2006, an increase of $10.2 billion (30.0%).

Total foreign liabilities increased at the end of 2007 by $48.3 billion (31.5%) to reach $201.6 billion against $153.3 billion at the end of 2006.

Retail Banks

The consolidated balance sheet for retail banks rose to BD 18,604.5 million at the end of 2007 compared to BD 8,677.0 million at the end of 2006 (114.4%). The major increases are due to changes in the types of
licences of some banks, where some wholesale banks have been converted to retail banks.

Assets

Total domestic assets increased by BD 2,579.6 million (47.3%) to reach BD 8,037.3 million at the end of 2007. Claims on private non-banks increased by BD 1,217.5 million (39.0%) and claims on the Central Bank of Bahrain by BD 697.7 million (197.3%) and claims on banks by BD 371.1 million (34.0%). Claims on general government (loans) increased by BD 86.7 million (53.7%) compared with the end of 2006.

Foreign assets recorded an increase of BD 7,347.9 million (228.2%) reaching a total of BD 10,567.2 million at the end of 2007 compared to BD 3,219.3 million at the end of 2006. Claims on the non-banks increased by BD 3,911.9 million (225.1%), while claims on banks increased by BD 3,436.0 million (232.0%).

Loans and Credit Facilities

The current balance of loans and credit facilities for the economic sector rose by BD 1,152.7 million (38.0%) to reach BD 4,186.1 million at the end of 2007 compared to BD 3,033.4 million at the end of 2006.

The business sector consisted of 58.4% of total loans and credit facilities, while individuals and the government sector contributed 35.7% and 5.9% respectively.

Liabilities

Total domestic liabilities increased by BD 3,447.5 million (51.6%) from BD 6,682.2 million at the end of 2006 to BD 10,129.7 million the end of 2007. This was due to an increase in liabilities to private non-banks by BD 1,464.7 million (38.3%) and to banks by BD 945.4 million (88.2%), capital and reserves increased by BD 627.1 million (78.6%), liabilities to general government increased by BD 179.6 million (23.3%) and to Central Bank of Bahrain by BD 60.0 million (160.0 %).

Total foreign liabilities increased to BD 8,474.8 million at the end of 2007 compared to BD 1,994.8 million at the end of 2006, an increase of
BD 6,480.0 million (324.8%). Non-bank liabilities increased by BD 3,043.2 million (609.5%) and banks increased by BD 3,436.8 million (229.8%).

**Deposits**

Total domestic deposits increased to BD 6,199.6 million at the end of 2007 compared to BD 4,492.8 million at the end of 2006, an increase of BD 1,706.8 million (38.0%). This was due to higher private sector deposits which increased by BD 1,541.8 million (41.2%) and general government deposits which increased by BD 165.0 million (21.9%).

Domestic deposits in Bahraini dinar increased by BD 1,118.8 million (39.8%) to reach BD 3,931.4 million at the end of 2007. Domestic foreign currency deposits grew by 35.0% or BD 588.0 million to reach BD 2,268.2 million. Bahraini dinar deposits and foreign currency deposits constitute 63.4% and 36.6% of total deposits respectively.

**Wholesale Banks**

The consolidated balance sheet for wholesale banks rose by $ 32.0 billion or 19.5% to reach $ 196.3 billion at the end of 2007 compared with $ 164.3 billion at the end of 2006.

**Assets**

Total domestic assets rose to $ 16.2 billion at the end of 2007 compared with $ 13.1 billion at the end of 2006.

Foreign assets increased by $ 28.9 billion (19.1%) to $ 180.1 billion at the end of 2007. This was due to increases in claims on non-banks by $ 17.1 billion (39.9%) and on head offices and affiliates by $ 6.4 billion (13.5%), the value of securities held by banks increased by $ 5.4 billion (14.6%).

**Liabilities**

Total domestic liabilities increased by $ 1.0 billion (6.1%) to reach $ 17.3 billion at the end of 2007 compared with $ 16.3 billion at the end of 2006.
Foreign liabilities rose by $31.0 billion (20.9%) to reach $179.0 billion at the end of 2007, compared with $148.0 billion at the end of 2006. This increase was mainly due to an increase in liabilities to head offices and affiliates by $12.6 billion (25.6%), to banks by $12.2 billion (24.0%) and to and to non-banks by $4.9 billion (15.2%), while the value of securities increased by $1.2 billion (33.3%).

*Geographical Distribution of Assets / Liabilities and by Major Currencies*

The share of total assets of the Gulf Cooperation Council (with the exception of the Kingdom of Bahrain) reached a total of 34.3%, 36.5% for Western Europe, 12.6% for American countries, and 4.4% for Asian countries, while their share of total liabilities were 30.8% and 38.5% 7.5% and 6.1% respectively.

As for currency, the share of GCC currencies (with the exception of Bahraini Dinar) of the total assets and liabilities were 12.9% and 9.6%, respectively, and the dollar was 66.6% of total assets and 69.6% of total liabilities. As for the Euro, it comprised 11.5% of total assets and 11.4% of total liabilities.
III. Regulatory and Supervisory Developments

Strengthening the Regulatory and Supervisory Framework

In its efforts to reinforce the status of Bahrain as a financial centre and to raise competitiveness in the Kingdom of Bahrain, the CBB worked over the past two years to strengthen the legislative structure of the financial sector by issuing the Financial Trust Law in July 2006 and the Central Bank of Bahrain and Financial Institutions Law in September 2006.

The first law enabled financial institutions to expand their work through the establishment and management of financial trusts and to attract new overseas financial institutions specialising in this area. It also brings in various funds managed by regional financial centres outside the region.

The objective of the CBB Law is to strengthen the regulatory framework in the Kingdom and further develop the banking and financial sector. It also aims to raise confidence and prepare it for further advanced stages of growth. The Law enables the CBB to take all the necessary regulatory actions to facilitate and create the right environment for the financial sector in order to make Bahrain more attractive for investment.
Regulatory Developments

During the last two years, work was carried out to strengthen regulatory and supervisory policies as follows:

*Integrated Licensing Framework*

In April 2005, the CBB issued a proposal for an integrated licensing framework for licensees. This policy came into force in January 2006. Thereafter, new methods of calculation of annual license fees were implemented for the year commencing January 2007. The responsibility of granting licenses and setting license fees for CBB licensees of the CBB has been moved from the Ministry of Industry and Commerce to the CBB, where the process is now more transparent. License fees now relate to the type of regulated activities and the size of the institution.

*Basel II*

Since 2005, the Banking Supervision Directorates have worked intensively to draft the necessary directives in Volumes 1 and 2 of the Rulebook to implement the recommendations of the Basel II accord. These new requirements enter into force in January 2008.

With this in mind the CBB has issued new Rulebook modules for the first and third pillars of Basel II. The CBB issued detailed questionnaires to assess the current risk management systems used in banks in order to accurately identify any issues banks may have with implementation of capital adequacy ratios and the migration of systems compliant with the Basel II accord.

During 2006, a meeting was held with senior industry figures regarding new bank corporate governance roles and the increased responsibilities of senior executives and boards of directors in line with Basel II requirements.
Corporate Governance

The CBB issued in mid-2005 new rules and principles on corporate governance and internal controls for banks. These replaced the previous circulars issued in 1998 and 1999.

Regulatory Requirements Manual

After the passing of the Central Bank and Financial Institutions Law in September 2006 (CBB Law), the CBB established an internal committee to identify regulations, directives and decisions that require issuance. It also identified the responsible Directorates assigned to implement and follow up these regulations.

The CBB prepared several regulations and resolutions, and identified the financial services that are subject to its regulation. Subsequently it was decided to form a committee to handle licensee disputes. The CBB has also been reviewing and updating all Volumes of the Rulebook in line with the legal requirements resulting from the passing of the CBB Law.

During 2007, the CBB updated directives concerning investment funds. After consultation with the institutions in the financial sector that deal in investment funds, these were incorporated into rulebook Volume 6: Capital Markets. The directives have been in place and effective as of June 1, 2007.

There have also been some amendments to Volume 4 of the Rulebook which concerns investment firm licensees. These include updates to certain parts of the Volume, and other alterations consistent with the passing of the CBB Law in September 2006. It also incorporated new sections, such as directives regarding risk management practices.

Anti-Money Laundering

The CBB issued to banks and insurance companies amended regulations on combating money laundering and terrorism financing in 2005, which take into account the 40 + 9 recommendations issued by the FATF and certain recommendations contained in Financial Sector
Assessment Programme (FSAP) report issued by the International Monetary Fund.

The Anti Money Laundering Committee implemented policies to prevent money laundering and terrorism financing. The committee’s members include government ministries and authorities who have active roles in the fight against money laundering and terrorist financing. Through quarterly meetings, several topics have been discussed relating to promoting and supporting the reputation of Bahrain domestically and internationally.

The committee issued two resolutions on the establishment of two subcommittees, these are:

- The Legal Committee
- The Executive Committee responsible for the implementation of United Nations resolutions relating to money laundering and terrorism financing.

The Compliance Directorate concluded a number of inspection visits to banks and financial institutions licensed to make sure that they are in compliance with statutes and regulations related to money laundering and terrorism financing.

The CBB also held a number of seminars concerning the following:

- A symposium was held during 28th – 29th March 2007 in coordination with the French Embassy on money laundering and terrorism financing procedures. Representatives from banks, financial institutions and governmental agencies as well as the anti money laundering committee attended the symposium.

- Two seminars were held for staff working in anti money laundering. The first forum was held for bankers, and the second for workers in exchange and insurance companies.
Preparing a Policy Framework on Contingency Planning for Financial Crisis

In January 2007, CBB constituted a Task Force to prepare a policy framework on Contingency Planning for Financial Crisis in Bahrain. The Task Force successfully developed a Policy Framework outlining policies, procedures and processes for the prevention, management and containment of systemic financial distress.

The Framework identified possible sources of shocks to Bahrain’s financial system, reviewed leading indicators of financial crisis and identified various techniques for crisis management and resolution. It also covered institutional, legal and funding requirements for a reliable mechanism of crisis prevention and management. The framework will serve as a solid foundation on which to build more detailed program for the prevention and management of financial disturbances in Bahrain.

Ownership Regulation

In 2007, the CBB issued a consultative paper on revised requirements for controllers of banks and the maximum percentages of ownership allowed for different types of controllers. This paper is issued based on Article 52 of Law No (64) of the CBB Law. The finalised paper was issued at the end of September 2007 and became effective as of October 1, 2007.

Consultation Paper on Conventional Banks Offering Shari’a Compliant Products

The CBB has revised its regulations that allow conventional banks to deal in Shari’a compliant products and activities. The CBB issued a final paper in August 2007 after initial consultation and meetings with the banking sector in early 2007. The new regulation allows conventional banks greater ability to participate in Shari’a compliant activities under specific conditions.

Wholesale conventional banks can conduct any transaction with any Islamic financial institution as counterparties provided that the concerned bank has experienced professionals trained and qualified in
the field of Islamic banking. The banks are also required to disclose in their annual report the volume and number of Shari’āa compliant transactions in accordance with the relevant AAOIFI accounting and auditing standards.

As for conventional retail banks, in addition to the previous conditions, banks must adhere to additional conditions when dealing with retail customers. These are to provide services through dedicated counters or branches; whichever the bank deems appropriate. They are also required to appoint Shari’āa supervisory boards to regulate and approve products and Islamic processes in line with Shari’ā law.

New Framework for the Licensing of Private Bank Branches

The CBB developed a framework in December 2007 that includes licensing requirements for the opening of branches of private banks in the Kingdom, the first license of its kind in the region. The aim of this framework is to attract private banks that provide investment banking services as well as advisory services to high net worth individuals in the region.

Establishment of Special Committees to Settle Disputes

Based on the CBB Law of 2006, the CBB continued its efforts to enhance the supporting infrastructure for the financial services industry in the Kingdom of Bahrain by setting up two separate special committees tasked with expediting the resolution of disputes within the financial industry in August 2007. A committee was established to resolve disputes that arise between financial institutions (licensed by the CBB), and another was also set up to resolve disputes that arise from trust activities.

Financing Real Estate Investments

The CBB issued a consultation paper to the banking sector in December 2007 that outlines the application of new regulatory standards on investment and financing for the real estate sector for the banks in line with the three tier approach to consultation.
These standards include proposed limits on credit concentrations in the real estate sector as a percentage of total loans granted to the bank’s clients. The paper also set limits for banks’ investment exposures to the real estate sector either directly or through companies they own through Special Purpose Vehicles (SPVs).

The proposed standards also prevent banks from buying undeveloped real estate for purely speculative purposes.

**Schedule of Fines**

The CBB is currently studying the application of CBB Law provisions that allow for the setting of a schedule of fines for all banks, insurance companies, consulting firms and other institutions under its regulatory mandate in the event of the absence of adherence to CBB reporting requirements.

**Consultation Paper on Private Placement Memorandums (PPM)**

The CBB received feedback from banks and financial institutions with regard to the second consultation paper issued in the second half of 2007 on Private Placement Memorandums (PPM). This paper seeks to strengthen the level of transparency and disclosure for products marketed to accredited investors. The CBB examined the comments received and held extensive discussions with financial institutions in line with the CBB’s three-tier approach – which promotes an open and participatory approach to licensees in obtaining their views when issuing or modifying any regulatory policy. Finalised feedback from the banking system has been received and the policy is under review with the final paper expected to be issued during the first half of 2008.

**Proposal on the Organisation, Announcement and Payment of Dividends to Shareholders by Banks**

The CBB submitted a proposal to audit companies operating in the Kingdom regarding the organisation and simplification of processes on the dissemination and distribution of annual dividends by banks to investors. Technical discussions with audit firms regarding the proposal began in September 2007 and a final paper is expected to be
issued in the first half of 2008.

*Liquidity Provision at Banks*

The CBB established an internal working group to study the specific liquidity requirements of banks operating in Bahrain in comparison with internationally accepted standards currently in operation. It is expected that the first consultative paper will be issued in the first half of 2008, to receive comments from banks in preparation for the issuance of a final paper.

*Credit Reference Bureau*

After the establishment of the Bahrain Credit Reference Bureau, work began in 2007 during to develop a centre that will contain a database of information on companies located in Bahrain. The Bahrain Credit Reference Bureau will provide the credit information on individual bank customers.
Supervisory Developments

As part of its policies and regulatory framework, the CBB continued to inspect and ensure compliance of financial institutions to its regulatory and supervisory requirements during 2006 and 2007. The major banking supervision developments are as follows:

Inspection Directorate

The Inspection Directorate completed a pre-planned programme of on-site inspection visits to CBB licensees using the CMORTALE methodology.

The Directorate continued preparations for the implementation of Basel II, and also implemented a range of forward looking key initiatives. These included expanding and enhancing the utilization of sector-specific specializations, including those related to the insurance industry, which had previously been overseen by the Ministry of Industry and Commerce. The Islamic banking specialization was also enhanced, in line with the CBB vision to be a regulator of choice for the Islamic banking sector.

The Directorate made significant advances in respect of the principle based and risk focused approaches to supervision. This included both enhancements to the policies and procedures manual of the Directorate, and in the processes used during on-site work. In addition, the on-line review and monitoring of inspections was improved through the implementation of an upgrade to the TEAMMATE application, which is used to record details of inspection activities. Where appropriate, these enhancements incorporated relevant aspects of the CBB Law.

Training programmes designed to provide inspection staff with the necessary skills and experience in risk management, Islamic finance, insurance and other relevant subject areas were implemented. These will underpin the risk focused approach advocated by the CBB in respect of supervision activities.

The CBB Security Measures Committee, which coordinates and liaises with the Bahrain Bankers Society and the Ministry of Interior regarding
proposals to continuously review and improve security systems at banks and ATMS, played a critical role in ensuring debit and credit card transactions would comply with the EMV requirements defined by Europay International, MasterCard International and Visa International. These systems are designed to enhance the security of such transactions, and enhance those already in place within Bahrain. In addition, the Committee in co-ordination with other industry participants provided a platform for communicating and advising banks in relation to the benefits which can be derived from the implementation of the PCI Data Security Standard (PCI-DSS).

Banking Supervision

The CBB, in promoting a prudent regulatory framework, continued its supervisory work through off-site supervision to ensure the application of sound regulatory practices pertinent to banking and financial institutions.

Among the key developments were:

- Due to the accelerated growth of the real estate sector, the CBB monitored bank exposure concentrations to the sector on periodic basis, communicating to banks the need to exercise caution and care in their practices.

- The preparation of a model of periodic reports (Prudential Information Report for Credit Cards “PIRCC”) for credit card companies, which was implemented for the second quarter of 2007.

- The development and modernisation of periodic reports for all local banks to be consistent with the requirements of the new Basel II capital adequacy accord, which will be implemented during the first quarter of 2008.

- The electronic transmission of periodic reports from branches to foreign banks, which facilitates the CBB to automate and analyse the data in such reports, is planned for implementation during the first quarter of 2008.
• An update to the policies and procedures manual for off-site supervision of banks.

• The development of a monitoring model to follow up and identify deficiencies, issues and observations relevant to banks.

• A number of steps have been taken aimed at protecting consumers of banking and financial services including:
  
  o The issuance a Code of Best Practice on Consumer Finance and Charges.

  o The preparation of a model that disseminates bank charges and commissions applied by retail banks to customers and which will be available on the CBB website. The aim of this project is to promote transparency, and provide data which will allow customers with a comparison tool in relation to such charges.

The Banking Supervision Directorates also participated in GCC banking supervision meetings. A series of papers were prepared, including a new working paper which aims to unify and coordinate banking practices among the GCC countries. It was also agreed that the national standards for the countries should be to aim for conformation with Basel II standards, and that the work being prepared for other standards at the moment will be in conjunction with the forthcoming monetary union.

*Islamic Banking Supervision*

During 2007, the CBB completed drafting directives and guidelines for the application of capital adequacy standards consistent with the Basel II Capital Accord and the standards of the Islamic Financial Services Board. The CBB also visited several countries and international banks to raise awareness about Islamic banking, its products and principles.

The CBB has also been making efforts to ensure Islamic banks follow and apply other current international best practices and standards.
In order to keep pace with the needs of the sector in terms of qualified human and intellectual capital, the CBB in collaboration with several Islamic banks and conventional banks established the “Waqf” Fund. This fund was established to finance and develop training programmes in the area of Islamic banking in the Bahrain Institute of Banking and Finance (BIBF). Consultants were contracted to update the BIBF Diploma programme. The fund will then be used to develop and launch a postgraduate studies programme in Islamic Banking (Masters). Further training programmes will also be prepared in the area of Islamic jurisprudence. The fund will also hold panel discussions on topics related to the development of Islamic finance sector.

The CBB continued to support initiatives by the International Islamic Financial Market in the development of Islamic financial products such as repos, derivatives and other instruments. The CBB also contributed by collaborating with Islamic banks and the auditing industry to identify the Islamic accounting standards required to be developed to keep pace with the rapid growth of this sector.

*Financial Stability Directorate*

During 2007, the Financial Stability Directorate (FSD) successfully developed a range of analytical reports to complement its long-standing statistical publications. The Financial Stability Report is published semi-annually and is the flagship publication of the Directorate. It evaluates the performance of financial intermediaries, identifies potential risks to financial stability and proposes supervisory actions for any vulnerability. During the year, three (3) Financial Stability Reports were produced: January 2007 (internal), June 2007 and December 2007.

The FSD also introduced two new reports: a Balance of Payments Report and a Monetary and Financial Trends Report. The BOP Report presents the various accounts of the Balance of Payments, highlighting key developments that have affected the balance of payments during the review period. It also discusses movements in Bahrain's International Investment Position (IIP). The Monetary and Financial Trends Report highlights developments in key monetary and financial indicators, including monetary aggregates, domestic credit, interest rates, domestic public debt, exchange rates and official reserves. It also
covers trends in the Bahrain capital market. The BOP report will be published annually and the Monetary Trends report quarterly. Both are available on the CBB external website.

In November 2007, the Directorate produced a research report entitled Real Estate Sector and Financial Stability in Bahrain, which investigated the ongoing boom in the construction and real estate sector, the extent of banks’ exposure to this sector and implications for financial stability in Bahrain.

**Insurance Sector Supervision**

The insurance regulatory framework at the CBB has been updated to be in line with internationally accepted best practices. These updates were:

- Updating information in Volume 3 (Insurance) Rulebook on a quarterly basis and implementing the principles during the execution stages. Capital requirements have been updated for branches of foreign companies as well as the system of imposed fees on CBB licensees in addition to requirements for actuarial appointments.

- Hiring an external actuary to review the actuarial reports of selected life insurance companies.

- Preparing a draft manual containing supervisory policies and procedures to guide staff in the Insurance Supervision Directorate on the required methods and steps needed to supervise insurance companies.

- Updating Volume 3 (Insurance) Rulebook to reflect new provisions in Royal Decree No. 64 of September 2006 with respect to the promulgation of the CBB Law. These new directives, for example, include amendments in the calculation of unearned premiums on a time appointment basis.

**Capital Market Developments**

Since the CBB took the responsibility of supervising the capital market
as an integrated single regulator of the entire financial sector in 2002, the Capital Market Supervision Directorate has been implementing a plan aimed at the development of a regulatory and supervisory framework suited to the securities sector in both the issuance market and Bahrain Stock Exchange.

The development plan included three important stages. The first step was the development of criteria for the issuance, disclosure and offering of securities; and the simplification of procedures related to the issuance of securities either as new or existing issues. The second stage was the development and establishment of regulations for brokers and brokerage companies operating in the Bahrain Stock Exchange and the third is market surveillance to monitor the integrity and fairness of transactions.

In order to strengthen and stimulate the capital market in Bahrain, the Directorate based its review and development plans for regulations related to the capital market on the FSAP report of the IMF. It has also developed its framework based on the International Organisation of Securities Commissions (IOSCO) comprehensive framework of objectives and principles of securities market regulations.

During 2007, the Capital Market Supervision Directorate was able to achieve the following:

1. The Development of Legislation and Regulations:

   - The continuation of drafting Volume 6, which contains rules and regulations relating to the capital market. The first three chapters of the volume were completed – these are the chapters on the issuance and listing of securities, licensing and oversight of the securities market including financial standards, and requirements for the acquisition of the shares of listed companies. These will be used to prepare consultation papers that will be circulated to concerned parties at beginning of 2008.

   - Reviewing and updating CBB directive no. ODG/407/03 on disclosure standards and dissemination after consultation
with the parties concerned. The review will enhance transparency and disclosure standards in the market and provide reliable information relating to the performance of listed companies in an updated manner in shorter periods than before. Implementation of the amendments will start in 2008.

- A review and update of CBB directive No. ODG/282/04 which concerns a list of insider transactions in listed companies. Given the implementation of previous requirements the updated requirements related to their transactions can be followed which can be clearly identified. A grace period is offered to meet the criteria, upon which the requirements will then be in force beginning in early 2008.

- Developing regulatory and supervisory procedures for religious securities and Islamic debt instruments (SPV’s). The CBB has adopted a clear mechanism to follow up and ensure compliance of these two types of issues through the analysis of periodic reports required from the issuers, which will highlight their continuing obligations to investors. This system will start by the issuance of a consultation paper in early 2008.

With regard to the CBB’s relationship with the International Organisation of Securities Commissions (IOSCO), the CBB requested and was approved as the representative of the Kingdom of Bahrain in this international organisation by the relevant committee. A joint memorandum of understanding for the exchange of information and data (IOSCO – MMOU) with the rest of the members International Organisation was signed, which is expected to be ratified at the beginning of 2008, making the CBB the first central bank in the Arab region to have signed such an international agreement.

2. Regulatory Initiatives:

- Assisting four brokerage firms operating in Bahrain Stock Exchange to meet licensing and regulatory requirements
and conditions under Volume 4 of the rulebook which concerns investment business.

- Completion of a preliminary internal draft of regulations necessary for the formulation of operating manuals for the core functions of the Directorate in preparation for the issuance of a final manual during the 2008.

3. Investigation and Enforcement:

- During 2007, eleven transactions were investigated and indentified as deals that were suspicious of improper compliance to laws and regulations on market manipulation and abuse of insider information. During 2007, 9 cases have been forwarded to the investigation stage and one case has been forwarded to the Bahrain Stock Exchange Disciplinary Board to determine the nature of the offence and the penalty imposed or required action thereon.

- A preliminary study has been prepared for the selection and nomination an automated system to monitor the capital market (Market Surveillance System). This is expected to be bought and operational during the year 2008.
IV. CBB Projects and Activities

Payment Systems Developments

As part of the framework to develop the financial sector in the Kingdom of Bahrain, and to keep in line with high international standards of payments and settlement systems, the CBB Board of Directors approved the implementation of the Real Time Gross Settlement System (RTGS). The RTGS is a system used universally in large international financial centres to settle wholesale transactions on a “live” basis rather than on an end of day basis.

Before the execution of the RTGS in the second half of 2007, the prevalent system for monetary transactions in Bahrain was through the interbank payments system. Previously, interbank transactions were executed by banks sending messages to a central system housed at the CBB, whereupon the CBB would then complete the transfers. The system completed transactions immediately but did not enable banks to know their balance positions with the CBB on a real-time basis.

At the end of 2005 the CBB signed a contract with a Singaporean company BCSIS, specialising in payment system solutions. The company provided and implemented the operation of the system to the CBB. The implementation was in accordance with the Bank for International Settlements (BIS) standards.

The system includes a communication network between the CBB and financial institutions, therefore banks and institutions could both transact and know their positions with the CBB in real-time when necessary.

The system’s implementation started at the end of the first quarter of 2006. The initial implementation phase started with the installation of a core system and detailed technical specifications of the software. Thereafter, there was ongoing consultation and follow up with banks to
ensure the readiness of their systems. Training was also provided to relevant staff at banks as well as at the CBB.

The RTGS System went live on 14th June, 2007. The average daily number of transactions was 1,073 with an average daily value of BD 246.4 million. The highest number of transactions occurred on 26th December, 2007 where the number of transactions peaked at 3,001 with a value of BD 374.7 million.

**Scriptless Securities Settlement (SSS) System**

The SSS System is a system which permits the transfer of securities, either free of payment (free delivery), or against payment (Delivery vs. Payment) and settlement of securities and funds relating to the securities trades. The SSS System, which complements the RTGS System, also went live on 14th of June, 2007.

The SSS system can handle both conventional and Islamic securities. Conventional securities include Treasury Bills and Islamic securities like Sukuk AlSalam and Ijara Sukuk (short term and long term). The SSS system also has a built in auction module to take care of auction bids presented by the banks for each treasury bills issue. Bids for all securities are received online through the SSS System.

The SSS system handles ‘REPO’ transactions for banks’ liquidity purposes. All SSS transactions in BD settle in the RTGS System.

**Automated Cheque Clearing**

In 2007, the CBB upgraded its cheque clearing technology. This technology led to a significant reduction in timing for clearing cheques. In 2007, 2.7 million cheques were processed with the value of BD 3.7 billion.

On average, 10,363 cheques were processed daily, with an average value of BD 14.1 million per day.

**Information Technology Developments**
The Information Technology Directorate launched the infrastructure of real-time gross payment system (RTGS). The system has been initially tested on a pilot basis to ensure it operates reliably in case of disaster. The pilot test was successful and the system has gone live. CBB staff has also been trained to work through the RTGS portal.

In line with the strategic plan set for IT, work is underway to modernise the Human Resources system as well as the Accounts system. These systems will then be linked and expected to go live by the end of the first half of 2008.

The Directorate has also been working on modernising the reserve management system, which will provide a link to the management of financial institutions and of foreign investment portfolios. This system is expected to be operational at the end of the first half of 2008.

Finally, work is underway to developing the Licensing and Policy Directorates systems. The system will provide general information on financial institutions operating in the Kingdom, and will facilitate the application of licenses for financial institutions online. The system will be linked to the CBB’s internal departments who require access to the information available.

**New Licenses**

During the period 2005-2007 the CBB issued a total of 102 new licenses for financial institutions (32 in 2005, 33 in 2006, and 37 in 2007). These licenses included 19 banking institutions (three retail banks and 16 wholesale banks) and 13 representative offices of foreign banks and asset management companies, 32 insurance institutions (12 insurance companies and 20 insurance service providers), two securities market brokers, 16 investment companies, four finance companies, and 16 support service institutions.

The large number of new institutions licensed during this period is a reflection of the growing confidence in Bahrain as a financial centre and its ability to attract foreign investment, which will enhance Bahrain’s reputation and competitive position in banking and financial sector in the region.
During 2007, 273 investment funds were licensed and registered. 18 investment funds were locally incorporated by financial institutions in Bahrain, Kuwait, Jordan, Lebanon, Egypt, and UAE. 255 foreign funds have been registered abroad. The total number of locally incorporated investment funds operating in Bahrain at the end of December 2007 was 25.

In an effort to make Bahrain an attractive insurance centre, a number of international companies have been involved in opening offices in Bahrain. The CBB has taken initiatives to develop the required legislation for the insurance sector and this has resulted in attracting many companies to set up subsidiaries operating according to Takaful principles. These include:

- Allianz Takaful (Bahrain) B.S.C
- Hanover Re Group
- Hannover Re Takaful B.S.C
- T’azur Company B.S.C

Also, the first captive insurance holding company working in the region was licensed, called “Tabreed”.

**Approval of Security Issuance**

The Capital Market Supervision Directorate approved and declined applications for the issuance and listing of the following securities:

- Seef properties IPO as a public limited company.
- Six issues of Islamic Sukuk were approved.
- Six initial private offerings for company securities under who are under establishment.
- Five requests were approved to increase the capital of some listed
companies through rights issues.

- Two requests to issue international money market deposits on the London Stock Exchange.

As a reflection of the booming Bahrain capital market, the Bahrain All Share Index grew by more than 22% since the beginning of 2007 and the market value of all listed companies rose to more than BD 10 billion.

**Currency Issue**

The CBB has completed all the arrangements for the design and printing of the new banknotes that will have the name of the Central Bank of Bahrain as a successor to the Bahrain Monetary Agency.

The CBB has prepared a comprehensive public awareness programme about the new banknotes, and for this purpose prepared some specialised leaflets and posters.

The CBB has selected a new technology for the sorting, detection, and shredding of banknotes. The new system is expected to be operational in the first quarter of 2008.

**Participation in Conferences, Seminars, Meetings and Workshops**

Conferences, symposia, workshops and other similar events are important activities and events that play a role in promoting the financial sector in the Kingdom of Bahrain.

During 2007, the CBB hosted many conferences, seminars and workshops; operating as both provider of facilities and organiser of these events which raise the profile of the Kingdom’s banking sector. The CBB encouraged financial institutions to participate in those events to make them more fruitful.

Bahrain organised a large number of events in the region. The CBB continued to organise annual conferences such as the World Islamic Banking Conference in Bahrain, which has been held continuously for a
period of fourteen years now. Other activities include the Middle East Insurance Forum, the Annual Shari’a Conference, and other conferences held by the Bankers’ Society of Bahrain, the General Council for Islamic Banks and Financial Institutions (GCIBFI) which is headquartered in Bahrain, the Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI), and other institutions that support the banking and financial sector in the Kingdom of Bahrain.

Other activities that the CBB contributed to during the past year were administering the fourth Middle East Insurance Conference held in the Kingdom of Bahrain on 8th and 9th May 2007, under the title of “Growing Opportunities in a Promising Region.” The CBB also hosted an Arab forum meeting during the period of 4-5 April 2007 to oversee and monitor insurance business. The CBB participated in regular meetings of the International Association of Insurance Supervisors (IAIS) as a member of the Corporate Governance Task Force and hosted one of the Task Force meetings in Bahrain during June 2007.

To give those conferences greater international importance, the CBB has involved major international institutions in organising different conferences and events, including the International Monetary Fund (IMF), Bank for International Settlements (BIS), The Financial Stability Institute (FSI), the Islamic Development Bank (IDB), the Arab Monetary Fund (AMF), and other international financial institutions.

In addition to these conferences, the CBB initiated, in conjunction with the Bahrain Institute for Banking and Finance (BIBF), many specialised seminars in the areas of banking and finance. It also organised workshops designed to expand technical knowledge on the latest international developments in specific banking and financial domains.

At the international level, in order to demonstrate the expansion and development of the financial sector in the Kingdom of Bahrain, the CBB participated in a number of workshops and held many meetings with officials in financial sectors of Western and East Asian countries during 2006-2007. The aim was for the CBB to share Bahrain’s experiences and evolution as a financial centre in the Middle East and to give foreign officials the opportunity to recognise the various advantages and benefits Bahrain has reaped in its leading role in the development of the
financial sector, particularly Islamic banking, an area that many Western countries wish to participate in now and in the future.

The total number of conferences and events in which the CBB participated in during 2006-2007 inside and outside the Kingdom was 43.

**Realisation of the CBB’s Efforts in Developing the Financial Sector**

The CBB’s efforts during 2006 and 2007 had a prominent role in the economic banking and financial sector developments in Bahrain. The banking sector witnessed remarkable progress during the years 2006-2007, where the total assets of banking institutions rose from the $ 140.4 billion at the beginning of 2006 to $ 222.4 million at the end of September 2007, an increase of 58.4%.

The growth of the banking and financial sector has made it a fundamental pillar of the Bahrain economy and the largest contributor to real gross domestic product (GDP) with a contribution of 25.5% at the end of 2006.

The sector also contributed in providing employment opportunities. About 1500 new jobs were created, which is reflected by an 18% increase in the total number of workers in the sector, which reached a total of 9,752 workers in 2006.

As a result of the above performance, Bahrain’s long term foreign currency debt rating foreign increased from A- to A by Fitch Ratings agency, with an economic outlook of “stable”. Standard & Poor (S&P) long term foreign currency debt rating was confirmed as A, also with a “stable” economic outlook.
V. CENTRAL BANK OF BAHRAIN
Balance Sheet and Profit and Loss Account and Appropriation
31 DECEMBER 2007

AUDITORS’ REPORT TO THE CHAIRMAN OF THE BOARD OF DIRECTORS OF THE CENTRAL BANK OF BAHRAIN

We have audited the accompanying balance sheet of the Central Bank of Bahrain ("the Central Bank") as of 31 December 2007, and the related profit and loss account and appropriation for the year then ended.

Management Responsibility for the Balance Sheet and the Related Profit and Loss Account and Appropriation

The management is responsible for the preparation and fair presentation of the balance sheet and the related profit and loss account and appropriation in accordance with Royal Decree No. 64 for 2006. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of balance sheet, profit and loss account and appropriation that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors’ Responsibility

Our responsibility is to express an opinion on the balance sheet and the related profit and loss account and appropriation based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable
assurance whether the balance sheet and the related profit and loss account and appropriation are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the balance sheet and the related profit and loss account and appropriation. The procedures selected depend on the auditors’ judgment, including the assessment of the risks of material misstatement of the balance sheet and the related profit and loss account and appropriation, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity’s preparation and fair presentation of the balance sheet and the related profit and loss account and appropriation in order to design audit procedures that are appropriate for 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 Management, as well as evaluating the overall presentation of the balance sheet and the related profit and loss account and appropriation.

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 balance sheet, related profit and loss account and appropriation present fairly, in all material respects, the financial position of the Central Bank as of 31 December 2007 and the results of its operations for the year then ended in accordance with the accounting policies set out in Note 2 and in compliance with the Royal Decree No. 64 of 2006.

Ernst & Young
1 April 2008
Manama, Kingdom of Bahrain
Central Bank of Bahrain
BALANCE SHEET
at 31 December 2007

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BD ‘000</td>
<td>BD ‘000</td>
</tr>
<tr>
<td>Gold</td>
<td>2,500</td>
<td>2,500</td>
</tr>
<tr>
<td>Foreign reserves</td>
<td>1,957,843</td>
<td>1,252,918</td>
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<tr>
<td>Cash and due from Bahraini banks</td>
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<td>2,257</td>
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<td>Due from international organisations</td>
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<td>211</td>
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<tr>
<td>Equipment</td>
<td>2,352</td>
<td>1,037</td>
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<tr>
<td>Other assets</td>
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<td>8,144</td>
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<td>1,978,496</td>
<td>1,267,067</td>
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</table>

<table>
<thead>
<tr>
<th>LIABILITIES AND CAPITAL FUNDS</th>
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</thead>
<tbody>
<tr>
<td><strong>LIABILITIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes and coins in circulation</td>
<td>307,604</td>
<td>279,722</td>
</tr>
<tr>
<td>Bahraini dinar deposits</td>
<td>1,066,271</td>
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<tr>
<td>Due to Ministry of Finance</td>
<td>56,553</td>
<td>104,213</td>
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<td>Due to other central banks</td>
<td>372</td>
<td>242</td>
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<tr>
<td>Payable to Kingdom of Bahrain</td>
<td>10,505</td>
<td>10,831</td>
</tr>
<tr>
<td>Other deposits</td>
<td>85,481</td>
<td>68,926</td>
</tr>
<tr>
<td>Provision for currency withdrawn</td>
<td>6,315</td>
<td>6,353</td>
</tr>
<tr>
<td>Other payables</td>
<td>5,491</td>
<td>4,243</td>
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<tr>
<td></td>
<td>1,538,592</td>
<td>859,489</td>
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<table>
<thead>
<tr>
<th><strong>CAPITAL FUNDS</strong></th>
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</thead>
<tbody>
<tr>
<td>Capital</td>
<td>200,000</td>
<td>200,000</td>
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<tr>
<td>General reserve</td>
<td>163,716</td>
<td>153,211</td>
</tr>
<tr>
<td>Contingency reserve</td>
<td>58,000</td>
<td>38,000</td>
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<tr>
<td>Re-evaluation reserve</td>
<td>18,188</td>
<td>16,367</td>
</tr>
<tr>
<td></td>
<td>439,904</td>
<td>407,578</td>
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<tr>
<td></td>
<td>1,978,496</td>
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</tr>
</tbody>
</table>

____________________  ____________________
Chairman               Governor

Central Bank of Bahrain
Annual Report 2007
## Central Bank of Bahrain

**PROFIT AND LOSS ACCOUNT AND APPROPRIATION**

for the year ended 31 December 2007

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Notes</strong></td>
<td><strong>BD ’000</strong></td>
<td><strong>BD ’000</strong></td>
</tr>
<tr>
<td><strong>INCOME</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income</td>
<td>93,104</td>
<td>74,916</td>
</tr>
<tr>
<td>Interest expense</td>
<td>45,393</td>
<td>36,440</td>
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<tr>
<td>Net interest income</td>
<td>47,711</td>
<td>38,476</td>
</tr>
<tr>
<td>Registration and licensing fees</td>
<td>4,619</td>
<td>4,234</td>
</tr>
<tr>
<td>Exchange gain on sale of US dollars</td>
<td>5,280</td>
<td>3,300</td>
</tr>
<tr>
<td>Net realised investment (loss)</td>
<td>(169)</td>
<td>(3,465)</td>
</tr>
<tr>
<td>Net realised exchange (loss) on foreign reserves</td>
<td>(1,032)</td>
<td>(3,498)</td>
</tr>
<tr>
<td>Other</td>
<td>339</td>
<td>282</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>56,748</td>
<td>39,329</td>
</tr>
<tr>
<td><strong>EXPENDITURE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General and administration expenses</td>
<td>12,492</td>
<td>10,768</td>
</tr>
<tr>
<td>Managed funds and advisory fees</td>
<td>998</td>
<td>968</td>
</tr>
<tr>
<td>Note issue expenses</td>
<td>2,248</td>
<td>931</td>
</tr>
<tr>
<td><strong>Total Expenditure</strong></td>
<td>15,738</td>
<td>12,667</td>
</tr>
<tr>
<td><strong>PROFIT FOR THE YEAR</strong></td>
<td>41,010</td>
<td>26,662</td>
</tr>
<tr>
<td>Transfer to contingency reserve</td>
<td>9</td>
<td>20,000</td>
</tr>
<tr>
<td>Transfer to general reserve</td>
<td>8</td>
<td>10,505</td>
</tr>
<tr>
<td><strong>BALANCE PAYABLE TO KINGDOM OF BAHRAIN</strong></td>
<td>10,505</td>
<td>10,831</td>
</tr>
</tbody>
</table>
NOTES TO THE BALANCE SHEET AND PROFIT AND LOSS ACCOUNT AND APPROPRIATION at 31 December 2007

1 ACTIVITIES

The Central Bank of Bahrain ("the Central Bank") is the Central Bank of the Kingdom of Bahrain and operates under the Royal Decree No. (64) of 2006. The Central Bank is responsible for organising the issue and circulation of the currency of the Kingdom of Bahrain as well as its foreign exchange, managing the value of the currency of Kingdom of Bahrain, endeavouring to ensure monetary stability, supervising and regulating the banking, insurance and capital market sectors so as to realise the objectives of the economic policy of the Kingdom of Bahrain, and participating in the creation of a developed money and financial market. The Central Bank acts as the fiscal agent on behalf of the Government of the Kingdom of Bahrain and is the supervisory authority for the financial sector in the Kingdom of Bahrain. The Central Bank has no branches or operations abroad.

The Central Bank’s registered address is P O Box 27, located at the Central Bank Building, Diplomatic Area, Kingdom of Bahrain.

The balance sheet and profit and loss account and appropriation of the Central Bank for the year ended 31 December 2007 were authorised for issue in accordance with the approval of The Chairman and H.E. The Governor on 1 April 2008.

2 SIGNIFICANT ACCOUNTING POLICIES

The balance sheet and related profit and loss account and appropriation are prepared in compliance with the Royal Decree No. 64 of 2006.

Accounting convention

The balance sheet and related profit and loss account and appropriation are prepared under the historical cost convention.
Foreign reserves

Foreign reserves comprises deposits placed, net of deposits taken, and investments denominated in foreign currencies. All investments and deposits are carried at cost less provision for impairment.

For the Central Bank’s investments portfolio, premiums or discounts on purchase are amortised on a straight-line basis over the remaining life of the investment and included under interest income in the profit and loss account and appropriation.

Purchases or sales of financial assets are recognised on the settlement date, i.e. the date by which the executed asset trade must be settled.

Depreciation

The cost of the building and any addition thereto is expensed in the year in which the cost is incurred. The cost of other equipment is depreciated by equal annual installments over the estimated useful lives of the assets.

Foreign currencies

Foreign currency transactions are recorded at rates of exchange ruling at the date of the transactions.

Monetary assets and liabilities in foreign currencies at the balance sheet date are retranslated on the basis of the official par value of the Bahraini dinar in relation to the United States dollar and the closing market rates of exchange for the other currencies.

Forward foreign exchange contracts are stated at fair value.

In accordance with Article 22 (a) of the Royal Decree No. 64 of 2006, all profits resulting from the revaluation of the Central Bank’s assets or liabilities in gold or foreign currencies as a result of any change in the parity-rate of the Bahraini dinar or the rate of exchange of the Central Bank’s assets of such currencies, are recorded in a special account to be entitled “Revaluation Reserve Account”.

Central Bank of Bahrain
Gold

Gold is carried at cost.

Notes and coins in circulation

Notes and coins in circulation are stated net of the Bahraini dinar notes and coins held in banking stock.

Revenue recognition

Interest income is recognised on a time apportioned basis, taking into account the principal outstanding and the rate applicable. Registration and licensing fees are accounted for based on the calendar year to what they relate to. Investment gains are recognised when realised.

Note issue expenses

These are recognised when incurred.

3 FOREIGN RESERVES

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>BD ‘000</td>
<td>BD ‘000</td>
<td></td>
</tr>
<tr>
<td>Bond portfolios</td>
<td>596,619</td>
<td>577,670</td>
</tr>
<tr>
<td>Bank deposits and balances with portfolio managers</td>
<td>1,361,224</td>
<td>675,248</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,957,843</strong></td>
<td><strong>1,252,918</strong></td>
</tr>
</tbody>
</table>

This comprises the following:

All bonds are quoted in active markets with 97% being of investment grade BBB or higher (2006: 96%). All deposits and 92% of bonds are in US dollars (2006: 92%). For other foreign currencies, mainly Euros and Sterling, these are 80% hedged into US dollars. The bond portfolios include BD 4,817 thousand net unrealised gains on non-US
denominated bonds and related forward foreign exchange contracts used to hedge such bonds (2006: gain of BD 2,996 thousand).

The market value of the bond portfolios at 31 December 2007 was BD 591,847 thousand (2006: BD 575,652 thousand).

4  EXCESS OF AUTHORISED BACKING FOR CURRENCY IN CIRCULATION

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BD ’000</td>
<td>BD ’000</td>
</tr>
<tr>
<td>Authorised backing:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold</td>
<td>2,500</td>
<td>2,500</td>
</tr>
<tr>
<td>Foreign reserves - note 3</td>
<td>1,957,843</td>
<td>1,252,918</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,960,343</td>
<td>1,255,418</td>
</tr>
<tr>
<td>Currency in circulation:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes and coins</td>
<td>(307,604)</td>
<td>(279,722)</td>
</tr>
<tr>
<td>Excess of authorised backing over currency in circulation</td>
<td>1,652,739</td>
<td>975,696</td>
</tr>
</tbody>
</table>

The fair value of gold as at 31 December 2007 was BD 47,237 thousand (2006: BD 36,178 thousand).

5  OTHER ASSETS

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>BD ’000</td>
<td>BD ’000</td>
</tr>
<tr>
<td>Interest receivable</td>
<td>6,475</td>
<td>3,945</td>
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<tr>
<td>Staff loans</td>
<td>3,370</td>
<td>2,802</td>
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<tr>
<td>Others</td>
<td>1,768</td>
<td>1,397</td>
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<tr>
<td></td>
<td>11,613</td>
<td>8,144</td>
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6 OTHER PAYABLES

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<tr>
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<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BD '000</td>
<td>BD '000</td>
</tr>
<tr>
<td>Interest payable</td>
<td>2,722</td>
<td>2,555</td>
</tr>
<tr>
<td>Accrued expenses</td>
<td>1,066</td>
<td>229</td>
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<tr>
<td>Payables</td>
<td>1,703</td>
<td>1,459</td>
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<tr>
<td></td>
<td>5,491</td>
<td>4,243</td>
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</table>

7 CAPITAL

<table>
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<tr>
<th></th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BD '000</td>
<td>BD '000</td>
</tr>
<tr>
<td>Authorised</td>
<td>500,000</td>
<td>500,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Issued and fully paid up</td>
<td>200,000</td>
<td>200,000</td>
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<tr>
<td></td>
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</tr>
</tbody>
</table>

8 GENERAL RESERVE

<table>
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<tr>
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<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BD '000</td>
<td>BD '000</td>
</tr>
<tr>
<td>Balance at beginning of the year</td>
<td>153,211</td>
<td>142,380</td>
</tr>
<tr>
<td>Transfer from profit and loss account</td>
<td>10,505</td>
<td>10,831</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance at end of the year</td>
<td>163,716</td>
<td>153,211</td>
</tr>
</tbody>
</table>

In accordance with Article 12 of the Royal Decree No. 64 of 2006, the Central Bank maintains general reserve which is credited with the following percentages of its net profits:
• 100% of the Bank’s net profit until the amount of the general reserve reaches 25% of the authorised capital of the Central Bank;

• 50% of the net profit until the amount of the general reserve is equal to the authorised capital of the Central Bank;

• 25% of the net profit until the amount of the general reserve is double the amount of the authorised capital of the Central Bank.

Any net profit after such allocation is to be transferred to the Kingdom of Bahrain general account within three months of the date of the approval of the Central Bank’s accounts.

9 CONTINGENCY RESERVE

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance</td>
<td>BD '000</td>
<td>BD '000</td>
</tr>
<tr>
<td>Balance at beginning of the year</td>
<td>38,000</td>
<td>33,000</td>
</tr>
<tr>
<td>Transfer during the year</td>
<td>20,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Balance at end of the year</td>
<td>58,000</td>
<td>38,000</td>
</tr>
</tbody>
</table>

The Board has approved a transfer of BD 20,000 thousand of the year’s net profit to the contingency reserve. This includes BD 15,000 thousand that has been specifically allocated to fund the purchase of a new headquarters for the Central Bank.

10 RE-EVALUATION RESERVE

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance</td>
<td>BD '000</td>
<td>BD '000</td>
</tr>
<tr>
<td>Balance at beginning of the year</td>
<td>16,367</td>
<td>11,659</td>
</tr>
<tr>
<td>Movement during the year</td>
<td>1,821</td>
<td>4,708</td>
</tr>
<tr>
<td>Balance at end of the year</td>
<td>18,188</td>
<td>16,367</td>
</tr>
</tbody>
</table>
The re-evaluation reserve relates to unrealised exchange gains in accordance with Article 22 (a) of the Royal Decree No. 64 of 2006.