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1. Monetary Policy Developments

Overview

Monetary Policy Instruments

Monetary Policy management

Money Supply

Domestic Interest Rates
Overview

During 2009, the Central Bank of Bahrain ("CBB") continued to use a number of monetary policy measures aimed at maintaining the smooth functioning of financial markets in Bahrain. These measures included new monetary policy instruments as well as interest rate actions.

These measures were set out to ease the pressure on the dinar money market, which was a result of the uncertainty caused by the global credit crunch.

Monetary Policy Instruments

The FX Swap facilities were introduced in 2008 and allow banks to exchange Bahraini dinars against US dollars. The facilities are accessible on all working days without a limit on amounts. In 2009, the CBB reviewed its terms for the FX SWAP facility in light of improved market conditions and decided to offer an additional facility with a 1-month maturity. The CBB has also started to charge fees on its 1-week and 1-month FX SWAPs to prevent banks from making risk-free arbitrage transactions.

Public Debt Tools

In accordance with the CBB Law, CBB issues on behalf of the Government of Bahrain, short and long-term debt instruments, including treasury bills, Salam and Ijarah Sukuk. The issuance of all government debt securities is executed in coordination with the Ministry of Finance.

The CBB issued conventional 3-month treasury bills denominated in Bahraini dinar on a weekly basis, which have a value of BD 25 million, and six-month bills on a monthly basis, which have a value of BD 5 million. During 2009, the CBB also issued 12 month T-Bills on 3 occasions for a total value of BD 45 million.

The CBB also issued on a monthly basis the three-month Salam Sukuk (BD 6 million) and 6-month Ijarah Sukuk (BD 5 million).

Finally, the CBB issued a 2-year Government Development Bond and a 3-year long-term Ijarah Sukuk in varying denominations and for different maturities upon the request of the Ministry of Finance.
Monetary Policy Management

Reserve Requirements

All retail banks are required to maintain, on a daily basis, a specific percentage of their non-bank deposits (denominated in Bahraini dinar), in a non-interest-bearing account at the CBB.

In March 2009, the required reserve ratio was lowered from 7% to 5% following a significant decline in inflationary pressures and a fall in asset prices.

Monetary Policy Committee

The CBB’s Monetary Policy Committee (“MPC”) met on a weekly basis throughout 2009. The MPC closely evaluated economic and financial developments, monitored liquidity conditions, provided recommendations for monetary policy instruments and set interest rates on facilities offered by the CBB. With its regular meetings and recommendations submitted to H.E the Governor, the MPC played a vital role in the CBBs efforts to mitigate the effects of the global financial crisis on Bahrain.

Money Market Forum

During 2009, the CBB began to host the Bahrain Money Market Forum on a monthly basis (instead of quarterly) to discuss global, regional and local developments and their potential impact on financial institutions operating in Bahrain. The Forum has proved to be an effective and fruitful channel to connect leading market participants and the CBB in discussing various important financial market issues.

The Forum, established in 2007, comprises of representatives of conventional and Islamic retail banks operating in Bahrain, in addition to the members of the CBB’s MPC.

Money Supply

Broad money M2, (defined as Currency in Circulation plus Private Sector Demand, Time and Saving Deposits), reached BD 7,119.3 million at the end of 2009, a 5.8% increase over the end-2008 level. This was due to an increase in private sector demand deposits by BD 240.8 million (15.1%) and in time and savings deposits by BD 131.3 million (2.7%). The broadest measure of money
M3, (defined as M2 plus government deposits) increased by BD 359.7 million (4.5%) to reach BD 8,404.2 million.

**Domestic Interest Rates**

*Key Policy Interest Rates*

On 15 September 2009, the policy interest rate on one week deposits was reduced from 0.75% to 0.5%, with the rate on overnight deposits remaining unchanged at 0.25%. Also, the interest rate on overnight REPOs was lowered from 2.75% to 2.25%

*Interbank Rates*

The Bahrain Interbank Offered Rate (“BHIBOR”) was developed in 2006 by the CBB in collaboration with a number of active banks in Bahrain and Reuters. BHIBORs indicate the BD interbank offered rates between banks from overnight to 12 month maturities.

As at end-2009, the 3 month BHIBOR rate was 1.30%, compared to 2.84% at end-2008. The 6 month BHIBOR rate was 1.53% at end-2009, down from 2.99% at end-2008.

*Loan and Deposit Rates*

At the end of 2009, the weighted average BD time deposit rate (3-12 months) stood at 1.36%, compared to 1.29% at the end of 2008. The weighted average savings rate decreased slightly from 0.23% to 0.22%. The weighted average interest rate on business loans decreased from 7.43% at end-2008 to 6.84% at end-2009, while the interest rate on personal loans decreased from 8.09% to 7.7%. 
2. Banking Developments

The Consolidated Balance Sheet of the Banking System

Retail Banks

Wholesale Banks
The Consolidated Balance Sheet of the Banking System

Total assets for the banking system (retail and wholesale banks) decreased to USD 221.8 billion by the end of 2009, compared to USD 252.4 billion at the end of 2008, a decrease of USD 30.6 billion, or 12.1%. Wholesale banks represented 73.1% of total assets, whilst retail banks accounted for 26.9%.

Domestic banking assets amounted to USD 42.2 billion at the end of 2009 compared to USD 48.5 billion at the end of 2008, representing a decrease of USD 6.3 billion (13.0%). Foreign assets amounted to USD 179.6 billion, compared to USD 203.9 billion at the end of 2008, a decrease of USD 24.3 billion (11.9%).

Domestic liabilities dropped to USD 47.7 billion at the end of 2009 compared to USD 54.5 billion at the end of 2008, a decrease of USD 6.8 billion (12.5%). Total foreign liabilities decreased by USD 23.8 billion (12.0%) to reach USD 174.1 billion against USD 197.9 billion at the end of 2008.

Retail Banks

The consolidated balance sheet of retail banks declined by 5.9% to BD 22.5 billion at the end of 2009, compared to BD 23.9 billion at the end of 2008.

Total domestic assets fell by BD 0.2 billion (1.8%) to reach BD 10.9 billion, with claims on banks declining by BD 0.7 billion (25.7%) and claims on private non-banks shrinking by BD 0.05 billion (0.7%).

Foreign assets recorded a decrease of BD 1.1 billion (8.7%), reaching a total of BD 11.6 billion at the end of 2009 compared to BD 12.7 billion at the end of 2008. Claims on foreign non-banks decreased by BD 1.3 billion (20.6%), while claims on foreign banks increased by BD 0.1 billion (1.9%).

Total domestic liabilities of retail banks decreased by BD 0.7 billion (5.6%) from BD 12.4 billion at the end of 2008 to BD 11.7 billion at the end of 2009. This was due to a decrease in liabilities to banks by BD 1.2 billion (44.4%) and liabilities to the CBB by BD 0.06 billion (24.8%). Liabilities to general government decreased by BD 0.04 billion (3.2%).

Total foreign liabilities decreased to BD 10.8 billion at the end of 2009 compared to BD 11.5 billion at the end of 2008, a decrease of BD 0.7 billion.

1 This includes conventional and Islamic retail banks.
Liabilities to banks decreased by BD 0.6 billion (9.2%) while liabilities to non-banks decreased by BD 0.08 billion (1.6%).

Loans and Credit Facilities

Outstanding loans and credit facilities of retail banks stood at BD 5,884.9 million at end-2009, a 0.05% decline compared to the BD 5,887 million at end-2008. The business sector accounted for 64.9% of total loans and credit facilities, while individuals and the government sector represented 28.5% and 6.7% respectively.

Deposits

Retail banks’ total domestic deposits increased to BD 8.0 billion at the end of 2009 compared to BD 7.6 billion at the end of 2008, an increase of BD 0.4 billion (5.3%). This was due to higher private sector deposits which increased by BD 0.4 billion (6.6%) and general government deposits which increased by BD 0.01 billion (0.5%).

Domestic deposits in Bahraini Dinar increased by BD 1.0 billion (19.8%) to BD 5.9 billion at the end of 2009. Domestic foreign currency deposits fell by 21.1% or BD 0.6 billion to BD 2.1 billion. Bahraini Dinar deposits and foreign currency deposits constituted 63.8% and 36.2% of total deposits respectively.

Geographical and Currency Distribution of Assets

The share of total assets accounted for by the member countries of the Gulf Cooperation Council (“GCC”) (with the exception of Bahrain) reached a total of 22.0%, while Asia accounted for 11.5%, Western Europe accounted for 7.4%, North and South America for 5.9%, and other Arab countries for 2.0%.

In terms of currency, the share of US dollar denominated assets was 44.7%, while the GCC currencies (excluding Bahraini dinar) accounted for 8.5% of total assets. The Euro represented 5.4% of total assets.

Wholesale Banks

The consolidated balance sheet of wholesale banks fell by USD 26.9 billion or 14.2% to USD 162.0 billion at the end of 2009, compared with USD 188.9 billion at the end of 2008.

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2 This includes conventional and Islamic wholesale banks.
3 The balance sheets of wholesale banks are usually denominated in USD.
Total domestic assets declined to USD 13.2 billion at, compared with USD 18.9 billion at the end of 2008.

Foreign assets decreased by USD 21.1 billion (12.4%) to USD 148.9 billion at the end of 2009. This was due to decreases in claims on non-banks by USD 6.9 billion (9.8%), in the value of securities held by banks by USD 6.2 billion (18.1%) and in claims on banks by USD 4.6 billion (25.1%).

Total domestic liabilities of wholesale banks fell by USD 4.9 billion (22.8%) to USD 16.6 billion at the end of 2009 compared with USD 21.5 billion at the end of 2008. The decrease was due to a decline in domestic liabilities to banks by USD 2.5 billion (22.5%).

Foreign liabilities decreased by USD 21.9 billion (13.1%) to reach USD 145.4 billion at the end of 2009, compared with USD 167.3 billion at the end of 2008. This decrease was mainly due to a drop in liabilities to head office and affiliates by USD 14.1 billion (19.0%) and to banks by USD 7.9 billion (15.9%), while liabilities to non-banks decreased by USD 0.6 billion (2.3%).

*Geographical and Currency Distribution of Assets*

The share of total assets accounted for by the GCC (with the exception of Bahrain) reached a total of 38.0%, while Western Europe accounted for 33.3%, North and South America for 10.4%, Asia for 5.3% , and other Arab countries for 3.6%.

As for currency, the share of GCC currencies (excluding Bahraini dinar) of total assets was 11.6% with the dollar accounting for 67.4% of total assets and the Euro comprising 10.6% of total assets.
3. Regulatory and Supervisory Developments

Regulatory Developments

Supervisory Developments
Regulatory Developments

As part of CBB’s continuing development of the financial regulatory framework, work was carried out during the year 2009 to strengthen regulatory policies and to develop appropriate prudential regulations, in order to maintain financial stability and market integrity.

Updates to CBB Rulebook

Volume 4 (Investment Business)

A major update of the Rulebook was issued in October 2009 pertaining to Investment Business. The update included the introduction of new regulations in addition to enhancing current requirements to bring them in line with best international practises.

Furthermore, the “Quarterly Prudential Return”, a reporting requirement for Investment Business Licensees, was issued in final form at the end of the first quarter of 2009. As with all other proposed regulations, the form was issued after being reviewed and circulated to licensed institutions and auditing firms for consultation.

The CBB is still working closely with consultants to review and finalise the remaining modules within Volume 4 of the Rulebook, namely:

- Group Supervision (“GS”)
- Dispute Procedures (“DP”)
- Public Disclosure (“PD”)
- Compensation (“CP”)

Upon ensuring that the above modules contain all the rules and regulations required to regulate Investment Business Licensees, they will be issued to the industry for consultation, after which they will be amended as appropriate, and then issued in their final form.

Volume 5 (Specialised Licensees)

As part of its effort to enhance the regulation of the financial industry, the CBB is currently working on developing Rulebook Volume 5 which will include new requirements to govern the activities of the following specialised licensees: Financing Companies (Conventional & Islamic), Money Changers, Representative Offices, Fund Administrators and Trust Service Providers. A
committee was formed to undertake this project and is expected to produce the first set of requirements for Money Changers during the first quarter of 2010.

**Volume 6 (Capital Markets)**

During 2009, the CBB continued to work on modernising the capital market regulatory framework to be in line with international standards and practices. The CBB consulted with international agencies, stakeholders, interested parties as well as other financial sector participants to update its regulations. The CBB, in collaboration with a multitude of institutions, also took steps to develop new and innovative financial instruments as well as promote its regulatory framework in order to maintain confidence and integrity within this sector.

During the year, the Capital Markets Supervision Directorate (“CMSD”) issued new modules for the CBB Rulebook Volume 6 including:

- Take-overs, Mergers, Acquisitions and Share Repurchases Module (“TMA”), which was finalised on 21st January 2009 and implemented on 1st March 2009.
- Cooperation and Exchange of Information with Overseas Authorities Module (“ICO”), which was finalised on 4th March 2009 and implemented on 1st April 2009.
- Clearing, Settlement and Central Depository Module (“CSD”), which was finalised on 9th April 2009 and implemented on 1st May 2009.
- Market Abuse and Manipulation Module (“MAM”), which was finalised on 20th April 2009 and implemented on 1st June 2009.
- Market Surveillance, Investigation and Enforcement Module (“MIE”), which was finalised on 5th November 2009 and implemented on 1st December 2009.
- Market Intermediaries and Representatives License Module (“MIR”), which was finalised on 15th December 2009 and implemented on 1st January 2010.

Furthermore, work continued on other Modules of Volume 6, including Modules on Dispute Resolution and Arbitration Module (“DRA”); the Anti-Money Laundering and Combating of Financial Crime Module (“AML”); and Offering of Securities Module (“OFS”). These modules will be issued during 2010.
**New Licensing Regulation**

In Accordance with Article 44 of the CBB Law, Decree No. 64, the CBB prepared a draft regulation on the conditions of granting a licence for the provision of regulated services. The draft regulation consists of 8 articles that include the requirements and conditions that the CBB expects prospective licensees to meet as well as the documents required upon the submission of the license application. This draft will be ready for consultation with the financial sector and the general public in the first quarter of 2010.

**Regulation on Registration of Insurance Consultants, Insurance Brokers and Representatives of Insurance Companies**

On 2nd July 2009, the CBB issued Resolution (11), in respect of the registration of insurance consultants, insurance brokers and representatives of insurance companies. The Resolution includes new requirements that mandate minimum qualifications for those engaging in or advising on insurance sales. By introducing minimum qualifications for appointed insurance representatives (tied agents), the CBB expects the insurance market to grow substantially and the buying public can be assured they are dealing with well trained and competent insurance representatives.

**Liquidity Risk Management Consultation Paper**

The global financial crisis emphasised the importance of banks maintaining adequate levels of liquidity. In recognition of this, CBB issued a consultation paper to licensees in June 2009, setting out CBB’s views on the future of liquidity regulation within Bahrain. The consultation paper proposed new directives to banks on key elements of sound liquidity risk management policies and procedures. A second consultative paper on the topic is in preparation, and will take into account the banks’ feedback as well as the requirements of the latest Basel consultative paper on liquidity which was released in December 2009.

**Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)**

As part of its continuing program to improve the AML/CFT framework in Bahrain, the CBB’s Financial Crime (“FC”) Module specific to AML/CFT was amended in the following areas:
1. The position of Deputy MLRO is now a controlled function and prior approval from the CBB is now required for the appointment of the Deputy MLRO.

2. New authorisation requirements in respect of transfers of funds to and from foreign countries by charities and similar organisations supervised by the Ministry of Social Development (“MOSD”) were introduced.

In addition, the Policy Committee (a Kingdom of Bahrain committee on which the CBB is represented) which is responsible for formulating AML/CFT policies, procedures and coordinating with relevant internal and external bodies, has been reviewing the existing AML Law to ensure it is in line with the latest developments in the Financial Action Task Force (“FATF”) recommendations.

**Occupational Saving Schemes**

During the first quarter of 2009, the CBB issued in final form the Standard Conditions for Occupational Saving Schemes (“OSS”) for institutions licensed under Volumes 1 (Conventional Banks), 2 (Islamic Banks) and 4 (Category 1 and 2 Investment Business firms) of the CBB Rulebook.

The schemes aim at segregating employees’ savings from funds belonging to employers through facilitating the establishment of occupational saving schemes as trusts under the Financial Trust Law (Law No. 23 of 2006). The regulations governing the schemes also address the registration conditions, reporting requirements and restriction of investments.

**Controlling Level of Real Estate Exposures**

In line with the CBB’s objective of ensuring that bank assets remain sound and diversified, the regulatory risk weighting of all real estate holdings by banks remained at 200%.

**Strengthening the Protection of both Deposits and Unrestricted Investment Accounts**

The CBB is in the process of finalising new regulations to reform the existing deposit protection arrangements. In order to maintain a level playing field and to encourage a healthy competitive environment between Conventional and Islamic banks, the new proposed regulation provides protection to
unrestricted investment account holders of Islamic banks vis-a-vis the deposits of the conventional banks. The purpose of the reform is to establish a pre-funded scheme to bring deposit protection more closely in line with international best practice, and in particular to establish two separate funds (i.e. a Conventional fund and an Islamic fund) which shall be maintained and administered by one board in which the funds are accumulated separately in advance based on regular contributions by the member banks.
Supervisory Developments

Corporate Governance

As part of the CBB’s endeavours to further strengthen corporate governance practices at banks, the CBB embarked on an examination of the effectiveness of the board of directors with an emphasis on the need for a larger number of totally independent directors, in addition to identifying potential for any conflicts of interest, and improving the composition of board sub-committees.

Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)

In the area of AML/CFT, CBB’s efforts have focused on raising levels of awareness amongst all licensees and ensuring the effective enforcement of the regulatory framework that has been developed in recent years.

The CBB continued to carry out examinations on relevant licensees to ensure compliance with the CBB’s regulations and to help improve their system of internal controls with respect to the prevention, detection, monitoring and reporting of suspicious transactions. Efforts were focused in 2009 on upgrading the level of AML/CFT awareness within banks, moneychangers and insurance firms through examination visits.

In May 2009, the Middle East and North Africa Financial Action Task Force (“MENAFATF”) plenary meeting took place in Bahrain, hosted by the CBB. During the MENAFATF plenary meeting, the CBB submitted the Kingdom’s follow-up report, which highlighted Bahrain’s AML/CFT developments during the period of 2006-2008, following the 2005 Financial Sector Assessment Program (“FSAP”) evaluation conducted by the International Monetary Fund (“IMF”) and the World Bank.

Likewise, the CBB also hosted the Africa/Middle East Regional Review Group (“RRG”) meeting which was held in September 2009. The RRG is a working group under the umbrella of the FATF and its role is to enhance international cooperation and improve compliance at a national level as well as work with jurisdictions to remedy the shortcomings underlined in the mutual evaluation.
Banking Supervision Directorates

As the global financial crisis continued during 2009, CBB intensified its prudential oversight of banks in Bahrain.

- **Prudential Meetings:** The CBB’s Banking Supervision team conducted 53 prudential meetings in 2009. Further, quarterly meetings were conducted with banks to discuss their lending practices, interest rates on loans, reviews of risk management, the impact of the global financial crisis.

- **Follow up of Basel II Implementation:** The Banking Supervision Directorates continued to follow up on banks’ progress in implementing Basel II requirements, specifically, pillar 2 and 3, by reviewing banks’ monthly progress reports and conducting separate meetings with most of the banks to ensure their adherence to the CBB directives in this regard.

- **Risk Assessment Reports:** The Directorates mandated all banks to submit risk assessment reports to monitor their financial position more accurately. These reports constituted a thorough investigation into high level controls, procedures and processes within banks in Bahrain in relation to credit, market, operational, liquidity and risks, as well as other risks including reputational risk, strategic risks. Also reports issued covered corporate governance, human resources, compliance functions, financial and accounting controls and investor relations and measures covering the banks’ readiness to comply with Basel 2, Pillar 2 requirements.

- **Review of Risk Management System and Practices:** As part of Basel II implementation, all locally incorporated banks were asked to carry out internal risk management assessments in order to enhance risk management policies, practices and procedures. The outcomes of these reviews are being discussed on a bank-by-bank basis and a follow-up process has been set up to ensure compliance with CBB requirements and enhancement of internal systems in accordance with applicable best practice standards.

- **Connected Party Exposures:** To further enhance its supervisory oversight, the CBB started monthly monitoring of exposures to parties connected to banks with the objective of more closely monitoring any
potential risk concentration and ensuring compliance with the CBB’s prescribed limits. Previously, such exposures had been monitored on a quarterly basis as part of the routine PIR reporting.

- **Review of Compliance with CBB Large Exposure Directives:** To supplement the comprehensive assessment of risk management, the CBB conducted a detailed review of banks’ large exposure policies and limits vis-à-vis CBB regulatory requirements and best practices. Any identified non-compliant matters were followed up and banks have been required to set out and follow timetables for the completion of any outstanding matters.

- **Enhancing Liquidity Monitoring and Management:** Underscoring the importance of maintaining adequate levels of liquidity, the CBB enhanced its monitoring of banks’ liquidity positions by asking them in the autumn of 2008 to report their liquidity positions on a daily basis until March 2009 and subsequently, on a weekly basis. In addition, all retail branches of foreign banks were required to notify the CBB of any developments or trends that may have a material effect on the financial position of the parent bank or the liquidity position of the Bahrain branch.

- **Quarterly Reports for Islamic Banks:** Islamic banks are now mandated to provide quarterly reports by the banks’ external auditors on the quality of public disclosure. These reports are used as a supervisory tool to analyse the transparency and accuracy of banks’ financial reports provided to the public.

- **Meetings on Financial Statements:** The CBB initiated special meetings with locally incorporated banks, along with their external auditors to discuss their year-end financial statements before being submitted to the Board of Directors for approval. The discussions encompassed the basis of realisation of profits, valuation practices, and exposure to impaired assets, adequacy and breakdown of provisions, proposed dividends and allocation of staff bonuses.

- **Monitoring of Board Meetings:** To ensure efficiency and effectiveness of Bahraini banks’ boards, the CBB started to closely monitor attendance and participation in board meetings. The CBB also started reviewing the composition of banks’ board committees, requiring banks to avoid any potential conflict of interest and mandating the appointment of independent board members.
Studies/Surveys: To enhance its proactive monitoring, the CBB undertook special studies/surveys on credit derivatives and bank charges on corporate/commercial loans and consumer finance.

Bahrain Credit Reference Bureau: The CBB coordinated with the Bahrain Credit Reference Bureau (“BCRB”) on extending credit referencing services to Motor Vehicle Dealerships with the objective of ensuring that the BCRB becomes more extensive and effective. Moreover, the CBB is currently consulting with the Bahrain Chamber of Commerce and Industry on the need for BCRB to include corporate accounts.

Other activities undertaken by the Supervision Directorates include:

GCC Monetary Union: The CBB has contributed towards the development of the GCC monetary union by actively participating in the meetings of the GCC Committee for Banking Supervision, as well as by studying and developing a set of unified banking sector rules and regulations for accomplishing the objective of monetary union.

EMV (Europay international, Mastercard International, Visa international) Compliance: During 2009, the CBB worked with retail banks to successfully introduce EMV ‘Chip and Pin’ technology for all credit and debit card transactions. EMV technology provides customers with improved security when using their cards, as it combines an advanced configuration of the embedded ‘smart’ Chip, linked with a Personal Identification Number (“PIN”) which customers are advised to use to authorize all point of sales transactions, including those at ATMs and ‘customer present’ merchant-based transactions. In addition, the points of sales terminals throughout Bahrain have been upgraded to provide customers with the facility to use a PIN number, rather than the previous method of a card swipe supported by a signature. This security technology is considered to constitute best practice in the financial industry, and it is used in many other counties. By adopting these best practices, the reputation of the financial industry in Bahrain is further enhanced. Most banks have already introduced the new cards, and these have been distributed to customers. The CBB anticipates the remaining roll-out to be completed during 2010.
Capital Markets Supervision (CMS) Directorate

The CMSD regulates and supervises the capital markets in Bahrain, and its main objective is to maintain a transparent and efficient capital market, to ensure investor protection.

The following are the CMSD’s achievements during 2009:

- **Conversion of the Bahrain Stock Exchange (BSE) to a Joint Stock Company**: His Majesty King Hamad Bin Isa Al Khalifa issued Law No. 57 of 2009 on the BSE on December 23, 2009. The new law has repealed Decree Law No. (4) for the year 1987 concerning the establishment and organisation of the Bahrain Stock Exchange as amended by Decree Law No. (21) for the year 2002. The BSE has been given a transformation period of six months to adjust its status to a joint stock company, starting from the day after the date of publication of the Law in the Official Gazette. In addition, any provision inconsistent with this law is repealed.

- **Approvals and reviews of prospectuses**: The CMSD issued on 2009 its no objection to 21 public and private offering documents after assuring the completeness of all the information and details as per CBB’s Disclosure standards. The size of these issues is 1,906,989,230 securities with a value of USD 2.2 billion.

  Also, the CMSD reviewed and provided comments and observations on 14 public and private offering documents as per CBB’s Disclosure Standards. However these documents have not been approved, pending to be updated and rectified with CMSD’s comments by the lead managers of these offerings. The size of these issues is 1,275,862,877 securities with a value of USD 2,337,872,389.

- **Market Surveillance**: During the year 2009, the strengthened CBB investigation activities cause the number of suspected transactions to decrease to a total of 13 transactions. Investigations have been carried out in 11 transactions and found not to be violating rules and regulations of the CBB. Furthermore, 2 transactions were forwarded to the BSE for investigation and another to take enforcement action against the violators.

- **Licenses, approvals and circulars**: In addition to the issuance of CBB’s in-principle approval to Bahrain Financial Exchange ("BFX"), the CBB issued
its in-principle approval to BFX to establish its clearing, settlement and central depository company on 22nd November 2009 under the name of “Bahrain Financial Exchange Clearing & Depository Co. B.S.C. (c)” (BCDC), to facilitate and enable BFX and BCDC to commence operations and offer their services during the first quarter of 2010.

In addition, the CMSD granted its approval to the BSE to be a member in the Association of National Numbering Agency (“ANNA”) on 1st November 2009 and act as the National Numbering Agency for the Kingdom of Bahrain.

The CMSD also issued a circular dated 20th August 2009, regarding and observing the quality of compliance from listed companies’ CEOs and managers on their financial result press releases for the respective financial quarter. The CMSD has ensured the requirement to be in compliance with Article 65 of CBB’s Disclosure Standards.

- **Review the regulations and operating systems:** The CMSD received the BFX rulebook on 31st August 2009. It is currently being reviewed to ensure that it meets all the rules and regulations stipulated in the Markets & Exchanges (MAE) Module of CBB Rulebook Volume 6.

Further, the CMSD received the BSE rulebook on 10th December 2009, and that is also being reviewed, to ensure that it meets all the rules and regulations stipulated in the Markets & Exchanges (MAE) Module of CBB Rulebook Volume 6.

- **Compliance with Disclosure Standards:** As per Resolution No. 49 of 2007 in respect of Dissemination of Listed Companies’ Financial Statements and Board of Directors’ Meetings, the table below shows the number of non-compliance companies with the articles of the abovementioned resolution:
<table>
<thead>
<tr>
<th>Quarterly</th>
<th>Yearly</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>non publishing of financials with 45 days</td>
</tr>
<tr>
<td>1</td>
<td>Publishing in two newspapers</td>
</tr>
<tr>
<td>1</td>
<td>Publishing in the newspapers simultaneously with the BSE</td>
</tr>
<tr>
<td>12</td>
<td>Notifying the BSE of the BOD meeting</td>
</tr>
<tr>
<td></td>
<td>Publishing the AGM Agenda</td>
</tr>
</tbody>
</table>

**Financial Institutions Supervision Directorate**

**Collective Investment Undertakings (“CIU”)**

In 2009, the Financial Institutions Supervision Directorate continued the exercise of classifying the locally incorporated CIUs (Collective Investment Undertakings) that existed prior to June 2007, in order to comply with the requirements of the CIU Module within the CBB Rulebook Volume 6. As of the end of 2009, 62% of the previously established funds had been classified in accordance with the rules and guidelines of the CIU Module.

In addition, the Directorate continued to monitor the performance of investments of the locally incorporated funds, in order to ensure their compliance with the requirements of the CIU Module.

**Real Estate Investment Trusts (“REIT”s)**

The CBB has noted a growing demand for the establishment of trusts by local firms, including the establishment of Real Estate Investment Trusts (“REIT”s) which are real estate companies that offer shares to the public and are created in the form of a trust.

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4 In June 2007 there was a revamp of the mutual funds regulatory framework through the issuance of the CIU Module within the CBB Rulebook Volume 6. This was followed by an execution phase to apply the new set of rules and guidelines that govern CIUs in the Kingdom of Bahrain.
During the third quarter of 2009, the CBB authorised and approved its first REIT in the form of a unit trust and in accordance with the Financial Trust Law of Bahrain.

Going forward, it is part of the CBB’s initiatives to develop and introduce a set of REIT regulations, taking into consideration the need to address conditions in the local and regional markets while observing the international best practice in this field.

**Insurance Sector Supervision**

The Insurance Supervision Directorate released an updated Insurance Market Review in June 2009. The review provides very detailed information on the condition of the insurance industry in Bahrain and provides the reader with greater insight into the insurance market.

Also, the insurance regulatory framework at the CBB has been updated to be in line with international best practice. Recent amendments included the following:

- The CBB published Resolution (15) in respect to the procedures that govern the portfolio transfer of the insurance licensees in Bahrain on the 23rd April 2009. In line with this Resolution and with Articles (66) and (67) of the CBB Law No. (64) of 2006, the CBB has published all the portfolio transfer requests from the insurance companies licensed in Bahrain and transacting insurance activities in Saudi Arabia which have obtained the final license from the Saudi Arabian Monetary Agency (“SAMA”).

- During the year, the Insurance Rulebook (Volume 3) was updated on a quarterly basis, with CBB overseeing the implementation of the updated requirements. Insurance appointed representative requirements and their licensing fees have been updated, as well as more detailed filing requirements dealing with motor insurance.

- The external actuary appointed by the CBB has continued reviewing the actuarial reports of selected life insurance companies for the financial year 2008, to ensure that these life companies maintain adequate reserves to meet their obligations towards policyholders.

- Prudential meetings were conducted with most of the Bahraini Insurance Firms and Overseas Insurance Firms (Foreign Branches).
The CBB continued to monitor closely the impact of the financial crisis on insurance firms and has met with some of the locally incorporated insurance companies to ensure their financial soundness. Due to the uncertain investment climate, the CBB is examining the impact of the investments downturn on the insurance companies’ investment portfolios on a monthly basis.

The CBB has coordinated the efforts between the Arab Forum of Insurance Regulatory Commissions (“AFIRC”) and the Bahrain Institute of Banking and Finance (“BIBF”) to issue the first certificate for insurance regulators in the Middle East in both Arabic and English.

As a member of the "Solvency Requirements for Takaful Operators Working Group" of Islamic Financial Standards Services Board (“IFSB”), the CBB participated in the consultation exposure draft which was published in December 2009. In addition, the CBB continued its contribution as a member of the Governance and Compliance Sub-committee of the International Association of Insurance Supervision (“IAIS”) which aims to establish international corporate governance standards for the insurance industry.

**Inspection Directorate**

The Inspection Directorate completed its planned programme of on-site inspection visits to CBB licensees using the CMORTALE methodology. This methodology assesses Capital, Management, Operational risks, Risk management, Transparency, Asset quality, Liquidity and Earnings. In addition to this, the Directorate undertook a number of subject-specific visits to banks.

The Directorate made significant advances with respect to risk focused approaches to supervision. The Directorate improved its key strategic initiatives, which included a restructuring of the management framework within the Directorate to facilitate greater focus on each of the specialist areas within the Directorate’s scope of responsibilities.

Further, the Directorate increased both productivity and efficiency through increased utilisation of the upgraded TEAMMATE application, facilitating improved on-line review and monitoring of inspections.

In response to the greater focus towards the assessment of risk within the financial sector, the Directorate identified and implemented training and
development programmes designed to provide inspection staff with the skills and experience necessary to assess the extent to which best practice risk management had been effectively embedded in the financial sector. These initiatives further improve the risk focused approach championed by the CBB with respect to enhanced supervision activities.

The Directorate played an integral role in the CBB Security Measures Committee, which coordinates and liaises with the Bahrain Association of Bankers and the Ministry of Interior regarding proposals to continuously improve security systems at banks and ATMs. The Directorate also focused on ensuring that all licensed banks comply with the EMV requirements defined by Europay International, MasterCard International and Visa International. The implementation of these standards will enhance the security of all card-based transactions, and enhance the customer-focused security framework 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”).

Financial Stability Directorate

During 2009, the Financial Stability Directorate (“FSD”) continued conducting macro prudential surveillance of the financial system to identify areas of potential concern and undertake research and analysis on issues relating to financial stability. The FSD also continued to perform the following core functions:

- Issuing various publications such as the semi-annual Financial Stability Reports, the annual 2009 Economic Report, Balance of Payments Report (annual), Monetary and Financial Trends (quarterly) along with other periodical publications that monitor domestic and international macro-financial developments.

- Undertaking general research on issues relating to financial stability in Bahrain and conducting a number of presentations on financial stability developments.

- Collecting, compiling and disseminating statistical information and releasing financial data that is published through its Monthly Statistical Bulletin and quarterly Economic Indicators.
• Conducting annual surveys such as the Manpower Survey, Credit Card Survey, Coordinated Portfolio Investment ("CPIS") Survey, Worker’s Remittances Survey, and Locational International Banking surveys.

• Maintaining CBB’s relations with major international institutions and agencies and acting as a point of contact for other third parties, both domestic and overseas.

Among other key developments during the year 2009 were the following:

• Conducting the National Accounts Survey on a quarterly basis starting in 2009 where summary forms are now submitted by banks on a quarterly basis. The higher frequency data helps Bahrain comply with the IMF Special Data Dissemination Standards ("SDDS").

• Introducing the Early Warning Report ("EWR"), an internal CBB document, produced semi-annually with the aim of indentifying potential threats to the safety and soundness of systemically-important banks in Bahrain.
4. Other CBB Projects and Activities

New Licenses

Payment System (SSS & RTGS)

Currency Issue

CBB Training Programs

Participation in Conferences, Seminars, Meetings and Workshops
New Licenses

During 2009, the CBB issued a total of 13 new licenses for financial institutions and professionals. These licenses included 2 retail banks 8 insurance service providers, and 3 registered actuaries.

The new institutions licensed during 2009 are:

1- Ebda Bank B.S.C. (c)
2- Family Bank B.S.C.
3- Majid Al Futtaim Asset Management (Bahrain) B.S.C. (c)
4- Key Capital Investment Management Ltd.
5- Itqan Financial Services W.L.L.
6- Masheed Captive Insurance Company B.S.C. (c)
7- Bahrain Emirates Insurance Company B.S.C.
8- NFH Insurance Broker S.P.C.
9- Hardy Arig Insurance Management W.L.L.
10- Bahrain Insurance Association
11- Mr. Adebowale Oluranti Ajayi (actuary)
12- Mr. Akshay D. Pandit (actuary)
13- Mr. Marios Argyrou (actuary)

Despite the recent conditions in the global financial markets, interest in establishing a presence in Bahrain on the part of international institutions remains strong, reflecting the confidence of these companies in Bahrain’s potential as a leading financial centre.

Payment System (“SSS” & “RTGS”)

Bank transfers through the Real Time Gross Settlement System (“RTGS”) numbered 312,028 in 2009, for a total amount of BD 39.9 billion broken down as follows:

- The volume of bank transfers among commercial banks through RTGS was 85,637 for a value of BD 33.4 billion.
- The volume of customer transfers through the RTGS numbered 226,391 for a value of BD 6.5 billion during 2009.
- Banking operations carried out though Securities Settlement System (“SSS”) totalled 670 in 2009 for a value of BD 3.7 billion.
Currency Issue

During 2009, major accomplishments of the Currency Issue Directorate included:

- Conducting inspection visits to retail banks and money changers working in Bahrain, to make sure that banks’ money counters conform to the standards applied in uncovering counterfeit and forged new Bahraini dinars.

- Starting to destroy banknotes unfit for circulation, through the new counting and sorting machine, linking all operations to the official records of the Directorate.

- To mark the 10th anniversary of H.M. King Hamad bin Isa Al Khalifa’s ascension to the throne, the Directorate, in cooperation with the Ministry of Finance, released three commemorative medals (gold-plate, silver-plate and pure bronze) for collectors in Bahrain and abroad.

- Circulation-unworthy banknotes destroyed in 2009 totalled BD 40.22 million including those from the third and forth issue of the Bahraini dinar. The Directorate destroyed banknotes equivalent to BD 40.2 million during the year.

Total withdrawals by commercial banks during 2009 totalled BD 957.54 million while daily deposits were BD 922.70 million. Money in circulation as at 31 December 2009 reached BD 406.40 million with new banknotes, old banknotes and coins representing 92.3% (an amount of BD 375.11 million), 4.7% (an amount of BD 19.09 million), and 3% (an amount of BD12.21 million), respectively.

CBB Training Programs

During 2009, the CBB continued to focus on ensuring that its staff has the right skills and capabilities to discharge their responsibilities.

To meet these commitments, the CBB has undertaken the following capacity building activities:

- Provided skills and knowledge training to a total of 165 employees, including extensive use of the BIBF to provide training for 139
employees in areas including conventional and Islamic banking; insurance; management; and computer skills.

- Introduced an improved induction programme for new employees and delivered a number of internal seminars using in-house expertise.

- Provided internships for 12 university students, designed to help them to prepare to enter the workplace.

Participation in Conferences, Seminars, Meetings and Workshops

This year the CBB focused its efforts on three major conferences:

- The ninth GCC Banking Conference, which was held from March 24th to March 25th 2009. The conference attracted over 500 participants from the GCC and the Middle East as well as participants from North America and Europe, Africa and Russia.

- The sixth annual Gulf Insurance Forum held from November 4th to November 5th, which was in collaboration with the Bahrain Insurance Association.

- The Sixteenth Annual Conference of the Islamic Banks which was hosted by the Kingdom of Bahrain from December 6th to December 8th 2009, with the participation of more than 1,200 decision-makers in Islamic finance from more than 40 countries.

The CBB visited or hosted a number of countries and international financial institutions to strengthen financial cooperation and for further development of the financial services industry in the Kingdom. Visitors to Bahrain included a French delegation headed by the Chairman of MEDEF International, the Deputy Governor of Malaysia, the Minister of Industry and Trade of the Republic of Kazakhstan and the Deputy Prime Minister and the Minister of Foreign and Economic Relations, Industry and Investment of the Republic of Uzbekistan.

In addition, the CBB initiated a number of seminars and specialised workshops in conjunction with the BIBF aimed at expanding knowledge in the fields of banking and finance. The CBB continues to support these conferences, seminars and workshops to reflect the Kingdom of Bahrain as a
centre for financial excellence in the region.

The CBB either organised or participated in 36 conferences and events. Officials of the CBB also conducted 29 interviews with Arabic and international media.
CBB’s Organizational Chart
5. CENTRAL BANK OF BAHRAIN
Balance Sheet and Profit and Loss Account and Appropriations 31 December 2009

INDEPENDENT AUDITORS REPORT TO THE BOARD OF DIRECTORS OF THE CENTRAL BANK OF BAHRAIN

BALANCE SHEET

PROFIT AND LOSS ACCOUNT AND APPROPRIATION For the year ended 31 December 2009

Notes to the balance sheet and profit and loss account and appropriation for the year ended 31 December 2009
INDEPENDENT AUDITORS REPORT TO THE BOARD OF DIRECTORS OF THE CENTRAL BANK OF BAHRAIN

We have audited the accompanying financial statements of Central Bank of Bahrain (the “Central Bank”) which comprise of the balance sheet as of 31 December 2009, and related profit and loss account and appropriation for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management responsibility

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 Note 2 to these financial statements and in compliance with Royal Decree No. 64 of 2006. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of the 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 balance sheet and the related profit and loss account and appropriation are free from material misstatement.

An audit involves performing procedure to obtain audit evidence about 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 risk 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 consider internal control 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 for the year ended 31 December 2009, have been prepared, in all material respect, in accordance with the accounting policies set out in Note 2 of the balance sheet and related profit and loss account and appropriation and in compliance with the Royal Decree No. 64 of 2006.

17 March 2010
Manama, Kingdom of Bahrain
# CENTRAL BANK OF BAHRAIN

**BALANCE SHEET**

(Expressed in thousands of Bahraini Dinars)

<table>
<thead>
<tr>
<th>Assets</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gold</td>
<td>2,500</td>
<td>2,500</td>
</tr>
<tr>
<td>Foreign reserves</td>
<td>1,858,817</td>
<td>1,926,435</td>
</tr>
<tr>
<td>Due from Ministry of Finance</td>
<td>177,780</td>
<td>-</td>
</tr>
<tr>
<td>Cash, due from Bahraini banks and treasury bills</td>
<td>9,207</td>
<td>36,978</td>
</tr>
<tr>
<td>Other assets</td>
<td>6,572</td>
<td>7,298</td>
</tr>
<tr>
<td>Equipment</td>
<td>2,099</td>
<td>2,512</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>2,056,975</td>
<td>1,975,723</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes and coins in circulation</td>
<td>405,626</td>
<td>370,772</td>
</tr>
<tr>
<td>Bahraini Dinar deposits</td>
<td>1,033,682</td>
<td>963,924</td>
</tr>
<tr>
<td>Other deposits</td>
<td>122,078</td>
<td>94,812</td>
</tr>
<tr>
<td>Payable to Kingdom of Bahrain</td>
<td>8,500</td>
<td>10,500</td>
</tr>
<tr>
<td>Provision for currency withdrawn</td>
<td>6,286</td>
<td>6,298</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>3,830</td>
<td>2,029</td>
</tr>
<tr>
<td>Due to other central banks</td>
<td>414</td>
<td>410</td>
</tr>
<tr>
<td>Due to Ministry of Finance</td>
<td>-</td>
<td>62,661</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>1,580,416</td>
<td>1,511,406</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Capital funds</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td>200,000</td>
<td>200,000</td>
</tr>
<tr>
<td>General reserve</td>
<td>182,716</td>
<td>174,216</td>
</tr>
<tr>
<td>Contingency reserve</td>
<td>77,015</td>
<td>71,400</td>
</tr>
<tr>
<td>Revaluation reserve</td>
<td>16,828</td>
<td>18,701</td>
</tr>
<tr>
<td><strong>Total capital funds</strong></td>
<td>476,559</td>
<td>464,317</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total liabilities and capital funds</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2,056,975</td>
<td>1,975,723</td>
</tr>
</tbody>
</table>

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Qassim Fakhro
Chairman

Rasheed Al Maraj
Governor

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**Chapter 5: CBB Balance Sheet and Profit and Loss Account and Appropriation**
## CENTRAL BANK OF BAHRAIN
### PROFIT AND LOSS ACCOUNT AND APPROPRIATION
For the year ended 31 December 2009
(Expressed in thousands of Bahraini Dinars)

<table>
<thead>
<tr>
<th>Note</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income</td>
<td>28,108</td>
<td>73,976</td>
</tr>
<tr>
<td>Interest expense</td>
<td>(5,065)</td>
<td>(29,199)</td>
</tr>
<tr>
<td>Net interest income</td>
<td>23,043</td>
<td>44,777</td>
</tr>
<tr>
<td>Registration and licensing fees</td>
<td>5,604</td>
<td>5,252</td>
</tr>
<tr>
<td>Exchange gain on sale of US dollars</td>
<td>4,936</td>
<td>5,489</td>
</tr>
<tr>
<td>Net realised investment gain</td>
<td>7,249</td>
<td>4,937</td>
</tr>
<tr>
<td>Other income</td>
<td>624</td>
<td>336</td>
</tr>
<tr>
<td></td>
<td>41,456</td>
<td>60,791</td>
</tr>
<tr>
<td>Expenditures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff costs</td>
<td>(9,809)</td>
<td>(8,392)</td>
</tr>
<tr>
<td>General and administration expenses</td>
<td>(6,018)</td>
<td>(6,610)</td>
</tr>
<tr>
<td>Managed funds and advisory fees</td>
<td>(931)</td>
<td>(914)</td>
</tr>
<tr>
<td>Notes issue expenses</td>
<td>(2,083)</td>
<td>(3,900)</td>
</tr>
<tr>
<td></td>
<td>(18,841)</td>
<td>(19,816)</td>
</tr>
<tr>
<td>Profit for the year before provision</td>
<td>22,615</td>
<td>40,975</td>
</tr>
<tr>
<td>Provision for impairment</td>
<td>4</td>
<td>-</td>
</tr>
<tr>
<td>Net profit for the year</td>
<td>22,615</td>
<td>34,400</td>
</tr>
<tr>
<td>Transfer to contingency reserve</td>
<td>11</td>
<td>(5,615)</td>
</tr>
<tr>
<td>Transfer to general reserve</td>
<td>10</td>
<td>(8,500)</td>
</tr>
<tr>
<td>Balance payable to Kingdom of Bahrain</td>
<td>8,500</td>
<td>10,500</td>
</tr>
</tbody>
</table>
Notes to the balance sheet and profit and loss account and appropriation for the year ended 31 December 2009
(Expressed in thousands of Bahraini Dinars)

1. Activity

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 issued by His Majesty the King Hamad bin Isa Al Khalifa King of the Kingdom of Bahrain (the “Royal Decree”).

The Central Bank is responsible for organizing 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, endeavoring 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 and is 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 2009 were authorised for issue in accordance with the approval of the Chairman of the Board of Directors and The Governor on 17 March 2010.

2. Significant accounting policies

The balance sheet and related profit and loss account and appropriation are prepared in compliance with the Royal Decree.

2.1 Accounting convention

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

Foreign reserves comprise deposits placed 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 is settled.

2.3 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 instalments over the estimated useful lives of the assets.

2.4 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.

In accordance with Article 22 (a) of the Royal Decree, 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 required to be recorded in a special account to be entitled “Revaluation Reserve Account”.

In accordance with the requirement of the Royal Decree, the gain or loss on the foreign exchange contracts is recognised in Revaluation Reserve account. Upon disposal of the assets the related gain or loss on the forward contracts is recognised in the profit and loss account and appropriation.
2.5 *Provision for impairment*

The Central Bank assesses at each balance sheet date whether there is objective evidence that an investment is impaired. This includes a significant decline in the fair market value of the investment below its cost.

2.6 *Gold*

Gold is carried at cost.

2.7 *Notes and coins in circulation*

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

2.8 *Revenue recognition*

Interest income is recognised on a time apportioned basis, taking into account the principle 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.

2.9 *Notes issue expenses*

Expenses related to issuing notes are recognised when incurred.

3. **Excess of authorised backing for currency in circulation**

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<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 4</td>
<td>1,858,817</td>
<td>1,926,435</td>
</tr>
<tr>
<td></td>
<td>1,861,317</td>
<td>1,928,935</td>
</tr>
<tr>
<td>Notes and coins in circulation</td>
<td>(405,626)</td>
<td>(370,772)</td>
</tr>
<tr>
<td>Excess of authorised backing over currency in circulation</td>
<td>1,455,691</td>
<td>1,558,163</td>
</tr>
</tbody>
</table>

According to Article 19 of the Central Bank law, foreign reserves permanently maintained by the Central Bank shall not be less than 100% of the value of the
currency in circulation.

The fair value of gold as at 31 December 2009 was BD 62,563 thousands (2008: BD 49,019 thousands).

4. Foreign reserves

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds portfolios</td>
<td>600,374</td>
<td>546,294</td>
</tr>
<tr>
<td>Bank deposits</td>
<td>1,265,018</td>
<td>1,386,716</td>
</tr>
<tr>
<td></td>
<td><strong>1,865,392</strong></td>
<td><strong>1,933,410</strong></td>
</tr>
</tbody>
</table>

Less: provision for impairment

|                    | (6,575) | (6,575) |
|                    | **1,858,817** | **1,926,435** |

All bonds are quoted in active markets with 97% being of investment grade BBB or higher (2008: 96%). All deposits and 90% of bonds are in US dollars (2008: 89%). For other foreign currencies, mainly Euros and Sterling, these are 98% hedged into US dollars. The bond portfolios include BD 2,938 thousand net unrealised gains on non-US denominated bonds and related forward foreign exchange contracts used to hedge such bonds (2008: gain of BD 5,330 thousand).

The market value of the bond portfolios at 31 December 2009 was BD 578,622 thousand (2008: BD 514,229 thousand).

During the year, the Central Bank has not recognised any impairment provision (2008: BD 6,575 thousand.)

5. Due from Ministry of Finance

The amount represents the net due from/ to the Ministry of Finance, for payments and receivables related to the Ministry made by the Central Bank.
6. **Cash, due from Bahraini banks and treasury bills**

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>8,609</td>
<td>9,478</td>
</tr>
<tr>
<td>Due from Bahraini banks</td>
<td>578</td>
<td>2,699</td>
</tr>
<tr>
<td>Treasury bills issued by the Government of Bahrain</td>
<td>20</td>
<td>24,801</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>9,207</td>
<td>36,978</td>
</tr>
</tbody>
</table>

7. **Other assets**

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest receivable</td>
<td>1,379</td>
<td>1,907</td>
</tr>
<tr>
<td>Staff loans</td>
<td>3,348</td>
<td>3,462</td>
</tr>
<tr>
<td>Others</td>
<td>1,845</td>
<td>1,929</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>6,572</td>
<td>7,298</td>
</tr>
</tbody>
</table>

8. **Other liabilities**

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest payable</td>
<td>97</td>
<td>193</td>
</tr>
<tr>
<td>Accrued expenses</td>
<td>75</td>
<td>296</td>
</tr>
<tr>
<td>Payables</td>
<td>3,658</td>
<td>1,540</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>3,830</td>
<td>2,029</td>
</tr>
</tbody>
</table>

9. **Capital**

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Authorised</td>
<td>500,000</td>
<td>500,000</td>
</tr>
<tr>
<td>Issued and fully paid up</td>
<td>200,000</td>
<td>200,000</td>
</tr>
</tbody>
</table>
10. General reserve

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at beginning of</td>
<td>174,216</td>
<td>163,716</td>
</tr>
<tr>
<td>the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfer from profit</td>
<td>8,500</td>
<td>10,500</td>
</tr>
<tr>
<td>and loss account and</td>
<td></td>
<td></td>
</tr>
<tr>
<td>appropriation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance at end of the</td>
<td>182,716</td>
<td>174,216</td>
</tr>
<tr>
<td>year</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In accordance with Article 12 of the Royal Decree, the Central Bank maintains general reserve which is credited with the following percentages of its net profit:

- 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.

11. Contingency reserve

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at beginning of</td>
<td>71,400</td>
<td>58,000</td>
</tr>
<tr>
<td>the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfer during the year</td>
<td>5,615</td>
<td>13,400</td>
</tr>
<tr>
<td>Balance at end of the</td>
<td>77,015</td>
<td>71,400</td>
</tr>
<tr>
<td>year</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The Board has approved a transfer of BD 5,615 thousand of the current year’s net profit to the contingency reserve.
12. Revaluation reserve

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at beginning of the year</td>
<td>18,701</td>
<td>18,188</td>
</tr>
<tr>
<td>Movement during the year</td>
<td>(1,873)</td>
<td>513</td>
</tr>
<tr>
<td>Balance at end of the year</td>
<td>16,828</td>
<td>18,701</td>
</tr>
</tbody>
</table>

The revaluation reserve relates to exchange gains and losses recognised in accordance with the Royal Decree.

13. Contingent liabilities and commitments

Contingent liabilities and commitments, some of which are offset by corresponding obligations of third parties, arise in the normal course of business, including contingent liabilities in respect of guarantees and indemnities in connection with liquidity support operations. As at 31 December 2009 there were no outstanding contingent liabilities or commitments (2008: Nil)

14. Comparatives

Certain prior year amounts have been reclassified to conform to the current year’s presentation. Such reclassifications do not effect previously reported net profit or capital funds.