Annual Report

2010
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1. Monetary Policy Developments

Overview

Monetary Policy Instruments

Monetary Policy management

Money Supply

Domestic Interest Rates
Overview

During 2010, 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 a range of monetary policy instruments as well as interest rate actions.

Monetary Policy Management

Monetary Policy Committee

The CBB Monetary Policy Committee ("MPC") met on a weekly basis throughout 2010. 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.

Reserve Requirements

All retail banks are required to maintain, on a monthly basis, a specific percentage of their non-bank deposits (denominated in Bahraini dinars), in a non-interest-bearing account at the CBB. During 2010, the reserve percentage remained unchanged at 5%.

Money Market Forum

During 2010, the CBB continued to host the Bahrain Money Market Forum on a monthly basis 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.
Foreign Exchange Swap Facility

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 2010, 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 also started to charge fees on its 1-week and 1-month FX Swaps to eliminate risk-free arbitrage opportunities.

Domestic Interest Rates

Key Policy Interest Rates

During 2010, there was no change to the interest rates on facilities provided by the CBB to retail banks, where the one-day BD Deposit rate remained at 0.25% and for the one week maturity, 0.5%. There was also no change to the 2.25% lending rate offered by the CBB to retail banks for the one-day maturity against Treasury Bills and BD Deposits.

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. BHIBOR indicates the BD interbank offered rates between banks from overnight to 12 month maturities.

As at end-2010, the 3-month BHIBOR rate was 1.20%, compared to 1.30% at end-2009. The 6-month BHIBOR rate was 1.50% at end-2010, down from 1.53% at end-2009.

Loan and Deposit Rates

At the end of 2010, the weighted average BD time deposit rate (3-12 months) stood at 1.07%, compared to 1.36% at the end of 2009. The weighted average savings rate increased slightly from 0.22% to 0.25%. The weighted average interest rate on business loans increased from 6.84% at end-2009 to 7.30% at end-2010, while the interest rate on personal loans decreased from 7.70% to 7.10%.
Public Debt Issuance

In accordance with the Central Bank of Bahrain and Financial Institutions Law ("CBB Law") of 2006, the CBB issues short and long-term debt instruments on behalf of the government of Bahrain. These include Treasury Bills, Sukuk Al Salam and Ijarah Sukuk. The issuance of all government debt securities is executed in coordination with the Ministry of Finance ("MOF").

During 2010, the CBB issued conventional 3-month Treasury Bills, denominated in Bahraini dinars, on a weekly basis, and having an issue amount of BD 25 million and a total amount of BD 250 million at end-2010. Six-month Bills were also issued, on a monthly basis, with an issue amount of BD 20 million and a total amount of BD 120 million. In addition, the CBB issued 12-month Treasury Bills on a quarterly basis, with an issue amount of BD 50 million and a total amount of BD 200 million.

During 2010, the CBB on behalf of MOF issued 3 Development Bonds in local currency (BD) for a total value of BD 450 million for a range of different maturities (3 to 7 years).

The CBB also issued a 3-month AlSalam Sukuk (BD 12 million) and a 6-month Ijara Sukuk (BD 10 million) on a monthly basis.

The CBB also issued on behalf of the MOF, long-term Ijara Sukuk of different issue amounts and different maturities, under the advice of the MOF. The CBB implemented the first Islamic Sukuk Liquidity Instrument ("ISLI"), which is a CBB Sharia Board compliant sell/buyback of Ijara Sukuk (issued in local currency) held by the CBB. The processing of the ISLI is in the Securities Settlement System ("SSS") and the settlement takes place in the Real-Time Gross Settlement ("RTGS") System. This instrument has been renewed three times during 2010.
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) increased modestly to USD 222.2 billion by the end of 2010, compared to USD 221.8 billion at the end of 2009, an increase of 0.2%. Wholesale banks represented 70.5% of total assets, whilst retail banks accounted for 29.5%.

Domestic banking assets amounted to USD 45.8 billion at the end of 2010 compared to USD 42.2 billion at the end of 2009, representing an increase of USD 3.6 billion (8.5%). Foreign assets amounted to USD 176.4 billion, compared to USD 179.6 billion at the end of 2009, a decrease of USD 3.2 billion (1.8%).

Domestic liabilities grew to USD 50.8 billion at the end of 2010 compared to USD 47.7 billion at the end of 2009, an increase of USD 3.1 billion (6.5%). Total foreign liabilities decreased by USD 2.8 billion (1.6%) to reach USD 171.3 billion against USD 174.1 billion at the end of 2009.

Retail Banks

The consolidated balance sheet of retail banks increased by 9.3% to BD 24.6 billion at the end of 2010, compared to BD 22.5 billion at the end of 2009.

Total domestic assets grew by BD 2.2 billion (20.2%) to reach BD 13.1 billion, with claims on banks increasing by BD 0.9 billion (47.4%) and claims on securities growing by BD 0.6 billion (75.0%).

Foreign assets recorded a decrease of BD 0.1 billion (0.9%), reaching a total of BD 11.5 billion at the end of 2010 compared to BD 11.6 billion at the end of 2009. Claims on foreign non-banks increased by BD 0.3 billion (5.9%) from BD 5.1 billion at the end of 2009 to BD 5.4 billion at the end of 2010, while claims on foreign banks decreased by BD 0.4 billion (6.2%), reaching a total of BD 6.1 billion at the end of 2010.

Total domestic liabilities of retail banks increased by BD 1.6 billion (13.7%) from BD 11.7 billion at the end of 2009 to BD 13.3 billion at the end of 2010. This was due to an increase in liabilities to private non-banks by BD 0.7 billion (10.3%) and liabilities to banks by BD 0.5 billion (33.3%). Liabilities to general government also increased by BD 0.3 billion (23.1%).

1 This includes conventional and Islamic retail banks.
Total foreign liabilities increased to BD 11.3 billion at the end of 2010 compared to BD 10.8 billion at the end of 2009, an increase of BD 0.5 billion (4.6%). Liabilities to banks increased by BD 0.8 billion (13.1%) while liabilities to non-banks decreased by BD 0.3 billion (6.4%).

**Loans and Credit Facilities**

Outstanding loans and credit facilities of retail banks stood at BD 5.7 billion at end-2010, a 3.4% decline compared to the BD 5.9 billion at end-2009. The business sector accounted for 64.9% of total loans and credit facilities, while individuals and the government sector represented 31.6% and 5.3% respectively.

**Deposits**

Retail banks’ total domestic deposits increased to BD 9.1 billion at the end of 2010 compared to BD 8.0 billion at the end of 2009, an increase of BD 1.1 billion (13.8%). This was due to higher private sector deposits which increased by BD 0.6 billion (8.8%) and general government deposits which increased by BD 0.3 billion (23.1%).

Domestic deposits in Bahraini Dinar increased by BD 1.2 billion (20.3%) to BD 7.1 billion at the end of 2010. Domestic foreign currency deposits fell by 9.5% or BD 0.2 billion to BD 1.9 billion. Bahraini Dinar deposits and foreign currency deposits constituted 67.6% and 32.4% 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”) (excluding Bahrain) reached a total of 21.2%, while Asia accounted for 10.2%, Western Europe accounted for 6.0%, North and South America for 5.7%, and other Arab countries for 2.5%.

In terms of currency, the share of US dollar denominated assets was 45.1%, while the GCC currencies (excluding Bahraini dinar) accounted for 7.6% of total assets. The Euro represented 4.0% of total assets.
Wholesale Banks\(^2\) \(^3\)

The consolidated balance sheet of wholesale banks fell by USD 5.3 billion or 3.3% to USD 156.7 billion at the end of 2010, compared with USD 162.0 billion at the end of 2009.

Total domestic assets declined to USD 11.0 billion at 2010, compared with USD 13.2 billion at the end of 2009.

Foreign assets decreased by USD 3.1 billion (2.1%) to USD 145.8 billion at the end of 2010. This was due to decreases in claims on non-banks by USD 8.1 billion (12.8%), in the value of securities held by banks by USD 1.0 billion (3.6%) and in claims on head office and affiliates by USD 0.8 billion (2.0%).

Total domestic liabilities of wholesale banks fell by USD 1.2 billion (7.2%) to USD 15.4 billion at the end of 2010 compared with USD 16.6 billion at the end of 2009.

Foreign liabilities decreased by USD 4.1 billion (2.8%) to reach USD 141.3 billion at the end of 2010, compared with USD 145.4 billion at the end of 2009. This decrease was mainly due to a drop in liabilities to head office and affiliates by USD 13.2 billion (21.9%) and to banks by USD 0.3 billion (0.7%), while securities decreased by USD 0.2 billion (4.4%).

Geographical and Currency Distribution of Assets

The share of total assets accounted for by the GCC (excluding Bahrain) reached a total of 32.9%, while Western Europe accounted for 39.0%, North and South America for 10.2%, Asia for 6.5%, and other Arab countries for 3.3%.

As for currency, the share of GCC currencies (excluding Bahraini dinar) of total assets was 9.0% with the dollar accounting for 67.6% of total assets and the Euro comprising 10.6% of total assets.

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\(^2\) This includes conventional and Islamic wholesale banks.

\(^3\) The balance sheets of wholesale banks are usually denominated in USD.
3. Regulatory and Supervisory Developments

Regulatory Developments

Supervisory Developments
Regulatory Developments

As part of CBB’s continuing development of the regulatory framework for the financial system, work was carried out during the year 2010 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)

During 2010, the Financial Institution Supervision Directorate (“FISD”) continued, in accordance with its objectives, to develop the rules and regulations pertaining to its licensees, either by way of updating or introducing new rules. As a result, a number of initiatives commenced and updates to Regulations were issued over the year, as follows:

- At the beginning of 2010, the Directorate commenced the exercise of updating and restructuring the Collective Investment Undertaking (“CIU”) Module with the aim of enhancing the regulatory framework pertaining to CIUs, taking into consideration the current developments in the local and regional markets and the needs of their participants, while observing international best practices. Considerable progress has been accomplished to date, with the objective of sending the update to market consultation in 2011.

- In July 2010, a major update of CBB Rulebook Volume 4 was issued. The update included the issuance of the Training and Competency Module, which sets out the minimum competencies and qualifications required to carry out controlled functions. Additionally, it included the introduction of new rules and enhancements to requirements within some of the existing rules.

- In October 2010, FISD issued a circular to Investment Business Licensees, Categories 1, 2 and 3, requiring such licensees to include a statement that they are regulated by the CBB on all written communication including business cards. The aim of this circular was to enhance investor protection in the financial sector.

- In an effort to encourage transparency, a circular was issued to all Investment Business Firms Categories 1 and 2, requiring them to disclose the amounts of Assets Under Management (“AUM”) in
the audited annual accounts, to be implemented for the financial year ending 31st December 2010. Accordingly, all off-balance sheet items would now be disclosed in the annual statements, offering a higher level of transparency.

To reduce the likelihood of licensees being used for financial crime including money laundering activities the following initiatives were taken:

- The Financial Crime Module of CBB Rulebook Volume 4 addresses this crucial area and is being monitored by the Compliance Directorate. The FISD liaises with the Compliance Directorate on such matters and ensures that every financial institution under its supervision has a qualified MLRO appointed at all times.

- With regards to observing Anti-money Laundering requirements for CIUs, the FISD ensures that any eligible CIU is authorised or registered prior to being marketed in Bahrain. Such authorization/registration is subject to the CIU observing the Anti Money Laundering Law of Bahrain at all times.

**Volume 5 (Specialised Licensees)**

In October 2010, the CBB issued eight specific Modules pertaining to Money Changers, as part of CBB Rulebook Volume 5 (Specialised Licensees). The Modules captured all of the existing requirements which were previously set in the form of circulars previously issued over a period of several years, and are complemented by five Common Modules pertaining to all specialised licensees.

**Volume 6 (Capital Markets)**

During 2010, the CBB continued to work on modernising the capital market regulatory framework to bring it into line with international standards and practices. The CBB consulted with licensees, international agencies, stakeholders, interested parties as well as other financial sector participants to update its regulations. The CBB, in collaboration with financial sector institutions, also took steps to introduce 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:
• Market Intermediaries and Representatives License Module ("MIR"), which was finalised on 15th December 2009 and implemented on 1st January 2010.

• Dispute Resolution, Arbitration and Disciplinary Proceedings Module ("DRA"), which was finalised on 29th June 2010 and implemented on 1st July 2010.

• Anti-Money Laundering & Combating Financial Crime Module ("AML"), which was finalised on 10th November 2010 and implemented on 10th November 2010.

Furthermore, work continued on other Modules of Volume 6, including Modules on Offering of Securities Module ("OFS") and Corporate Governance Module ("COG"). These Modules will be issued during 2011.

Additional progress was also made with regard to existing Modules, such as:
• Market Surveillance, Investigation & Enforcement Module ("MIE")
• Prohibition of Market Abuse and Manipulation Module ("MAM")

New Licensing Regulation

The CBB issued the first consultation paper on the conditions of granting a license for the provision of regulated services for the financial sector and general public at the end of October 2010. The CBB has taken this step in accordance with Article (44) of the CBB Law, Decree No. (64) to make the procedures for applying for a license more effective and clear. The consultation paper identifies the information and documents that applicants are required to submit along with the application for a license. The CBB has received some comments from the financial sector, studied them and the regulation is under legal review.

Corporate Governance

The Ministry of Industry and Commerce ("MOIC"), in conjunction with the CBB issued Bahrain’s National corporate Governance Code on 16th March 2010, applicable to all public shareholding companies effective 1st January 2011.

In October 2010 the CBB updated the Corporate Governance requirements in the Rulebook Module on High level Controls for Rulebook Volumes 1 & 2
which are applicable to Conventional & Islamic Banks respectively. These requirements include the Corporate Governance Principles issued by the MOIC. The CBB expects the Code to enhance the effectiveness of corporate governance in banks and to apply with effect from January 2011.

Locally incorporated banks were required to undertake a detailed self assessment of their current compliance with the HC Module including the new CG Code and submit the said review to the CBB. The review also contained the measures to be taken by banks to address the gaps and achieve full compliance with the rules by 2011.

The CBB is currently working on updating corporate governance requirements in Rulebook Volumes 3 & 4 for insurance & investment firms respectively which will be issued in January 2011.

Enhancing Liquidity Monitoring and Management

The CBB has issued a second consultation paper at the end of July 2010 to further enhance liquidity risk management in banks in line with Basel 3 guidelines taking into account banks’ comments on the first consultation paper as well as to the consultation paper issued by the Basel Committee in December 2009. The CBB is currently studying the banking sector’s comments on the second consultation paper. The CBB is also currently comparing the requirements of the consultation paper issued by the CBB with the final version of the Basel paper on the management of liquidity risk, which was released in December 2010.

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

Efforts were focused in 2010 on upgrading Bahrain’s regulatory framework specific to AML/CFT through the Policy Committee, which is a Government of Bahrain committee chaired by the CBB. The Policy Committee is responsible for formulating AML/CFT policies, procedures and coordinating with relevant internal and external bodies.

The Policy Committee has revised the existing AML Law in an effort to synchronise all AML/CFT related issues as well as be in line with the latest developments in the Financial Action Task Force (“FATF”) recommendations. The revised AML/CFT Law will include all predicate offences and has been forwarded to the relevant parliament committees for final approval.
As part of its systematic programme to improve the AML/CFT framework in Bahrain, the CBB has 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. Examination visits help upgrade the level of AML/CFT awareness within banks, moneychangers, insurance firms and the capital market sector.

On a regional level, the Middle East and North Africa Financial Action Task Force (“MENAFATF”) plenary meeting was held on November 2010 in Doha, Qatar. 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 2006-2010, 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 May 2010. 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.

Controlling the Level of Real Estate Exposures

With the objective of ensuring that banks’ asset portfolios remain sound and diversified, the CBB engaged in continuous dialogue with banks to address and avoid any risk concentration towards the real estate sector. As such, real estate exposures were monitored on a quarterly basis to note any abnormal changes thereon. Furthermore, the regulatory risk weighting for all real estate holding by banks remained at 200% in order discourage any excessive real estate expansion.

Strengthening the Protection of both Deposits and Unrestricted Investment Accounts

The CBB’s Board has approved the Regulation on Protecting Deposits and Unrestricted Investment Accounts after the issuance of four consultation papers to the banking sector. The proposals were finalized after taking into account industry comments as well as consulting with the Shari’a Supervisory Board of the CBB. The final regulation will be issued in the Official Gazette
once ready.

The new Regulation aims to modify the current system of deposit protection and replace it with a new prefunded system to Bahrain’s arrangements more closely in line with international best practices. In a prefunded scheme a dedicated fund is accumulated through regular premium payments by member banks; this fund is then immediately available to compensate depositors in the event of a bank failure.
Supervisory Developments

Compliance Directorate

The CBB efforts have focused on ensuring the effective enforcement of the regulatory framework. More specifically, the CBB’s Financial Crime (“FC”) Module specific to AML/CFT was amended in the following areas:


2. Official issuance of Volume 5 Financial Crime Module specific to Moneychangers, thus replacing the previous Circulars and licensing requirements governing moneychangers. The FC module was also updated to include additional requirements pertaining to cash couriers.

Banking Supervision Directorates

The CBB continued with its proactive supervisory approach including enhanced monitoring of the banking sector while concurrently taking steps to provide positive signals to the market. The objective was to provide adequate assurance to the consumers of the banking sector, ensure financial stability in the system and enhance market confidence to facilitate economic growth.

Accordingly, the following measures were taken by the CBB during the year:

- **Prudential Meetings**: The Banking Supervision Directorates conducted 75 prudential meetings with licensees. In addition, quarterly meetings with banks in the presence of their external auditors were continued in 2010, to discuss lending practices, interest rates, general market conditions etc.

- **Quantitative Impact Study for Basel 3**: With the objective of developing a timetable and a transitional period for the implementation of Basel 3 in Bahrain, the CBB requested its locally incorporated banks to perform an impact assessment of the Basel Committee proposals on higher global minimum standards for Banks on solo and consolidated capital adequacy ratios.
Furthermore, as part of the CBB’s endeavour to ensure its regulatory framework remains aligned with international best practices the CBB requested banks to provide their comments on the Basel Committee proposal on methodologies for risk and performance alignment of remuneration. The feedback from the industry will be taken as the basis to formulate amendments in Volume 1 and 2 of the CBB Rulebook.

- **Reporting Accountant Assignments:** As part of its efforts to augment its onsite supervisory resources the CBB appointed qualified “Reporting Accountants” on to undertake onsite bank examinations. Fourteen such assignments were conducted by Reporting Accountants during the 2010 covering both conventional and Islamic licensees. The issues examined included, inter alia, compliance with the Code of Practice for consumer credit and charges, risk management and control.

- **Related Party Exposures:** The CBB continued with its monitoring of related party exposures on a monthly basis with the objective of limiting any risk concentration and ensuring compliance with CBB rules.

- **Consolidated Supervision:** A part of the CBB’s consolidated supervision approach for locally incorporated banks; onsite visits to subsidiaries were conducted in the UK, Seychelles, Kuwait, Switzerland and Pakistan. These visits also facilitated cross border exchange of information between the CBB and the host country regulatory agency.

- **Liquidity Monitoring:** The CBB continued its monitoring of banks’ liquidity position on a weekly basis, in addition to its assessment of liquidity on quarterly basis. The liquidity risk assessment was based on bank specific risks as well as external events affecting the bank and used both quantitative and qualitative indicators. The weekly liquidity reports submitted by banks also highlighted maturity gaps between assets and liabilities under different time buckets.

- **Quarterly Reports for Islamic Banks:** The Directorates continued to receive the 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. Any shortfall in the level of disclosure is addressed by the CBB in a timely manner.

- **Meeting on Financial Statements**: The CBB conducted quarterly meetings with locally incorporated retail banks to discuss their interim financial statements. In addition, annual trilateral meetings were also held with bank management along with their external auditors, to discuss year-end financial statements for 2009, before such statements are submitted to the respective bank’s Board of Directors for approval. The discussions encompassed the basis of recognition of income, valuation practices, impaired assets, breakdown and adequacy of provisions, proposed dividends and staff bonuses. Moreover, banks were urged by the CBB to have collective impairment provisions of 1% of their net loans portfolio.

- **Monitoring of Board Meetings**: To ensure efficiency and effectiveness of Bahraini banks’ boards, the Directorate continued its close monitoring of the attendance and participation in board meetings. The Directorate also continued 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 supervisory approach, the CBB undertook special studies/surveys on Small Medium Enterprises (“SMEs”) and mortgage financing by banks and financing companies in Bahrain.

- **Bahrain Credit Reference Bureau (“BCRB”)**: To facilitate improved decision making in credit disbursement and enhance credit quality in the banking system, the CBB coordinated with the BCRB to expand its credit referencing services to include corporate credit and extend its services to cover non-CBB licensees like the utility companies. The CBB is in consultation with the industry to activate the BCRB’s corporate credit referencing services by 1st April 2011.

Other activities undertaken by the Supervision Directorates include:

- **GCC Monetary Union**: The CBB continued to actively participate in the Banking Supervision Committee of the GCC Monetary Union entrusted with the task of harmonisation of the supervision rules of the member countries.
• **EMV Compliance**: The CBB continued to work with retail banks to replace the old magnetic stripe cards with new EMV compliant chip and pin cards. All licensee card issuers were directed by the CBB to be EMV compliant by the end of 2010. The EMV technology provides customers with improved security when using their cards including those at ATMs and ‘customer present’ merchant-based transactions.

**Inspection Directorate**

The Inspection Directorate completed its planned programme of onsite inspection visits to CBB licensees including full scope and subject specific visits. The Directorate employed an enhanced risk focused examination approach using the CMORTALE methodology. This methodology assesses the risk profile of the CBB’s licensees with the ultimate objective of promoting the safety and soundness of financial institutions through onsite procedures aimed at identifying regulatory action required to reduce the risk of insolvency, the potential loss of market confidence, and losses to depositors or investors.

With a view to expand the on-site inspection coverage of Banks, the Inspection Directorate’s efforts were supplemented by risk centric on-site assessments undertaken by selected reporting accountants.

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.

The Directorate played an integral role in the CBB Security Measures, which liaises with All Retail Banks, Card Companies and the Ministry of Interior regarding initiatives to continuously improve and implement security systems such as Close Circuit Television (“CCTV”) at banks, money changers and ATMs.

During 2010, the Directorate participated in the discussions hosted in Riyadh by the GCC Task Force Technical Payment Committee, which focused on promoting enhanced networking and communication solutions.

**Capital Markets Supervision (“CMSD”)**
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 2010:

- **Developments:**
  a) Issuance of Resolution No.(43) of the year 2010, amending Resolution No.(1) of the year 2007, concerning the services subject to the supervision of the CBB, adding the services of operating exchanges, institutions, clearing houses, central depositories, and intermediaries operating in the exchanges to the list. The resolution was published in the Official Gazette on 9th December 2010.

  b) Issuance of Resolution No. (26) of the year 2010, amending the Resolution No. (1) of the year 2007, identifying the categories of annual fees for exchanges and other institutions dealing in securities and financial instruments. The resolution was published in the Official Gazette on 9th December 2010.

- **Transformation of the Bahrain Stock Exchange to a joint stock company:** Issuance of decree No. (60) for the year 2010, regarding the establishment of Bahrain Bourse B.S.C. (c). The Decree No. (60) for the year 2010 was published in the Official Gazette No.(2980) issued on 30th December 2010.

- **Approvals and reviews of prospectuses:** CMSD issued in 2010 its “no objection” to 54 public and private offering documents after ensuring the completeness of all the information and details as per the CBB Law, CBB’s Disclosure standards and the Guidelines on the Issuing and offering of Debt Securities. The gross total value of these issues amounted USD 37.2 billion.

  CMSD also reviewed and provided comments and observations on a further 6 public and private offering documents that were not approved. These offering documents are currently being updated and rectified in line with CMSD’s comments by the lead managers of these offerings. The gross total value is of these issues is USD 751,801,685.
• **Market Surveillance System:** In 2010 the CMSD started their process of inviting proposals from various interested vendors to implement an enhanced Market Surveillance System (“MSS”) for the capital market in Bahrain in line with the best international standards and practices. The new Market Surveillance System is expected to be in operation during 2011.

• **Licenses and Approvals:** The Bahrain Financial Exchange (“BFX”) received CBB’s license on 18th October 2010. In addition, the BFX Clearing and Depository Corporation (“BCDC”) obtained its license on 5th October 2010. The CBB issued in-principle approvals for a number of applications for membership of Bahrain Financial Exchange (“BFX”), as detailed below:

  - CMSD issued in-principle approval to the following proprietary Authorised remote members:

    - Global Commodities DMCC Dubai
    - Dynamic Commodities and Forex DMCC
    - Supama International DMCC
    - Alankit Global Resources DMCC

  - The Licensing Directorate in coordination with the CMSD issued in principle approval for licensing under Module MIR of the CBB Rulebook Volume 6:

    - Arab Global Financial Services

Further, applications have been recorded by the CBB for licensing as members of BFX and BCDC and are still under review.

• **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-compliant companies with the articles of the abovementioned resolution:
Financial Institutions Supervision Directorate (“FISD”)

During the course of 2010, the FISD continued to fulfil its responsibilities through various supervisory tools, including in-depth financial analysis, prudential meetings held with management of licensees, formal requests for information from the sector, liaising internally with other Directorates at the CBB, in addition to the ongoing monitoring of licensees through regular communication and exchange of correspondence.

The FISD also authorised / registered 13 Bahrain domiciled Collective Investment Undertakings (“CIUs”), one of which is Bahrain’s second CIU structured as a unit trust, utilizing Bahrain’s Financial Trust Law and in accordance with the requirements of the CIU Module of CBB Rulebook Volume 6.

The Directorate also authorised / registered 215 overseas domiciled CIUs to be marketed to residents in Bahrain, to reach a total of 228 authorised / registered CIUs during the year.

As part of its supervisory role in monitoring CIUs’ compliance with the requirements of the CIU Module, the FISD continued the exercise of classifying Bahrain domiciled CIUs established prior to June 2007, in accordance with the requirements of the CIU Module. As of the end of 2010, 89% of the previously established CIUs had been classified, compared to 62% as of the end of 2009.

In addition, the Directorate continued to monitor the performance of Bahrain domiciled CIUs, and their compliance with the requirements of the CIU Module, as well as their investment policies. This has necessitated more
frequent reporting to CBB by relevant parties regarding issues such as investment strategy breaches.

**Insurance Sector Supervision**

The Insurance Supervision Directorate released the Annual Insurance Market Review in June 2010. The review provides detailed information of the condition and status of the insurance industry in Bahrain. The statutory report provides uniform financial reporting of insurance firms. The total gross premiums in Bahrain increased to BD 200 million which lead to an increase in the insurance sector contribution in the GDP to 2.59% in 2009.

Furthermore, the Insurance Supervision Directorate at the CBB has applied a range of measures to promote stability of the Insurance sector:

- The CBB requested company management to submit their year-end financial statements and attend a meeting at the CBB with their external auditors prior to the submission of the financial statements for approval to the Board of Directors.

- The CBB has continued to monitor closely the impact of the world financial crisis on the financial status of insurance firms. Meetings were conducted with some of the locally incorporated insurance companies to ascertain the impact of the financial crisis on the company’s investments and their measures to mitigate the impact. A monthly investment report is submitted to the CBB.

- The CBB has proceeded with publishing the portfolio transfer requests for ten offshore companies which have been licensed by CBB in Bahrain and transacted insurance activities in Kingdom of Saudi Arabia after obtaining the final license from Saudi Arabian Monetary Agency as per Article (66) of CBB and Financial Institutions Law No. (64) of 2006. The final approval for transferring the portfolio for eight of these companies has already been published.

The CBB along with the Bahrain Insurance Association (“BIA”) has worked to put in place a Motor Insurance Compensation Fund. This fund will compensate injured parties in cases where the owner of the vehicle that caused the accident did not possess a valid insurance policy ("uninsured vehicle"), where the identity of the vehicle that caused the accident or the owner and/or the driver of the vehicle were not identified ("hit & run"), and in the event of the insurer being insolvent. This initiative reflects the
industry’s commitment in fulfilling its social responsibility towards automobile victims in Bahrain.

In addition, the CBB has taken action to amend the license of some companies that has seriously violated CBB Laws and Regulations outlined in Insurance Rulebook (Volume 3). The CBB continued its effort to resolve complaints from the general public in respect of insurance products.

The CBB has implemented extensive disclosure requirements as outlined in its Public Disclosure Module of the Insurance Rulebook (Volume 3), where in their Annual Report all Bahraini insurance firms must provide timely information that facilitates market participants’ assessment of the firm. There are five broad categories of information, each of which must be addressed in clear terms and with appropriate details to help achieve a satisfactory level of transparency. These five categories are financial position, financial performance, corporate governance, compliance and risk management strategies and practices.

Financial Stability Directorate

During 2010, the Financial Stability Directorate (“FSD”) continued conducting macro prudential surveillance of the financial system to identify areas of potential concern and to 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 Financial Stability Report (semi-annual), the Economic Report (annual), Balance of Payments Report (annual), Monetary and Financial Trends (quarterly), internal Early Warning report (semi-annual) 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, Semi-annual Credit Card Receivables Survey, Coordinated Portfolio Investment (“CPIS”) Survey (annual), Worker’s Remittances Survey (as requested), Locational International Banking surveys (quarterly).

• 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 2010 were the following:

• Introducing a Sensitivity Test Report, an internal CBB document, produced semi-annually with the aim of identify and quantify any vulnerabilities of systemically important banks in Bahrain and measure the impact based on hypothetical shocks.

• Introducing The Financial Soundness Indicators (“FSIs”) Report, an internal document, produced semi-annually with the purpose of assessing the safety and soundness of the banking sector through the use of selected Financial Soundness Indicators.

• Introducing the Coordinated Portfolio Investment Report, a document that summarises trends in portfolio investments within a calendar year while highlighting trends in portfolio investments domestically and globally.
4. Other CBB Projects and Activities

New Licenses

Payment System (SSS & RTGS)

Currency Issue

CBB Training Programs

IT Projects

Participation in Conferences, Seminars, Meetings and Workshops
New Licenses

During 2010, the CBB licensed and registered a total of 14 new financial institutions and professional entities, which are listed below:

1- Canara Bank - Wholesale Bank (Branch)
2- Zurich Insurance Company - Insurance Firm (Branch)
3- ACE Insurance Broker W.L.L. - Insurance Broker
4- Horizon Insurance Consultancy Company W.L.L. - Insurance Consultant
5- SIO Assets Management Co. B.S.C. (c) - Investment Business Firm (Category 1)
6- Sarasin-Alpen (Bahrain) B.S.C. (c) - Investment Business Firm (Category 2)
7- Alpen Capital (Bahrain) - Investment Business Firm (Category 3)
8- Secure Cash Processing B.S.C. (c) - Ancillary Service Provider
9- Bahrain Share Registering Company W.L.L. – Registrar
10- BFX Clearing and Depository Corporation B.S.C. (c) - Clearing House and Central Depository License
11- BFX B.S.C. (c) - Exchange License
12- Bahrain Association of Banks - Registered Society
13- GCC Board Directors Institute (BDI) - Registered Professional Body
14- Dr. Suan Boon Tan - Registered Actuary

Bahrain continues to provide a stable environment with high standards of transparency and regulations. These factors have contributed to making it the preferred choice for many institutions as a hub to expand their activities in the region, regardless of the adverse international market conditions.

The introduction of the new regulation for the Capital Market was the basis for establishing a new Exchange and a new Clearing House & Central Depository that are regulated by the CBB. In addition, the CBB has registered a Society and a Professional Body as part of its new policy of registering such entities according to the CBB’s Law.

**Payment System (“SSS” & “RTGS”)**

Bank transfers through the Real Time Gross Settlement System (“RTGS”) numbered 350,787 in 2010, for a total amount of BD 42.9 billion broken down as follows:
• The volume of bank transfers among commercial banks through RTGS was 96,901 for a value of BD 35.4 billion.

• The volume of customer transfers through the RTGS numbered 253,886 for a value of BD 7.5 billion during 2010.

• Banking operations carried out though Securities Settlement System ("SSS") totalled 964 in 2010 for a value of BD 4.3 billion.

Cheque Clearing

The number of cheques cleared in 2010 was 3,112,889 with a total amount BD 4.4 billion. The daily average number of cheques cleared in 2010 was 12,592 and their average amount was BD 17.8 million.

ATM network (Benefit)

The number of withdrawals processing through the local ATM network system (Benefit) during 2010 was 5,043,752 with a total amount BD 469.6 million with a daily average of 13,818 transactions for BD 1.287 million.

Currency Issue

During 2010, major accomplishments of the Currency Issue Directorate included:

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

• Releasing a circular on 11th May 2010 to all retail banks in Bahrain with respect to withdrawals and deposits that were to take place through the RTGS from 1 June 2010 onwards. This circular requires all retail banks to have enough credit in their accounts at CBB to provide for their withdrawals, whereby their accounts will be directly debited. From 1 June 2010 onwards, withdrawals and deposits were subject to the RTGS system.

• On the occasion of Bahrain’s national day, the directorate issued a commemorative set of silver coins. The set consists of six silver coins
replicating those currently in circulation. Each set is offered for sale for BD 60.0

- In its efforts to increase public awareness of Bahraini dinar’s security features and phases of evolution, the directorate compiled a documentary explaining the security features of the fourth issue of Bahraini dinar. This documentary film is being shown at the Currency Museum.

The directorate continued the processes of counting, sorting, and direct destruction of worn-out currency, using the new counting and sorting machine. The amount of currency destroyed during 2010 totalled BD 33,790,560, spanning all Bahraini dinar issues. The directorate undertook the direct destruction of BD 27,011,560 (A process of sorting out fit banknotes from unfit banknotes that are not suitable for use by destroying unfit banknotes using a special online shredding machine and then a special incinerator to prevent environmental pollution) while indirect destruction handled a total of BD 6,779,000 (A process performed from time to time where old banknotes and banknotes of smaller denominations are destroyed using a special shredding machine under the supervision of CBB’s external auditor.)

Daily withdrawals and deposits during 2010 totalled BD 988,480,875 and BD 957,136,670 respectively. Currency in circulation, as at 31 December 2010, reached BD 437,755,265 Coins and banknotes constitute BD 13,403,355 and BD 424,351,910 respectively. New banknote put in circulation totalled BD 410,200,325 a ratio 96.665% of the total money in circulation, while old banknotes BD 14,151,585 a ratio of 3.335%.

**CBB Training Programs**

As in previous years, CBB has continued its emphasis on the development of its employees’ capabilities in a wide range of relevant disciplines. In 2010, a greater focus has been placed on sponsoring staff to attain professional qualifications and on the acquisition of specialised technical knowledge and skills in order to improve their performance.

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

- Sponsored 18 employees to acquire diverse professional qualifications in varied areas such as Finance, Accounting, Insurance, HR, etc.
• Arranged a specialised tailored training program on Risk Management to provide 84 employees with comprehensive grounding in market, credit, operational, and liquidity risks. The program was delivered in cooperation with GARP (Global Association for Risk Professionals).

• Provided skills and knowledge training to a total of 173 employees, including extensive use of the BIBF to provide training for 89 employees in areas covering banking and financial institution supervision, insurance, management, computer skills, etc.

• Enrolled over 120 CBB employees in FSI-Connect, a web based learning and information resource for financial sector supervisors worldwide, which provide a wide range of training tutorials in different specialised central banking areas, including key risk management topics, finance, financial instrument, insurance, payment and settlement, etc.

**IT Projects**

During the course of 2010, a number of projects were completed within the IT department. They included the following:

• **Enhancement and upgrade to the Accounting software:** the existing Accounting software was upgraded to the latest version. In addition, maintaining the accounting details via cost-centres was implemented to facilitate adequate budget reporting.

• **Preparation for replacing the treasury system:** the CBB has completed initial testing and a parallel run for the new treasury system that will replace the existing in-house developed system. The new system is expected to go-live during early 2011.

• **Integration of Currency Issue (Withdrawal/Deposit) with RTGS:** the CBB has integrated the existing system for Currency Issue with the Real Time Gross Settlement System. The main objectives being as follows:
  - Ensure that each commercial bank is able to withdraw Bahraini Dinars only when it has sufficient funds in its account with the CBB.
  - Provide the commercial banks with immediate liquidity for other real time payments, when they deposit Bahraini Dinars with the CBB.
This project was implemented successfully by the IT Directorate staff.

- **Business Continuity Management:** the CBB has initiated a project to update the existing Business Continuity Management framework and to align it with international best practices.

- **Infrastructure Security:** the ITD has completed a project to have a complete review of the IT infrastructure security by external consultants and to replace/modify components of the infrastructure in order to enhance the existing IT Security in keeping with technological developments.

- **IT Infrastructure Management:** the ITD has implemented a system to provide proactive monitoring of IT infrastructure, to detect problems and bottlenecks. This will ensure prompt resolution of possible issues. As part of the project a standards-based enterprise Help Desk has also been implemented.

The ITD is now able to proactively collect, analyze and summarise technical data collected from networks and systems to enable it to identify emerging problems.

ITIL standards for proactive management of service outages & incidents and centralised end-user support centre have been put in place.

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

During 2010, the CBB supported a total of 60 conferences and functions. They ranged from annual specialised conferences to press conferences organised in Bahrain.

The conferences that the CBB supports annually are the World Islamic Banking Conference (“WIBC”), the World Islamic Funds & Capital Markets Conference (“WIFCMC”), the AAOIFI World Bank Conference, the Annual AAOIFI Sharia Conference and the Middle East Insurance Forum.

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

- The WIBC has now been taking place for 17 years. It has grown steadily more successful since it was brought to Bahrain in 1995 following 2 years in Dubai. This success continued in 2010, and
although the effects of the Global Financial Crisis continued to be felt, the event attracted more than 1,500 delegates from nearly 50 countries. This is an indication of the importance of the conference and the great value that it gives the participants and audience.

- The 6th Middle East Insurance Forum was held in the presence of more than 450 insurance industry participants early in 2010. The participants discussed the theme ‘Back To Basics’, and debated issues with their peers to review the future of the insurance industry in the region. They also discussed the role of regulators in strengthening the insurance sector.

- Bahrain hosted the Global Seminar and Tri-Annual meeting of the International Association of Insurance Supervisors (“IAIS”). The event was a platform for observers and members of the IAIS to discuss topics of importance for the global insurance industry. The organisation of this event was in accordance with very specific IAIS guidelines and standards. The ECU met the expectations of the IAIS organizing committee successfully.

The CBB was honoured at the Middle East Insurance Awards 2010 organised by Insurex which took place on 7th April 2010 in Dubai, UAE. The CBB received an award for "The Best Regulator Initiative of the Year". The award was in relation to Resolution (11) introduced by CBB and implemented in July 2009, which has unveiled new guidelines that mandate minimum qualifications requirements 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 will grow substantially and the buying public can be assured they are dealing with well trained and competent insurance representatives.

In addition, as a result of the continued development of the rules, regulations and reporting requirements of Takaful regulations, the CBB has won the Takaful award as “Best Financial Centre in Takaful Industry” for the third year, in July 2010.

The CBB also arranged a number of delegation visits from a number of countries, creating opportunities for expanding banking services from Bahrain internationally. Some of these delegations held one day forums to introduce participants to opportunities that exist in several overseas financial centres. Among the Heads of the delegations were the Crown Prince of Luxembourg, the Australian Ambassador and the Ambassador of Singapore.
From an educational perspective, the ECU continues to organise educational visits to the CBB from reputable educational institutions and facilities, both from the regional and internationally. These included the Gulf University of Syria and a group of post graduate students from the University of Darden which come to CBB every year. This visit has developed to be part of their annual educational program.

In conjunction with the Bahrain Institute for Banking and Financial Studies the CBB hosts many specialised seminars and technical workshops aimed at expanding knowledge of global developments in the fields of banking and finance which are organised by the ECU in partnership with international bodies such as the Union of Arab Banks. By working in conjunction with the BIBF the CBB assists in familiarising participants with the role of the Institute and the courses and the range of services they offer.
5. FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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 2010

Notes to the balance sheet and profit and loss account and appropriation for the year ended 31 December 2010
AUDITORS REPORT TO 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 2010, and related profit and loss account and appropriation for the year then ended.

Management responsibility

Management is responsible for the preparation of the balance sheet and the related profit and loss account and appropriation in accordance with the basis of accounting described in Note 2 and Royal Decree No. 64 of 2006, and for such internal control as management determines is necessary to enable the preparation of balance sheet and the related profit and loss account and appropriation that are free from material misstatement, whether due to fraud or error.

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 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 considers 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 are prepared, in all material respects, in accordance with the accounting policies described 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.

15 March 2011
Manama, Kingdom of Bahrain
### CENTRAL BANK OF BAHRAIN

#### BALANCE SHEET

(Expressed in thousands of Bahraini Dinars)

As at 31 December

<table>
<thead>
<tr>
<th>Note</th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2010</td>
<td>2009</td>
</tr>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold</td>
<td>2,500</td>
<td>2,500</td>
</tr>
<tr>
<td>Foreign reserves</td>
<td>2,267,669</td>
<td>1,858,817</td>
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<tr>
<td>Due from Ministry of Finance</td>
<td>105,298</td>
<td>177,780</td>
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<tr>
<td>Cash, due from Bahraini banks and treasury bills</td>
<td>1,319</td>
<td>9,207</td>
</tr>
<tr>
<td>Other assets</td>
<td>8,183</td>
<td>6,572</td>
</tr>
<tr>
<td>Equipment</td>
<td>1,780</td>
<td>2,099</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>2,386,749</td>
<td>2,056,975</td>
</tr>
<tr>
<td><strong>LIABILITIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes and coins in circulation</td>
<td>436,985</td>
<td>405,626</td>
</tr>
<tr>
<td>Bahraini Dinar deposits</td>
<td>1,289,793</td>
<td>1,033,682</td>
</tr>
<tr>
<td>Other deposits</td>
<td>156,601</td>
<td>122,078</td>
</tr>
<tr>
<td>Payable to Kingdom of Bahrain</td>
<td>5,500</td>
<td>8,500</td>
</tr>
<tr>
<td>Provision for currency withdrawn</td>
<td>6,271</td>
<td>6,286</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>4,921</td>
<td>3,830</td>
</tr>
<tr>
<td>Due to other central banks</td>
<td>1,660</td>
<td>414</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>1,901,731</td>
<td>1,580,416</td>
</tr>
<tr>
<td><strong>Capital funds</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td>200,000</td>
<td>200,000</td>
</tr>
<tr>
<td>General reserve</td>
<td>188,216</td>
<td>182,716</td>
</tr>
<tr>
<td>Contingency reserve</td>
<td>80,915</td>
<td>77,015</td>
</tr>
<tr>
<td>Revaluation reserve</td>
<td>15,887</td>
<td>16,828</td>
</tr>
<tr>
<td><strong>Total capital funds</strong></td>
<td>485,018</td>
<td>476,559</td>
</tr>
<tr>
<td><strong>Total liabilities and capital funds</strong></td>
<td>2,386,749</td>
<td>2,056,975</td>
</tr>
</tbody>
</table>

Qassim Fakhro  
Chairman

Rasheed Al Maraj  
Governor
CENTRAL BANK OF BAHRAIN
PROFIT AND LOSS ACCOUNT AND APPROPRIATION

For the year ended 31 December 2010
(Expressed in thousands of Bahraini Dinars)

<table>
<thead>
<tr>
<th>Note</th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income</td>
<td>25,387</td>
<td>28,108</td>
</tr>
<tr>
<td>Interest expense</td>
<td>(5,350)</td>
<td>(5,065)</td>
</tr>
<tr>
<td><strong>Net interest income</strong></td>
<td>20,037</td>
<td>23,043</td>
</tr>
<tr>
<td>Registration and licensing fees</td>
<td>5,280</td>
<td>5,604</td>
</tr>
<tr>
<td>Exchange gain on sale of US dollars</td>
<td>4,766</td>
<td>3,836</td>
</tr>
<tr>
<td>Net realised investment gain</td>
<td>5,031</td>
<td>8,349</td>
</tr>
<tr>
<td>Other income</td>
<td>856</td>
<td>624</td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td>35,970</td>
<td>41,456</td>
</tr>
<tr>
<td><strong>Expenditures</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff costs</td>
<td>(10,257)</td>
<td>(9,809)</td>
</tr>
<tr>
<td>General and administration expenses</td>
<td>(6,326)</td>
<td>(6,018)</td>
</tr>
<tr>
<td>Managed funds and advisory fees</td>
<td>(966)</td>
<td>(931)</td>
</tr>
<tr>
<td>Notes issue expenses</td>
<td>(3,004)</td>
<td>(2,083)</td>
</tr>
<tr>
<td><strong>Total expenditures</strong></td>
<td>(20,553)</td>
<td>(18,841)</td>
</tr>
<tr>
<td><strong>Profit for the year before provision</strong></td>
<td>15,417</td>
<td>22,615</td>
</tr>
<tr>
<td>Provision for impairment</td>
<td>4</td>
<td>(517)</td>
</tr>
<tr>
<td><strong>Profit for the year</strong></td>
<td>14,900</td>
<td>22,615</td>
</tr>
<tr>
<td>Transfer to contingency reserve</td>
<td>11</td>
<td>(3,900)</td>
</tr>
<tr>
<td>Transfer to general reserve</td>
<td>10</td>
<td>(5,500)</td>
</tr>
<tr>
<td><strong>Balance payable to Kingdom of Bahrain</strong></td>
<td>5,500</td>
<td>8,500</td>
</tr>
</tbody>
</table>
Notes to the balance sheet and profit and loss account and appropriation

For the year ended 31 December 2010
(Expressed in thousands of Bahraini Dinars)

1. Activity

The Central Bank of Bahrain (the Central Bank or CBB) is a public corporate entity established by the Central Bank of Bahrain and Financial Institutions Law 2006 on 7th September 2006. It operates under the Royal Decree No. (64) of 2006 issued by His Majesty King Hamad bin Isa Al Khalifa King of the Kingdom of Bahrain (the Royal Decree).

The CBB is responsible for maintaining the monetary and financial stability in the Kingdom of Bahrain.

The CBB implements the Kingdom’s monetary and foreign exchange rate policies, manages the government's reserves and debt issuance, issues the national currency and oversees the country's payments and settlement systems. It is also the sole regulator of Bahrain’s financial sector, covering the full range of banking, insurance, investment business and capital markets activities. 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 2010 were authorised for issue in accordance with the approval of the Chairman of the Board of Directors and the Governor on 15 March 2011.

2. Significant accounting policies

The balance sheet and related profit and loss and appropriation have been prepared in accordance with the following significant accounting policies. These policies have been consistently applied to all the years presented, unless otherwise stated.
2.1 Accounting convention

The balance sheet and related profit and loss account and appropriation are prepared in accordance with the Royal Decree. The balance sheet and related profit and loss account and appropriation are prepared under the historical cost convention on the accrual basis of accounting.

2.2 Gold

Gold is carried at cost.

2.3 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.

2.4 Cash, due from Bahraini banks and treasury bills

These balances comprise cash in hand, deposits held with banks that are denominated in Bahraini Dinars and short-term highly liquid treasury bills with original maturities of three months or less.

2.5 Equipment

Buildings comprise mainly offices. All property and equipment used by the Bank is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the profit and loss account and appropriation.
2.6  Notes and coins in circulation

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

2.7  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/ (losses) resulting from the revaluation of the Central Bank’s assets or liabilities in 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”.

Upon disposal of the assets denominated in foreign currencies, the related gain or loss on the foreign exchange element of the disposed asset is recognised in the profit and loss account and appropriation.

Forward contracts are revalued for foreign exchange movements on a monthly basis. Gains or losses on a monthly basis are recorded in the revaluation reserve for unsettled forward contracts. Such gains or losses are reversed in the subsequent month. Gains and losses that arise upon settlement of futures contracts are calculated by comparing the foreign exchange rate at the time of purchase with the foreign exchange rate at the time of settlement and the resulting gains or losses are recorded in the Revaluation Reserve.
2.8 Provision for impairment

The Central Bank assesses at each balance sheet date whether there is objective evidence that an investment is impaired. Investments in Bonds are assessed for impairment on a portfolio basis. Factors considered in determining objective evidence of impairment include comparison of total cost with fair market value of each portfolio to determine if there is significant and other than temporary decline in the fair market value of the portfolio.

2.9 Revenue recognition

Interest income

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

Registration and licensing fees

Registration and licensing fees are accounted for based on the calendar year they relate to and are recognised on an accrual basis.

Net realised investment gains and losses

Net realized investment gains and losses arising from the sale of assets are recognised when such assets are disposed of.

2.10 Interest expense

Interest expense on the amounts due from Bahraini Dinar and other deposits is recognised on an accrual basis using the straight line method in the profit and loss account and appropriation.

2.11 Notes issue expenses

Expenses related to issuing notes are recognised when incurred.
3. Excess of authorised backing over currency in circulation

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</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</td>
<td>2,267,669</td>
<td>1,858,817</td>
</tr>
<tr>
<td></td>
<td>2,270,169</td>
<td>1,861,317</td>
</tr>
<tr>
<td>Notes and coins in</td>
<td>(436,985)</td>
<td>(405,626)</td>
</tr>
<tr>
<td>circulation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excess of authorised</td>
<td>1,833,184</td>
<td>1,455,691</td>
</tr>
<tr>
<td>backing over currency</td>
<td></td>
<td></td>
</tr>
<tr>
<td>in circulation</td>
<td></td>
<td></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 2010 was BD 66,077 thousand (2009: BD 62,563 thousand).

4. Foreign reserves

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds portfolios</td>
<td>627,454</td>
<td>600,374</td>
</tr>
<tr>
<td>Bank deposits</td>
<td>1,647,307</td>
<td>1,265,018</td>
</tr>
<tr>
<td></td>
<td>2,274,761</td>
<td>1,865,392</td>
</tr>
<tr>
<td>Less: provision for</td>
<td>(7,092)</td>
<td>(6,575)</td>
</tr>
<tr>
<td>impairment</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2,267,669</td>
<td>1,858,817</td>
</tr>
</tbody>
</table>

All bonds are quoted in active markets with 99% being of investment grade BBB or higher (2009: 97%). All deposits and 91% of bonds are in US dollars (2009: 90%). For other foreign currencies, mainly Euros and Sterling, these are 98% hedged into US dollars. The bond portfolios include BD 445 thousand net unrealised losses on non-US denominated bonds and related forward foreign exchange contracts used to hedge such bonds (2009: gain of BD 2,938 thousand).

The market value of the bond portfolios at 31 December 2010 was BD 639,060 thousand (2009: BD 578,622 thousand).
The Central Bank has recognised an impairment provision amounting to BD 517 thousand for the year ended 31 December 2010 (2009: nil).

5. **Due from Ministry of Finance**

The amount represents the net due from 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>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>621</td>
<td>8,609</td>
</tr>
<tr>
<td>Due from Bahraini banks</td>
<td>698</td>
<td>578</td>
</tr>
<tr>
<td>Treasury bills issued by the Government of Bahrain</td>
<td>-</td>
<td>20</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,319</strong></td>
<td><strong>9,207</strong></td>
</tr>
</tbody>
</table>

7. **Other assets**

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest receivable</td>
<td>2,225</td>
<td>1,379</td>
</tr>
<tr>
<td>Staff loans</td>
<td>4,035</td>
<td>3,348</td>
</tr>
<tr>
<td>Others</td>
<td>1,923</td>
<td>1,845</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8,183</strong></td>
<td><strong>6,572</strong></td>
</tr>
</tbody>
</table>

8. **Other liabilities**

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrued expenses</td>
<td>167</td>
<td>172</td>
</tr>
<tr>
<td>Payables</td>
<td>4,754</td>
<td>3,658</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4,921</strong></td>
<td><strong>3,830</strong></td>
</tr>
</tbody>
</table>
9. Capital

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</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>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at beginning of the year</td>
<td>182,716</td>
<td>174,216</td>
</tr>
<tr>
<td>Transfer from profit and loss account and appropriation</td>
<td>5,500</td>
<td>8,500</td>
</tr>
<tr>
<td>Balance at end of the year</td>
<td>188,216</td>
<td>182,716</td>
</tr>
</tbody>
</table>

In accordance with Article 12 of the Royal Decree, the Central Bank maintains a 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>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at beginning of the year</td>
<td>77,015</td>
<td>71,400</td>
</tr>
<tr>
<td>Transfer during the year</td>
<td>3,900</td>
<td>5,615</td>
</tr>
<tr>
<td>Balance at end of the year</td>
<td>80,915</td>
<td>77,015</td>
</tr>
</tbody>
</table>
The Board has approved a transfer of BD 3,900 thousand of the current year’s net profit to the contingency reserve.

12. Revaluation reserve

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at beginning of the year</td>
<td>16,828</td>
<td>18,701</td>
</tr>
<tr>
<td>Movement during the year</td>
<td>(941)</td>
<td>(1,873)</td>
</tr>
<tr>
<td>Balance at end of the year</td>
<td>15,887</td>
<td>16,828</td>
</tr>
</tbody>
</table>

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

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 2010 there were no outstanding contingent liabilities or commitments (2009: Nil).

14. Comparatives

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