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1. Monetary Policy Developments

Overview

Monetary Policy Management

Domestic Interest Rates

Public Debt Issuance
Overview

During 2011, 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 2011. 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 2011, the reserve percentage has not change from 5%.

Money Market Forum

During 2011, 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 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 representatives of conventional and Islamic retail banks operating in Bahrain, in addition to members of the CBB’s MPC.
Foreign Exchange Swap Facility

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 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 prevent banks from making risk-free arbitrage transactions.

Domestic Interest Rates

Key Policy Interest Rates

During 2011, there was no change in the facilities interest rates provided by the Central Bank of Bahrain to retails banks, where the one-day BD Deposit rate remained at 0.25% and 0.5% for the one week maturity. 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 Deposit.

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-2011, the 3 month BHIBOR rate was 1.26%, compared to 1.24% at end-2010. The 6 month BHIBOR rate was 1.57% at end-2011, compared to 1.53% at end-2010.

Loan and Deposit Rates

At the end of 2011, the weighted average BD time deposit rate (3-12 months) stood at 1.11%, compared to 1.07% at the end of 2010. The weighted average savings rate decreased slightly from 0.25% to 0.24%. The weighted average interest rate on business loans decreased from 7.30% at end-2010 to 5.58% at...
end-2011, and the interest rate on personal loans also decreased from 7.10% to 6.28% for the same period.

**Public Debt Issuance**

In accordance with the CBB Law, the CBB issues, on behalf of the Government of Bahrain, short and long-term debt instruments, including Treasury Bills, Sukuk AlSalam and Ijarah Sukuk. The issuance of all government debt securities is executed in coordination with the Ministry of Finance (MOF).

During 2011, the CBB issued conventional 3-month treasury bills, denominated in Bahraini dinars, on a weekly basis, with an issue amount of BHD 25 million. Under a request from the MOF, on June 8th, 2011, the issue amount was changed from BHD 25 million to BHD 35 million. Six (6)-month Treasury Bills were also issued, on a monthly basis, with an issue amount of BHD 20 million. This amount was increased from 20 million to 30 million, effective June 12th, 2011. In addition, the CBB issued 12-month Treasury Bills on a quarterly basis, with an issue amount of BHD 50 million. The issue amount was changed from BHD 50 million to BHD 100 million on June 9th, 2011.

During 2011, the CBB issued Government Development Bonds in local currency (BHD) and (USD) currency for different maturities between (2 to 10 years).

The CBB also issued, on a monthly basis, three-month AlSalam Sukuk (BHD) where the issue amount was increased from BHD 12 million to BHD 18 million, from June 29th, 2011.

In addition, the CBB issued, on a monthly basis, six-month Ijara Sukuk for BHD 10 million, raised to BHD 20 million on June 23rd, 2011.

The CBB also issued long term Ijara Sukuk of different issue amounts and different maturities, under advice of the MOF. On 7th April, 2011, there was a local issue for BHD 200 million with a 5 year maturity and a fixed return of 5.5%. On 22nd November 2011, the CBB issued a 7 year, International Ijara Sukuk for USD 750 million with a fixed return of 6.273%.

The CBB implemented the first Islamic Sukuk Liquidity Instrument (ISLI), which is a CBB Sharia Board compliant sell/buyback of Ijarah Sukuk (issued in local currency) held by the CBB. The processing of this is in the SSS System and the settlement takes place in the RTGS System. This instrument has been renewed four times during the year of 2011.
Chapter 2: Banking Developments

The Consolidated Balance Sheet of the Banking System

Retail Banks

Wholesale Banks
The Consolidated Balance Sheet of the Banking System

Total consolidated balance sheet for the banking system (retail and wholesale banks) decreased modestly to USD 197.1 billion by the end of 2011, compared to USD 222.2 billion at the end of 2010, a decrease of 11.3%. Wholesale banks represented 65.8% of total assets, whilst retail banks accounted for 34.2%.

Domestic banking assets amounted to USD 47.4 billion at the end of 2011 compared to USD 45.8 billion at the end of 2010, representing an increase of USD 1.6 billion (3.5%). Foreign assets amounted to USD 149.7 billion, compared to USD 176.4 billion at the end of 2010, a decrease of USD 26.7 billion (15.1%).

Domestic liabilities decreased to USD 50.2 billion at the end of 2011 compared to USD 50.8 billion at the end of 2010, a decrease of USD 0.6 billion (1.2%). Total foreign liabilities decreased by USD 24.5 billion (14.3%) to reach USD 146.9 billion against USD 171.4 billion at the end of 2010.

Retail Banks

The consolidated balance sheet of retail banks increased by 2.8% to BD 25.3 billion at the end of 2011, compared to BD 24.6 billion at the end of 2010.

Total domestic assets grew by BD 0.9 billion (6.9%) to reach BD 14.0 billion, with claims on private non-banks increasing by BD 1.0 billion (15.4%) and claims on general government securities growing by BD 0.5 billion (35.7%).

Foreign assets recorded a decrease of BD 0.2 billion (1.7%), reaching a total of BD 11.3 billion at the end of 2011 compared to BD 11.5 billion at the end of 2010. Claims on foreign non-banks increased by BD 0.2 billion (3.7%) from BD 5.4 billion at the end of 2010 to BD 5.6 billion at the end of 2011, while claims on foreign banks decreased by BD 0.4 billion (6.6%), reaching a total of BD 5.7 billion at the end of 2011.

Total domestic liabilities of retail banks increased by BD 0.7 billion (5.3%) from BD 13.3 billion at the end of 2010 to BD 14.0 billion at the end of 2011. This was due to an increase in liabilities to private non-banks by BD 0.3 billion (4.1%) and liabilities to general government by BD 0.3 billion (18.8%). Capital and reserve also increased by BD 0.1 billion (5.6%).

1 This includes conventional and Islamic retail banks.
Total foreign liabilities remained unchanged at BD 11.3 billion at the end of 2011. Liabilities to banks decreased by BD 1.2 billion (17.4%) while liabilities to non-banks increased by BD 1.2 billion (27.3%).

**Loans and Credit Facilities**

Outstanding loans and credit facilities of retail banks stood at BD 6.4 billion at the end of 2011, a 12.3% increase compared to the BD 5.7 billion at the end of 2010. The business sector accounted for 63.0% of total loans and credit facilities, while individuals and the government sector represented 33.5% and 3.5% respectively.

**Deposits**

Retail banks’ total domestic deposits increased to BD 9.4 billion at the end of 2011 compared to BD 9.1 billion at the end of 2010, an increase of BD 0.3 billion (3.3%). This was due to higher private sector deposits which increased by BD 0.2 billion (2.7%) and general government deposits which increased by BD 0.2 billion (12.5%).

Domestic deposits in Bahraini Dinar increased by BD 0.2 billion (2.8%) to BD 7.3 billion at the end of 2011. Domestic foreign currency deposits raised by 10.5% or BD 0.2 billion to reach BD 2.1 billion. Bahraini Dinar deposits and foreign currency deposits constituted 77.7% and 22.3% of total domestic 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 17.8%, while Asia accounted for 9.5%, Western Europe accounted for 7.5%, North and South America for 5.5%, and other Arab countries for 2.8%.

In terms of currency, the share of US dollar denominated assets was 43.9%, while the GCC currencies (excluding Bahraini dinar) accounted for 5.9% of total assets. The Euro represented 4.0% of total assets.
Wholesale Banks\textsuperscript{2,3}

The consolidated balance sheet of wholesale banks fell by USD 27.0 billion or 17.2% to USD 129.7 billion at the end of 2011, compared with USD 156.7 billion at the end of 2010.

Total domestic assets declined to USD 10.1 billion at 2011, compared with USD 11.0 billion at the end of 2010.

Foreign assets decreased by USD 26.1 billion (17.9%) to USD 119.6 billion at the end of 2011. This was due to decreases in claims on head office and affiliates by USD 9.4 billion (24.2%), in claims on banks by USD 7.8 billion (37.1%) and in claims on non-banks by USD 9.5 billion (17.2%).

Total domestic liabilities of wholesale banks fell by USD 2.6 billion (16.9%) to USD 12.8 billion at the end of 2011 compared with USD 15.4 billion at the end of 2010.

Foreign liabilities decreased by USD 24.4 billion (17.3%) to reach USD 116.9 billion at the end of 2011, compared with USD 141.3 billion at the end of 2010. This decrease was mainly due to a drop in liabilities to non-banks by USD 12.6 billion (39.0%) and to banks by USD 7.9 billion (19.0%), while liabilities to head office and affiliates decreased by USD 4.2 billion (8.9%).

Geographical and Currency Distribution of Assets

The share of total assets accounted for by the GCC (excluding Bahrain) reached a total of 34.6%, while Western Europe accounted for 36.9%, North and South America for 12.1%, Asia for 4.2%, and other Arab countries for 3.6%.

As for currency, the share of GCC currencies (excluding Bahraini dinar) of total assets was 8.6% with the dollar accounting for 71.1% of total assets and the Euro comprising 9.8% of total assets.

\textsuperscript{2} This includes conventional and Islamic wholesale banks.
\textsuperscript{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 2011 to strengthen regulatory policies and to develop appropriate prudential regulations, in order to maintain financial stability and market integrity.

Updates to CBB Rulebook

Credit Risk Management Module

- New rules have been released by the CBB in January 2011 which are considered amendments to the existing large exposures rules. The new rules define an “underwriting exposure” along with introducing new rules with regards to temporary exposures arising from banks’ investment business with the intention to securitize assets or place them with investors.

- In addition, the existing limits and rules on exposures to connected parties for both Conventional and Islamic banks have been aligned and made more stringent.

- A new directive was issued by the CBB in January 2011 which set out limits for approval’s thresholds in respect of any investment in the capital instruments of another entity which represents 10% or more of the locally incorporated bank’s capital base or is equivalent to or more than 20% of the capital instruments of the concerned entity. The new Directives and approval thresholds conform to the requirements of Basel Core Principle 5 and are required as key components of an effective banking supervision framework.

Business & Market Conduct Module

- The CBB issued new directives in October 2011 on minimum requirements for customer complaints handling procedures to be followed by all CBB’s licensees. The CBB has taken this step to ensure adequate customer protection in accordance with Article 3 of the Central Bank of Bahrain and Financial Institutions Law of 2006, which provides for the protection of depositors and customers of financial institutions and enhancing the confidence in the position of the Kingdom of Bahrain as an international financial centre. The proposed directive aims at promoting fairness, honesty
and professionalism among those who provide financial products and services, ensuring that the customer complaints handling arrangements are working in an efficient and effective manner. The customer complaints handling procedures should cover all regulated services provided by the CBB’s licensees.

- New requirements have been put in place in October 2011 for all retail banks and financing companies making it mandatory for all to provide transaction advice service through the SMS (for free) for all types of local & international financial transactions (e.g. POS, ATM, Internet, etc) on credit and debit cards no later than 31st March 2012.

**Operational Risk Management Module**

In view of the increased usage of internet banking as well as the concerns about its security, and in order to reemphasize the importance for all retail banks and financing companies in keeping their systems and information as secure as possible, the CBB has issued a new directive in October 2011 requiring all retail banks and financing companies that provide internet banking services, to regularly test their systems against security breaches and verify the robustness of the security controls in place at least twice in a year. These tests may be conducted by security professionals, such as “Ethical Hackers” that provide penetration testing services and accordingly, provide vulnerability assessment of the system.

**Capital Adequacy and Public Disclosures Modules**

A consultation paper was issued in September 2011 to implement the changes to Basel II framework. These changes included amendments to the IRB and standardised approaches for securitisations and re-securitisations, changes to the standardised and internal models approaches to market risk capital charges and methodology and a new capital charge for incremental risk in the trading book. The papers also contained new disclosure requirements, stress testing guidance and some other minor adjustments to the market risk framework. The final rules will be incorporated as of January 2012.
**Corporate Governance**

- The first update in January 2011 included a major change to comply with the requirements of the Code of Corporate Governance issued by the Ministry of Industry and Commerce. This was followed by two other updates in April and October 2011.
- In an effort to enhance corporate governance within the area of Investment Business, and to encourage Directors to contribute actively and fulfil their responsibilities, a consultation paper on proposed rules on attendance of Directors at the Board of Directors meetings was issued in February 2011. The proposal is aimed at prohibiting proxies for directors at such meetings and requiring individual board members to attend at least 75% of all board meetings in a given year. The new rules were issued in their final form as part of the April 2011 update to Volume 4.

**Collective Investment Undertaking (CIU) Module**

Financial Institutions Supervision Directorate (FISD) completed the process of updating the CIU Module, and released it for industry consultation during the last quarter of 2011. The major aim of the update was to enhance the regulatory framework pertaining to CIUs, taking into consideration the current developments in the local and regional markets and the needs of the industry participants, while observing the international best practices.

The updated version of the CIU Module re-organizes and expands the current regulation to include new rules pertaining to Corporate Governance, the responsibilities of relevant persons towards CIUs and their participants, Bahrain Real Estate Investment Trusts (B-REITs) and Private Investment Undertakings (PIUs).

In brief, the Corporate Governance Chapter lays down a set of rules that must be complied with in order to maintain an adequate framework for the governance and operation of the CIU to ensure that the CIU is governed effectively and in the best interests of CIU’s participants.

The B-REITs chapter governs the operations of Bahrain domiciled CIUs investing in income generating real estate properties, both locally and abroad, either directly or indirectly.

Lastly, the PIU chapter was introduced to facilitate certain types of private investments of high net worth individuals and institutional investors.
Money Changers

Also within the area of Money Changers, and in line with best practice and market conditions, changes were gradually introduced to the licensing conditions for licensees authorized after January 2011, as follows:

Firstly, to have at least one controller being a regulated financial institution owning or controlling 20% or more of the voting capital.

Secondly, to maintain a minimum paid up capital of BD500,000, while retaining the requirement for existing licensees at the current levels of BD200,000.

Such requirements were introduced through updates to the specific Modules, issued in January, April and July of 2011.

Administrators

Upon realizing the necessity of introducing a new type of license for administrators of financial instruments and fund registrars, the CBB developed such a license and in February of 2011, a consultation introducing five specific modules pertaining to Administrator licensees was introduced. The modules were finalized and issued in May 2011.

Prior to the introduction of the Administrator license, the same activities have been conducted by registered administrators and ancillary service provider licensees. Accordingly towards the third quarter of 2011, the FISD undertook the task of gradually changing the status of the existing service providers to Administrator Licensees.

New Licensing Regulation

The CBB has issued a new Resolution no. (43) of the year 2011 on the conditions of granting a license for the provision of regulated services in September 2011, following a consultation process with the financial sector and the general public. The CBB has taken this step in accordance with Article 44 of the Central Bank and Financial Institutions Law, Decree No. 64 to make the procedures more effective, clear and to identify information and documents required to be submitted along with the application for a license. The new Regulation requires any application for a bank license to have at least one
shareholder which is a regulated financial institution holding at least 20% of the applicant’s shares.

**Basel III adoption**

Within the CBB’s efforts to assess the readiness of banks in Bahrain in complying with Basel III requirements, the CBB has conducted two evaluations to study the impact of the implementation of Basel 3 on the banks in Bahrain in 2010 and 2011 and a consultation paper was issued in August 2011 accordingly. The CBB has studied banks’ comments. A working group will be formed with the banks to discuss and study the main issues in order to develop an implementation plan for Basel 3.

**Corporate Governance**

The CBB has incorporated the Corporate Governance Principles issued by the Ministry of Industry and Commerce in the Rulebook Volumes 1 & 2 for Conventional & Islamic Banks respectively in October 2010, in Rulebook Volumes 3 & 4 for Insurance & Investment companies in January 2011 and for capital markets in April 2011. The purpose of this Code is to establish best-practice corporate governance principles in the Kingdom of Bahrain, and to provide protection for investors and other company stakeholders.

The new High Level Controls Module incorporates the nine fundamental Principles of corporate governance stipulated in the code for financial institutions, their boards and management to follow. As the Islamic finance is considered an increasingly important market segment, one of the principles of the code is targeting Islamic institutions in relation to the implementation of Islamic Shari'a principles. These principles are considered the minimum requirement for banks to comply with; however banks are always encouraged to adopt higher standards of corporate governance.

The new HC Module includes more detailed requirements on the role of the board and their committees in establishing clear and efficient management structure which aims at achieving optimum assurance of rigorous controls of critical functions such as financial audit and internal control. One of the fundamental new requirements played by the board is their critical role in disclosing the financial institution’s Corporate Governance to the public and to its shareholders.
Proposed Regulation

- The CBB has issued three consecutive consultation papers on the draft regulation on the “Procedure for Processing Applications of Banks to Transfer Financial Services Business in the Kingdom of Bahrain”. This proposed regulation requires that any CBB licensee must not transfer any or part of its business which includes a regulated service constituting over 5% of its total assets or total liabilities (or such other amount as the CBB shall specify from time to time) unless the prior approval of the CBB is obtained. The regulation will be issued in its final form in the near future based on the outcome of the consultations and meeting held with banks.

- The CBB issued a consultation document in April 2011 dealing with a proposed regulation under Article 42 of the Central Bank of Bahrain and Financial Institutions Law of 2006 (‘CBB Law’) prohibiting or restricting the offering, marketing and promotion of Financial Services in Bahrain by any unlicensed person unless a permission to do so is obtained from the CBB or the activities come within the terms of an exemption granted by the CBB. According to the comments received and discussions held between the CBB and the financial institutions, the draft regulation will be issued in its final form in the Official Gazette in the near future.

Under Consultation

- As part of CBB’s continuous initiatives to strengthen the regulatory framework for the Islamic finance industry, a new consultation paper has been issued in October 2011 proposing new requirements regarding the issuance of restricted Shari’a profit sharing investment accounts (RIAs). The requirement will prohibit the issuance and opening of any new profit sharing investment arrangements in the form of ‘restricted investment accounts’ where the bank acts as mudarib or trustee. Any new restricted shari’a profit sharing investment relationships may only be opened in the form of units or shares in a collective investment undertaking and will be subject to the rules and guidance contained in Module CIU (Volume 6) and relevant sections of Module BC Chapter 9 (Volume 2).

- In an attempt to achieve the CBB’s objective of protecting the interest of the customers of financial institutions and to enhance the Kingdom’s reputation as international financial centre, a consultation paper was issued in December 2011 on a proposed directive on the public disclosure
requirements regarding credit facilities as well as those disclosures that must be made by credit institutions to individual borrower(s), whether these be during the course of the initial negotiation of the credit facility or during the term of the facility being offered. It also outlines by what means such disclosures should be made. The purpose of this directive is to ensure that customers of retail banks and financing companies are fully informed of the interest/profit rates and other fees charged in respect of all credit facilities. Credit facilities include all financing facilities (consumer and housing financing) as well as credit cards, overdraft, revolving and other types of credit offered to retail customers.

Limiting Bahrain Credit Reference Bureau (BCRB) Credit Information Retention

The Central Bank of Bahrain, with the objective of protecting the interests of customers has issued a Directive in February 2011 which requires the retention of credit information of insolvent individuals for reasons beyond their control such as for example, loss of job and who settled their obligations according to prior arrangement with the bank at a later date, for a maximum of five years from the date of settlement.

Strengthening the Protection of both Deposits and Unrestricted Investment Accounts

To promote confidence in the banking sector, a new resolution with respect to promulgating a regulation “Protecting Deposits and Unrestricted Investment Accounts” has been issued in January 2011 and accordingly a Deposit and Unrestricted Investment Accounts Protection Board (the Board) has been established.

The CBB has taken this initiative considering the need to develop the current post-funded scheme and replace it with a new prefunded scheme to bring deposit protection more closely in line with international best practices, as most of those schemes have turned to a prefunded schemes where funds being collected and paid in advance to compensate depositors.

The new scheme overcome the disadvantages of the previous scheme, most importantly to have funds available in its capacity instead of depending on commitments difficult to collect in a short time period without leaving an adverse effect on the banking and financial system. The new scheme requires the establishment of two separate funds (Conventional fund and Islamic fund) which shall be maintained and administered by one board. The funds
will be accumulated separately in advance based on regular contributions by the member banks. The two funds cover eligible accounts which include all types of deposits in conventional and Islamic banks in addition to the unrestricted investment accounts in Islamic banks which were not covered in the previous scheme.

The new scheme covers eligible account holders of individuals up to BD20,000 from the total amount of their eligible accounts.

Supervisory Developments

Compliance Directorate

During the year 2011, the Central Bank of Bahrain continued its efforts with particular emphasis on upgrading the Kingdom’s regulatory framework specific to AML/CFT through the Policy Committee, which is a national committee chaired by the CBB and is responsible for formulating AML/CFT policies, procedures and coordinating with relevant internal and external bodies. The Policy Committee has continued its regular quarterly meetings in 2011, in order to follow-up the work plan among the committee members. The Committee has revised the existing AML Law in an effort to synchronize all AML/CFT related issues as well as be in line with the latest developments in the Financial Action Task Force (“FATF”) recommendations. The proposed amendments to the AML/CFT Law have been approved by the Cabinet and forwarded to the Parliament and Shura Council for final approval in preparation for its issuance by His Majesty the King Hamad bin Isa Al Khalifa.

The Policy Committee contributed in the preparation of Ministerial Order No. 126 of 2011 which was ultimately issued by the Minister of Industry and Commerce in July 2011 to legally enforce the Ministry’s existing Anti-Money Laundering Mandatory Rules and Guidelines which have been issued in 2006 and further enhance the implementation of AML/CFT requirements which are in conformity with the FATF requirement in this respect.

As part of its systematic program 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, to further enhance the on-site AML/CFT supervision and to help the licensees improve their systems of internal controls with respect to the prevention, detection, monitoring and reporting of suspicious transactions. Such 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”) 14th plenary meeting was held in November 2011 in Algeria. During the MENAFATF plenary meeting, the CBB submitted the Kingdom’s 3rd follow-up report, which highlighted Bahrain’s AML/CFT developments during the period of 2006-2011, following the 2005 Financial Sector Assessment Program (“FSAP”) evaluation conducted by the International Monetary Fund (“IMF”) and the World Bank.

In view of the Kingdom’s efforts to rectify issues raised in the FSAP evaluation as well as accomplishments in this respect, the MENAFATF plenary meeting has decided to consider Bahrain’s request to be subject to a process of update every two years instead of the annual follow up process. Such a step is regarded as an acknowledgement to the Kingdom’s achievements towards streamlining its regulatory framework in line with the recognized international standards.

The CBB has also participated in the Bahrain Centre of Excellence program (BCE) for the year 2011 by presenting its success story in the field of combating money laundering and financing of terrorism and efforts exerted in maintaining Bahrain’s reputation in this regard.

**Banking Supervision Directorates**

The CBB continued its efforts towards ensuring financial stability and protecting consumer interest while enhancing market confidence and facilitating market development. To achieve these objectives, the CBB pursued proactive supervisory approach including enhanced monitoring of the banks and financial institutions, provided adequate assurance to the consumers of the banking sector through initiating measures that provide positive signals to the market and facilitate the development of the market.

Accordingly, the following measures were taken by the Retail Banking Supervision Directorate (RBSD) of the CBB during the year:

- **Liquidity Monitoring:** As part of its monitoring of banks’ liquidity position the Retail Banking Supervision Directorate (RBSD) continued to scrutinize liquidity reports highlighting maturity gaps between assets and liabilities under different time buckets on a weekly basis. In addition, the CBB also conducted assessment of banks /financial institutions 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.

- **Monitoring of Real Estate Exposures:** As part of its efforts to avoid risk concentration to volatile sectors, specifically the real estate sector, the CBB continued to monitor, on a quarterly basis, banks’ exposures to the real estate sector.

- **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 the Central Bank’s rules.

- **Monitoring of Impaired Loans Portfolio:** The impaired loans portfolio of banks were monitored and analyzed on a quarterly basis to observe any abnormal changes. Accordingly, banks were advised to take preemptive measures to check the growth in impaired loans portfolio.

- **Prudential Meetings:** The Conventional Banking Supervision Directorates conducted 51 (28 retail, 23 wholesale) prudential meetings with the licensees under their supervision. In addition, quarterly meetings with banks in the presence of their external auditors were continued in 2011, to discuss their financial results, effect of any unexpected events on the bank, among others.

- **Meetings on Financial Statements:** Annual trilateral meetings were also held with banks along with their external auditors, to discuss year-end financial results for 2010, before such statements are submitted to the respective bank’s Board of Directors for approval. The meetings deliberated issues pertaining to recognition of income, valuation practices, impaired assets, breakdown and adequacy of provisions, proposed dividends and staff bonuses. Banks were urged to build up a Collective Impairment Provisioning equals to 1% of net book value of loans portfolio.

- **Corporate Governance:** The new Code of Corporate Governance incorporated in the CBB’s Rulebook Module on High level Controls came into effect from January 2011. Locally incorporated banks were directed to undertake a detailed self assessment of their compliance with the HC Module and submit the same to the CBB. The review also included the measures initiated to address the gaps and achieve full compliance with the rules by the end of 2011. The CBB while closely monitoring the banks progress to achieve full compliance with the HC
Module provided guidance and support to their endeavour. In case of non compliance with the guidelines banks were asked to write to the CBB about the mechanism to report such non-compliance to its stakeholders.

- **Studies/Surveys:** Continuing with its proactive supervisory approach the RBSD undertook special studies/surveys encompassing SME financing including restructured facilities given by banks and financing companies in Bahrain as well as exposure of Bahrain based banks to European countries. Since the month of February, 2011 banks were asked to submit their SME financing exposure reports to CBB on monthly basis.

- **SME Sector Support:** With the aim of supporting the SME sector the CBB along with Tamkeen conducted tripartite meetings with major retail banks and urged them to participate in the SME Financing Scheme of Tamkeen. Moreover, banks were urged to restructure their loans to SMEs and not impose any additional charges while providing support to SMEs to overcome the difficult market conditions.

- **Assessment of BCPs:** The CBB assessed banks Business Continuity Plans in real life situation during the difficult period in the year. All the BCPs were successful in their operations.

- **QIA on Basel III:** With the objective of developing a timetable and the transitional period for the implementation of Basel 3 in the Kingdom of Bahrain, the CBB interacted with banks to gauge their preparedness for implementing Basel III and conducted Quantitative Impact Study for capital adequacy and liquidity. To further enhance liquidity risk management regime in the Kingdom, the CBB will continue examining the liquidity requirements under Basel 3 for its effective and tailor-made implementation in Bahrain. Towards achieving this objective it has already conducted quantitative impact assessment of Basel 3 requirements on banks in Bahrain. Moreover, the CBB conducted workshop on Basel 3 in conjunction with Union of Arab Banks to increase awareness and knowledge of senior bankers on Basel 3 and the challenges associated with its implementation.

- **Unifying Banking Regulations between GCC States:** The CBB through its active participation in the GCC Banking Supervision Committee contributed to the English version draft paper of on unifying set of banking rules and regulations on supervision for the GCC member countries.
• **Public Disclosure by Banks:** The CBB continued monitoring of banks’ compliance with the public disclosure requirements, by requesting them to submit the public disclosure report duly reviewed by the bank’s external auditors. The Supervision Directorates used this mechanism as one of the supervisory tools to assess the extent of transparency and disclosures made by banks to its stakeholders. Any non-compliance by banks was not accepted by the CBB and banks were asked to rectify the situation.

• **Monitoring of Banks BOD and Organization Structure:** With the objective of assessing the performance of the bank’s Board of Directors, besides assessing the compliance with above mentioned CG requirements, the CBB required banks to submit the corporate governance reports on an annual basis and also send its representatives to the AGM of banks. Such review emphasized on the attendance of the Directors and the role played by them in BOD meetings as also the structure of BOD committees, the appointment of independent directors et al. The organization structure of banks was reviewed to ensure that there is no conflict of interest in the reporting lines of management and the banks had succession planning in place.

• **Promoting Competition:** With the objective of enhancing competition and improving customer service, the RBSD allowed additional retail banks to have their Point of Sales Terminal thereby giving more options to the users and minimizing possibilities of monopolistic practices.

Other activities undertaken by the Supervision Directorates include:

• **Bahrain Credit Reference Bureau (BCRB):** As part of its objective of protecting customer interests, the CBB continued its efforts to support banks to bring down the open errors accounts with the BCRB. Consequently, such error accounts were significantly reduced from 1705 to 10 during the year. This ensured that accurate information on borrowers is being reported to the BCRB by banks and financial institutions thus avoiding much hardship caused to customers due to misreporting.

• **EMV Compliance:** The RBSD continued to work with retail banks and financing companies in the Kingdom to successfully replace the old magnetic stripe cards with new EMV compliant chip and pin cards.
• **Internet Banking Security**: The Directorate reviewed the internet security measures of retail banks specifically related to customer transactions with the aim of enhancing the security levels of such transactions and protect the customers interests.

• **Compliance with the “Code of Best Practice on Consumer Credit and Charging”**: The RBSD continued to monitor the adherence of retail banks and financing companies with the provisions of the Code. The aim was to ensure that licensees act fairly, responsibly and reasonably in their dealings with consumer and are transparent in their dealings.

The CBB continued its stringent monitoring of the disclosures made by its licensees to ensure their compliance with the CBB’s requirements that are aligned to Basel 2 Pillar 3 guidelines. In this regard, the CBB has also devised and disclosed to banks a penalty structure outlining the amount of penalty to be imposed in case of delay in submitting or disclosing the requisite information in accordance with the CBB rules.

• **Enforcement Actions**: The CBB has encouraged high standards of compliance by its licensees, thus reducing the risks to their customers and the financial system. It believes that effective enforcement facilitates effective supervision. Accordingly, and as enshrined in Article 38 of the CBB Law, the CBB has taken 17 enforcement measures against retail licensees (no enforcement measure against wholesale licensees) including imposition of penalties, during the year 2011 in respect of market discipline matters.

*Islamic Financial Institutions Supervision*

The Directorate is responsible for the supervision of the Islamic Financial Institutions that provide regulated banking services. These include 6 Wholesale Banks, 6 Retail Banks, 3 Financing Companies, 1 Branch of a Foreign Bank and 1 Microfinance Institution.

The following are the key milestones achieved during the year 2011:

• Receiving, compiling, and analyzing monthly, quarterly, and annual supervisory reports/returns; to produce the analytical reports that are used as supervisory tools to diagnose the administrative and financial condition of the Banks and Financial Institutions. Accordingly, the CBB
conducts/holds regular supervisory meetings with the Banks and Financial Institutions, as per the agreed schedule of meetings.

- Following-up and discussing the annual financial statements of the Banks and Financial Institutions and holding meeting with them in the presence of their External Auditors.

- The Directorate mandated Islamic Banks to submit Risk Assessment Reports to monitor their financial position more closely. These reports constitute a thorough investigation into the high level controls, procedures and processes within Banks in The Kingdom of Bahrain in relation to the treatment of Credit risk, Market risk, Operational risk, Liquidity risk, Reputational risk, Strategic risks, as well as the procedures in relation to Corporate Governance, Human Resources, Compliance, Financial Control, Accounting and Investors Relations.

- The Directorate mandated Islamic Banks also to provide semi-annual reports on Public Disclosure. These reports are reviewed by the Bank’s External Auditors and are used as a supervisory tool to analyse the transparency and accuracy of banks’ financial reports provided to the public.

- To ensure efficiency and effectiveness of banks’ Board of Directors members, the Directorate has started closely monitoring member’s attendance and participation in Board meetings. During 2011, the Directorate paid special attention to the composition of the Board of Directors and its sub-committees, requiring banks to avoid any potential conflict of interest and mandating the appointment of independent Board members.

- The Directorate designed and conducted a training course in supervising/regulating Islamic Financial Institutions for representatives of the Central Bank of Sudan, Central Bank of Oman, Central Bank of Nigeria and Central Bank of Djibouti.

- The Central Bank of Bahrain has conducted a study on the banks readiness to implement the requirement of Basel III and meetings were held with Executives of Islamic Banks in this regard.

- The Directorate mandated the banks to submit reports of their compliance with the Corporate Governance requirements and procedures that are undertaken in the event of irregularities.
Inspection Directorate

In 2011, 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 focused on the following assessment elements- capital adequacy, management quality, operational risk, risk Management, transparency and disclosure, asset quality, liquidity and earnings. 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.

Capital Markets Supervision (“CMSD”)

During this period, the CMSD worked to complete the regulatory and legal framework, including Volume 6 of the CBB Rulebook relating to the capital market, with its main objectives being to enhance transparency and develop the capital market, and protect investors. These included the following activities:

Developments:

- Issuance of Resolution No. 59 of the year 2011 in respect of: “Specifying the Procedures to be followed for the Registration of Pledges and Liens on Securities and the Discharge and Lifting of such Pledges and Liens”. This Resolution was published in the Official Gazette No. ١٠٠٤, issued on 29th December 2011.
• Accordingly, the CMSD mandated the Bahrain Bourse to meet the requirements of this Resolution within a maximum period of 6 months from the date of issuance of the Resolution, as per CMSD’s letter Ref. CMS/I013/2012 dated 10th January 2012.

• On 1st December 2011, the CMSD submitted to the Legal Directorate draft procedures regarding “the listing of securities and financial instruments on CBB licensed Exchanges, including the suspension of trading and delisting”, for their review and finalization prior to issuance in the near future.

• The CMSD made its comments and observations on the new draft Commercial Companies Law prepared by the Ministry of Industry & Commerce, with the CBB focusing on the removal of any obstacles that might hinder the development of the capital market and eliminate any conflicts or overlap with regards to the duties and responsibilities of the CBB and Ministry of Industry & Commerce in the capital market sector.

• Issued a new Module for the CBB Rulebook Volume 6, (Corporate Governance Module) (“COG”), which took effect on 1st September 2011.

• The CMSD continued to work on other Modules of Volume 6, including Modules on the Offering of Securities (“OFS”) and Disclosure Standards (“DIS”), which will shortly be sent out as Consultation Papers to the industry, after having being reviewed by the CBB’s Regulatory Policy Committee.

Licensed of Exchanges and Clearing, Settlement and Central Depositories

• Bahrain Bourse (BHB):

  a) The issuance of Resolution No. (02) of 2012, with regards to granting Bahrain Bourse Co. B.S.C (c) final license approval by the CBB, subject to meeting the conditions and requirements stipulated in the CBB’s letter Ref. OG/481/2011 dated 29th December 2011.

  b) In accordance with the Capital Markets Supervision Directorate’s official letter to the Bahrain Bourse dated 11th August 2011, Bahrain Bourse issued its Market Rules to listed companies, members and related parties on 23rd October 2011 as a Consultation Paper. The Bahrain Bourse is currently working on the completion and
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finalization of its Listing Rules and Clearing, Settlement and Depository Rules, which will be issued within the next period.

• The Bahrain Financial Exchange (BFX):

After completing the final operational requirements, the BFX successfully launched its traditional trading derivatives platform on 23rd November 2011. It commenced trading in three trading derivatives products; gold futures, natural gas futures and EURO/USD futures traded by its five registered members.

Primary Market:

In 2011, the CMS Directorate issued its no objection to the use of 35 public and private offering documents (comparing to 54 offering documents in 2010) 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 to USD 2.22 billion (comparing to USD 38.90 billion in 2010), which includes, two issues of Government Islamic Sukuk with a total value of USD 1.28 billion (comparing to USD 1.25 billion in 2010), 15 issues of private placements in ordinary shares with a total value of USD 639 million (comparing to USD 31.15 billion in 2010), two priority rights issues with a total value of USD 64 million (comparing to USD 1.31 billion in 2010), and 16 private issues of structured financial instruments with a total value of USD 145 million.

Also, the CMSD reviewed and provided comments and observations on 8 public and private offering documents, as per CBB’s Disclosure Standards. However, these documents have not been approved, pending being updated and rectified with CMSD’s comments by the lead managers of these offerings. The gross total value of these issues is more than USD 462 million.

Market Surveillance System

In 2011 the Central Bank of Bahrain started to study several offers made by well-known international companies that provide the latest technological Market Surveillance Systems for secondary market trading. Accordingly, the CBB is now in the final stages of selecting the most suitable system.
Investigation

Two cases were found to have been suspected of potential violations to the rules and regulations and studied for possible market manipulation, where preliminary reports were prepared. One of those identified was in relation to concealing final beneficial ownership by one of the shareholders, and the second case was in relation to the potential misuse of the trading account.

Enforcement

1. Non-compliance letters were issued to 43 companies (compared with 58 companies during the year 2010) for not disclosing ownership of 5% and above in shares of listed companies on a timely basis, as required by the CBB.

2. Non-compliance letters were issued to 16 companies (compared with 13 companies during the year 2010) for inaccuracy in the information disclosed on ownership, as per the CBB requirements.

Resolutions regarding the temporary suspension of trading on the Bahrain Bourse were issued to 16 listed companies due to untimely submission of financial statements. In addition, two companies were suspended due to issues relating to their operations and activities.

Corporate Governance Standards

In an effort to implement the Corporate Governance standards issued by the Ministry of Industry and Commerce, as well as the Corporate Governance Module under Volume 6 of the CBB’s Rulebook on corporate governance, the following has been conducted:

1. Allocation of a separate item in the listed companies’ AGM Agenda specific to the financial year 2010, which provided for the "approval of the proposed plan and an implementation programme and a commitment to the corporate governance standards.” All listed companies complied with the above and also sent their action and implementation plans to the Capital Markets Supervision Directorate.

2. In collaboration with The Directors Counsel, the CMSD issued a survey on 5th June 2011 to all listed companies and capital market service providers in order to identify their standards and level of compliance with corporate governance, and to subsequently formulate a road map to meet all these criteria by the end of the year 2011, as well as
completion of an integrated report for publication on the application of corporate governance standards by listed companies.

3. On October 31, 2011, the CMSD received The Director Counsel’s report, which reviewed the overall compliance by listed companies to corporate governance standards, and also included recommendations on improving the performance levels of companies to apply those standards.

Financial Institutions Supervision Directorate (“FISD”)

During the course of 2011, the FISD continued to fulfil its responsibilities by implementing rules and regulations and using various supervisory tools, including in-depth financial analysis, prudential meetings 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.

As part of its supervisory role in monitoring the Collective Investment Undertakings (CIUs’) sector, FISD continued to use its supervisory tools to observe the industry and ensure adherence to the rules and regulations stipulated in the CIU Module, the CBB Law, and other relevant regulatory requirements.

Additionally, FISD has almost completed the exercise of classifying the Bahrain domiciled CIUs that existed prior to the issuance of the CIU Module, in accordance with the requirements of the Module.

As of the end of 2011, 99% of the previously established CIUs had been classified, compared to 89% classified as of the end of 2010.

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.

During 2011, FISD authorized / registered 3 Bahrain domiciled CIUs. The Directorate also authorized / registered 243 overseas domiciled CIUs to be marketed to residents in Bahrain, to arrive at a total of 246 authorized / registered CIUs during the year.

After finalizing all the Modules pertaining to Money Changer licensees at the end of 2010, the FISD commenced since the beginning of 2011 on ensuring
that all existing licensees are in compliance with the introduced regulations in relation to their operations, capital adequacy and reporting.

During the course of 2011, the FISD continued to ensure that the Representative Office licensees adhere to the requirements of the Modules introduced at the end of 2010 as part of CBB Rulebook Volume 5.

Moreover, the FISD has continued to monitor the performance of the financial institutions under its supervision, through various supervisory tools, including the scrutinizing of financial reports submitted by licensees on a monthly or quarterly basis and through conducting regular management meetings.

During the year 2011, emphasis continued to be placed on the capital adequacy levels of Investment Business Licensees in particular and on monitoring performance of asset managers under current market conditions.

**Insurance Sector Supervision**

The Insurance Supervision Directorate released Insurance Decennial Report in September 2011. The report highlights the performance of the insurance industry in Bahrain for a ten year period from 2001-2010 and analyses the insurance (both “conventional insurance & reinsurance” and “Takaful & Retakaful” business) by class of business in the Kingdom with touching upon the origin and the historical background of the insurance market in Bahrain. The total gross premiums in Bahrain increased to BD 210 million and insurance penetration (ratio of gross premiums to GDP) stood at 2.55% in 2010.

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 global 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 three 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 CBB has continued to register the appointed representatives during 2011, as follows:

<table>
<thead>
<tr>
<th>No. of Companies</th>
<th>No. of Registered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local and Foreign Banks</td>
<td>9</td>
</tr>
<tr>
<td>Commercial Companies</td>
<td>1</td>
</tr>
<tr>
<td>Individuals</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>10</td>
</tr>
</tbody>
</table>

The CBB along with the Bahrain Institute of Banking and Finance (BIBF) and members of Arab Forum of Insurance Regulatory Commissions (AFIRIC) has worked to introduce “Certified AFIRIC Supervisor (CAS) Program” in 2011, which is considered the first certificate for insurance regulators in the Middle East.

In addition, the CBB has taken an initiative to issue Motor Insurance Compensation Fund. This Fund is designed to compensate the injured parties in the following circumstances: absence of a valid insurance policy for the vehicle that cause the accident “uninsured vehicle”, if 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.

The CBB has issued a consultation paper on client’s money, which aimed at enhancing the regulatory framework in relation to appointed representatives and insurance brokers. It shall also strengthen the role that the CBB is undertaking towards protecting clients money from being utilized in other than the purpose outlined in insurance contracts.

The CBB intends to introduce a modified model for Takaful companies. The objective of modifying the existing Takaful rules is to facilitate a faster growth of the Takaful business in Bahrain while protecting the interest of all
stakeholders, vis-à-vis shareholders, participants, and Takaful operator. This will be an enhanced formula for the hybrid model of Wakala and Mudarabah, which is expected to help solve the issue of frequent Qard Al Hasan injections by shareholders in order to keep the Participants’ fund(s) solvent. Moreover, this model is expected to ensure that Participants’ fund remains solvent and participants get their due share in the profits generated by the fund. For Takaful Operators, the model gives them fair treatment for managing the business. This initiative is another step in reaffirming Bahrain as the jurisdiction of choice for all the Takaful/ Retakaful companies in the world.

Financial Stability Directorate

During 2011, 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), Sensitivity Stress Testing Report (semi-annual), Financial Soundness Indicators 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, 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.
4. Other CBB Projects and Activities

New Licenses

Payment System (“SSS” & “RTGS”)

Cheque Clearing

ATM Network (Benefit)

Currency Issue

CBB Training Programs

IT Projects

External Communications Unit

CBB’s Organizational Chart
New Licenses

The number of new licenses has increased in 2011 by 20 license compared to 14 new license in 2010, reaching to a total of 414 as of 31st December 2011 compared to a total of 406 as of 31st December 2010. Taking into consideration the fact that several insurance companies restricted to do business outside the Kingdom of Bahrain, which were mainly serving the Kingdom of Saudi Arabia market, have relocated their offices to Saudi to comply with the latest insurance law in Saudi.

The Central Bank of Bahrain ("CBB") has issued several licenses to different financial sectors, as shown in the list below:

1- Allied Bank Limited - Wholesale Bank (Branch)
2- J Equity Partners B.S.C. (c) - Investment Business Firm Category 1
3- Taka'ud Saving & Pension B.S.C. (c) - Investment Business Firm Category 1
4- Deloitte Corporate Finance Limited - Investment Business Firm Category 3 (Branch)
5- Al Taira Middle East B.S.C. (c) - Investment Business Firm Category 3
6- Bank of London and the Middle East Plc. - Representative Office
7- AMP Capital Investors Limited - Representative Office
8- Notz, Stucki & Cie S.A. - Representative Office
9- GlobeMed Bahrain W.L.L. - Ancillary Service Provider
10- Bahrain Bourse B.S.C. (c) – Licensed Exchanges
11- Grrans Commodities B.S.C. (c) - Licensed Securities Dealer
12- Arab Global Findex B.S.C. (c) – Licensed Securities Broker & Dealer
13- XO Bahrain – Licensed Securities Broker & Dealer
14- MAC Securities W.L.L. – Licensed Securities Broker & Dealer
15- Evermore Global (Bahrain) B.S.C. (c) - Licensed Securities Broker & Dealer
16- A-Level Brokers W.L.L. - Licensed Securities Broker & Dealer
17- Arab Global Findex B.S.C. (c) - Licensed Securities Clearing Member
18- Evermore Global (Bahrain) B.S.C. (c) - Licensed Securities Clearing Member
19- Grrans Commodities B.S.C. (c) - Licensed Securities Clearing Member
20- Mr. Ronald Chidiac - Registered Actuary

Compared to year 2010, the main growth of new licensees was in the Capital Market sector. On the contrary, there was a reduction in the growth of new licensees in the Insurance sector as shown in the graph below:

![Graph showing new licensees growth by sector]

**Payment System (“SSS” & “RTGS”)**

Bank transfers through the Real Time Gross Settlement System (“RTGS”) numbered 388,492 in 2011, for a total amount of BD 46.8 billion broken down as follows:

- The volume of bank transfers among retail banks through RTGS was 101,703 for a value of BD 40.2 billion.
- The volume of customer transfers through the RTGS numbered 286,789 for a value of BD 6.6 billion during 2011.
Banking operations carried out though Securities Settlement System (“SSS”) totalled 1109 in 2011 for a value of BD 4.5 billion.

Cheque Clearing

The number of cheques cleared in 2011 was 2,918,208 with a total amount BHD 4.3 billion dinars.

ATM network (Benefit)

The number of withdrawals processing through the local ATM network system (Benefit) during 2011 was 5,511,461 with a total amount BHD 546,2 with a daily average of 15100 transactions for BHD 1,496 million.

Currency Issue

During 2011, major accomplishments of the Currency Issue Directorate included:

- Purchasing another new machine from the G&P Company in Germany for Counting & sorting currency notes and shredding unfit currency notes received from the retail banks.
- Extending its hall for currency counting and sorting, in order to install the new machine.
- Issuing a new commemorative coin set in November, 2011 which contained circulation coins, to present to guests and visitors of the CBB, the Currency Issue Directorate and the currency museum.
- Purchasing US$ 50 million to face any emergency situation in February/March 2011.
- The value of currency notes and coins in circulation reached BD 553.45 million, the highest level ever recorded, mainly due to subsidies granted by His Majesty King Hamad bin Isa Al Khalifa to people of Bahrain and normal salary payments to staff of the public and the private sector.

The directorate continued its operations such as sorting of currency notes and shredding of unfit currency notes using the machine which was directly linked to the records of the directorate. The value of shredded
unfit currency notes amounted to BD 32.18 million in 2011, out of which unfit currency notes worth of 23.56 million were shredded online. The value of unfit currency notes shredded off-line amounted to BD 8.6 million.

The daily value of currency withdrawals amounted to BD 1.17 billion in 2011, while that of the currency deposits stood at BD 1.099 billion. The value of currency issues recoded BD 509.7 million on 31st December 2011, of which currency notes and coins amounted to BD 495.696 million and BD 14.056 million respectively. The fourth issue of the new series of currency notes reached a level of BD 483.322 million and amounted to 96.504% of the total value of currency in circulation. The value of the third issue of the new series of currency notes stood at BD 12.374 million or 2.96% of the total value of currency in circulation.

CBB Training Programs

The Central Bank of Bahrain places great emphasis on developing the professional capabilities and competence of its staff.

In 2011, we have continued to promote the professional and personal development of our staff, by ensuring their participation in appropriate training and development activities.

During the year, this included:

- Sponsorship of eight employees to acquire professional qualifications in various areas, including accounting and finance.

- Enrolment of 163 employees on local and international training programs appropriate to their job demands, including:
  - Banking and financial institutions supervision.
  - Insurance
  - Management
  - Computing
  - Human Resources Management

- Enrolled over 99 employees to attend 84 courses in the Bahrain Institute of Banking and Finance (BIBF).
• Renewed the FSI-Connect subscription for 133 employees, who have managed to complete over 124 specialized tutorials. This makes the e-learning experience at the Central Bank of Bahrain one of the most successful experiences as it stimulates employees to continuously learn and develop their competencies.

IT Projects

During the course of 2011, a number of projects were completed within the IT department. They included the following:

• **Enhancement to the Real Time Gross Settlement (RTGS) System:** The existing RTGS system has been enhanced to be able to handle clearing of files generated by the Cheque Truncation System at Benefit.

• **Replacing the Existing Treasury System:** The CBB has implemented a highly sophisticated Treasury, Risk & Cash Management system. It provides a powerful front, middle, and back office treasury, risk, and cash management system with fully integrated accounting capabilities and seamless straight through processing. It offers integration with external systems such as Bloomberg, SWIFT, Reuters and fund managers and all information would be available as a single repository. The new system replaces a legacy in-house developed system. The new system is expected to go-live during early 2011.

• **Implementation of an Institutional Information System:** Institution information system is collecting non-financial information from financial institutions such as Core Objectives, Board of Directors information, Staff Details and other related information about the Institutions which has to be filled by the institutions’ external users.

• **Business Continuity Management:** The CBB, as part of its continuous improvement process, strengthened the existing Business Continuity Management framework. This was done by enhancing the various procedures and infrastructure, both business and IT, required to ensure continuity of business.

• **Enhancement of Human Resource system:** The existing systems were enhanced to automate staff payments via straight trough processing by utilizing SWIFT standard messaging. An additional module was also implemented to automate the calculation of bonuses, salary increments
and promotions based on each employee’s appraisal results and scorings.

**External Communications Unit**

The External Communications Unit (ECU), in cooperation with all the other departments and divisions of the Central Bank of Bahrain (CBB), continues with its efforts in implementing the vision of the CBB, which aims to preserve the status of the Kingdom of Bahrain as a leading financial hub.

Through its role in the CBB, the ECU seeks to promote awareness and publicise the role of the CBB as a regulatory body that follows best international standards. The ECU’s role in the CBB can be summarised into three main functions, namely: (1) organizing events, conferences, seminars and specialized workshops for the different sectors whether in the banking and finance or insurance sector, (2) dealing with the media, and (3) administering the website of the CBB.

In 2011 the CBB supported more than 30 conferences and workshops, including annually held conferences such as the Middle East Insurance Forum, the Annual Sharia Conference of the Accounting and Auditing Organisation for Islamic Financial Institutions and the Annual World Islamic Banking Conference to name but a few.

In 2011, the Middle East Insurance Forum, themed "Translation of Potential into Growth in the Regional Insurance Industry", welcomed more than 450 participants, including some of the most prominent leaders in the insurance industry in the region. Over the past few years, this forum has come to be the biggest and most significant annual platform in the Middle East that attracts international and regional insurance industry leaders. The 2011 forum witnessed lively and important discussions and debates on the issue of successfully supporting the future development of the insurance markets in the region.

The second annual conference was the Annual Sharia Conference organised by the Accounting and Auditing Organization for Islamic Financial Institutions. The conference provided a platform for the exchanging of ideas, discussing issues related to Islamic banking and facilitating the development and introduction of new standards in addition to revising and updating the existing ones. A large number of leading Sharia scholars and members of Sharia Supervisory Boards of Islamic financial institutions meet each year at this conference, along with other senior representatives of central banks and
regulatory bodies and senior executives from Islamic financial institutions. 2011’s conference discussed important topics related to accounting and Sharia supervision standards, the most important of which were the “Practicalities of Sharia auditing and review”, “Agency (Wakeel) contract in investments”, “Realities of Ijarah (leasing) contracts”, “Issues on true and fictitious Sukus”, “Treatment of delinquent financings and alternatives to debt structuring” and the “Impact of multiple terms and conditions in contracts”.

One of the largest annual conferences that is supported, and hosted by the CBB is the World Islamic Banking Conference (WIBC). Held for the fifteen years in a row in the Kingdom of Bahrain under the patronage of the Prime Minister His Royal Highness Prince Khalifa bin Salman Al Khalifa, the 2011 conference saw the participation of over 1300 leading Islamic finance and industry professionals from more than 50 countries. The conference, theme was "Competing for Global Growth", included a special roundtable session on Islamic banking in the United Kingdom at which the participants discussed, reviewed and analysed the latest developments in Islamic finance in the UK and assessed the opportunities to build international partnerships. The conference also saw a similar roundtable session on Islamic banking in France that discussed the latest developments in this sector there. A key event at this conference was the launch of the World Islamic Banking Competitiveness Report 2011/2012 under the theme “A Brave New World of Sustainable Growth”.

As part of its ongoing mandate, the ECU also cooperates with any government body that requests support for its conferences in terms of sending invitations to journalists to cover the conference, or providing it with leaflets or publications on the banking sector in the Kingdom of Bahrain.

Furthermore, the ECU works closely with the Economic Development Board to achieve the Bahrain Economic Vision 2030. The 2030 Vision aims to enhance the status of Kingdom of Bahrain as a regional hub for financial services and a leading international centre for Islamic banking and finance, by conducting effective promotional and marketing campaigns to attract world-class financial institutions and new high quality products to Bahrain. The ECU’s role in this is to arrange interviews with reporters and journalists from international newspapers and agencies such as the Financial Times, Bloomberg, Reuters and others, as this is one of the most effective means to introduce Bahrain to the world as a financial services centre, with efficient regulatory infrastructure and laws needed for the management of such financial institutions and attracting inward investments.

The CBB continues to support its partnership with the banking and financial
sector, including the Accounting and Auditing Organization for Islamic Financial Institutions, as well as the Bankers’ Society of Bahrain, the Bahrain Insurance Association and the Union of Arab Banks, among others. The CBB encourages concerned societies to participate in CBB supported conferences to enhance cooperation and the exchange of views between the participants. The ECU maintains a consistent contact with these institutions and includes them in the relevant arrangements for the events.

Among the workshops held this year, the CBB supported a seminar organised by the Union of Arab Banks on "Basel III - The new set of requirements and its challenges”. The seminar which was held at the Bahrain Institute of Banking and Finance (BIBF) discussed the recommendations of Basel III and the role of regulators in directing the proper implementation of Basel III by the banks.

The CBB cooperates on a consistent basis with the BIBF in launching several banking and specialised programmes each year, as well as conducting technical workshops designed to expand the knowledge of participants and keep them up to date on global developments in the area of banking and finance. The ECU always ensures that the BIBF is involved in all of the supported events.

2011 witnessed the launching of the “Fundamentals of Risk Management” programme. This programme compliments the CBB’s efforts in implementing best practice risk management principles in the financial industry in Bahrain. The role of the ECU was to cooperate with the BIBF in promoting and advertising such programmes to the targeted audience.

The CBB also joined forces with the BIBF and the British Chartered Institute for Securities & Investment (CISI) in launching the “Financial Advice Programme”, which is considered one of the most advanced academic programmes. It was the first programme of its kind to be held in Bahrain and was designed based on the requirements set out in the Rule Book of the CBB.

Participation in Conferences, Seminars, Meetings and Workshops

- 11-12 Jan, Bahrain World Economic Society, Crowne Plaza, Bahrain
- 26-30 Jan - World Economic Forum Annual Meeting 2011-Davos-Klosters, Switzerland
- 2-Feb-Launch of Bahrain Financial Exchange-Bahrain
- 7-8 Feb-Middle East Insurance Forum 2011-Gulf Hotel, Bahrain
- 18-Feb-G20 Finance Ministers & CB Governors Meet-Paris
- 21-Feb-Bloomberg Product Launch-Bahrain
- 2-Mar-Annual Capital Markets and Investor Relations conference -Ritz, Bahrain
- 10-Mar-52nd meeting of the committee of Governors of the Central Banks and Monetary Agencies in the Gulf Cooperation Council (GCC) states.- Abu Dhabi
- 23-24 Mar-10th GCC Banking Conference-Doha
- 8-9 May-IISS Geo-Economic Strategy Summit - Bahrain Global Forum-Ritz Bahrain
- 12-13 May 2011-8th IFSB Summit-Luxembourg
- 30-31 May -AAOIFI Annual Shari’a Conference 2011-Crowne Plaza Hotel, Bahrain
- 8-9 June -WIBC Asia 2011-Singapore
- 21-22 Sept-Workshop on Development of Non-oil Revenues “Developing Bahrain’s Economy: Introduction of Taxes”-Crowne Plaza
- 24-Sept IMF Annual Meetings - BAB Reception-Washington
- 26-27 Sept-7th Annual World Islamic Funds & Capital Markets Conference 2011-Bahrain
- 28-Sep-IIFM 24th Board Meeting-Bahrain
- 4-Oct-Certified Institute for Securities & Investment ‘Continuing Professional Development’ Inaugural Event-Crowne Plaza
- 4-5 Oct -60th GCC Banking Supervision Committee Meeting-Dubai
- 6-Oct- 25th IFSB Technical Committee Meeting-Abu Dhabi
- 9-Oct-Launch of Risk 1 Programme, BIBF-BIBF, Bahrain
- 12-Oct-BNPP’s C&C Conference -Bushido Restaurant
- 23-24 Oct-Annual AAOIFI Conference on Islamic Banking and Finance 2011-Crowne Plaza
- 25-Oct-Bloomberg’s 2011 Focus Day-Sheraton
- 26-27 Oct-Arab Monetary Fund - FSI High Level Meeting-Abu Dhabi
- 31/10-01/11-Kuwait Financial Forum-Kuwait
- 1-2 Nov -BCICAI Seminar-Bahrain
- 9 or 10 Nov-Al Baraka Stone Laying Foundation-Governor
- 14-15 Nov -IIF MENA Regional Economic Forum-Abu Dhabi
- 17-Nov-19th IFSB Council Meeting & 4th IFSF-Malaysia
- 20-21 Nov -ACC 3rd Annual International GRC & Financial Crimes Conference & Exhibition-Dubai, UAE
- 21-Nov-Increasing access to credit in MENA through Effective Financial Infrastructure Workshop-Sofitel, Bahrain
- 21-23 Nov - 18th World Islamic Banking Conference 2011-Bahrain
- 23 Nov, 8pm-WIBC - Kishore Mahbubani Dinner- Capital Club, Bahrain
- 23-Nov-AMP Capital Launch- Capital Club, Bahrain
- 23-24 Nov - MENA Mortgage and Affordable Housing Congress-Radisson, Bahrain
- 28-30 Nov - Union of Arab Banks - The Challenges of Basel III Implementation and Its Requirements-BIBF, Bahrain
- 8-Dec-Supreme Council for Women-BFH
- 13-Dec-CBB-IFSB/Deloite IFKCI Executive Roundtable 'Emerging Regulatory Issues in Risk Management in Islamic Financial Institutions'-Ritz, Bahrain
- 14-Dec-Public Hearing IFSB-Ritz, Bahrain
- 14-Dec-Woman's Day-CBB, Bahrain
- 15-Dec-University of Wales BIBF Students Visit-CBB, Bahrain

Media Coverage

The ECU continues to cooperate with the relevant media outlets by publicising the latest developments in the banking and finance sector and by informing all who are concerned about the news of the CBB through issuing press releases, reports, books and periodicals. The ECU also arranges press and TV interviews to promote the banking and finance sector, the Islamic financial sector and/or insurance sector as required.

Newsletter

The ECU continues to issue a quarterly review of the summary of happening in the sector. The ECU coordinates with the Executive Directors of the CBB in selecting various trend topics that relate to the latest developments in the banking and finance or insurance sector. The newsletter includes articles and speeches presented by CBB officials at events and conferences that the CBB supports. The newsletter also holds the latest figures of the financial sector, in addition to publishing the laws, regulations or directives that were issued by the CBB recently. More than 1500 people subscribe to this review and the ECU constantly receives requests to be added to the distribution list.

The CBB Website

It is the responsibility of the ECU to manage the content upload and maintenance of the CBB website on an ongoing basis, in addition to uploading any new information, publications or press releases issued by the CBB. The ECU checks the accuracy of the information on the website in cooperation with all the CBB directorates to ensure that all contents are correct and updated on a daily basis.
The ECU arranges responses to inquiries and questions received through the website by coordinating with the department concerned and providing an answer to the external inquiry. The ECU also monitors the website to check for errors or problems and, if any, they are corrected within the ECU, or reported to the IT Directorate and the web management company to resolve the problem.

The ECU has recently commenced the process of creating a mirror Arabic website. This will enable a large segment of the CBB’s audience / stakeholders to benefit from the information provided by the CBB. The task of creating an Arabic website for the CBB was initiated based on the directives of His Excellency the Governor who is keen to provide the best services in a user-friendly way to meet the needs of the public.

The CBB website received the award of excellence for the 2011 e-Government awards for the (e-Economy) category. The announcement was made during the opening ceremony of the Bahrain International e-Government Forum 2011.
CBB’s Organizational Chart
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
INDEPENDENT AUDITORS’ REPORT TO THE BOARD OF DIRECTORS
CENTRAL BANK OF BAHRAIN
Manama, Kingdom of Bahrain 2 April 2012

Report on the financial statements

We have audited the accompanying financial statements of the Central Bank of Bahrain (the “Central Bank”), which comprise the balance sheet as at 31 December 2011, and the related profit and loss account and appropriation for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Responsibility of the management for the financial statements

The management of the Central Bank is responsible for the preparation and fair presentation of these financial statements 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 the financial statements that are free from material misstatement, whether due to fraud or error.

Auditors’ responsibility

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

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

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

**Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Central Bank as at 31 December 2011, and its financial performance for the year then ended in accordance with the accounting policies described in Note 2 of these financial statements and in compliance with the Royal Decree No. 64 of 2006.
## BALANCE SHEET
(Expressed in thousands of Bahraini Dinars)

<table>
<thead>
<tr>
<th>Note</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gold</td>
<td>3</td>
<td>2,500</td>
</tr>
<tr>
<td>Foreign reserves</td>
<td>3,4</td>
<td>2,175,067</td>
</tr>
<tr>
<td>Due from Ministry of Finance</td>
<td>5</td>
<td>-</td>
</tr>
<tr>
<td>Cash, due from Bahraini banks and treasury bills</td>
<td>6</td>
<td>48,933</td>
</tr>
<tr>
<td>Other assets</td>
<td>7</td>
<td>10,858</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td></td>
<td><strong>2,237,358</strong></td>
</tr>
<tr>
<td>Notes and coins in circulation</td>
<td>3</td>
<td>508,998</td>
</tr>
<tr>
<td>Bahraini Dinar deposits</td>
<td></td>
<td>1,037,946</td>
</tr>
<tr>
<td>Other deposits</td>
<td></td>
<td>180,244</td>
</tr>
<tr>
<td>Due to other central banks</td>
<td></td>
<td>250</td>
</tr>
<tr>
<td>Due to Ministry of Finance</td>
<td>5</td>
<td>501</td>
</tr>
<tr>
<td>Profit payable to the Government of Kingdom of Bahrain</td>
<td></td>
<td>5,500</td>
</tr>
<tr>
<td>Provision for currency withdrawn</td>
<td></td>
<td>6,245</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>8</td>
<td>4,641</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td></td>
<td><strong>1,744,325</strong></td>
</tr>
<tr>
<td>Capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td>9</td>
<td>200,000</td>
</tr>
<tr>
<td>General reserve</td>
<td>10</td>
<td>193,716</td>
</tr>
<tr>
<td>Contingency reserve</td>
<td>11</td>
<td>83,976</td>
</tr>
<tr>
<td>Revaluation reserve</td>
<td>12</td>
<td>15,341</td>
</tr>
<tr>
<td><strong>Total capital funds</strong></td>
<td></td>
<td><strong>493,033</strong></td>
</tr>
<tr>
<td><strong>Total liabilities and capital funds</strong></td>
<td></td>
<td><strong>2,237,358</strong></td>
</tr>
</tbody>
</table>

The financial statements on pages 48 to 58 were approved by the Board of Directors on 2 April 2012 and signed on its behalf by:

Qassim Fakhro  
Chairman

Rasheed Al Maraj  
Governor

The notes on pages 51 to 58 are an integral part of the balance sheet and profit and loss account and appropriation.
PROFIT AND LOSS ACCOUNT AND APPROPRIATION
For the year ended 31 December 2011
(Expressed in thousands of Bahraini Dinars)

<table>
<thead>
<tr>
<th>Note</th>
<th>Income</th>
<th>Year ended 31 December 2011</th>
<th>Year ended 31 December 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Interest income</td>
<td>22,067</td>
<td>25,387</td>
</tr>
<tr>
<td></td>
<td>Interest expense</td>
<td>(4,339)</td>
<td>(5,350)</td>
</tr>
<tr>
<td></td>
<td>Net interest income</td>
<td>17,728</td>
<td>20,037</td>
</tr>
<tr>
<td></td>
<td>Registration and licensing fees</td>
<td>5,564</td>
<td>5,280</td>
</tr>
<tr>
<td></td>
<td>Exchange gain on sale of US dollars</td>
<td>5,783</td>
<td>4,766</td>
</tr>
<tr>
<td></td>
<td>Net realised investment gain</td>
<td>4,883</td>
<td>5,031</td>
</tr>
<tr>
<td></td>
<td>Other income</td>
<td>961</td>
<td>856</td>
</tr>
<tr>
<td></td>
<td>Total income</td>
<td>34,919</td>
<td>35,970</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Expenses</th>
<th>Year ended 31 December 2011</th>
<th>Year ended 31 December 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Staff costs</td>
<td>(10,717)</td>
<td>(10,735)</td>
</tr>
<tr>
<td></td>
<td>General and administration expenses</td>
<td>(6,937)</td>
<td>(5,848)</td>
</tr>
<tr>
<td></td>
<td>Managed funds and advisory fees</td>
<td>(999)</td>
<td>(966)</td>
</tr>
<tr>
<td></td>
<td>Notes issue expenses</td>
<td>(2,205)</td>
<td>(3,004)</td>
</tr>
<tr>
<td></td>
<td>Total operating expenses</td>
<td>(20,858)</td>
<td>(20,553)</td>
</tr>
</tbody>
</table>

|      | Profit for the year before impairment provision | 14,061 | 15,417 |
|      | Provision for impairment | 4 | - | (517) |
|      | Profit for the year | 14,061 | 14,900 |

|      | Transfer to contingency reserve | 11 | (3,061) | (3,900) |
|      | Transfer to general reserve | 10 | (5,500) | (5,500) |
|      | Balance payable to Kingdom of Bahrain | 5,500 | 5,500 |

The financial statements on pages 48 to 58 were approved by the Board of Directors on 2 April 2012 and signed on its behalf by:

Qassim Fakhro
Chairman

Rasheed Al Maraj
Governor

The notes on pages 51 to 58 are an integral part of the balance sheet and profit and loss account and appropriation.
Notes to the financial statements for the year ended 31 December 2011
(Expressed in thousands of Bahraini Dinars)

1. Activity

The Central Bank of Bahrain (the “Central Bank”) 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 Central Bank is responsible for maintaining the monetary and financial stability in the Kingdom of Bahrain.

The Central Bank 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 financial statements of the Central Bank, comprise the balance sheet as at 31 December 2011, and the related profit and loss account and appropriation for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

2. Significant accounting policies

The financial statements have been prepared in accordance with the requirements of the Royal Decree No. 64 of 2006 using the following significant accounting policies. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Accounting convention

The financial statements 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/ placements 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**

All equipment used by the Central 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 in the Central Bank.
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 Central Bank of Bahrain and Financial Institution Law, 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 in the profit and loss account and appropriation 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 in the profit and loss account and appropriation when incurred.

2.12 Provision

Provision is recognised if, as a result of a past event, the Central Bank has a present legal or constructive obligation that can be estimated reliably, and it is probably that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.
Chapter 5: Financial Statements for the Year Ended 31 December 2011

3. Excess of authorised backing over currency in circulation

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</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>2,175,067</td>
<td>2,267,669</td>
</tr>
<tr>
<td></td>
<td>2,177,567</td>
<td>2,270,169</td>
</tr>
<tr>
<td>Notes and coins in circulation</td>
<td>(508,998)</td>
<td>(436,985)</td>
</tr>
<tr>
<td>Excess of authorised backing over currency in circulation</td>
<td>1,668,569</td>
<td>1,833,184</td>
</tr>
</tbody>
</table>

According to Article 19 of the Central Bank of Bahrain and Financial Institution 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 2011 was BD 88,467 thousand (2010: BD 79,914 thousand).

4. Foreign reserves

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds portfolios</td>
<td>673,239</td>
<td>627,454</td>
</tr>
<tr>
<td>Bank deposits</td>
<td>1,508,920</td>
<td>1,647,307</td>
</tr>
<tr>
<td></td>
<td>2,182,159</td>
<td>2,274,761</td>
</tr>
<tr>
<td>Less: provision for impairment</td>
<td>(7,092)</td>
<td>(7,092)</td>
</tr>
<tr>
<td></td>
<td>2,175,067</td>
<td>2,267,669</td>
</tr>
</tbody>
</table>

All bonds are quoted in active markets with 98% being of investment grade BBB or higher (2010: 99%). More than 99% of deposits and 73% of bonds are in US dollars (2010: 91%). For other foreign currencies, these are 99% hedged into US dollars. The bond portfolios include BD 2,701 thousand net unrealised losses on non-US denominated bonds and related forward foreign exchange contracts used to hedge such bonds (2010: loss of BD 445 thousand).

The market value of the bond portfolios (including cash and accrued interest held within these portfolios) at 31 December 2011 was BD 674,957 thousand (2010: BD 613,985 thousand).

The Central Bank has recognised an impairment provision amounting to nil for the year ended 31 December 2011 (2010: BD 517 thousand).
5. Due from/ to Ministry of Finance

The amount represents the net due from/ to the Ministry of Finance for payments and receipts related to the Ministry made by the Central Bank.

6. Cash, due from Bahraini banks and treasury bills

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>19,416</td>
<td>621</td>
</tr>
<tr>
<td>Due from Bahraini banks</td>
<td>23,017</td>
<td>698</td>
</tr>
<tr>
<td>Treasury bills issued by the Government of Bahrain</td>
<td>6,500</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>48,933</strong></td>
<td><strong>1,319</strong></td>
</tr>
</tbody>
</table>

Cash includes US dollars held by the Central Bank amounting to US$ 51,438 thousand (equivalent BD 19,392 thousand) (2010: US$ 1,586 thousand (equivalent BD 598 thousand)).

Due from Bahraini banks include an overnight placement with a Bahraini bank amounting to BD 13,000 thousand and a three month deposit with another Bahraini bank amounting to BD 9,410 thousand.

7. Other assets

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest receivable</td>
<td>2,295</td>
<td>2,225</td>
</tr>
<tr>
<td>Staff loans</td>
<td>4,781</td>
<td>4,035</td>
</tr>
<tr>
<td>Equipment</td>
<td>1,708</td>
<td>1,780</td>
</tr>
<tr>
<td>Others</td>
<td>2,074</td>
<td>1,923</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>10,858</strong></td>
<td><strong>9,963</strong></td>
</tr>
</tbody>
</table>

8. Other liabilities

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrued expenses</td>
<td>132</td>
<td>167</td>
</tr>
<tr>
<td>Payables</td>
<td>4,509</td>
<td>4,754</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4,641</strong></td>
<td><strong>4,921</strong></td>
</tr>
</tbody>
</table>
9. Capital

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</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>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at beginning of the year</td>
<td>188,216</td>
<td>182,716</td>
</tr>
<tr>
<td>Transfer from profit and loss account and appropriation</td>
<td>5,500</td>
<td>5,500</td>
</tr>
<tr>
<td>Balance at end of the year</td>
<td>193,716</td>
<td>188,216</td>
</tr>
</tbody>
</table>

In accordance with Article 12 of the Central Bank of Bahrain and Financial Institution Law, the Central Bank maintains a general reserve which is credited with the following percentages of its net profit:

- 100% of the 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 and allocation to the contingency reserve 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 financial statements.

11. Contingency reserve

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at beginning of the year</td>
<td>80,915</td>
<td>77,015</td>
</tr>
<tr>
<td>Transfer during the year</td>
<td>3,061</td>
<td>3,900</td>
</tr>
<tr>
<td>Balance at end of the year</td>
<td>83,976</td>
<td>80,915</td>
</tr>
</tbody>
</table>

In accordance with Article 21 the Central Bank of Bahrain and Financial Institution Law, the Board has approved a transfer of BD 3,061 thousand of
the current year’s net profit to the contingency reserve.

12. Revaluation reserve

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at beginning of the year</td>
<td>15,887</td>
<td>16,828</td>
</tr>
<tr>
<td>Movement during the year</td>
<td>(546)</td>
<td>(941)</td>
</tr>
<tr>
<td>Balance at end of the year</td>
<td>15,341</td>
<td>15,887</td>
</tr>
</tbody>
</table>

The revaluation reserve relates to exchange gains and losses recognised in accordance with the Central Bank of Bahrain and Financial Institution Law 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 2011 there were no outstanding contingent liabilities or commitments (2010: Nil) with the exception of outstanding foreign exchange contracts with a notional value of BD 229,613 thousand (2010: BD 92,234 thousand).

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.