

مَصْرَفُ الْبَحْرَيْنِ الْمُرَكَّبِي
Central Bank of Bahrain

Annual Report

2013

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Chapter

1

1. Monetary Policy Developments

Overview

Monetary Policy Management

Domestic Interest Rates

Public Debt Issuance

Overview

During 2013, 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 2013. 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 2013, the reserve requirement remained unchanged at 5%.

Money Market Forum

During 2013, the CBB conducted meetings with all retail banks 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 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 Monetary Policy Committee (“MPC”).

Domestic Interest Rates

Key Policy Interest Rates

During 2013, there was no change in the facilities interest rates provided by the CBB to retail 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 and Ijara Sukuk.

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

As at end-2013, the 3 month BHIBOR rate was 1.15 %, compared to 1.18% at end-2012. The 6 month BHIBOR rate was 1.51 % at end-2013, compared to 1.52% at end-2012.

Loan and Deposit Rates

At the end of 2013, the weighted average BD time deposit rate (3-12 months) stood at 1.08%, compared to 1.00 % at the end of 2012. The weighted average rate on saving accounts increased from 0.22% to 0.25%. The weighted average interest rate on business loans (excluding overdrafts) increased from 4.94% at end-2012 to 5.08% at end-2013, while interest rate on personal loans decreased from 5.96% to 5.90% 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 2013, the CBB issued conventional 3-month treasury bills, denominated in Bahraini dinars, on a weekly basis, with an issue amount of BD 35 million. From 4th September, 2013, the issue amount was raised from BD 35 million to BD 45 million as per the instruction received from the MOF.

Six (6)-month Treasury Bills were also issued, on a monthly basis, with an issue amount of BD 30 million. In addition, the CBB issued 12-month Treasury Bills on a quarterly basis, with an issue amount of BD 100 million. From 5th September, 2013, the issue amount was raised from BD 100 million to BD 150 million as per the instruction received from the MOF.

On 1st August 1, 2013, the CBB, under advice of the Ministry of Finance, issued a USD 1.5 billion international development bond with a maturity period of ten (10) years at a fixed rate of 6.125%. On 4th July, 2013, the CBB issued a BD 150 million local government development bond with a maturity period of 3 years at a fixed rate of 2.9% in addition to a BD 350 million local government development bond with a maturity period of seven (7) and a half years at a fixed rate of 5.5%.

The CBB also issued, on a monthly basis, three-month AlSalam Sukuk (BD) for BD 36 million from 25th September 2013 the issue amount was changed from BD 18 million to BD 36 million as per instruction received from the Ministry of Finance.

In addition, the CBB issued, on a monthly basis, six-month Ijara Sukuk for BD 20 million.

On 13th May 2013, a BD 100 million Ijara Sukuk was issued with a fixed rate of 1.45% with maturity period of 2 years.

Chapter

2

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) increased to USD 192.0 billion by the end of 2013, compared to USD 186.3 billion at the end of 2012, an increase of 3.1%. Wholesale banks represented 60.8% of total assets, whilst retail banks accounted for 39.2%.

Domestic banking assets amounted to USD 48.7 billion at the end of 2013 compared to USD 48.3 billion at the end of 2012, representing an increase of USD 0.4 billion (0.8%). Foreign assets amounted to USD 143.3 billion, compared to USD 138.1 billion at the end of 2012, an increase of USD 5.2 billion (3.8%).

Domestic liabilities decreased to USD 50.5 billion at the end of 2013 compared to USD 51.2 billion at the end of 2012, a decrease of USD 0.7 billion (1.4%). Total foreign liabilities increased by USD 6.4 billion (4.7%) to reach USD 141.5 billion against USD 135.1 billion at the end of 2012.

Retail Banks¹

The consolidated balance sheet of retail banks increased by 4.8% to BD 28.3 billion at the end of 2013, compared to BD 27.0 billion at the end of 2012.

Total domestic assets grew by BD 0.3 billion (2.0%) to reach BD 15.5 billion, with claims on private non-banks increasing by BD 0.5 billion (6.3%) and claims on general government securities growing by BD 0.8 billion (36.4%).

Foreign assets recorded an increase of BD 1.0 billion (8.5%), reaching a total of BD 12.8 billion at the end of 2013 compared to BD 11.8 billion at the end of 2012. Claims on foreign non-banks increased by BD 2.0 billion (33.3%) from BD 6.0 billion at the end of 2012 to BD 8.0 billion at the end of 2013, while claims on foreign banks decreased by BD 1.0 billion (17.2%), reaching a total of BD 4.8 billion at the end of 2013.

Total domestic liabilities of retail banks increased by BD 0.1 billion (0.7%) from BD 15.0 billion at the end of 2012 to BD 15.1 billion at the end of 2013. This was due to an increase in liabilities to private non-banks by BD 0.7 billion (8.8%) and liabilities to capital and reserve by BD 0.2 billion (10.0%).

¹ This includes conventional and Islamic retail banks.

Total foreign liabilities increased to reach BD 14.8 billion at the end of 2013. Liabilities to banks increased by BD 0.4 billion (5.8%) as well as liabilities to non-banks which increased by BD 0.9 billion (18.0%).

Loans and Credit Facilities

Outstanding loans and credit facilities of retail banks stood at BD 7.2 billion at the end of 2013, a 5.9% increase compared to the BD 6.8 billion at the end of 2012. The business sector accounted for 60.0% of total loans and credit facilities, while individuals and the government sector represented 37.6% and 2.4% respectively.

Deposits

Retail banks' total domestic deposits increased to BD 10.7 billion at the end of 2013 compared to BD 9.9 billion at the end of 2012, an increase of BD 0.8 billion (8.1%). This was due to higher private sector deposits which increased by BD 0.7 billion (8.8%) and general government deposits which increased by BD 0.1 billion (5.3%).

Domestic deposits in Bahraini Dinar increased by BD 0.7 billion (8.9%) to BD 8.6 billion at the end of 2013. Domestic foreign currency deposits increased by 5.0% or BD 0.1 billion to reach BD 2.1 billion. Bahraini Dinar deposits and foreign currency deposits constituted 80.3% and 19.7% 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 19.3%, while Asia accounted for 9.4%, Western Europe accounted for 7.0%, North and South America for 5.4%, and other Arab countries for 2.7%.

In terms of currency, the share of US dollar denominated assets was 45.4%, while the GCC currencies (excluding Bahraini dinar) accounted for 5.2% of total assets. The Euro represented 3.5% of total assets.

Wholesale Banks^{2 3}

The consolidated balance sheet of wholesale banks increased by USD 2.1 billion or 1.8% to USD 116.7 billion at the end of 2013, compared with USD 114.6 billion at the end of 2012.

Total domestic assets declined to USD 7.5 billion at 2013, compared with USD 7.9 billion at the end of 2012.

Foreign assets increased by USD 2.5 billion (2.3%) to USD 109.2 billion at the end of 2013. This was due to increases in claims on banks by USD 0.9 billion (7.2%), and in claims on non-banks by USD 1.0 billion (3.4%).

Total domestic liabilities of wholesale banks decreased by USD 1.2 billion (10.5%) to USD 10.2 billion at the end of 2013 compared with USD 11.4 billion at the end of 2012.

Foreign liabilities increased by USD 3.3 billion (3.2%) to reach USD 106.5 billion at the end of 2013, compared with USD 103.2 billion at the end of 2012. This increase was mainly due to an increase in liabilities to non-banks which increased by USD 6.6 billion (31.4%).

Geographical and Currency Distribution of Assets

The share of total assets accounted for by the GCC (excluding Bahrain) reached a total of 29.4%, while Western Europe accounted for 38.6%, North and South America for 11.9%, Asia for 8.7%, and other Arab countries for 3.7%.

As for currency, the share of GCC currencies (excluding Bahraini dinar) of total assets was 11.5% with the dollar accounting for 65.5% of total assets and the Euro comprising 9.5% of total assets.

² This includes conventional and Islamic wholesale banks.

³ The balance sheets of wholesale banks are usually denominated in USD.

Chapter

3

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 2013 to strengthen regulatory policies and to develop appropriate prudential regulations, in order to maintain financial stability and market integrity.

Updates to CBB Rulebook

Basel III adoption

As part of its continuous endeavours to enhance the regulatory framework by adopting Basel committee's standards, the CBB has issued high level directives in June 2013 which include the timeframe for the implementation of Basel 3.

These directives are based on several phases, which commenced with "the Assessment Phase" in the first quarter of 2013 when the CBB issued its directives to all locally incorporated banks requiring them to report pro-forma Basel 3 ratios on leverage, capital adequacy and liquidity on a quarterly basis with effect from March 2013.

The adopted timeframe provides transitional arrangements for banks to comply with the new capital requirements and aims to ensure the ability of banks to meet the new capital requirements within a reasonable period which begins in 2015. It is worth mentioning that Bahraini banks have to comply with a capital adequacy ratio of 12.5% which is higher than the minimum required by Basel 3 Convention.

The CBB has also issued a consultation paper in December 2013 to all conventional bank licensees on amendments to Module CA ("Capital Adequacy") of the CBB Rulebook Volume 1, which will include the new definition of Regulatory Capital according to Basel 3 requirements.

The CBB intends to issue a similar consultation paper for Islamic banks during the first quarter of 2014.

Proposed Directives on Credit Grading/Classification System

The CBB has issued in June 2013 a second consultation paper concerning credit grading system that includes what was agreed upon during the meetings that the CBB held with banks and audit firms to discuss their

comments on the first consultation paper that was issued in February 2012 in this regard. The CBB intends to issue such directives in its final form during the second quarter of 2014.

The proposed Directive includes amendments to “Credit Risk Management” Module of the CBB Rulebook regarding the classification of credit. It sets out minimum provisioning levels for Non-Performing Loans and other credit facilities with local banks, which will help boost the credibility of provisioning levels, to ensure and maintain the quality of loan/financing portfolios and provisioning levels.

Proposed Consultation Paper on Remuneration Practices of Licensed Banks

The CBB has issued directives on remuneration practices of licensed banks in November 2013, in an attempt to develop the CBB rules on compensation practices for banks and in order to work towards compliance with international standards on compensation.

These directives include Compensation Principles and Standards issued by Basel Committee on Banking Supervision on remuneration policy and Assessment Methodology. These directives are also in line with relevant regulatory requirements applicable globally in accordance with the directives of the Financial Stability Board (“FSB”).

The directives also require that banks apply effective corporate governance principles related to the remuneration of managers in banks, and material risk takers whose job responsibilities involve taking significant risk decisions in addition to the allowances and remuneration of the members of the Board of Directors. In addition, the directives also require implementation of sound remuneration practices related to salaries and bonuses that are commensurate with the results of risk; hence it entails reduction of bonuses in the case of deterioration of the Bank's performance.

The remuneration practices should take into consideration that risks evolve over time and hence it must take into consideration the time horizon of these risks and therefore, bonuses should be deferred accordingly. The management must not pay remuneration in the case of unrealised gains, or if the expected profits are uncertain, until payments are effectively collected.

Proposed Regulation with respect to the Conditions and Procedures for Obtaining Approval for Controlled Functions within Licensees

The CBB, in March 2013, issued a draft regulation which outlines the terms and conditions for the CBB approval requirements of licensees' memberships on the Board of Directors and for any executive post as required under Article 65(a) of the CBB Law.

The draft regulation has been sent to the Legislation and Legal Opinion Commission for review and final issuance in the Official Gazette.

New Directives on Training & Competencies Requirements for Licensed Banks

The CBB has issued a new "Training and Competency" Module in October 2013 to ensure satisfactory levels of competence, in terms of an individual's knowledge, skills, experience and professional qualifications in accordance with Article 65(b) for persons occupying controlled functions. The Module was issued in its final form after studying and taking the financial sector's comments into consideration with regards to the consultation paper.

New Risk Management Module for Islamic Banks.

The CBB has issued a new Risk Management Module under Rulebook Volume 2 for Islamic Banks in January 2013 after concluding the consultation with Islamic banks and taking into consideration the comments received.

This Module incorporates the Guiding Principles issued by the Islamic Financial Services Board ("IFSB") "Risk Management Standard - December 2005" and Risk Management Principles issued by the Basel Committee.

The new RM Module sets out fifteen principles of risk management that give practical effect to managing the risks underlying the business that Islamic bank licensees may adopt. Apart from a general prudent risk management requirement (Principle 1), the principles are grouped into six categories of risks, and these must be used as the basis for Islamic banks' risk management processes. The six categories of risks are:

- ✓ Credit Risk
- ✓ Equity Investment Risk
- ✓ Market Risk
- ✓ Liquidity Risk
- ✓ Rate of Return Risk

✓ Operational Risk

Consultation on Treating all Restricted Investment Accounts as Collective Investment Undertakings

As part of CBB's continuous initiatives to strengthen the regulatory framework for the Islamic finance industry, a new consultation paper has been issued 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 relationship 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 7). The comments received on the consultation paper have been studied and the directive was issued in its final form in January 2013 for Islamic banks.

New Directives on Internal Audit Function in Banks

The CBB will issue during the first quarter of 2014, new Directives related to internal audit function within banks as part of its efforts to promote a strong internal audit function in line with international best practices. These directives are based on the Basel Committee's final paper issued in June 2012 'The internal audit function in banks'.

The new Rules encourage banks' internal auditors to comply with and to contribute to the development of national and international professional standards and promote due consideration of prudential issues in the development of internal audit standards and practices.

Proposed Directives on Business & Market Conduct for Licensed Islamic Banks

The CBB has issued in May 2013 a consultation paper on proposed amendments to Business and Market Conduct Module to reflect the IFSB principles on business conduct "Guiding Principles on Conduct of Business for Institutions Offering Islamic Financial Services" issued in December 2009. Later during 2013, the CBB received feedback from banks on this consultation paper and they're currently under internal study.

The proposed Module covers principles that are intended to enhance the protection of the interests of customers and the integrity of the market. Also to promote a climate of confidence and a supportive environment that upholds transparency and fair dealing, and also strengthen the relevant moral, social and religious dimensions in conducting business.

Proposed Regulation on Close-Out Netting

The CBB has issued a new consultation paper in January 2013 on a draft regulation introducing and governing “close-out netting” in the Kingdom of Bahrain in accordance with Article (108) of the CBB Law.

The comments received from banks have been studied and discussed internally. The draft regulation will be forwarded to the Legislation and Legal Opinion Commission for review and final issuance in the Official Gazette.

The draft regulation includes rules and conditions that must be met in the market contract and procedures that must be followed to implement the netting in accordance with this contract, including the identification of any of the agreements it shall apply to (termed “market contracts”). The draft regulation has been based predominantly on a template developed by ISDA.

The introduction of close-out netting in Bahrain could have significant benefits for the local banking community. It will lay down an efficient streamlined procedure for settling financial transactions which will lead to greater consistency in dealings between counterparties and more confidence in the financial sector. This, in turn, could lead to lower borrowing costs for financial institutions and a potential reduction in capital adequacy charges.

Regulation Governing Control in Investment and Insurance Firm Licensees

The CBB has issued a consultation paper on a draft Regulation governing control in investment and insurance firm licensees.

This Regulation includes provisions and limits of control and ownership in investment and insurance firms; in addition to the procedures for obtaining approval for applications for control and the CBB’s procedures to study such applications.

This Regulation is in accordance with Article (52) of the Central Bank of Bahrain and Financial Institutions Law.

Rulebook Volume 5

Issuance of some of Rulebook Volume 5 Modules related to Specialised Companies

a) New directives related to Financing Companies – Conventional and Islamic

The CBB has developed new directives related to financing companies – conventional and Islamic as part of its initiatives to develop a regulatory framework for specialised companies falling under Rulebook Volume 5. The new Modules that have been issued are: Authorisation Module, CBB Reporting Requirements Module, High Level Controls Module, Capital Adequacy Module and General Requirements Module as phase 1 in February 2013

The CBB will issue in January 2014 another set of Modules for financing companies following a thorough consultation process. These Modules are: Public Disclosure, Training & Competency, Business Conduct and Operational Risk.

b) New directives related to Microfinance Institutions

The CBB issued a number of consultation papers in May 2013 that include new directives for Microfinance Institutions such as Authorisation Module, High Level Controls Module, General Requirements Module, Capital Adequacy and Liquidity Requirements Module, Business Conduct Module, CBB Reporting Requirements Module and Public Disclosure Module.

The new Directives are considered quite flexible to accommodate the unique nature of microfinance activities in relation to retail conventional and Islamic Banking activities and in order to apply a balanced and orderly working framework that does not impose a burden or additional costs on micro finance institutions.

The CBB has studied the comments received from the industry in relation to these new directives and presented them to the Regulatory Policy Committee. These directives will be issued in their final form in January 2014.

c) New directives related to Ancillary Service Providers

The CBB is currently working on developing new directives related to Ancillary Service Providers in order to issue them as consultation papers in the first quarter of the year 2014.

Money Changers

All Modules pertaining to Money Changer licensees had been issued at the end of 2010, and FISD ensured that all Money Changer Licensees are fully compliant with their requirements in relation to their operations, capital adequacy and reporting.

On 21st January 2013, a circular was sent to all money changers who are permitted to import and export cash consignments. The circular contained a set of requirements in which such exchanges must comply with in order to avoid any unforeseen disruption of their activities while conducting such business.

Rulebook Volume 6

Issuance of a new Offering of Securities ("OFS") Module

The CBB has issued new directives in December 2013 with respect to requirements for the issuing and offering of securities in or from the Kingdom of Bahrain, as part of its efforts to enhance Bahrain's regulatory and supervisory framework for the capital market sector.

The new OFS Module aims to introduce a consistent, effective and harmonised approach in the regulation and supervision of the issuing and offering of securities in line with the requirements laid out in the CBB Law. The development in the financial sector has led to the demand for such a framework and it is essential to the long-term viability and success of Bahrain's capital markets.

These directives contain all the key requirements relating to the issuing and offering of securities, including a number of new requirements that have been introduced to facilitate the raising of capital and meet market requirements and international best practices. It will further underscore the protection afforded to investors and the level of market integrity in the capital market in Bahrain.

Supervisory Developments

Compliance Directorate

During the year 2013, 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 Committee contributed to revising Article (3) of law No. 4 of the year 2001 with regards to anti money laundry and terrorist financing to be in line with the latest developments in the Financial Action Task Force ("FATF") recommendations. **His Majesty the King Hamad bin Isa Al Khalifa** issued law No.25 for the year 2013 with respect to identifying the twenty crimes related to money laundering and terrorist financing.

In light of the new FATF recommendations introduced in February 2012, the Policy Committee has decided to work with ministries and government authorities on a unified strategic plan with regards to anti money laundering and terrorist financing. The national plan aims to implement the new FATF recommendations within the specified time frame based on country's risk assessment. As the revised FATF 40 recommendations require a systematic, risk-based AML/CFT assessment at both country level and institutional level, ministries and regulatory authorities will be responsible for thoroughly analysing and addressing the recommendations based on their relevance and applicability.

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 enhance the level of AML/CFT awareness within banks, moneychangers, insurance firms and the capital market sector.

The government of Bahrain is negotiating with the US government to sign Model 1 ("IGA 1") of the Foreign Account Taxation Act ("FATCA") Agreement.

The Compliance Directorate has been coordinating with the licensees to ensure their readiness for FATCA. The licensees were requested to provide

detailed implementation plans outlining the steps that have been taken to ensure that all systems and procedures are in place to meet FATCA requirements by the proposed deadline.

Banking Supervision Directorates

The CBB with the objective of protecting the interest of consumers of banking services as well as ensuring financial stability, continued its proactive monitoring of banks and financial institutions while taking measures that facilitate enhanced transparency and disclosures as well as provide adequate assurance to consumers.

During the year 2013, the following measures were taken by the Banking Supervision Directorate as part of its mandate:

- **Monitoring the Level of Real Estate Exposures:** The CBB continued with its monitoring of the banks' exposure to the real estate sector on a monthly basis so as to avoid risk concentration therein.
- **Related Party Exposures:** The CBB continued its monitoring of related party exposures of locally incorporated banks 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 was continued to be monitored by the CBB on a quarterly basis with the objective of keeping track of any abnormal trends in the portfolio. The banks were accordingly advised to take pre-emptive measures to check the growth in impaired loans.
- **Prudential Meetings:** The Conventional Banking Supervision Directorates conducted 50 prudential meetings with the CBB's licensees, which discussed the previous year's performance, strategy for the ensuing year, and other supervisory issues of concern for the CBB.
- **Meeting on Financial Statements:** The CBB conducted annual meetings with banks along with their external auditors, to discuss year-end financial statements for 2013, before such statements are submitted to the respective bank's Board of Directors for approval. The

discussions encompassed; basis of recognition of income, valuation practices, impaired assets, breakdown and adequacy of provisions, proposed dividends and staff bonuses.

- **Studies/Surveys:** As part of its objective of protecting customer's interest as well as enhancing the quality of banking services in Bahrain, the CBB undertook special studies/surveys involving, among others, the opening of accounts for non-residents in Bahrain. Consequently, the process of opening such accounts was made relatively easier. The CBB also initiated a study to assess the level of non-performing consumer loans in the banking system. The assessment will be continued during 2014.
- **Bahrain Credit Reference Bureau ("BCRB"):** The CBB coordinated with the BCRB to expand its credit referencing services to cover credit information on all companies/corporates based in Bahrain, with the objective of enhancing the credit quality in the banking system. Accordingly, the CBB directed all banks including retail, wholesale and foreign bank branches as well as financing companies to ensure that they are process and IT-enabled to go live by 1st January 2014, with the User Acceptance Test conducted and completed by BCRB during the year.
- **Consolidated Supervision:** The CBB as part of its consolidated supervision approach pursued locally incorporated banks and conducted onsite visits to subsidiaries of these institutions in UK and UAE. These visits also facilitated cross border exchange of information between the CBB and the host country regulatory agency.
- **Domestic-Systematically Important Banks ("D-SIBs"):** The CBB methodology identified certain retail banks as D-SIBs based on criteria of size, complexity and interconnectedness. This follows the principles of the methodology detailed in the BCBS papers, tailored to the specific requirements of the financial industry in Bahrain. These banks were directed to prepare recovery and resolution plans in line with the Financial Stability Board SIFI recommendations.

- **Appointed Experts Assignments:** As part of its efforts to augment the effectiveness of its supervisory practices the CBB appointed qualified “Appointed Experts” to undertake Agreed Upon Procedures and onsite Examination of its licensees. As such 3 assignments were handled during 2013 covering conventional licensees. The issues examined included inter-alia compliance with the Code of Practice for consumer credit and charges, risk management and control.
- **Monitoring of Banks BOD and Organisation Structure:** The CBB reviewed corporate governance reports submitted by banks on an annual basis with the objective of evaluating the performance of the Board of Directors in bank boards. The reviews emphasised on the attendance of the Directors and the role played by them in BOD meetings and also the structure of BOD committees and the appointment of independent directors. The organisational structures of banks were reviewed to ensure that there is no conflict of interest in the reporting lines of management and the banks had succession planning in place. As part of its monitoring of banks corporate governance the CBB also sent its representatives to the AGM/EAGM of banks.
- **Implementation of Electronic Submission of Returns and Analysis of Data (“ESRAD”):** With the objective of bringing efficiency in submission of information by licensees to the CBB, it initiated measures during the year by appointing a vendor through bid process management, to implement an electronic system called as ESRAD for online submission of data by licensees. The system will enable licensees to submit prudential returns online and generate MIS reports on the banks data submitted therein. The system presently is being tested by the Information Technology and Conventional Banking Supervision Directorates team and is expected to go live in 2014.

Other activities undertaken by the Supervision Directorates include:

- **Protecting Consumers Interests:** The CBB with the objective of ensuring that consumers of financial services are not overcharged by the banks for the services rendered undertook a survey on fees and

charges being charged by the banks and financial institutions and encouraged the banks/financial institutions to impose only justifiable charges on their services rendered.

- **Bahrain Credit Reference Bureau (“BCRB”):** The CBB continued its efforts towards data cleansing and facilitating greater availability of accurate customer information. Accordingly, it worked with retail banks and financing companies to bring down the open errors accounts with the BCRB to very low levels. This helped in reducing any hardships caused to customers due to misreporting.
- **EMV Compliance:** Although most of the retail banks and financing companies had become EMV compliant, the CBB continued to work with remaining retail banks and financing companies in the Kingdom to successfully replace the old magnetic stripe cards with new EMV compliant chip and pin cards.
- **Compliance with the “Code of Best Practice on Consumer Credit and Charging”:** The CBB’s supervisory team 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 consumers and are transparent in their dealings.
- **ATMs and Internet Banking Security:** The CBB alerted banks about new methods of ATM Phishing and hacking of internet banking systems. The CBB advised the banks to implement state of the art technology in dealing with these instances as well as strictly implement the requisite measures to protect the customer’s interests in such cases of fraud. The CBB required the Banks/financing companies providing internet banking services to regularly test their systems against security breaches and verify the robustness of security controls in place through conducting penetration testing by external experts at least once every six months and the reports thereon need to be submitted to the CBB. The Supervision Directorates shall monitor these reports to assess the vulnerability and the robustness of the internet banking system.

Towards promoting greater transparency and market discipline in the financial sector, the CBB continued its efforts of stringent monitoring of the disclosures made by its licensees and ensured that they are completely compliant with the CBB's requirements which are aligned to Basel Pillar 3 guidelines.

- **Public Disclosure by Banks:** The public disclosure requirements of the CBB were continuously monitored to ensure that licensees are in compliance with them. As such, the banks were required to submit their public disclosures report duly reviewed by their 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. In this regard, the CBB enforced and implemented a penalty structure outlining the amount of penalty to be imposed on banks in case of delay by the banks in submitting or disclosing the requisite information in accordance with the CBB rules.
- **Enforcement Actions:** The CBB continues to encourage high standard of compliance by its licensees, thus reducing the risk 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 Conventional Banking Supervision Directorates at the CBB have taken 60 enforcement actions against their licensees including imposition of penalties, during the year 2013.

Islamic Financial Institutions Supervision

The Directorate is responsible for the supervision of the Islamic Financial Institutions that provide regulated banking services. These include ٢٠ Wholesale Banks, ٦ Retail Banks, 2 Financing Companies, 1 Branch of a Foreign Bank and 1 Microfinance Institution .

The following are the key milestones achieved during the year 2013:

- Worked with Islamic Finance Services Board ("IFSB") in revising Standards on Capital Adequacy and Sukuk Securitisation, Supervisory Review Process, and Core Principles for Islamic Finance Regulations as members in the Technical Committees and Working Groups, as well as the membership in a Sub-Committee on Guidance Note on Quantitative Measures for Liquidity Risk Management.

- Participated in surveys for Islamic Financial Services Board (“IFSM”) and International Monetary Fund (“IMF”).
- Participated in Roundtable Discussions arranged by Waqf fund on topics of high importance to the industry, where industry professionals, regulators and Shari’a scholars converge to discuss the relevant aspects in details.
- Presentation to Waqf fund regarding SPVs supervision.
- Presentation on Liquidity Risk Management for IFSM Workshop in Doha.
- Conducting surveys and studies on Shari’a and regulatory aspects. Opened Women’s branch of Ithmaar Bank in Riffa.
- Participated in educating westerners about Islamic Banking by making presentations for Master’s level students from Dauphine Islamic Finance Executive Master’s Program at the University of Dauphine, Paris.
- Participated in weekly Rulebook familiarisation sessions.
- Visited local banks’ subsidiaries abroad and met with their supervisory authorities to discuss mutual matters.
- Supervising three merger processes between banks – Elaf with Capital Management House and Capinvest, Bank AKhair with Khaleeji Commercial Bank, and Al-Salam Bank with BMI.

Inspection Directorate

The Inspection Directorate completed its planned programme of onsite inspection visits to CBB licensees including full scope and subject-specific visits. The Directorate employed a 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 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.

During the year, the Directorate has developed an enhanced risk profiling methodology to assess the business, control failure and systemic risks of the licensees. The updated risk profiling methodology has been designed to enable enhanced assessment of probability of default and systemic risk of CBB licensees and is in alignment with international best practices.

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.

During 2013, the Directorate participated in the discussions hosted in Riyadh by GCC Task Force and Technical Payment Committee, which focused on promoting enhanced networking and communication solutions.

Capital Markets Supervision ("CMSD")

Capital Markets Supervision (CMS) Directorate

Volume 6 (Capital Markets)

During 2013, the CBB continued to work on modernising the capital markets regulatory framework to be in line with international standards and practices. The CBB consulted with its licensees, international agencies, stakeholders and interested parties, as well as other financial sector participants, to update its regulations. The CBB, in collaboration with the financial sector institutions, also took steps to introduce new and innovative financial instruments, as well as promote its regulatory framework, in order to maintain confidence and integrity within this sector.

Developments & Achievements

Development of the Rules and Regulations

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 markets, and protect investors. These included the following activities:

- Issuance of the Offering of Securities (OFS) Module in its final form on 9th December 2013 as part of Volume 6 of the CBB Rulebook after consultation

with the industry and which will come into effect beginning of the year 2014.

- The CMSD continued to work on other Modules of Volume 6, including the Disclosure Standards (“DIS”) Module, and the Internal Control and Risk Management (“IRM”) Module which will shortly be sent out as Consultation Papers to the industry.
- 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.
- **Licensing of Exchanges and Clearing, Settlement and Central Depositories**

1. Bahrain Bourse (BHB):

- a) The issuance of Resolution No. (02) of 2012 on 9th January 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.

Currently, Bahrain Bourse Co. B.S.C © is coordinating with the Licensing and Policy Directorate at the CBB on this subject, and any update on the completion and issuance of its rulebook and the segregation of the Clearing, Settlement and Central Depository functions through the establishment of an independent Clearing, Settlement and Central Depository Company.

- b) The CBB granted its in-principle and conditional approval to Bahrain Bourse on 25th March 2013, for establishing an independent, Single Person Company that will offer clearing, settlement and central depository services. The main objective for setting up the new Company is to segregate the clearing, settlement and central depository operations from trading operations of Bahrain Bourse. Accordingly, the Bahrain Bourse is required to finalize and complete necessary procedures and documentation after passing the relevant Board Resolution.

- c) Several meetings were held with officials of Bahrain Bourse to discuss and mutually agree on the proposed modifications to be incorporated in BHB's draft Market Rules that were approved by BHB's Board of Directors on 30th June 2013 and submitted to the CBB for approval on 14th July 2013.

Currently, Bahrain Bourse is working on finalizing its draft Listing Rules as well as the Clearing, Settlement and Central Depository (CSD) Rules.

- d) The Bahrain Bourse has submitted its draft "Bahrain Growth & Investment Market (BGIM) Rules" to the CBB on 26th December 2013. The CMS Directorate is currently reviewing the draft BGIM Rules in line with the CBB Law, rules and regulations.

- e) The Bahrain Bourse is currently working on installing and operating its new automated trading system.

- **The Bahrain Financial Exchange (BFX):**

The Bahrain Financial Exchange (BFX) commenced operation of its conventional division on 23rd November 2011 and has the following 6 products listed:

1. BFX Gold Futures
2. BFX Silver Futures
3. BFX Natural Gas Futures
4. BFX EUR-USD Futures
5. BFX MCX \$ Gold Futures
6. BFX MCX \$ Silver Futures

The BFX has 9 trading members whereas BCDC has 6 clearing members.

The CBB has approved the following derivative products to be listed and traded on the BFX. The product approvals are granted for a period of one year and are renewed thereafter.

| No | Product Name | Date of Approval | Date of last renewal |
|----|---------------------------|------------------|----------------------|
| 1 | BFX Gold Futures | 02.11.2011 | 20.05.2013 |
| 2 | BFX Silver Futures | 30.12.2012 | 20.05.2013 |
| 3 | BFX MCX \$ Gold Futures | 30.12.2012 | 20.05.2013 |
| 4 | BFX MCX \$ Silver Futures | 30.12.2012 | 20.05.2013 |

| | | | |
|---|-------------------------|------------|------------|
| 5 | BFX Natural Gas Futures | 02.11.2011 | 20.05.2013 |
| 6 | BFX EUR-USD Futures | 02.11.2011 | 20.05.2013 |
| 7 | BFX Zinc Futures | 11.06.2013 | - |
| 8 | BFX Nickel Futures | 11.06.2013 | - |
| 9 | BFX Lead Futures | 11.06.2013 | - |

- **Licenses for Market Intermediaries and Representatives:**

- 1. Trading Members:**

- The CBB issued its final approval as a Licensed Broker Dealer to the following:
 - VIBHS B.S.C © on 13th March 2013 for membership at the Bahrain Financial Exchange (BFX).
 - Triocon Financial Brokers W.L.L on 18th March 2013 for membership at the Bahrain Financial Exchange (BFX).
 - Elegant Commodities B.S.C © on 27th March 2013 for membership at the Bahrain Financial Exchange (BFX).
 - SMC Comex International DMCC on 4th April 2013 for membership at the Bahrain Financial Exchange (BFX).
 - Tradeline Securities W.L.L on 25th April 2013 for membership at the Bahrain Financial Exchange (BFX).
- The CBB issued its in-principle confirmation as a Licensed broker Dealer to the following:
 - Bonanza Global DMCC – Bahrain Branch on 13th May 2013 for membership at the Bahrain Financial Exchange (BFX).

- 2. Clearing Members:**

- The CBB issued its final approval as Clearing Members at the BFX Clearing and Depository Corporation (BCDC) to the following:
 - VIBHS B.S.C © on 13th March 2013 for membership as Clearing Member (Self) at the BFX Clearing and Depository Corporation (BCDC).

- Elegant Commodities B.S.C © on 27th March 2013 for membership as Clearing Member (Self) at the BFX Clearing and Depository Corporation (BCDC).
- b) The CBB issued its in-principle confirmation as Clearing Member at the BFX Clearing and Depository Corporation (BCDC) to the following:
 - Bonanza Global DMCC – Bahrain Branch on 13th May 2013 for membership as Clearing Member (Self) at the BFX Clearing and Depository Corporation (BCDC).
- **Primary Market:**

In 2013, the CMS Directorate issued its no objection to the use of 42 public and private offering documents (comparing to 30 offering documents in 2012) 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, as follows:

| Type of CBB Approval | Issues Value \$ | No. of Issues | Offering Method | Type of Security |
|------------------------------------|--------------------|------------------|-------------------------|-------------------------|
| - | - | - | Public Offering | Ordinary Shares |
| Registration – Article (81) | 1,345,725,500 | 18 | Private Placement | |
| - | - | - | Rights Issue | |
| - | - | - | Public Offering | Conventional Bonds |
| Registration – Article (81) | 253,049,000 | 2 | Private Placement | |
| Filing - Exempt from Article 81 | 2,600,000,000 | 4 | | |
| Registration – Article (81) | 1,500,000,000 | 1 | Governmental | |
| - | - | - | Governmental | Islamic Sukuk |
| - | - | - | Private Placement | |
| - | - | - | Convertible Murabaha | |
| - | - | - | Rights Issue | Preference Shares |
| - | - | - | Private Placement | |
| - | - | - | - | International Issues |
| Exempt from Article 81 | 96,000,000 | 17 | Private Placement | Structured Products |
| | 5,794,774,500 | 42 | | Total |

The gross total value of these issues amounted to USD 5.79 billion (comparing to USD 6.61 billion in 2012), which includes, one issue of Kingdom of Bahrain Government bonds with a total value of USD 1.5 billion, 18 issues of private placements in ordinary shares with a total value of USD 1.34 billion (comparing to USD 740 million in 2012), 6 issues of private placements in conventional bonds with a total value of USD 2.85 billion (Comparing to USD 4.25 billion in 2012), and 17 private issues of structured financial instruments with a total value of USD 96 million (comparing to USD106 million in 2012).

- **Compliance with Disclosure Standards:**

As per Resolution No. 49 of 2007 in respect of Dissemination of Listed Companies' Financial Statements and Board of Directors' Meetings, all listed companies notified the Bahrain Bourse on the dates of the Board of Directors meetings before five days from the end of each quarter for the year 2013, with the exception of Gulf Monetary Group and Taib Bank for all the quarters.

All listed companies, with the exception of Gulf Monetary Group and Taib Bank, published their Annual financial results for the year 2012 in two local newspapers within the prescribed deadline of (60) days following the end of the year. Likewise, the listed companies also held their Annual General Meetings within the (90) days deadline.

Moreover, all listed companies published their 2013 quarterly financial results within the prescribed deadline of (45) days following the end of quarter one, two and three of the same year, with the exception of Bahrain Middle East Bank for the first quarter and Ithmaar Bank for the second quarter, as well as Gulf Monetary Group and Taib Bank for all the quarters. The financial results were published in two local newspapers and included the required four main financial statement extracts

- **Market Surveillance:**

1. During 2013, 15 suspected transactions been detected with the prospect of non-compliance with the laws, rules and regulation. After scrutinizing and analysing the transactions, two cases of breach were identified in which the first one were transferred to Bahrain Bourse in order for them to provide the CMSD with their comments and explanations with regards to the transactions, and the other case were solved by the CMSD. The rest of the 13 cases were all normal with no violation of rules were identified.

- **Compliance and Enforcement:**

- During 2013 the CMS Directorate issued 54 letters of notice to the companies listed on the Bahrain Bourse, for not abiding by the on-going obligations, as follows:

| No-Compliance | Number of companies non-compliant | Number of letters of notice |
|---|-----------------------------------|-----------------------------|
| Circular: CMS/L018/2007: Listed company submit Register of interest within timeframe of 5 working days after end of each month | 18 | 33 |
| Resolution 49/2007: Article (3):Listed company Publish annual financial statement within timeframe (60 days) in two local newspapers as a minimum and simultaneously to Press and Exchange | 2 | 2 |
| Resolution 49/2007: Article (4):Listed company Publish quarterly reviewed financial statement within set time frame (45 days) in two local newspapers as a minimum and simultaneously to Press and Exchange | 4 | 4 |
| Resolution 49/2007: Article (4):Suspension of trade for non-compliance with publishing quarterly reviewed financial statement within set time frame (45 days) | 2 | 2 |
| Non-compliance with the CBB' requirements related to disclosure standards with regards to publishing the comparative figures for the period of the financial statements, for each quarter | 1 | 1 |
| Disclosure Standards-39.1 :Circulars, notes of meetings, proxy forms and advertising material must be submitted in draft form at least 5days in advance for approval | 4 | 4 |
| Disclosure Standards -65: Content and preparation of a public announcement | 8 | 8 |

- The Directorate also issued notification letters to the two trading member companies warning them to the revocation of license if the company fails to exercise its activity within 6 months, as per the conditions of license.
- **Listing:**
 1. The Capital Markets Supervision Directorate issued its no objection to two listings of Government Development Bonds on 10th January and 11th July 2013, and one Government Islamic Leasing on 13th May 2013 on the Bahrain Bourse.
 2. The CMSD reviewed and provided comments and observations on the profile listing documents pertaining to three listing applications for closed Bahraini shareholding companies, to list on Bahrain Bourse. However, these profile listing documents have not been approved by the CMSD until December 2012, pending being updated and rectified with CMSD's comments by the applicants until the date of issuing this report.
 3. The CMSD issued its conditional in principle no objection to the listing of one Company on Bahrain Bourse as Closed Bahraini Shareholding Company, subject to meeting some conditions, before the CMSD issue its final no objection to the listing. However, the listing has not been approved by the CMSD until December 2012, because the Company did not meet some of the CMSD conditions stipulated in the abovementioned letter until the date of issuing this report.
- 1. **Delisting:**

On 18th March 2013, Alba Floating Rate Bonds Issue was delisted from Bahrain Bourse due to maturity.

 2. On 15th September 2013, Makaseb Emirates Equity Fund (MAKASEB.F) delisted due to liquidation of the fund.
 3. On 15th September 2013, Makaseb Emirates Opportunities Fund (MAKASEB.EOF) was delisted due to liquidation of the fund.
 4. On 15th September 2013, Makaseb Qatar Equity Fund (MAKASEB.QEF) delisted due to liquidation of the fund.

5. On 30th December 2013 Global US Dollar Money Market (GLBL.UDMMF) was delisted due to liquidation of the fund.

- **Joint Work of the Gulf Cooperation Council (GCC)**

1. The Supreme Council decided at its 34th annual meeting, which was held in Kuwait on 11th and 12th December 2013, the following:
 - a. Approve the continuation of implementing the unified regulation for listing (Equity Shares/Bonds and Sukuk) securities in the GCC capital markets as an advisory paper for 1 more year, and Implementing unified regulation for listing Investment Funds as an advisory paper units for 2 more years in preparation for the final review and action to be applied on a mandatory basis.
 - b. The adoption of the unified regulations to be implemented for 2 years as an advisory paper in preparation for the final review and action to be applied on a mandatory basis for the following:
 - Unified regulations for the Issuance and Offering of Investment Funds in the GCC financial markets.
 - Unified regulations for the Issuance and Offering of Bonds/Sukuk in the GCC financial markets.
 - Unified regulations for Trading and Market Surveillance in the GCC securities financial markets.
2. The CBB's Capital Markets Supervision Directorate participated in the exceptional meeting of the Heads of Securities Commissions held at the General Secretariat in Riyadh on 6th October 2013, and in the meeting agreed to continue implementing the unified regulations for listing (Equities– Bonds/Sukuk) securities in the GCC capital markets as an advisory paper for 1 more year, and implementing the unified regulation for listing investment funds as an advisory paper for 2 more years in preparation for the final review and action to be applied on a mandatory basis.
3. The CBB's Capital Markets Supervision Directorate participated in the 12th meeting of the Listing, Disclosure and Corporate Governance Taskforce on October 27-28, 2013, where in the meeting the proposed amendments to

the Listing unified regulations were discussed and the periodic reports on implementation of the unified Disclosure Standards and Corporate Governance in the GCC as well.

4. The CBB's Capital Markets Supervision Directorate participated in the 14th meeting of the Issuance and Public Offering Taskforce on September 24-25, 2013, to discuss the GCC unified regulations for the Issuance of Bonds/Sukuk, and Companies Financing and Restructuring.
5. The CBB's Capital Markets Supervision Directorate participated in the Seventh meeting of the Market Surveillance and Supervision over the exchanges in the GCC on June 04-05, 2013, the group was briefed that the GCC Ministerial Committee agreed in its eighth meeting (30th April, 2013) on the minutes of the Sixth Meeting of the group (March 2013) on the unified rules of the Market Surveillance and Supervision over the trading in the financial markets in the GCC States to recommend it to the Ministerial Council to refer to the Supreme Council for the endorsement and implementation on advisory basis for two years basis to be followed by a review for implementation on compulsory basis.
6. In the eighth meeting of the Market Surveillance and Supervision over the exchanges in the GCC States on October 29-30, 2013 the group agreed to postpone the discussion of the draft of the unified rules on Procedures and Mechanism of Inquiry, Information Gathering and Investigation, until the implementation of the unified rules of the Market Surveillance and Supervision over the trading in the financial markets in the GCC States during the advisory period.

Financial Institutions Supervision Directorate ("FISD")

Overall responsibilities of FISD as part of CBB

The Financial Institutions Supervision Directorate ("FISD") supervises financial institutions, other than banks, namely, Investment Business Firms Categories 1, 2 and 3, Money Changers, Trust Service Providers, Ancillary Service Providers, Representative Offices of Investment Firms and Administrators/Registrars. In carrying out its responsibilities, the FISD ensures that all of the licensees under its supervision adhere to CBB Law and their respective regulations through CBB Rulebook Volumes 4 and 5. Additionally, the FISD is responsible for the authorisation and registration of Bahrain domiciled and overseas funds, as appropriate, and the supervision of Bahrain domiciled funds through the implementation of the rules within CBB Rulebook Volume 7.

Routine Responsibilities During 2013

During the course of 2013, 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 also continued to use its supervisory tools to monitor the industry and ensure adherence to the rules and regulations stipulated in CBB Rulebook Volume 7 (“CIUs”) and other relevant regulatory requirements.

Developments achieved/or and new regulations/circulars issued during 2013.

Being vigilant of the continuous developments in the local, regional and international financial centres, the CBB continuously enhances its existing regulations to ensure parity with best market practice, and identifies gaps based on industry demand and international developments. As a result of such strategy, the FISD identifies certain areas for development and sets at the beginning of each year objectives which are then executed.

Several consultations were issued to FISD licensees during the course of 2013, in order to get their views on proposed regulations and incorporate them, wherever necessary. Such consultations included the following:

On 7th March 2013, a consultation was issued to all investment business firms, money changer licensees, trust service providers, administrators, registrars, ancillary service providers and non-bank representative offices, requesting their feedback and comments on the Draft Resolution with respect to the conditions and procedures of obtaining approval for controlled functions within licensees.

Another consultation was issued on 30th June 2013 to Operators and Trustees of CIUs and PIUs regarding the change in due date and payment method for CBB annual fees for CIUs and PIUs.

On 25th September 2013, a consultation was issued to all investment business firms regarding the proposed regulation governing control in investment business firm licensees.

A final consultation was issued on 22nd October 2013, and addressed to all banks and investment business firms of Category 1 and 2, administrators, registrars, trust service providers, auditors and law firms regarding the proposed law with respect to investment limited partnerships.

Insurance Sector Supervision

The Insurance Supervision Directorate released the Insurance Market Review Report of 2012. The Report presents the financial performance of the insurance industry in Bahrain for the years 2011 and 2012 (both ,conventional insurance & reinsurance and Takaful & Retakaful business) by class of business in the Kingdom while highlighting the origin and the historical background of the insurance market in Bahrain. Total gross premiums in Bahrain increased to BD 239 million in 2012. Insurance penetration (ratio of gross premiums to GDP) stood at 2.09% in 2012.

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

- The CBB requested Insurance Firms' 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 continued to receive monthly investment reports and assess the performance of the investment portfolio.
- The CBB has proceeded with publishing the portfolio transfer requests for two 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 completed a consultation paper to revise the existing Takaful model from a regulatory perspective as one such step in reaffirming Bahrain as the jurisdiction of choice for the Takaful and Retakaful industry to enhance measuring and assessing the solvency status for Takaful and Retakaful Firms and is expected to increase the ability of the firms to distribute surpluses to participants and dividends to shareholders. As part of the consultation process, the CBB has been proactive in liaising with not just the Takaful industry for their views and comments on the proposed

rules, but also with the Shariah Supervisory Boards of a number of Takaful companies to ensure conformity of the revised rules and guidance with Shariah requirements. The CBB has successfully concluded the consultation phase. The proposed modifications shall be implemented during the first quarter of 2014.

- The CBB has continued to register appointed representatives during 2013. The current number of the registered appointed representatives stands as follows:

| | No. of Companies | No. of Registered |
|----------------------|------------------|-------------------|
| Licensed Banks | 13 | 188 |
| Commercial Companies | 4 | 24 |
| Individuals | - | 50 |
| Total | 17 | 262 |

- The CBB along with the Bahrain Institute of Banking and Finance ("BIBF") and members of Arab Forum of Insurance Regulatory Commissions ("AFIRC") has introduced, Certified Insurance Supervisor ("CIS") Program in 2012, which is the first certificate for insurance regulators in the Middle East. This certificate is considered as the minimum qualification by many jurisdictions for Insurance Compliance Officers.
- The CBB has taken an initiative to issue a 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 caused the accident, uninsured vehicle, if 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. It is worth mentioning that this initiative is currently in its final stage and the final draft of this resolution has already been discussed with the legal affairs in the Kingdom, in which it is planned to be discussed by Shura Council and Council of Representatives.
- The CBB issued new rules and guidance on client money in April 2012 after successfully undergoing the consultation process. The rules and guidance present requirements that have to be met by insurance brokers and appointed representatives with regards to holding client money for which they are responsible for. The rules are aimed at ensuring proper protection of client money, to minimise the risk of client money being utilised by insurance brokers & appointed representatives and to prevent

the commingling of client money with the insurance brokers' and appointed representatives' assets. The rules became effective from 1st July 2012.

- As the roles of the intermediaries and Third Party Administrators (“TPAs”) are critical for the well-being of the insurer and for safeguarding the interest of the clients, the CBB has successfully curbed the practice of insurance firms dealing with non-licensed/non-registered TPAs and intermediaries. This was implemented after giving appropriate notices to the insurance firms to comply with such requirements.

Financial Stability Directorate

During 2013, 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 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.

Chapter

4

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 Organisational Chart

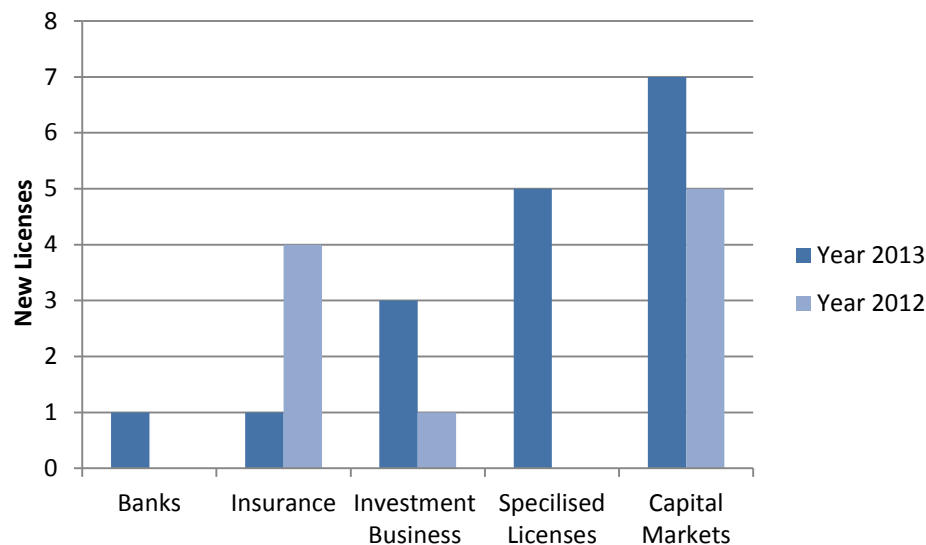
New Licenses

The Central Bank of Bahrain (“CBB”) has issued 17 new licenses in 2013 compared to 10 new licenses issued in 2012, reaching a total of 415 licensees to provide financial services as of 31st December 2013 compared to a total of 405 licensees as of 31st December 2012.

Those new licenses were issued for different license categories, as shown in the list below:

- 1- Gulf Investment Corporation - Conventional Wholesale Bank
- 2- AIM Investment Management B.S.C. (c) - Investment Business Firm Category 1
- 3- ASMA Capital Partners B.S.C. (c) - Investment Business Firm Category 2
- 4- Julius Baer (Bahrain) B.S.C. (c) - Investment Business Firm Category 2
- 5- Lulu International Exchange B.S.C. (c) – Money Changer
- 6- Health 360 Ancillary Services Company W.L.L. - Ancillary Services Provider
- 7- NextCare Bahrain Ancillary Services Company B.S.C. (c) - Ancillary Services Provider
- 8- Cigna Saico Benefits Services W.L.L. - Ancillary Services Provider
- 9- VIBHS Commodities B.S.C. (c) - Licensed Securities Broker – Dealer
- 10- VIBHS Commodities B.S.C. (c) - Licensed Securities Clearing Member
- 11- Triocon Financial Brokers W.L.L. - Licensed Securities Broker – Dealer
- 12- Elegant Commodities B.S.C. (c) - Licensed Securities Broker – Dealer
- 13- Elegant Commodities B.S.C. (c) - Licensed Securities Clearing Member
- 14- SMC Comex International DMCC-Foreign Branch Company - Licensed Securities Broker – Dealer
- 15- Tradeline Securities W.L.L. - Licensed Securities Broker – Dealer
- 16- Sigma Actuaries W.L.L. - Registered Actuary
- 17- Bahrain Asset Managers Association – Registered Society

The main growth of new licenses issued was in the Capital Market sector and Specialised Licenses sector as shown in the graph below:



New Licensees Growth by Sector

Payment System (“SSS” & “RTGS”)

Bank transfers through the Real Time Gross Settlement System (“RTGS”) numbered 504,894 in 2013, for a total amount of BD 53.1 billion broken down as follows:

- The volume of bank transfers among retail banks through RTGS was 97,346 for a value of BD 45.6 billion.
- The volume of customer transfers through the RTGS numbered 407,548 for a value of BD 7.54 billion during 2013.
- Banking operations carried out though Securities Settlement System (“SSS”) totalled 2692 in 2013 for a value of BD 7.6 billion.

Cheque Clearing

The number of cheques cleared in 2013 was 3,249,487 with a total amount BD 9.1 billion.

ATM Network ("BENEFIT")

The number of withdrawals processing through the local ATM network system ("BENEFIT") during 2013 was 7,754,198 with a total amount BD 776 million with a daily average of 21,244 transactions for BD 2,126 million.

Currency Issue

During 2013, major accomplishments of the Currency Issue Directorate included:

- The CIS in co-operation with the Bahrain International Circuit (Formula 1) issued a commemorative medal and 100 fils on the occasion of the 10th anniversary of the start of the first race (Formula 1) in the Kingdom of Bahrain, which was held on April 4, 2004 has been addressing the Royal Mint British to do basic medal and the currency will be put to the acquisition during the Formula 1 race in 2014.
- Based on the directives of Top management of the Central Bank of Bahrain, in cooperation with the Information Technology directorate put all the prices commemorative medals gold, silver and bronze, which are sold to the public interested and amateur medals on the website of the Central Bank of Bahrain and the expected completion of the program during the first quarter of 2014
- On the occasion of Eid al-Fitr the CIS issued new banknotes and coins amounting to BD 11,000,000/- and also issued during the Eid al-Adha occasion new banknotes and coins amounting to BD 9,000,000.-/
- The CIS continued its operations of accounting, sorting of currency notes and shredding of unfit currency notes using the machine which was directly linked to records of the CIS. The value of shredded unfit currency notes amounted to BD 92,653,405/- in 2013.
- The daily value of currency withdrawals amounted to BD 1,326,363,875/- in 2013, while that of currency deposits stood at BD 1,270,923,700/- , the value of currency in circulation recorded BD 578,706,265/- on 31st December 2013, of which currency notes and coins amounted to BD 16,396,055/- and BD 562,310,210/- respectively. The fourth issue of the new series of currency notes reached a level of BD 551,854,409/- and amounted to 98.141% of the total value of currency in circulation. The value of the third issue of the new series of currency notes stood at BD 10,455,800/- or 1.859% of the total value of currency in circulation .

CBB Training Programs

During 2013, the CBB continued to focus on ensuring that its staff have the right skills and capabilities to discharge their responsibilities.

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

- Developing employees' skills and knowledge through the use of the BIBF to provide 143 employees with training in 99 training courses covering areas including finance; Islamic banking; insurance; management; and computer skills.
- Enhancing technical competencies through enrolling 108 employees in 105 external training programs, workshops and conferences, organised by specialised institutes, international organisations and other central banks.
- Enhancing soft competencies through enrolling 124 employees in 19 Soft Skills workshops, seminars and conferences, organised by specialised institutes.
- Sponsoring 4 employees for different professional qualifications in accounting, finance, and information technology.
- 35 employees are enrolled in the induction and mentoring programme.
- Providing internships for 1[^] university students, designed to prepare them to enter the workplace.
- Making use of technology through providing access to 140 employees to internet-based e-learning covering principally technical subjects.

IT Projects

During the course of 2013, a number of projects were completed within the IT department. They included the following:

- **Electronic Submission of Returns and Analysis of Data (“ESRAD”).** The CBB is in the process of implementing a solution to provide its licensees with the ability to submit their periodic returns online. Once the data is submitted on-line, the concerned Supervision Directorates’ users will be

able to generate MIS reports and to produce Dashboards that allow Senior Management the ability to view all Licensees and the various financial ratios to determine the financial health of the Licensee. Also, the concerned users will be alerted, if any of the Licensees' financial ratios are not within a defined range. The Project is currently in the User Acceptance Test ("UAT") phase and will shortly be rolled out to the Licensees in a phased manner.

- **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 and regular testing.
- **STR Application Enhancement.** The current STR application implemented via the new Extranet website, facilitate financial institutions, Banks, Money Changers, etc. to report suspicious transactions to the CBB online in a secured manner. The users are able to view reports about suspected suspicious transactions and to search within the transactions.
- **Blocking – Unblocking.** Banking Services Directorate ("BKD") in the Central Bank of Bahrain ("CBB") is the intermediary between the courts of the Ministry of Justice and Islamic affairs and the banks in Bahrain. Therefore, it is responsible for receiving court letters indicating the court's requests for blocking the customer's account, inquiring about the customer's balance, or unblocking a blocked account, and acting accordingly upon this request.

To enhance the existing system for Blocking and un-Blocking of accounts based on information provided by the ministry of justice the CBB has implemented an online system facilitating the responses by banks to any request from the Ministry of Justice in a timely fashion. The system reduces the time required for the manual flow of letters from Court to Banks and Back from Banks to Court through CBB.

External Communications Unit

External Communication Unit's Objectives:

In order to maintain journalists' confidence and enhance relationships, the External Communication Unit ("ECU") was assigned face-to-face interviews with each local newspaper on a monthly basis to be held with the CBB Executives. The ECU ensures the follow-up of all issues in the local press. They are contacted immediately to obtain the necessary information on any person complaining. In addition, the Unit is responsible for providing the interested participants of conferences with the needed information.

Periodic reports produced by the ECU:

- Daily reports on all CBB news published in the local, regional and international newspapers.
- Monthly reports on all the CBB news that was published in the local, regional and international newspapers.
- Semi-annual reports of the unit's activities and an annual report on the achievements of the year along with what have been published during the year.
- Monthly reports on complaints published in the local newspapers which have been redirected to the concerned directorates while ensuring appropriate follow-up, and responding to such complaints if necessary.
- This report is a means of recording any complaint or observation mentioned in the local newspapers. The ECU dealt with 167 articles/ letters out of which 40 were complaints. However, the remaining articles were observations and they are being followed-up by the CBB.

Quarterly published topics:

| Topics | Date |
|---|--------------------------|
| <ol style="list-style-type: none"> 1. Bahrain is sound base for insurance industry 2. Regulators must join hands to tackle systemic risks 3. Life insurance driving insurance growth in Bahrain 4. Public awareness campaign on insurance 5. Predicting insolvency of insurance firms 6. New regulatory developments in Bahrain 7. Strengthening banks a top priority for CBB 8. Bahrain unrivalled as financial services hub 9. S&P Upgrades Bahrain outlook 10. Bahrain remains most free economy in MENA region 11. Bahrain Islamic Bank is acquired in Key deal 12. Need for investor safeguards stressed 13. Strong growth prospects for Bahrain economy 14. PineBridge Investments opens Bahrain Office 15. Bourse in bid to promote online trading 16. Bahrain to host major forum on occupational insurance 17. Stage set for annual AAOIFI Shari'a forum 18. Islamic funds forum on way in Bahrain | Issue 34 – Jan to March |
| <ol style="list-style-type: none"> 1. Islamic banks urge to prepare for new, rigorous rules' along with updates from the financial sector. 2. Depth needed in Islamic investment 3. Sukuk market posts record issuances 4. Islamic banks must become bigger 5. IIFM issues Wakalah master agreement 6. Ethical issues in Islamic banks 7. CBB crafting microfinance rules 8. Bahrain banks on growth path 9. Healthy return to profitability 10. CBB meets new BAB board 11. Call for Arab banking cooperation 12. Financial Sector Fact Sheet | Issue 35 – April to June |
| <ol style="list-style-type: none"> 1. Bahrain economy to post strong growth this year. 2. Project spending, oil sector to drive growth 3. New rules on collection of CBB annual licensing fees. 4. CBB improves same-day cheque clearing speed. 5. Basel III – Final call for Bahrain's banks. 6. Bahrain's Al Salam, BMI Bank on course to merge. 7. CBB strategy to enhance skills of industry staff. 8. Solveig Nicklos is new BIBF chief 9. Islamic finance standards and global rules. 10. Waqf Fund's effort to groom Shari'a scholars. 11. Solid decade to propel future economic growth. 12. Financial markets recover from global turmoil. 13. Bahrain Bourse publishes Investors' Guide 2013 14. World Islamic Banking Conference marks 20 years. 15. AAOIFI – World Bank Forum. 16. Insurance. Takaful under spotlight. | Issue 36 – Sept to Dec. |

Events that Central Bank of Bahrain organised and/or participated in:

| | | |
|---|---|--|
| 26-27 June | Kuala Lumpur Islamic Banking Conference 2013 Malaysia | Mr. Khalid Hamad |
| 28 th July | GMCO BOD Meeting Riyadh – KSA | H.E. The Governor |
| 17-18 Sept. | The 58th meeting of the Committee of Monetary Authorities and Central Bank Governors in the GCC Countries | <ul style="list-style-type: none"> • The Committee of Monetary Authorities and Central Bank Governors in the GCC Countries held its 58th meeting in Manama during the period 17-18 Sept. 2013. • The committee discussed the recommendations of the committees on the banking supervision and monitoring, GCC payment systems, and guidelines of harmonisation of GCC banking supervision supervisory instructions, and the progress of GCC Payments systems' strategy proposal. The committee discussed also the monetary and finance developments of the GCC countries. |
| 22-24 Sept. | "Fraud Prevention and Fraud Risk Management" BIBF 3-day seminar in association with ACFE, USA | <ul style="list-style-type: none"> • Under the patronage of the CBB, and in partnership with the Association of Certified Fraud Examiners ("ACFE") USA, and for the first time in the MENA region, a seminar on the "Fraud Prevention and Fraud Risk Management" was held in Kingdom of Bahrain. • The seminar shed light on the risk of fraud on important economic institutions such as banks, insurance companies, the corporate and ministerial organisations, employers, employees and stakeholders of the growing economic structures in the region. |
| 26 th Sept. | FSB RCG MENA 4th Meeting | <ul style="list-style-type: none"> • The Central Bank of the Republic of Turkey ("CBRT") hosted the fourth meeting of the FSB Regional Consultative Group for the Middle East and North Africa ("RCG-MENA") in Istanbul. Mr. Khalid Hamad attended the meeting in which the members discussed ongoing policy development work on financial regulatory reforms, vulnerabilities and regional financial stability issues, including the potential implications for the region of the evolving global economic and financial-market developments. |
| 30 th Sept. – 1 st Oct. | 66th meeting of the GCC Banking Supervision | Attended by Mr. Khalid Hamad |

| | | |
|------------------|---|--|
| 7-8 Oct. 2013 | Middle East Takaful Forum Gulf Hotel – Bahrain | <ul style="list-style-type: none"> • The opening keynote was presented BY Mr. Abdul Rahman Al Baker who stated that “the regulatory system is one of the main initiatives that aim at sustaining profitability on the long term for Takaful industry which is witnessing a remarkable growth, and the regional market has great potentials to achieve growth and prosperity”. • Mr. Al Baker declared to the press that the CBB, which supervises the insurance companies in Bahrain, is going to issue a consultation paper by the end of Oct. The consultation deals with a new approach to calculate the capital adequacy for Takaful firms. “This paper would assist the Takaful firms in calculating their solvency in accordance with Islamic principles and would contribute ultimately in forming and attractive Takaful market for a number of companies”. In terms of the challenges that are faced by the Takaful industry, he said: “the government is the key player in this regard, in addition to maintaining qualified staff to operate the Takaful operations which are different from the conventional insurance”. |
| 11-13 Oct. | Middle East Annual Meeting Washington – USA | H.E. The Governor |
| 21-22 Oct. | Professional Liability Insurance Forum Ritz Carlton – Bahrain | <ul style="list-style-type: none"> • Under the patronage of CBB, The General Arab Insurance Federation (“GAIF”), in association with the Bahrain Insurance Association (“BIA”), hosted the Professional Liability Insurance Forum attended by more than 300 leaders in the field of insurance, reinsurance and members of GIAF. • The forum discussed the region’s needs and requirements in terms of professional liability insurance and the Occupational Insurance, Professional Liability for engineers and architects in addition to the professional liability for insurance brokers, The Civil Liability of the Physician for the Medical Mistakes, bankers professional liability and carriers liability against their customers. |
| 29-30 Oct. | The 9th World Islamic Economic Forum London | <ul style="list-style-type: none"> • The 9th World Islamic Economic Forum was held in London for this year, being one of the leading financial and cultural centers of the world and the business gateway between the Muslim and non-Muslim world. • The forum was held at Excel London from 29 – 31 October 2013, bearing the theme “Changing World, New |

| | | |
|----------|---|---|
| | | Relationships” to encapsulate the emergence of new economic linkages between nations across borders, religions and cultures in a fast changing world. |
| 3-5 Nov. | 11th GCC Banking Conference UAE | H.E. The Governor |

| | | |
|----------------|---|--|
| 14-17 Nov. | 38th ICA Conference "Adjusting to a New Economic Order" Bahrain | <ul style="list-style-type: none"> • The event was organised by ICA in The Ritz-Carlton under the patronage of Bahrain Economic Development Board and attended by H.E The Governor. • The conference discussions focused on the world economy and the significance of the kingdom of Bahrain as a regional financial center. During The conference, several aspects were discussed such as the Islamic finance, the global financial crisis effect upon the economic system, in addition to the investors current situation. |
| 18-19 November | AAOIFI - World Bank Annual Conference on Islamic Banking and Finance – 2013 Kingdom of Bahrain | <ul style="list-style-type: none"> • H.E. The Governor inaugurated the conference with his speech: "The Islamic financial industry achieved remarkable milestones in the previous years through provided several product and by its worldwide expansion despite of the difficult economic conditions. And there are international regulatory standards that need to be adapted by similar standards to the Islamic banking. • The CBB will keep applying the best practices to incorporate such standards into its applicable regulatory system in Bahrain, that is, we commenced our consultations with the sector to implement these standards. The role of the banking supervisory bodies played either locally or globally forms one of the pillars to improve the banking industry in addition to the main role of the industry by which it can develop itself and its performance practices and complying with the best governance standards. • The CBB considers the role of AAOIFI is very essential in developing and enhancing the operations of the Islamic banks through creating new accounting standards that are in compliance with the best international practices which in turn would assist increasing the financial institutions to increase their the competitiveness their global growth. |
| 18-19 November | Workshop On Risk Governance | <ul style="list-style-type: none"> • The workshop was held under the patronage of CBB, and in cooperation with BIBF in cooperation and the World Bank • Mr. Khalid Hamad, CBB Executive Director of Banking Supervision said as part of his welcome remarks at the workshop, "The BIBF has introduced a multi-level Risk Management Program in conjunction with the CBB, and we have implemented mandatory standards developed by the BIBF for those who sell financial products to consumers." • He added: "Our key goals are ethics; transparency; and fairness for all those who |

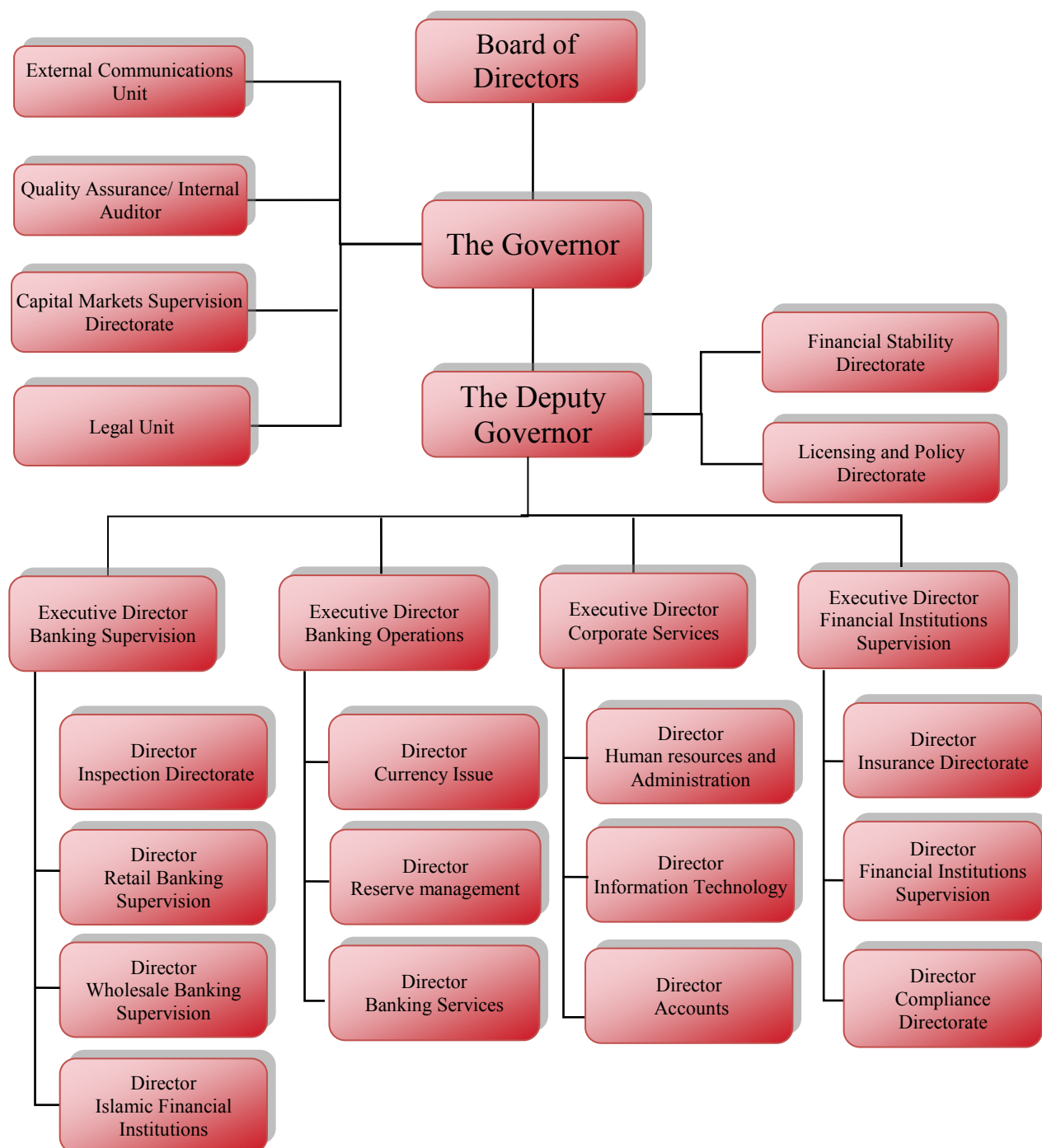
| | | |
|--------------|---|--|
| | | operate in the financial world, and CBB continues to learn and innovate in conjunction with the evolution of the financial industry. Effective risk governance requires foresight and decision makers to balance short-term needs against the long-term financial health of the company." |
| 25 November | GCC Monetary Union Riyadh | Attended by Mr. Khalid Hamad |
| 1-2 December | Cybercrime And Security Seminar BIBF | <ul style="list-style-type: none"> • The BIBF is launching a GCC wide Seminar of Cybercrime and Security in Bahrain under the patronage of the CBB. • The seminar featured penetration, hacking attacks and APTs ("Advanced Persistent Threats"), Malware and Spyware, Denial of Service attacks, Risk Scenarios in the Cloud, Social Engineering Risks, BYOD ("Bring Your Own Device") Risks, Audits and Risk Assessments, Key Cyber Security Controls and BYOD best practices. |
| 4-5 December | The 20th Anniversary Special Edition of the WIBC Kingdom of Bahrain | <ul style="list-style-type: none"> • The 20th Anniversary special edition of the World Islamic Banking Conference ("WIBC 2013"), was held under the patronage of HRH Prince Khalifa Bin Salman Al Khalifa, The Prime Minister of the Kingdom of Bahrain and supported by the CBB in the Gulf Hotel. • Attended by more than 1,300 attendees from over 50 countries set to join over 100 high-profile speakers and 65 and key sponsors in the market. The conference commenced its activities with pre-conference summit organised by the "international financial Islamic market" on 3rd Dec. which focused on developing a set of complicated insights within a practical framework through which the critical issues faced by the Islamic finance sector can be understood. • The main WIBC 2013 conference, attended by HRH Shaikh Ali bin Khalifa Al Khalifa, was inaugurated by H.E. The Governor, saying that: "the main goal of this event is to determine practical, constructive and sustainable frameworks that improve the competitiveness of the Islamic finance which requires financial strength and confidence. • Then, he addressed the importance of expanding the range of Islamic finance in new markets. Many potential countries participated in a conference held recently in London expressed serious interest in the Islamic finance. All such developments are positive. However, we should |

| | | |
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| | | be prepared to improve the potential opportunities to maintain the sustainability of the sector. |
|--|--|--|

Number of Press Releases issued by CBB

| | | |
|--------------------|---|--|
| 118 press releases | 48 press releases about events and CBB activities | <ul style="list-style-type: none"> • Published in local, regional newspapers and some of them were published in the international newspapers • Published in CBB official website in both; English and Arabic |
| | 70 press releases about Treasury Bills and Sukuk | |

CBB's Organisational Chart



Chapter
5

5. FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

*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 2013*

*Notes to the balance sheet and profit and loss account and appropriation for the year
ended 31 December 2013*

CENTRAL BANK OF BAHRAIN
FINANCIAL STATEMENTS
for the year ended 31 December 2013

CENTRAL BANK OF BAHRAIN

FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2013

| | Pages |
|---|--------------|
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| FINANCIAL STATEMENTS | |
| Balance sheet | 2 |
| Profit and loss account and appropriation | 3 |
| Notes to the financial statements | 4 - 10 |



KPMG Fakhro
Audit
12th Floor
Fakhro Tower
PO Box 710, Manama
Kingdom of Bahrain

CR No. 6220
Tel +973 17 224807
Fax +973 17 227443
Internet www.kpmg.com.bh

INDEPENDENT AUDITORS' REPORT TO THE BOARD OF DIRECTORS

CENTRAL BANK OF BAHRAIN
Manama
Kingdom of Bahrain

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 2013, 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 2013, 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.

KPMG Fakhro
Partner Registration No. 83
6 June 2015

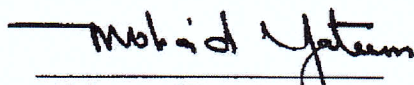
CENTRAL BANK OF BAHRAIN


BALANCE SHEET

(Expressed in thousands of Bahraini Dinars)

| | | As at 31 December | |
|--|------|-------------------|------------------|
| | Note | 2013 | 2012 |
| ASSETS | | | |
| Gold | 3 | 2,500 | 2,500 |
| Foreign reserves | 4 | 2,335,691 | 2,289,840 |
| Due from Ministry of Finance | 5 | - | 75,445 |
| Cash, due from Bahraini banks and treasury bills | 6 | 51,661 | 28,503 |
| Other assets | 7 | 13,051 | 11,356 |
| Total assets | | 2,402,903 | 2,407,644 |
| LIABILITIES | | | |
| Notes and coins in circulation | 3 | 577,960 | 522,511 |
| Bahraini Dinar deposits | | 1,264,089 | 1,300,540 |
| Other deposits | | 98,224 | 138,568 |
| Due to other central banks | | 545 | 785 |
| Due to Ministry of Finance | 5 | 5,940 | - |
| Profit payable to the Government of Kingdom of Bahrain | | 7,000 | 4,500 |
| Provision for currency withdrawn | | 6,224 | 6,234 |
| Other liabilities | 8 | 8,110 | 5,598 |
| Total liabilities | | 1,968,092 | 1,978,736 |
| Capital funds | | | |
| Capital | 9 | 200,000 | 200,000 |
| General reserve | 10 | 200,716 | 198,216 |
| Contingency reserve | 11 | 17,947 | 15,037 |
| Revaluation reserve | 12 | 16,148 | 15,655 |
| Total capital funds | | 434,811 | 428,908 |
| Total liabilities and capital funds | | 2,402,903 | 2,407,644 |

The financial statements on pages 2 to 10 were approved by the Board of Directors on 6 June 2015 and signed on its behalf by:


 Mohammed Hussain Yateem
 Chairman


 Rasheed Al Maraj
 Governor

The notes on pages 4 to 10 are an integral part of the balance sheet and profit and loss account and appropriation.

CENTRAL BANK OF BAHRAIN

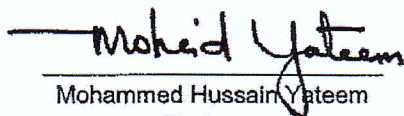
PROFIT AND LOSS ACCOUNT AND APPROPRIATION

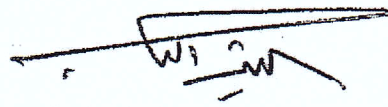
For the year ended 31 December 2013

(Expressed in thousands of Bahraini Dinars)

| | Note | Year ended 31 December 2013 | Year ended 31 December 2012 |
|--|------|--------------------------------|--------------------------------|
| Income | | | |
| Interest income | | 16,172 | 16,261 |
| Interest expense | | (4,963) | (3,636) |
| Net interest income | | 11,209 | 12,625 |
| Registration and licensing fees | | 5,380 | 5,468 |
| Exchange gain on sale of US dollars | | 6,252 | 7,610 |
| Net realised investment gain | | 2,386 | 5,507 |
| Other income | | 1,441 | 1,157 |
| Total income | | 26,668 | 32,367 |
| Expenses | | | |
| Staff costs | | (11,706) | (12,162) |
| General and administration expenses | | (5,374) | (5,873) |
| Managed funds and advisory fees | | (1,118) | (1,053) |
| Notes issue expenses | | (560) | (1,588) |
| Total operating expenses | | (18,758) | (20,676) |
| Profit for the year before impairment provision | | 7,910 | 11,691 |
| Provision for impairment | 4 | - | - |
| Profit for the year | | 7,910 | 11,691 |
| Transfer to contingency reserve | 11 | (2,910) | (2,691) |
| Transfer to general reserve | 10 | (2,500) | (4,500) |
| Balance payable to Kingdom of Bahrain | | 2,500 | 4,500 |

The financial statements on pages 2 to 10 were approved by the Board of Directors on 6 June 2015 and signed on its behalf by:


 Mohammed Hussain Yateem
 Chairman


 Rasheed Al Maraj
 Governor

The notes on pages 4 to 10 are an integral part of the balance sheet and profit and loss account and appropriation.

CENTRAL BANK OF BHRAIN

Notes to the financial statements for the year ended 31 December 2013 (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 2013, 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.

CENTRAL BANK OF BAHRAIN

Notes to the financial statements for the year ended 31 December 2013 (continued)
(Expressed in thousands of Bahraini Dinars)

2. Significant accounting policies (continued)

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.

CENTRAL BANK OF BAHRAIN

Notes to the financial statements for the year ended 31 December 2013 (continued) (Expressed in thousands of Bahraini Dinars)

2. Significant accounting policies (continued)

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 and is charged to profit and loss account.

Contingency reserve is utilised by the Central Bank to provide impairment for other assets used in relation to Central Bank's objectives within the framework of the general economic policy of the Kingdom in a manner that enhances and develops the national economy as determined by the Board.

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 probable 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.

CENTRAL BANK OF BAHRAIN

Notes to the financial statements for the year ended 31 December 2013 (continued) (Expressed in thousands of Bahraini Dinars)

3. Excess of authorised backing over currency in circulation

| | 2013 | 2012 |
|---|------------------|------------------|
| Authorised backing | | |
| Gold | 2,500 | 2,500 |
| Foreign reserves – note 4 | 2,335,691 | 2,289,840 |
| | <u>2,338,191</u> | <u>2,292,340</u> |
| Notes and coins in circulation | (577,960) | (522,511) |
| Excess of authorised backing over currency in circulation | <u>1,760,231</u> | <u>1,769,829</u> |

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 2013 was BD 68,401 thousand (2012: BD 93,811 thousand).

4. Foreign reserves

| | 2013 | 2012 |
|--------------------------------|------------------|------------------|
| Bonds portfolios | 796,959 | 706,541 |
| Bank deposits | 1,617,454 | 1,662,021 |
| | <u>2,414,413</u> | <u>2,368,562</u> |
| Less: provision for impairment | (78,722) | (78,722) |
| | <u>2,335,691</u> | <u>2,289,840</u> |

All bonds are quoted in active markets with 98% being of investment grade BBB or higher (2012: 99%). All the deposits (2012: 100%) and 69% of bonds are in US dollars (2012: 63%). For other foreign currencies, these are 100% hedged into US dollars. The bond portfolios include BD 9,319 thousand net unrealised losses on non-US denominated bonds and related forward foreign exchange contracts used to hedge such bonds (2012: loss of BD 5,821 thousand).

The market value of the bond portfolios (including cash and accrued interest held within these portfolios) at 31 December 2013 was BD 793,012 thousand (2012: BD 717,473 thousand).

The Central Bank has recognised an impairment provision amounting to nil for the year ended 31 December 2013 (2012: nil) in the profit and loss account.

However, the Central Bank has recognised an impairment provision amounting to BD nil for the year ended 31 December 2013 (2012: BD 71,630) which has been charged to the contingency reserve (refer note 11).

CENTRAL BANK OF BAHRAIN

Notes to the financial statements for the year ended 31 December 2013 (continued)
(Expressed in thousands of Bahraini Dinars)

5. Due from/ to Ministry of Finance

The amount represents the net due from/ to 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

| | 2013 | 2012 |
|--|---------------|---------------|
| Cash | 19,252 | 19,297 |
| Due from Bahraini banks | 10,595 | 706 |
| Ijara Sukuk / Treasury bills issued by the Government of Bahrain | 21,814 | 8,500 |
| | <u>51,661</u> | <u>28,503</u> |

Cash includes US dollars held by the Central Bank amounting to US\$ 51,008 thousand (equivalent BD 19,230 thousand) (2012: US\$ 51,123 thousand (equivalent BD 19,274 thousand)).

7. Other assets

| | 2013 | 2012 |
|---------------------|---------------|---------------|
| Staff loans | 4,987 | 4,791 |
| Interest receivable | 3,591 | 2,424 |
| Equipment | 1,865 | 1,883 |
| Others | 2,608 | 2,258 |
| | <u>13,051</u> | <u>11,356</u> |

8. Other liabilities

| | 2013 | 2012 |
|-------------------------------|--------------|--------------|
| Deferred license fee received | 4,473 | - |
| Other payables | 3,113 | 5,037 |
| Interest payable | 363 | 471 |
| Accrued expenses | 161 | 90 |
| | <u>8,110</u> | <u>5,598</u> |

9. Capital

| | 2013 | 2012 |
|--------------------------|----------------|----------------|
| Authorised | <u>500,000</u> | <u>500,000</u> |
| Issued and fully paid up | <u>200,000</u> | <u>200,000</u> |

CENTRAL BANK OF BAHRAIN

Notes to the financial statements for the year ended 31 December 2013 (continued) (Expressed in thousands of Bahraini Dinars)

10. General reserve

| | 2013 | 2012 |
|---|----------------|----------------|
| Balance at beginning of the year | 198,216 | 193,716 |
| Transfer from profit and loss account and appropriation | 2,500 | 4,500 |
| Balance at end of the year | <u>200,716</u> | <u>198,216</u> |

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

| | 2013 | 2012 |
|----------------------------------|---------------|---------------|
| Balance at beginning of the year | 15,037 | 83,976 |
| Transfer during the year | 2,910 | 2,691 |
| Utilised during the year | - | (71,630) |
| Balance at end of the year | <u>17,947</u> | <u>15,037</u> |

In accordance with Article 21 of the Central Bank of Bahrain and Financial Institution Law, the Board has approved a transfer of BD 2,910 thousand (2012: BD 2,691 thousand) of the current year's net profit to the contingency reserve and utilisation of BD nil (2012: BD 71,630 thousand) for impairment provision (refer note 4).

12. Revaluation reserve

| | 2013 | 2012 |
|----------------------------------|---------------|---------------|
| Balance at beginning of the year | 15,655 | 15,341 |
| Movement during the year | 493 | 314 |
| Balance at end of the year | <u>16,148</u> | <u>15,655</u> |

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.

CENTRAL BANK OF BAHRAIN

Notes to the financial statements for the year ended 31 December 2013 (continued) (Expressed in thousands of Bahraini Dinars)

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 2013 there were no outstanding contingent liabilities or commitments (2012: Nil) with the exception of outstanding foreign exchange contracts with a notional value of BD 340,801 thousand (2012: BD 356,497 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.