Always there

بنـــك البحــرين والكويت ش.م.ب

BANK OF BAHRAIN AND KUWAIT B.S.C.

Annual Report 2003

Contents

Shareholders of Bank of Bahrain and Kuwait

Citizens of the Kingdom of Bahrain	17.59%
Pension Fund Commission – Bahrain	18.56%
General Organisation for Social Insurance – Bahrain	13.85%
The National Bank of Kuwait S.S.K.	6.75%
Al Ahli Bank of Kuwait K.S.C.	6.75%
The Commercial Bank of Kuwait S.A.K.	6.75%
The Gulf Bank K.S.C.	6.75%
The Bank of Kuwait and the Middle East K.S.C.	6.75%
Kuwait Investment Projects Co. Asset Management	6.75%
Government of Kuwait – Kuwait Investment Authority	3.75%
Kuwait Investment Company S.A.K.	3.75%
Kuwait International Investment Company S.A.K.	2.00%

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P.O. Box 597, Manama, Kingdom of Bahrain.
Tel: (973) 17223 388, Fax: (973) 17229 822

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Telex: 8919 BN.
SWIFT: BBKUBHBM
Website: www.bbkonline.com
Commercial Registration: 1234

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Ahmed Al-Jaber Street, P.O. Box 24396,
13104 Safat, Kuwait.
Tel: (965) 241 7140, Fax: (965) 244 0937

Mumbai Branch
P.O. Box 11692, Jolly Maker Chambers II,
225 Nariman Point, Mumbai 400021, India.
Tel: (9122) 282 3698, Fax: (9122) 204 4458 / 284 1416

Hyderabad Branch
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Tel: (9140) 339 8219, Fax: (9140) 337 5977

Dubai Representative Office
Creek Tower, Office No. 18A, P.O. Box 31115, Dubai, UAE.
Tel: (9714) 221 0560 / 221 0570 / 223 7156
Fax: (9714) 221 0260

Subsidiaries
BBK Financial Services Company (wholly owned)
CrediMax (wholly owned)
Al Khaleej Islamic Investment Bank (wholly owned)

Associated Company
Bahrain Commercial Facilities Company (20.25%)

Other Shareholdings
Bahrain Telecommunications Company B.S.C
Securities and Investment Company (closed)

Designed and produced by Gulf Saatchi & Saatchi, Bahrain

H.M. King Hamad bin Isa Al Khalifa
KING OF BAHRAIN

H.H. Shaikh Jaber Al Ahmed Al Sabah
THE AMIR OF THE STATE OF KUWAIT

Always there

A shadow is found only where there is light. It never leaves your side or comes in your way. It walks with you. Like a shadow, the Bank of Bahrain and Kuwait is a part of you. Always there.

Here, we explore the shadows we create in your world, as we implement our three-year strategic plan.

An action plan where we continue to achieve a higher return on shareholders' equity and diversify our business with more innovative products and services.

Where we pledge to invest in high-end technology, commit ourselves further to customer service and expand geographically.

Where we instill in our people the principles of entrepreneurship, decision-making and ownership.

Where we support Bahrainisation and play a stellar role in the economic growth of the Kingdom of Bahrain.

Where as a shareholder, customer or employee, you can expect us to walk the distance.

with you, we achieve.

Vision Statement

Bank of Bahrain and Kuwait will be the premier regional financial services enterprise in providing superior products and services of high quality through innovation, technology and 'life long' customer relationships.

The Bank will expand its overseas presence in more locations in which it chooses to operate in order to satisfy the diversified needs of customers. We believe customers are the driving force in everything we do. We will not compromise on our absolute commitment to providing the very best in customer service.

We believe our people are our number one asset with the highest degree of competence, integrity and professionalism. We instill in our people the principles of entrepreneurship, decision-making and ownership through our commitment to training, development, delegation and performance-based reward systems.

We are determined to utilise 'cutting edge' technology which we recognise as most critical in supporting our short, medium and long-term business objectives.

Our shareholders are the source of our financial strength and can expect continued growth and profitability. They are supportive and confident of our vision for the future.

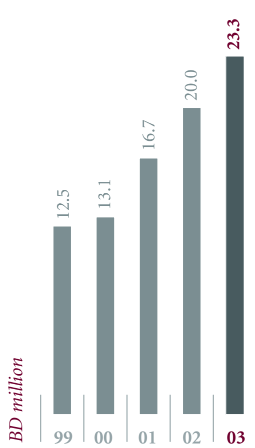
2003 Performance Highlights

- **Highest profit ever at BD 23.31 million – 16.5% growth over 2002**
- **Return on average equity tops 17.8%**
- **Cost to income ratio reduces to 46.3% – down from 47.7% in 2002**
- **Profits per employee at record high of BD 33,000 per employee**
- **Balance sheet footing grows by 8.1%; loans grow 22.8% while customer deposits grow 17.3%**
- **Moody's rating of the Bank rises two notches to Baa1/P-2, reflecting the strength of the Bahrain economy as well as the Bank's sustained performance**

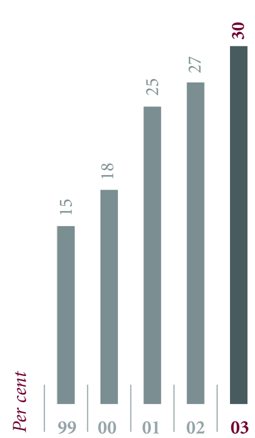
Financial Highlights

	1999	2000	2001	2002	**2003**
Income statement highlights *(BD million)*					
Net interest income	20.5	20.8	23.7	25.5	**26.1**
Other income	13.3	11.2	13.6	16.2	**21.4**
Operating expenses	15.6	16.8	18.9	19.9	**22.0**
Net profit for the year	12.5	13.1	16.7	20.0	**23.3**
Dividend	15%	18%	25%	27%	**30%**
Financial statement highlights *(BD million)*					
Total assets	1,028	1,059	1,101	1,215	**1,314**
Net loans	506	499	481	537	**659**
Investments	359	318	328	386	**415**
Deposits	859	847	873	985	**1,111**
Medium term loans	38	75	85	85	**38**
Shareholders' equity	111	115	126	131	**142**
Profitability					
Earnings per share (fils)	22	23	30	35	**41**
Cost : income	46.2%	52.4%	50.7%	47.7%	**46.3%**
Return on average assets	1.24%	1.22%	1.50%	1.66%	**1.83%**
Return on average equity	11.9%	12.0%	14.4%	16.1%	**17.8%**
Profit per employee (BD)	18,506	18,960	24,117	28,341	**32,739**

	1999	2000	2001	2002	**2003**
Capital					
Capital adequacy	15.6%	17.3%	17.1%	16.8%	**16.5%**
Shareholders' equity/Total assets	10.8%	10.9%	11.4%	10.8%	**10.8%**
Debt : equity	33.8%	65.6%	67.4%	64.7%	**26.5%**
Liquidity & business indicators					
Loans & advances/Total assets	49.2%	47.2%	43.7%	44.2%	**50.2%**
Investments excluding T bills/Total assets	26.6%	28.4%	26.4%	26.0%	**25.7%**
Liquid assets/Total assets	37.0%	41.4%	31.6%	34.1%	**32.4%**
Non inter-bank deposits/Loans & investments	86.3%	85.4%	95.4%	87.1%	**81.3%**
Net interest margin	2.48%	2.27%	2.41%	2.45%	**2.30%**
Number of employees	676	692	694	706	**712**

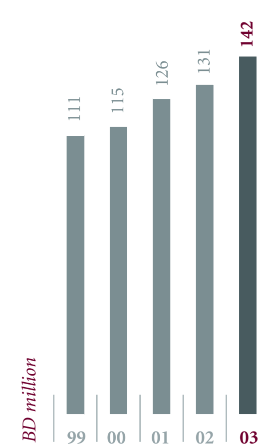


Net profit for the year



Dividend

Cost/Income



Shareholders' equity

Reach

When it comes to convenience banking, we are like the bank next door.

We cover Bahrain with one of the largest network of branches and ATMs.

And reach out to our overseas customers through

our presence in Kuwait, India and the UAE.

Chairman's Statement

Murad Ali Murad
CHAIRMAN

On behalf of the Board of Directors, I am honoured to present the 32nd annual report and consolidated financial statements of Bank of Bahrain and Kuwait for the year ended 31 December 2003.

The financial statements for the year represent the consolidation of the Head Office and domestic branches of the Bank in the Kingdom of Bahrain, the branch of the Bank in the State of Kuwait, the two branches in Mumbai and Hyderabad in the Republic of India, Dubai Representative Office in the United Arab Emirates and the Bank's wholly owned subsidiaries; CrediMax, BBK Financial Services and Al Khaleej Islamic Investment Bank.

I am pleased to announce that it has been another eventful and successful year for the Bank. In line with the strategy, the Bank achieved excellent results. Net profit for the year increased by 16.5% to BD 23.3 million, while total assets as at 31 December 2003 stood at BD 1,314 million, an increase of 8.1% over 2002.

The consolidated profits of the Bank represent an increase in return on shareholders' equity from 16.1% in 2002 to 17.8% in 2003. This is a significant achievement, given the increased competition in domestic as well as regional markets and the continued global economic slowdown.

With these results the Bank continues to be and for the fourth successive year the largest commercial bank in Bahrain by the size of assets.

Though the year witnessed considerable uncertainties in the region over the war in Iraq, there was little negative impact on business in Bahrain in general and activities of the Bank in particular. Business in most sectors was at normal level and if anything, there was growth in some sectors.

In addition to the uncertainties in the Gulf Region, conditions in various financial markets around the world were extremely slow particularly during the first half of the year with interest rates, specifically those in the United States, at historic lows. By the beginning of the second half there were some signs of turnaround, particularly the stock markets in the US. In the Gulf Region the stock market was extremely active with indexes mostly much higher compared to the previous year. The activity in domestic property and real estate market saw considerable growth probably supported by the very low rates of interest in domestic as well as international markets.

I am pleased to announce that in line with the resolution passed by the General Assembly in March, the Bank changed its Articles of Association. With this change the new Commercial Companies Law of 2001 was incorporated into these articles. One historic change in these articles is relating to the ownership structure. Before this change, the ownership structure was based on 50% of the Bank owned by Bahraini institutions and individuals and 50% by Kuwaiti financial and investment institutions. After the change this ownership structure now includes different nationalities and institutions from Bahrain, the Gulf Region and different countries of the world.

It is worth mentioning here that in December 2002, the Bank introduced its three year 2003–2005 strategy. This is the fourth strategy that the Bank implements. The focus of this strategy is to build on the strong financial position of the Bank, the diversity of its business and its market leadership in banking services based on technology. The most important objective in this strategy is to further enhance the shareholders' value by increasing the return on shareholders' equity to 20% by the end of the strategy period.

To attain this objective, the strategy plans to increase market share in some of the business sectors, expand others with further control on risk management and taking timely steps to get ready for Basel II Accord.

Further corporate objectives in the strategy were to enhance the ratio of gross income to operating expenses as well as look into possibilities of alliances, mergers and acquisitions and prepare studies relating to this objective.

As far as domestic activities are concerned the management focus was on business diversification using conventional and Islamic financial services and products in addition to its focus on electronic banking services. Furthermore, the management reviewed existing products and services to ensure that these continue to be competitive and cost effective. Special attention was given to industrial and developmental

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projects being undertaken by both public and private sector in Bahrain. It is also important to mention here the enhancements and features added to the retail products and services during the year to make them more competitive.

In addition to the new products introduced during the year in the Bank, new plastic card products were also launched by CrediMax including the introduction of platinum card. In fact, CrediMax continued its important and successful contribution to the income generated for the year and exceeded its budget. Other subsidiaries; namely BBK Financial Services and Al Khaleej Islamic Investment Bank were not operative during the year. The continuation of the activities by these two subsidiaries is an issue that is being addressed by management and the Board of Directors.

In the area of overseas activities the management continued to evaluate various markets especially those with existing presence, with the aim of further improving the return on these investments as well as studying possible presences in some new locations in the region.

Not only did the Bank give attention to asset growth but it also ensured that the management of liabilities will continue to have the necessary attention with the aim of achieving the diversity of sources of funding and the improvement of maturity mismatch profiles. In this regard the Bank completed successfully a US$ 125 million medium term deposit facility, lead managed by Standard Chartered Bank.

By mid year, the management prepared a complete study which was submitted to the Board of Directors with a proposal on the future and concept of domestic branches, taking into account the geography and demography of Bahrain, types of products and services to be provided through these branches and the effective use of modern technology.

The Board of Directors discussed and resolved to take a number of steps to implement the international standards and best practices of corporate governance. This is very much in line with the outlook of the regulators in Bahrain and other countries where the Bank operates. In fact, it is a well known policy of the Bank to take steps to apply international standards including those related to accounting, credit culture and increased disclosures. Among the first steps was the Code of Conduct that was signed by each member of the Board of Directors. At the same time internal regulations were approved by the Board relating to Board members and Management holding and trading in the shares of the Bank. The Board also resolved to establish a Strategy Committee from its members. This is in addition to the Executive Committee of the Board and the Board Audit Committee. Furthermore, the objectives of the General Manager for 2003 was approved by the Board of Directors at the beginning of the year while the objectives of his direct reports were brought to the attention of the Board.

I am pleased to state that the Bank continues its very important and active social and communal role. The General Assembly approved in its meeting in March, BD 500,000 for these activities which cover a vast number of domestic social, sporting and community activities.

I would like to take this opportunity on behalf of the members of the Board of Directors to thank the two outgoing Board Members, Mr Ali Mohammed Al Noor and Dr Zakariya Ahmed Hijris for their contribution during their directorship, wishing them well with their future endeavours. At the same time, I would like to welcome on behalf of the members of the Board of Directors the incoming directors, Mr Arif Khamis and Mr Saeed Al Marzooq and wishing them all the success.

On behalf of the directors, shareholders and staff, I wish to express our best wishes to His Majesty King Hamad bin Isa Al Khalifa, the King of Bahrain, and to His Highness Shaikh Jaber Al Ahmed Al Sabah, the Amir of the State of Kuwait and our gratitude to their governments for the continued support to the Bank.

A special thanks to all our customers for their trust and confidence which provided all of us the impetus to strive to work harder to provide them various services at their expectations or better.

I would also like to express our gratitude to our shareholders who continue to support the Bank financially. And last but not least to all our staff, both at home and abroad, for their diligence and hard work to help the Bank attain its objectives.

Murad Ali Murad

Growing Bahrain

We continue to play a major role in providing finance for key industrial and infrastructure projects, supporting further expansion plans and spearheading industrial diversification.

Board of Directors

Centre

Mr Murad Ali Murad
Chairman
Chairman of the Board Audit Committee
Board Director – Bahrain Telecommunications Company (Batelco); Board Director – Bahrain Commercial Facilities Co. (B.S.C.); Member – Council of Vocational Training in Banking Sector; Deputy Chairman – Board of Trustees of Ibn Khuldoon National School.

Left row from front

Mr Jassem Hasan Ali Zainal
Deputy Chairman
Member of the Executive Committee
Corporate Secretary and General Manager, Investment – Gulf Bank, Kuwait; Chairman of International Fund Managers Ltd.

Mr Hamad Ahmad Al Busairi
Board Director
Member of the Board Audit Committee
Senior Investment Manager – Kuwait Investment Authority, State of Kuwait; Board Director – Kuwait Investment Company; Board Director – GCC Electric Power Interconnection Authority, Kingdom of Saudi Arabia.

Mr Issam A. Aziz Al-Usaimi
Board Director
Advisor to the Chairman and Managing Director – Bank of Kuwait & the Middle East; Deputy Chairman – Kuwait Reinsurance Co.; Board Member – Kuwait and Middle East Financial Investment Co.

Mr Rasheed Mohammed Al-Maraj
Board Director
Chairman of the Executive Committee
Chairman – Bahrain Telecommunications Company (Batelco); Member – Economic Development Board; Chief Executive Officer – Arab Petroleum Investment Corporation, Kingdom of Saudi Arabia.

Mr Aref Saleh Khamis
Board Director
Member of the Executive Committee
Asst. Under-Secretary for Financial Affairs – Ministry of Finance & National Economy; Director – Gulf Aluminium Rolling Mills Co.; Director – Arab Ship Building & Repair Yard; Director – Sh. Mohd. Bin Khalifa Bin Salman Al Khalifa Cardiac Centre; Director – The Bahrain Petroleum Co. (Bapco); Member – Tender Board; Member – Supreme Council of Traffic.

Dr Farid Ahmed Al Mulla
General Manager and Chief Executive Officer, Bank of Bahrain and Kuwait.

Mr Yacuob Yousef Al Fulaij
Board Director
Deputy Chairman of the Executive Committee
Director – National Bank of Kuwait; Director – Kuwait Cinema Co.

Mr Abdulla Mohammed Alsumait
Board Director
Member of the Board Audit Committee
General Manager – Commercial Banking Group, Al-Ahli Bank of Kuwait; Chairman – Union of Kuwaiti Banks; Director – Credit Information Network Co. (K.S.C.C.).

Mr Mohammed Salahuddin
Board Director
Chairman – Mohammed Salahuddin Consulting Engineering Bureau; Board Member – Bahrain Water Bottling and Beverages Company (Closed) B.S.C.; Board Member – Sunni Waqf Directorate; Board Member – Bahrain Businessmen Association.

Mr Saeed A. Karim Al-Marzooq
Board Member
Member of the Board Audit Committee
Assistant Director General for Finance & Admin Affairs – Pension Fund Commission; Board Member and Acting General Manager – Housing Bank; Director – Deposit Protection Board.

Sh Mohammed Bin Isa Al Khalifa
Board Director
Member of the Executive Committee
Director of Finance and Investments – General Organisation for Social Insurance (GOSI); Chairman – Securities and Investment Company; Director – Bahrain Commercial Facilities Co.; Director – National Motor Co.; Director – Bahrain Stock Exchange; Director – Bahrain International Golf Course Company.

Mr Saad Mohammed Al Hooti
Board Secretary, Bank of Bahrain and Kuwait.

Mr Fuad Ismail Dashti *(not in photograph)*
Board Director
Member of the Executive Committee.
Vice Chairman – National Cleaning Co.

Business diversification

We constantly innovate, introducing customer-friendly products and services in the market.

Our focus on e-banking resulted in the launch of the internet payment gateway, *www.bahrainpay.com*, supporting the Kingdom's e-government and e-commerce initiatives.

Above all, we offer the widest range of electronic banking solutions with e-Bank, mBank, e-Bank Corporate, e-CallCentre, enterActive Loan, Telebank and BBKEXPRESS.

Management Review

Dr Farid Ahmed Al Mulla
GENERAL MANAGER AND
CHIEF EXECUTIVE OFFICER

A successful performance . . .
. . . without a shadow of doubt.

The past financial year was one of challenge for Bank of Bahrain & Kuwait. The global economic uncertainties, vigorous competitive activity and volatile market environments tested our strengths to the limit.

However, we were able to rise to the challenge and march ahead with success. We continue our impressive financial performance, upgrade our operations to even higher levels of excellence and further consolidate our reputation as the leading customer-focused Bank in the Kingdom of Bahrain.

We achieved significant profits, strengthened our assets and were able to offer better returns on shareholders' equity. The year 2003 also saw the Bank implement dynamic changes to well position itself to meet the challenges and harness opportunities of the future.

During the year, the Bank completed a comprehensive study for its domestic branch modernisation. The project aims at rationalising the distribution of the domestic branches network through the introduction of the 'Financial Mall' concept, which will encompass a diverse range of products and services.

Throughout the year we launched new banking products and services whilst improving existing ones to meet the ever-changing needs of diverse customers. We also created more delivery channels embracing the best resources of the real and digital world.

Reaching out by reaching in

In 2003, the Bank's various departments worked as a team and took a closer look at all internal processes, through the Process Improvement Programme (PIP), which aims to streamline and re-engineer internal procedures. PIP will result in reduced processing time, lesser paper work and swift work flow, resulting in efficiency and delivery improvement. Recommendations from the departments were carefully studied and a decision was taken to systematically implement them in a gradual manner in the year 2004.

Retail Banking: *Adopting a fresh new approach*

In a changing market environment, it pays to change your thinking. This was successfully demonstrated by the Retail Banking Division.

Over a period of time, we had observed that a hyperactive consumer finance market was steadily eroding its lending portfolio. Instead of looking the other way, we took a realistic approach and decided to face the challenge.

We worked on solutions to compete at an acceptable level of risk. We evaluated our exposure to consumer finance and the risks associated in such lending activities. We then established a criterion to measure and minimise risks.

With this approach, the Retail Banking Division launched an all-new consumer friendly loans package. Approved customers could obtain loans equivalent to their 48 months salary multiples with a highly competitive rate of interest and repayments over a period of 10 years. With these consumer-friendly features, the loan gained instant popularity and re-enforced the Bank's strengths in staying at the forefront of Retail Banking.

The Division also introduced new *mortgage loans* with the highest monthly salary multiple and repayment period where, customers purchasing land and building their own home could obtain a loan equivalent to their 70 months salary multiples with repayments over a period of 25 years.

The Retail Banking Division introduced strategic changes in its operations that helped reduce non-performing portfolios and delinquency rates. Procedures that would measure performance levels with greater accuracy and also develop more reliable Management Information Systems (MIS), were introduced. These procedures vastly strengthened the credit quality of the Bank's asset portfolio.

Realising the importance of customer service efficiency, we re-launched our *enterActive loan* by offering preferential rate of interest to stimulate greater use of this product and expanded the marketing of *Secura* (a range of insurance services in association with Bahrain Kuwait Insurance Company) throughout our branch network.

Corporate and International Banking: *Keeping a close eye on opportunities*

Against a backdrop of wise economic policies initiated by the Government of the Kingdom of Bahrain, the Bank's Corporate Banking Division successfully achieved its objective of higher growth and profitability for the year 2003.

During the year, a number of infrastructure and industrial projects were initiated to stimulate the various sectors of the economy. The sizeable investments in the public sector, the thrust towards greater economic liberalisation and significant policy changes to encourage private sector investment, all combined to create a vibrant market scenario. These initiatives had a positive impact on the economy. For instance, there was

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a rise in real estate and construction activity, there were more business opportunities for traders and contractors and there were more employment prospects for Bahraini nationals.

The Corporate Banking Division kept a close eye on the dynamic changes in the market and capitalised on the various opportunities that presented themselves.

The Bank – in association with a number of local, regional and international banks – organised the largest ever commercial financing of the Alba expansion project. We also played a lead role in financing the prestigious Formula One race-track project. Currently, we are working with several regional and international banks to finance and support Bapco's various modernisation projects.

The Corporate Banking Division is committed to participate in the growth of the Kingdom's economy. It is also confident of further enhancing its asset quality and exceeding performance levels in its ongoing mission of achieving greater excellence.

Challenging times call for creative solutions. In spite of the challenging market environment which was adversely impacted by the conflict in Iraq and the low interest rates and margins that led to considerable difficulties in asset formation and growth, the International Banking Department was able to grow its portfolio by making a tactical shift in the deployment of its assets. The Department moved away from traditional loan offerings and concentrated on structured finance for acceptable credit and yields.

During the year, the Department focused on three core segments: Correspondent Banking, Structured Finance and Islamic Banking.

In 2003, the Department successfully raised US$ 125 million to further strengthen the Bank's funding base. The response to the issue was reassuring, with the Bank attracting first time investments from a number of Asian banks. The Department has an ongoing role in developing and managing healthy business relationships with financial institutions around the globe.

The Structured Finance Unit within the International Department continued to participate in corporate finance transactions across the GCC region. It registered a boost in fee-based earnings during the year by actively soliciting trade related, structured asset financing and credit derivatives. Furthermore, the newly formed Islamic Banking Unit supported the Alba expansion project, through its array of Islamic banking services.

Electronic Banking: *Making banking easier*

Once again the Electronic Banking Division continues its commitment to providing customers banking services in a fast, easy and convenient manner through the introduction of innovative delivery channels.

During the year, the Division launched *SMS Bank*, an information and communication service for the Bank's customers. This unique facility allowed customers to receive text messages on their mobile phones relating to their salary credit, account balance, last three transactions and currency exchange rates.

The Bank's e-payment gateway *www.bahrainpay.com*, was also upgraded to accept not only the Bank's electron and credit cards, but also major international cards online, including Visa and MasterCard.

In addition to cash disbursement, transfers between accounts and utility payments, the ATMs (Automatic Teller Machine) can now facilitate the refill of prepaid telephone cards and SimSim cards.

During the year, the Division undertook various measures to increase awareness and ensure more utilisation of our e-banking channels, resulting in higher customer usage.

The Electronic Banking Division's plan for 2004 is to develop a new, interactive one-to-one portal. This highly personalised portal will offer customers easier access to more services as more customers are discovering that online banking is easy and a great time saver as they need not visit the Bank's branches for most services.

Treasury Services: *Exploring new avenues*

2003 was an impressive year for the Treasury Department. It continued to focus on providing competitive rates and quality service in foreign exchange and deposits. It also played an important role in the growth of the Bank's internally managed portfolio of bonds generating high income and additional liquidity.

The Department also explored new avenues going beyond traditional bonds. It successfully participated in various Islamic issues that were introduced in the market during the year.

The Treasury Department will continue to build on its inherent strengths and will seek to find innovative ways in generating higher returns for the Bank.

Investment Services: *Meeting the demand*

In a low interest rate environment, there is always a demand for products offering higher returns. In 2003, the Investment Services Department introduced new products to meet this demand.

The Department successfully completed the placement of a real estate fund of US$ 25 million. The fund – the second in association with The Kuwait Financial Centre in Kuwait – was closed early due to over-subscription. The Department also played a significant role in under-writing Alba's bond offer in the market to the value of US$ 60 million.

Overseas Branches: *Combining local know-how with international expertise*

India India continues to make vast strides in the economic field offering immense potential to investors. To play an effective role in this ever evolving market, we upgraded the core banking system of our Mumbai and Hyderabad branches. There is now a higher level of efficiency in operations, and customers are enjoying enhanced banking services.

The branch has identified retail lending as a prime untapped market and is developing a strategy to be a key player in this segment. Furthermore, the branch is also looking at capitalising on the strong links that exist between the GCC and India and is also working closely with several GCC-related entities such as consulates, shipping companies, airlines and petroleum companies to identify high potential accounts.

Kuwait The Kuwait market has been buoyed by the regime change in Iraq, opening up new prospects. We seized this opportunity to expand our operations in both corporate and retail sectors.

In spite of a slow start due to political uncertainties, the Bank's corporate banking portfolio grew in the areas of lending and trade finance which led to the development of new businesses.

Retail banking too witnessed a surge in activity with enhanced consumer loan products and improved customer service. In June 2003, the branch successfully launched a KD 25 million Certificate of Deposit scheme to boost its deposit base.

Dubai Representative Office Despite the developments in Iraq, the market in the United Arab Emirates (UAE) remained stable and

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unaffected. The Dubai Representative Office increased its corporate activities by participating in many key infrastructure projects in the UAE.

The Office's asset portfolio was further diversified with a significant presence in a wide range of industries including power, utilities, airlines, automobiles, paper, food and beverages and textiles.

The Office continues to attract many leading business groups in the UAE as its valued clients. It is also playing a significant role in supporting the Non-Resident Indian (NRI), by actively promoting a number of investment products and services to its NRI clients.

Information Technology: *Taking banking to a new era*

Over the years, information technology has emerged as the engine that drives business. In fact, an organisation's progress is directly linked to its effective investments in information technology.

In 2003, the Division further enhanced the Bank's electronic delivery channels which lead to the increased usage of the Bank's e-channels. It also improved the Bank's e-banking infrastructure with the aim of executing transactions in a quick, secure and efficient manner.

The year also saw the Division acquire a Net Order certification from Visa that would enable anyone with a Visa or MasterCard to buy products or services offered by our partners through our internet payment gateway, *www.bahrainpay.com*.

Of course, the advances in information technology are better appreciated if they benefit the end-user. Towards this end, the Division consistently reviewed its processing systems, upgraded servers and e-net facilities, improved card encryption techniques to ensure greater security. The Division also introduced a user defined report writer – a user friendly tool to help staff design reports, develop accounts and offer superior services to corporate and retail banking customers.

The Bank's Intranet service, which serves as the gateway to corporate information, was upgraded to allow employees easy access anytime, anywhere. New technologies were also implemented to reduce network overheads and enable employees to access all computer systems, review emails, look up directories and locate data while on the move.

During the year, the Division conducted a thorough evaluation of our branch automation and core banking system and completed its selection. The implementation of these systems will commence early 2004.

Through innovation and expertise, the Information Technology Division is continuously meeting the challenges of enhancing its technologies towards a more customer focused banking.

Financial Control & Planning: *Embracing a whole new attitude*

In 2003, the Financial Control & Planning Department underwent a major re-organisation. There were key changes in management positions and a new head was appointed to lead the Department.

A new strategy was put into effect clearly underlining the important role of proper financial control and planning. There was an added emphasis on providing proactive business support through enhanced management information, insightful performance reviews and detailed analysis.

During the year, the Department introduced the Group Accounting Policies Manual – a valuable guide on accounting policies and compliance with regulatory requirements – to ensure the integrity of the Bank's financial statements.

The Department also upgraded its financial systems to increase productivity. It implemented a new Oracle General Ledger, enhanced its Reconciliation System and further increased the effectiveness of its Account Payable System.

Operations: Operating at a higher level

During 2003, the Operations Department continued to focus on its objective of offering better and more efficient banking services. It well supported the Bank's customers through various operations including trade finance activities.

The Department acquired and implemented 'Quantum', a state-of-the-art, fully integrated electronic trade finance system, to support the treasury's back office activities. Quantum enables a closer and more efficient monitoring of the treasury back office operations.

Money laundering being a major concern in the banking industry, the Department reviewed issues governing money laundering with the objective of re-aligning its procedures with international regulations.

Business Development: Providing the insight

The Business Development Division continued to empower the Bank with its in-depth knowledge of the markets.

The Division monitored the local and regional economy, providing insightful reviews and accurate analysis. For example, the Division indicated greater market stability due to oil prices maintaining a relatively high level following the Iraqi conflict. Based on this analysis, the Division recommended that the Bank adopt a cautious outlook.

The Division plays a vital role in helping the Bank formulate new strategies for developing business. It also helps the Bank identify its business strengths, modify its processes and enhance existing products and services as well as develop new ones to maintain the competitive edge.

CrediMax: Continued focusing on added value and new products

CrediMax, the Bank's wholly owned subsidiary, continued to be the market leader and enjoyed its fifth successful year of operations.

During the year, CrediMax focused on adding extra value to its products and services. It introduced WinniMax, the largest card utilisation programme in the Kingdom offering monthly, quarterly and annual prizes. CrediMax also continued to build on its history ofi nnovation by introducing the first Platinum Card in Bahrain and launching the first affinity card programme with University of Bahrain.

Human Resources and Administration:
Investing in quality people for quality banking

The Bank continues to believe that people are our most valuable assets. They are the human face of the Bank who, inspire trust and confidence in customers.

During the year, the Division launched its newly designed Management Trainees Programme. This strategic initiative aims to build a cadre of qualified human resources who will be engrained in various positions in the Bank. The programme is part of the Bank's long-term Human Resources investment that will yield its benefits through securing the organisation against potential attrition and future succession.

The Division also redesigned its Performance Management System (PMS) addressing several concerns reported in the StaffSatisfaction Survey conducted in 2002. This new system will provide the competency framework that will form the foundation block for developing a structured succession planning process.

Dr Farid Ahmed Al Mulla

Organisation Structure and Management Profile

BOARD OF DIRECTORS

- **Board Secretariat**
- **Internal Audit**

GENERAL MANAGER AND CHIEF EXECUTIVE OFFICER

Dr Farid Ahmed Al Mulla
General Manager and Chief Executive Officer
PhD in Economics and International Relations. University of Sussex, UK – 1982. 21 years of banking experience. Joined Bank of Bahrain and Kuwait in 1990.

BANKING GROUP

Ahmed Al Banna
Deputy General Manager
BSc. University of Houston, USA – 1978.
20 years of banking experience. Joined Bank of Bahrain and Kuwait in 1987.

RISK MANAGEMENT

Amit Kumar
Senior Manager
MBA, Indian Institute of Management, Ahmedabad, India – 1983. 20 years of banking experience. Joined Bank of Bahrain and Kuwait in 1994.

CREDIT MANAGEMENT

Adnan A. Wahab Al-Arayyed
Senior Manager
Bachelor of Commerce in Business Administration, Beirut Arab University – 1984. 22 years of banking experience, all with Bank of Bahrain and Kuwait.

SHARED SERVICES GROUP

Vacant

Committees

EXECUTIVE COMMITTEE

Chairman: **Mr Rasheed Mohammed Al-Maraj**

Responsibility: Review, approve and direct executive management on all matters raised to the Board of Directors.

AUDIT COMMITTEE

Chairman: **Mr Murad Ali Murad**

Responsibility: Advise, report and recommend to the Board of Directors on the quality of the bank's operation with particular emphasis on systems of control.

ASSET AND LIABILITY MANAGEMENT COMMITTEE

Chairman: **Dr Farid Ahmed Al Mulla**

Responsibility: Enhance shareholders' value through establishment of policy and guidelines for the overall management of balance sheet and its associated risks.

Subsidiaries

CrediMax
Wholly owned

Al Khaleej Islamic Investment Bank
Wholly owned

BBK Financial Services Company
Wholly owned

BUSINESS DEVELOPMENT

Khalid Abdulla
Assistant General Manager
Ph.D in Economics from Exeter University, UK – 1991. 20 years academic and research experience with University of Bahrain. Joined Bank of Bahrain and Kuwait in 2000.

RETAIL BANKING

Jamal Hijres
Assistant General Manager
MBA, University of Bahrain – 1991. 25 years of banking experience, all with Bank of Bahrain and Kuwait.

CORPORATE & INTERNATIONAL BANKING

Abdul Karim Ahmed Bucheery
Assistant General Manager
Bachelor of Economic Sciences, University of Aleppo, Syria – 1976. 26 years of banking experience, joined Bank of Bahrain and Kuwait in 2001.

TREASURY, INVESTMENT & OVERSEAS BRANCHES

Ibrahim Buhindi
Assistant General Manager
MBA, Sheffield Hallem University, UK – 1999. 31 years of banking experience. Joined Bank of Bahrain and Kuwait in 1988.

ELECTRONIC BANKING

Abdul Wahid Abdulrahman Janahi
Assistant General Manager
Masters in Business Administration, University of Bahrain – 1997. 9 years of experience in telecommunication. Joined Bank of Bahrain and Kuwait in 2001.

INFORMATION TECHNOLOGY

Abdulla Abdulrahman Hussain
Assistant General Manager
MBA, University of Bahrain – 1994. 17 years of experience in information technology. Joined Bank of Bahrain and Kuwait in 2002.

FINANCIAL CONTROL & PLANNING

Vinit Kohli
Chief Financial Officer
B. Com (Honours) Delhi University, CA, Institute of Chartered Accountants of India. 23 years of experience. Joined Bank of Bahrain and Kuwait in 2002.

HUMAN RESOURCES & ADMINISTRATION

Abdul Hussain Bustani
Assistant General Manager
Higher National Diploma in Civil Engineering, Trent Polytechnic, UK – 1978. 16 years of banking experience. Joined Bank of Bahrain and Kuwait in 1988.

OPERATIONS

Mahmood Abdul Aziz
Senior Manager
Executive Management Diploma, University of Bahrain, Gulf Executive Management Program, University of Virginia. 32 years of Banking experience. Joined Bank of Bahrain and Kuwait in 1976.

SENIOR HUMAN RESOURCES COMMITTEE

Chairman: **Dr Farid Ahmed Al Mulla**

Responsibility: Optimise the contribution of the human capital asset through establishing the appropriate policies, procedures and guidelines for the management of human resources.

PROVISION COMMITTEE

Chairman: **Dr Farid Ahmed Al Mulla**

Responsibility: Review and decide on the Bank's provisioning requirements for loans and advances as well as the BMA requirements for sovereign exposures.

RISK MANAGEMENT COMMITTEE

Chairman: **Dr Farid Ahmed Al Mulla**

Responsibility: Identification, measurement, monitoring and control of risk. Establishing risk policies and procedures in pursuit of adopting best risk management practices.

STRATEGY AND FINANCIAL REVIEW COMMITTEE

Chairman: **Dr Farid Ahmed Al Mulla**

Responsibility: Review divisional financials and profitability and monitor progress on strategic initiatives.

STRATEGY COMMITTEE

Chairman: **Mr Murad Ali Murad**

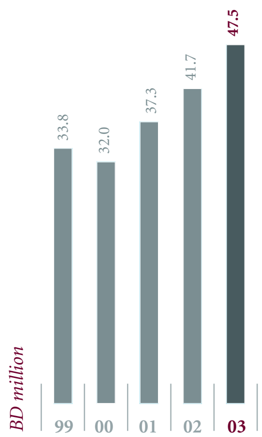
Responsibility: Review and recommend to the Board of Directors strategic initiatives submitted by the Executive Management.

Rewards for Shareholders

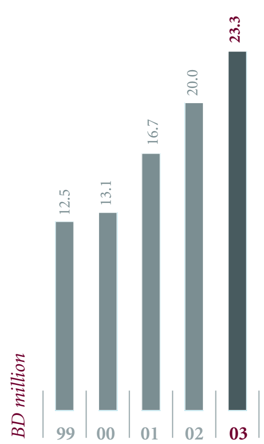
We recognise our shareholders as the source of our financial strength and continue to offer them increased growth and profitability.

The fact that the Bank's consolidated profit represents an increase in return on shareholders equity from 16.1 % in 2002 to 17.8 % in 2003, proves our commitment.

Financial Review



Total income



Net profit for the year

This review incorporates the consolidated operating results and the Balance Sheet of the Bank of Bahrain and Kuwait with its overseas branches and its subsidiaries, CrediMax, BBK Financial Services Company and Al Khaleej Islamic Investment Bank. The statements have been prepared and presented in conformity with the Bahrain Commercial Companies Law and the Bahrain Monetary Agency Law and in accordance with International Financial Reporting Standards.

OPERATING RESULTS

The Bank has shown a consistently strong operating performance for the year ended 31st December 2003. It has posted a net operating profit of BD 23.310 million, up from BD 20.009 million for 2002. This is a growth in net profits of 16.5% over 2002 profits. This improvement in performance is reflective of strong revenue growth while costs have been contained. As a result, the return on average equity has improved to 17.8%, up from 16.1% in 2002.

Operating income

Total operating income rose to BD 47.5 million, up from BD 41.7 million in 2002, representing a 14% increase. This increase in income came from higher fees and commission earned during the year, higher trading income as well as higher net interest income, emphasising that the growth was from core businesses of the Bank.

Net interest income

The overall net interest income grew marginally from BD 25.5 million to BD 26.1 million, the growth rate being impacted by exceptionally high interest recoveries in the previous year. The relatively lower growth in net interest income also reflects the Bank's conscious decision to improve the credit quality of its portfolio at the cost of higher margins. Although the loans portfolio grew by 22.8% and its investments portfolio grew by 7.4% over the previous year, the Bank was successful in funding most of this growth through customer deposits and

Summary Income Statement

	2003	2002	Variance BD millions	Change Per cent
Net interest income	**26.1**	25.5	0.6	2.4%
Other income	**21.4**	16.2	5.2	32.1%
Total income	**47.5**	41.7	5.8	13.9%
Operating expenses	**(22.0)**	(19.9)	-2.1	-10.6%
Taxation	**0.1**	(0.2)	0.3	-150.0%
Profits before provisions	**25.6**	21.6	4.0	18.5%
Net provisions	**(2.3)**	(1.6)	-0.7	-43.8%
Net profit (before appropriations)	**23.3**	20.0	3.3	16.5%

achieving a net interest margin of 2.30%, marginally lower than the previous year's margin of 2.45%.

Other income

Other operating income includes non-interest income which is earned from businesses such as dealing in foreign currencies, investment in funds, the sale of corporate banking and retail banking services and share of income of associate companies. The total income generated from these core activities during the year was 21.4 million, which was 32.1% higher than in the previous year (BD 16.2 million). This growth in income was mainly on account of increase in fees and commissions earned, higher trading and investment income and better income on managed funds. Fees and commissions earned, which includes income from the Bank's credit card business and loans fees from the Bank's corporate and retail banking customers, increased by nearly BD 3.2 million which was almost 33% over the previous year. Trading and investment income grew by BD 1.9 million approximately which was nearly double the trading and investment income in the previous year.

Operating expenses

Total operating expenses, which include staff, premises, equipment, depreciation and other administrative costs, increased by BD 2.1 million (10.7%), reflecting the Bank's continuous investment in technology and human resources. The largest growth on expenses came in the areas of staff cost which included costs of new recruitment, salary adjustments as well as some one-off restructuring costs. Other operating costs and depreciation grew marginally over 2002 by BD 0.5 million and BD 0.4 million respectively. This tight cost control resulted in a much improved cost-to-income ratio of 46.3% as compared to 47.7% in 2002.

Net provisions

The Bank follows the International Accounting Standard (IAS) 39 with regard to accounting for impairment of financial assets. The provisions for impairment of the Bank's financial assets are arrived at after calculating the Net Present Value of the anticipated future cash flows from financial assets, discounted at original interest rates. This approach to provisioning for impairment of the Bank's financial assets is aimed at providing more realistic estimates of the impairment in the value of the assets, thereby giving greater protection to the Bank's depositors and preserving the capital base of the Bank.

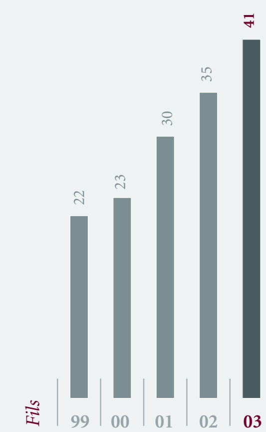
The net provisions for the year, including general provisions, were BD 2.3 million, up from BD 1.6 million last year. While the Bank did recover a substantial amount against its non-performing loans, the recoveries were offset by a higher level of provisioning as the Bank continued its strategy to provide aggressively against its non-performing portfolio as a measure of prudence.

Taxation

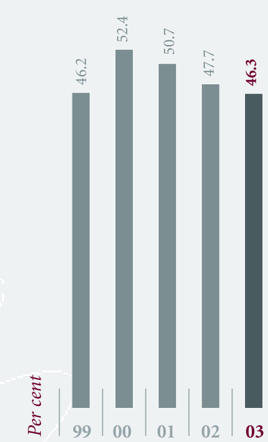
The operations of the Bank in India are subject to taxation in accordance with the regulations of India. During the year, the Bank had a small net tax credit as compared to a net tax charge of BD 0.2 million last year.

FINANCIAL POSITION

The total balance sheet size of the Bank grew over 8% year-on-year. Over 10.8% of the balance sheet was funded by shareholders' equity with the rest coming from customer and inter-bank deposits. Over 93% of the growth in the Bank's loans and advances portfolio was funded by growth in customer deposits, reflecting the Bank's strength in sourcing stable funding from its customer base.



Earnings per share



Cost/income

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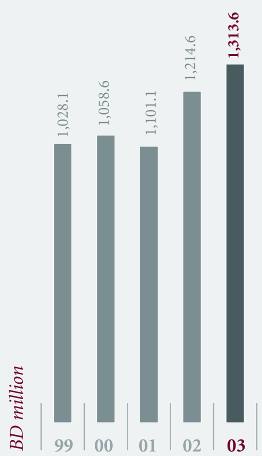
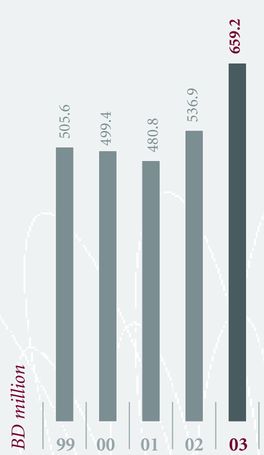


Total assets



Loans & advances

Summary Balance Sheet

	2003	2002	Variance BD millions	Change Per cent
Assets				
Cash and balances with central banks	**42.1**	64.9	-22.8	-35.1%
Treasury bills	**73.0**	69.8	3.2	4.6%
Deposits and due from banks	**168.1**	195.5	-27.4	-14.0%
Loans and advances	**659.2**	536.9	122.3	22.8%
Investments	**341.9**	316.6	25.3	8.0%
Other assets	**29.4**	30.9	-1.5	-4.9%
Total assets	**1,313.6**	1,214.6	99.0	8.1%
Liabilities				
Deposits and due from banks	**338.4**	326.1	12.3	3.8%
Medium term loans	**37.7**	84.8	-47.1	-55.5%
Customer deposits	**772.2**	658.4	113.8	17.3%
Other liabilities	**23.0**	14.2	8.8	62.0%
Total liabilities	**1,171.3**	1,083.5	87.8	8.0%
Shareholders' equity (before appropriations)	**142.3**	131.1	11.2	8.5%
Total liabilities & shareholders' equity	**1,313.6**	1,214.6	99.0	8.1%

Assets

The total asset base of the Bank continued to grow, registering an 8.1% growth in total assets. For the second year running, the loans portfolio of the Bank grew in double digits, crossing 22% growth in 2003. The total investments portfolio (including investments in Treasury bills and Kuwait Government bonds) grew 7.4% as well.

In support of local markets, the Bank maintained its investment in Treasury bills at BD 73.0 million (previous year BD 69.8 million). Treasury bills are short-term investments made by the Bank to park surplus liquid funds from time to time. Combined with other investments, including Kuwait Government bonds, these investments accounted for 31.6% of the total balance sheet of the Bank (31.8% at 2002 year end).

The investments portfolio of the Bank is classified into four categories namely "Held For Trading", "Available For Sale", "Originated Investments" and "Held To Maturity". They consist of quoted bonds, equities and unquoted securities that are mainly acquired with the intention of being retained for long-term and current debt and equity securities that are held for trading purposes. At the end of 2003, 60.2% of these investments were in the form of quoted bonds and equities (53.7% at the end of 2002). Those investments classified as "Available For Sale" have been measured at Fair Value and the resultant gains/losses have been taken directly to the Bank's equity. A major portion of the "Held to Maturity" portfolio was made up of highly rated and marketable fixed income securities. Investments also include long-term Kuwaiti treasury bonds and externally managed portfolios of well-diversified funds.

Investment in associated companies includes the Bank's 20.25% interest in the equity of the Bahrain Commercial Facilities Company, a public shareholding company. The carrying value of this investment represents the Bank's share in the total shareholders' equity of the company.

Kuwait Government bonds are long-term bonds that were issued as settlement by the Central Bank of Kuwait for resident Kuwaiti customers' debts and resident debts of other Gulf Co-operation Council nationals that were held by the Kuwait branch as at 1 August, 1990 and related interest up to 31 December, 1991.

Loans, advances and overdrafts, net of provisions for bad and doubtful debts, increased by BD 122.3 million to BD 659.2 million, reflecting an increase of 22.8% over 2002. This increase came from growth in corporate and consumer lending mainly in Bahrain and partly in Kuwait. As a percentage of total assets, the Bank's loans & advances increased in 2003 to 50.2% from 44.2% in the previous year.

Treasury bills and inter-bank deposits are money market instruments held essentially for liquidity purposes. Other assets mainly include accrued interest receivable, fixed assets net of accumulated depreciation, acquired assets pending sale, and prepaid expenses.

Liabilities

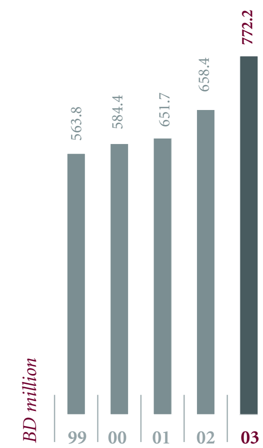
Current, savings and other deposits include balances of interest bearing and non-interest bearing accounts due to customers on demand and term deposits taken with different maturity dates, in various currencies and at varying rates of interest.

Customer deposits increased 17.3% to BD 772.2 million from BD 658.4 million at the end of 2002. Growth in stable customer deposits has been the thrust area for the Bank.

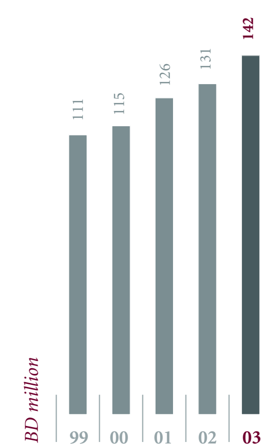
Deposits from banks and other financial institutions increased to BD 338.5 million from BD 326.1 million, up marginally by 3.8%.

During the year, the Bank repaid part of the medium term loans to the extent of BD 47.1 million, bringing the medium term loans down to BD 37.7 million at the end of 2003. This funding was replaced by deposits from financial institutions for a similar tenor with the objective of diversifying sources of funds and continually improving the maturity structure of the Bank's balance sheet.

Interest payable and other liabilities consist of accrued interest payable on interest bearing deposits, accrued expenses and provisions for contingent liabilities.



Customer deposits



Shareholders' equity

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Capital adequacy

Shareholders' equity, before appropriations, increased to BD 142.3 million at the end of 2003 from BD 131.1 million at the end of 2002. This has strengthened the financial position of the Bank. With this strong capital position, the Bank's capital adequacy ratio at the end of 2003 stood at 16.5% which is well above the 8% minimum required by the Basle Accord. This ratio measures total qualifying capital held by a bank in relation to its risk weighted assets and contingents. The Bahrain Monetary Agency had increased this minimum requirement to 12.0% with effect from 1998 for locally registered banks.

Risk Management

Efficient and timely management of risks involved in the Bank's activities is critical to its financial soundness and profitability. Risk management involves identifying, measuring, monitoring and managing risks on a regular basis. The objective of risk management is to increase shareholders' value and achieve return on equity that is commensurate with the risks assumed. To achieve this objective, the Bank uses state-of-the-art technology, the best risk management practices and skilled, experienced people.

The Board of Directors of the Bank has the overall responsibility of managing the risks. The Board approves and periodically reviews risk management policies and strategies of the Bank. The Management establishes procedures to implement these policies and strategies. The Risk Management Committee (RMC) and Asset and Liability Management Committee (ALMC) comprising Executive and Senior Management, are responsible for overall management of balance sheet and risk profile of the Bank.

RMC discusses important risk related issues, policies, procedures and reviews implementation of its decisions. ALMC reviews issues relating to the balance sheet at micro level. In order to ensure independence of risk management process, Head of Risk Management Department (RMD) reports directly to the General Manager.

The various risks to which the Bank is exposed to and how the Bank manages them individually are as follows:

Credit Risk

Credit Risk is defined as the potential that the Bank's borrower or counterparty will fail to meet its obligations in accordance with the agreed terms. The goal of credit risk management is to maximise the Bank's risk adjusted rate of return by maintaining credit risk exposures within acceptable parameters.

The Bank has well defined policies and procedures for identifying, measuring, monitoring and controlling credit risk in all of the Bank's activities, at the level of individual credit and portfolio. Credit limits are approved after thorough assessment of the credit worthiness of borrower or counterparty, including the purpose and structure of credit, and its source of repayment. Credit proposals are reviewed by Credit Management Department (CMD) before approval by the appropriate approving authority. Such reviews are conducted independent of Business Units, by Head of CMD, who reports directly to the General Manager.

The Credit growth, quality and portfolio composition are monitored continuously to maximise risk adjusted return and reduce the level of incidence of impairment and accretion of marginal credits. Bank monitors concentration risk by setting up limits for maximum exposure to individual borrower or counterparty, country, bank and industry.

Such limits are also stipulated for each product. These limits are approved after detailed analysis and are reviewed and monitored regularly.

Day to day monitoring of individual borrower or counterparty exposure is the responsibility of the respective Business Unit. The Bank's Credit Administration Unit, a part of the CMD, ensures that credit facilities are released after proper approval and against proper documentation. It also monitors excesses over limits, past dues, expired credits and promptly escalates exceptions if any, for corrective action.

The Bank has a risk asset rating policy which defines criteria for rating of risk assets. All credits are assigned rating in accordance with the defined criteria. All lending relationships are reviewed at least once in a year and more frequently in case of non-performing assets (NPAs). The Internal Audit Department conducts independent review of risk assets periodically and submits its report to Senior Management/Audit Committee. The Bank endeavours continuously to improve upon the internal Credit risk rating methodologies and Credit risk management policies and practices, to reflect the true Credit risk and testify Credit culture in the Bank.

It is the Bank's policy to ensure that provisions for credit loss are maintained at adequate level. For loans and advances considered by the management as individually significant, specific provision is made for the impairment loss worked out on the basis of estimated discounted value of future cash flows in line with IAS-39 guidelines. For the remaining accounts, which are individually not significant, specific provision is made based on historic trends and the current economic environment. As a part of portfolio credit risk management, general provision as per the internal policy is also maintained. All provisions are approved by the Provision Committee, which comprises members of the Executive Management.

In order to give more attention and make concerted efforts for recovery of non-performing loans and advances, they are managed by experienced and skilled staff under separate recovery/loan work out sections within Retail, Corporate and International Banking Divisions.

Liquidity Risk

Liquidity Risk is defined as potential inability of the Bank to meet its financial obligations (liquidity needs) due to funding mismatch. Management of liquidity risk requires that the Bank can meet its cash financial obligations as and when they fall due.

The Bank has in place a liquidity policy which describes the roles and responsibilities of the ALMC, Treasury and stipulates the broad guidelines with regard to minimum liquid assets to be maintained by the Bank. The Bank uses maturity ladder (time buckets) approach for managing its liquidity. The limits for funding requirement for each time bucket of the maturity ladder, the cumulative outflow of cash for each time bucket and various liquidity ratios to be maintained are approved by the ALMC based on Annual Liquidity Strategy. It is the Bank's policy to keep its assets in high quality liquid assets such as inter-bank placements, Treasury Bills and Government Bonds, to ensure that funds are available to meet maturing liabilities, un-drawn facilities and deposit withdrawals. A substantial proportion of the Bank's deposits is made up of retail current, savings and fixed deposit accounts which, though payable on demand or at short notice, have traditionally formed a stable deposit base and a source of core fund.

The day to day management of liquidity risk is the responsibility of the Global Treasurer. He monitors the sources and maturities of assets and liabilities closely and ensures that limits stipulated by the ALMC are complied with and that there is no concentration of funding from any one source.

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The Bank also draws up Contingency plans to deal with extraordinary conditions of liquidity risk after comprehensive scenario analysis. A special committee called Strategic Contingency Liquidity Committee (SCLC) set up to deal with any potential liquidity crisis emerging out of Iraq war, monitored implementation programmes as per the worked out Risk management strategies and Contingency plans, very effectively.

Interest Rate Risk

Interest rate risk is the exposure of the Bank's financial condition to adverse movements of interest rates. The Bank is exposed to this risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or re-price in a given period. Excessive interest rate risk can pose a significant threat to the Bank's earnings and capital base. Accordingly, an effective risk management process that maintains interest rate risk within prudent levels is essential to the safety and soundness of the Bank.

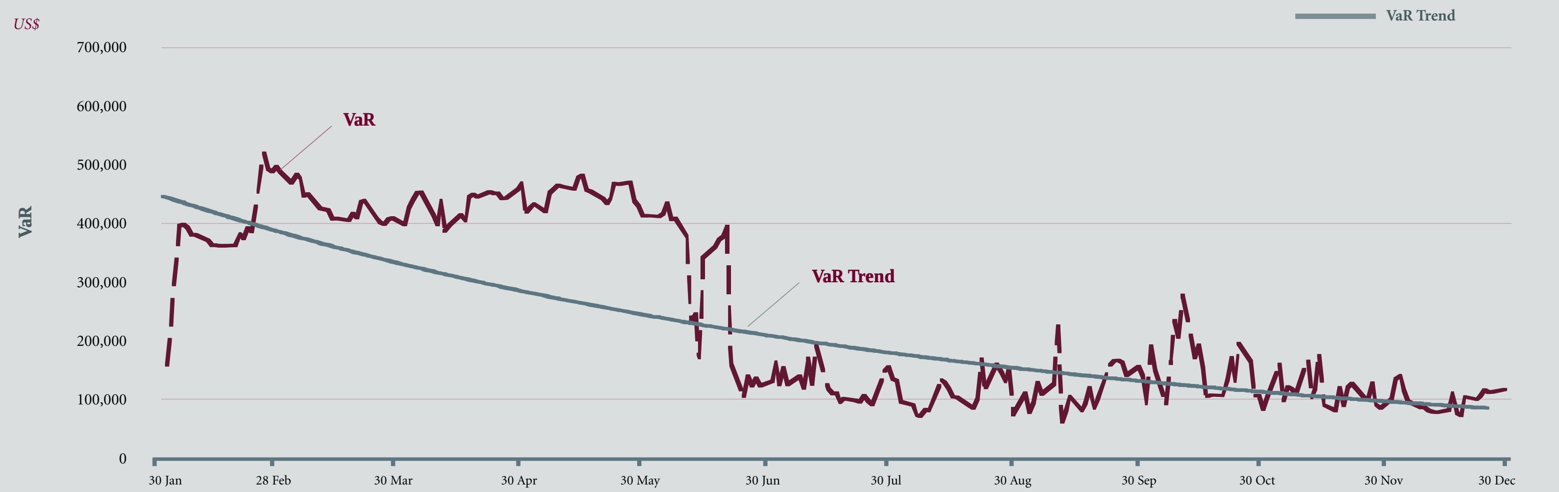
It is the Bank's policy to keep its assets and liabilities mismatches at minimum so as to maintain steady net interest income. The Bank monitors interest rate risk based on gap/duration limits. The Bank also uses 'what if' scenarios for changes, if any, in interest rates, for projecting net interest income of the Bank. The Bank uses derivative instruments such as interest rate swaps, floating rate agreements and bond futures to manage interest rate risk. Day to day management of interest rate risk is the responsibility of the Global Treasurer.

Market Risk

Market Risk is defined as the risk of losses in on or off balance sheet positions of the Bank arising from movements in market prices of interest rate related instruments, equities in the trading book and foreign exchange and commodity risk throughout the bank.

The Bank has clearly defined policies for conducting investment

Consolidated VaR (1 Day) for Bahrain and Kuwait – January to December 2003



(including trading investments) and foreign exchange business, which stipulate limits for these activities. Investments are made strictly in accordance with investment acceptance criteria which ensure that investments are marketable and liquid. The Bank does not undertake any commodity trading activity.

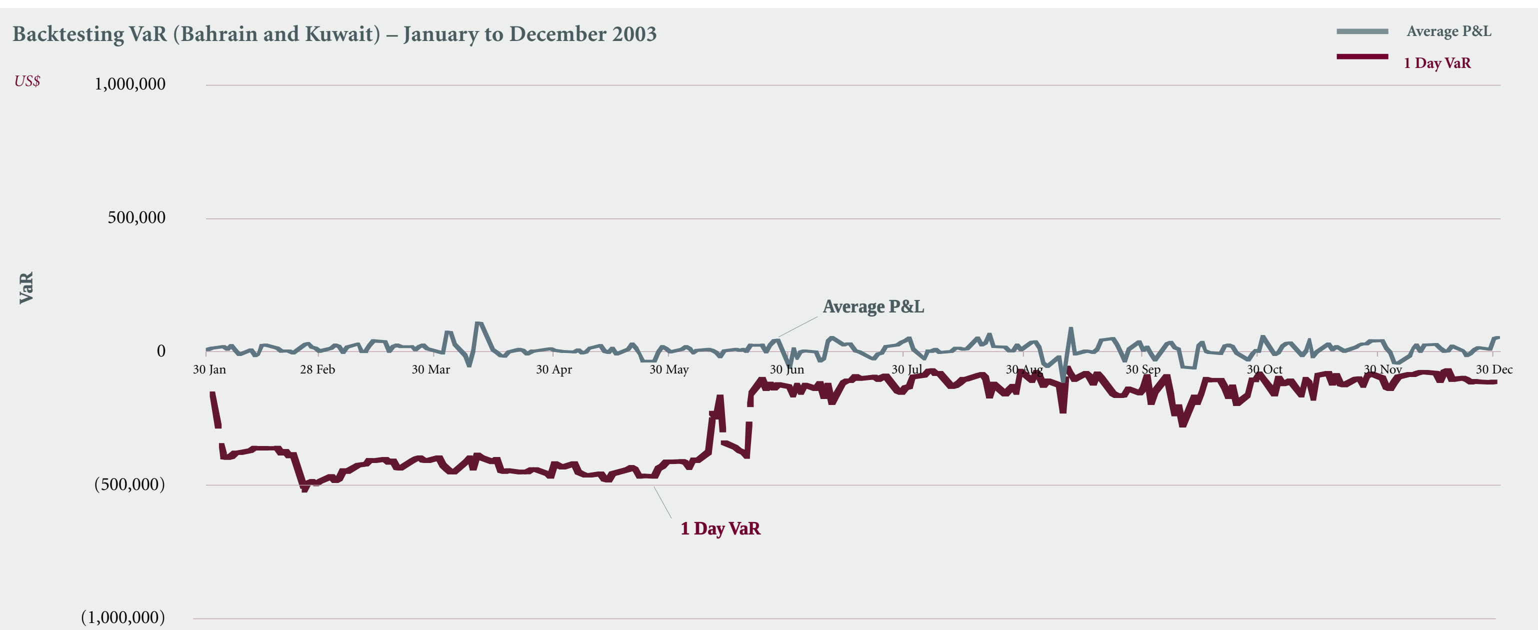
The Bank uses internal Value-at-Risk (VaR) model for measuring general market risk. The internal model was approved by the Bahrain Monetary Agency. VaR is calculated using a 99% confidence level for a 10-day holding period. This implies 1% possibility of the loss exceeding the VaR amount calculated by the model. As at 31st December 2003, VaR calculated based on the above parameters was BD 76, 723 (US$ 203,510).

A graph of VaR for the year 2003 is given on the previous page. The graph depicts the VaR movement for each day. The dark grey line in the middle of the graph is the regression line (trend line) of VaR.

Risk Management Department conducts backtesting in accordance with the Market Risk Capital Adequacy Regulations issued by the Bahrain Monetary Agency. Backtesting involves comparing on a daily basis, the one-day daily VaR with the average daily profit and loss (i.e. average of the closing and opening profit and loss). The objective is to ensure that the assumptions used for computing VaR are reasonable and result in a VaR number that is a good indicator of worst possible losses.

The chart below depicts the results of comparing the average profit and loss against the consolidated VaR for Bahrain and Kuwait during the year 2003. In circumstances where the average profit and loss was a loss,

Backtesting VaR (Bahrain and Kuwait) – January to December 2003



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the VaR was always greater than the loss, indicating a high correlation between the movement of projected loss and actual loss. During the year actual loss never exceeded the VaR estimates indicating that the assumptions used in computation of the VaR number are reasonable. The Bank also regularly conducts stress testing to identify events or scenarios that could greatly impact material trading positions taken by the Bank. As per the Bahrain Monetary Agency requirements, validation of the internal model is conducted by the Internal Audit Department of the bank and by the external auditors.

Legal Risk

Legal risk is the risk that contracts are not legally enforceable or documented correctly. It is the Bank's policy to use standard documents for majority of its lending. The standard documents of the Bank are prepared in consultation with the Bank's in-house Legal Department and/or external legal counsel. All non-standard documents are approved by the Bank's in-house Legal Department and/or external legal counsel.

The policies and procedures of the Bank ensure that credit facilities are released after obtaining proper documents.

Operational Risk

Operational risk is the exposure to loss resulting from inadequate or failed internal processes, people and systems or from external events. The Bank has clearly defined operations procedures for each of its product and service. The Bank has advanced computer systems which enable it to run operations with speed and accuracy.

All computer systems and operations procedures are approved by Internal Audit Department. The Internal Audit Department operates independent of other units of the Bank and reports directly to the Audit Committee which consist members of the Board. It conducts regular reviews of all business areas of the Bank and reports control deficiencies and exceptions to the Bank's policies and procedures. It also recommends measures to improve operational risk and these recommendations are implemented by the management immediately.

The Bank also has contingency plan to take care of any failure of its computer systems. Regular back-ups are made for all important datasets and they are stored outside the Bank's premises. This ensures that in case of any system failure, the Bank will be in a position to continue its operations without the loss of critical data or business transactions. As part of the disaster recovery plan, the Bank has established a back up site centre to stand in and be operational during an emergency.

The Bank has set up a state-of-the-art Business Continuity Plan (BCP). The main objective of BCP is to ensure that in the event of full/partial disaster, the Bank should be able to continue providing essential services to customers so that adverse effect of any disaster on the Bank’s business is minimised.

Compliance Function

The Bank has an established Compliance Unit to act as central co-ordinator in respect of matters relating to regulatory authority (BMA), including ensuring periodic reporting and responding to other statutory/regulatory requirements. The compliance function covers Bank's anti-money laundering initiatives, broad areas of corporate governance, adherence to best practices, code of conduct and conflict of interest.

Auditors' Report

To the Shareholders We have audited the accompanying consolidated balance sheet of Bank of Bahrain and Kuwait B.S.C. (the Bank) and its subsidiaries (the Group) as of 31 December 2003, and the related consolidated statements of income, cash flows and changes in equity for the year then ended. These consolidated financial statements are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2003, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements and the contents of the Chairman’s statement relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Bahrain Monetary Agency Law, nor of the memorandum and articles of association of the Bank, have occurred during the year ended 31 December 2003 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position, and that the Bank has complied with the terms of its banking licence. We obtained all the information and explanations which we required for the purpose of our audit.

Ernst & Young

Ernst & Young
8 February 2004
Manama, Kingdom of Bahrain

Consolidated Financial Statements

Consolidated Balance Sheet

31 December 2003

	Notes	2003 BD 000's	2002 BD 000's
ASSETS			
Cash and balances with central banks	4	42,146	64,876
Treasury bills	5	72,967	69,817
Trading investments		4,454	440
Deposits and due from banks and other financial institutions		168,052	195,461
Loans and advances to customers	6	659,167	536,880
Non-trading investment securities	7	324,557	295,971
Investment in associated company	8	5,081	4,936
Interest receivable and other assets	9	13,988	14,851
Kuwait Government bonds	10	7,833	15,331
Premises and equipment		15,373	16,086
TOTAL ASSETS		1,313,618	1,214,649
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits and due to banks and other financial institutions		334,985	326,136
Borrowings under repurchase agreements		3,477	-
Medium term loans	11	37,700	84,825
Customers' current, savings and other deposits		772,175	658,400
Interest payable and other liabilities	12	23,029	14,209
TOTAL LIABILITIES		1,171,366	1,083,570
SHAREHOLDERS' EQUITY			
Share capital	13	56,906	56,906
Treasury stock	13	(1,053)	(1,053)
Statutory reserve	14	21,006	18,675
General reserve	14	20,000	20,000
Cumulative changes in fair values	15	3,986	(586)
Foreign currency translation adjustments		(832)	(1,696)
Retained earnings		24,438	22,852
Proposed appropriations	16	17,801	15,981
TOTAL SHAREHOLDERS' EQUITY		142,252	131,079
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		1,313,618	1,214,649

The financial statements were authorised for issue in accordance with a resolution of the Directors on 8 February 2004.

Murad Ali Murad
CHAIRMAN

Jassem Hasan Ali Zainal
DEPUTY CHAIRMAN

Dr Farid Ahmed Al Mulla
GENERAL MANAGER AND CHIEF EXECUTIVE OFFICER

The attached notes 1 to 38 form part of these consolidated financial statements.

Consolidated Income Statement

Year ended 31 December 2003

	Notes	2003 BD 000's	2002 BD 000's
Interest income	17	**47,617**	51,291
Interest expense	18	**21,540**	25,838
Net interest income		**26,077**	25,453
Other operating income	19	**20,350**	15,260
NET INTEREST AND OTHER OPERATING INCOME		**46,427**	40,713
Net provision for losses on loans and advances to customers	6	**(1,104)**	(3,272)
Write backs of provision for impairment in other assets and contingencies	7	**-**	1,696
Provision for impairment in the value of non-trading investment securities	7	**(1,164)**	-
NET OPERATING INCOME AFTER PROVISIONS		**44,159**	39,137
OPERATING EXPENSES			
Staff costs		**12,592**	11,322
Other operating expenses		**6,974**	6,483
Depreciation		**2,470**	2,094
Total operating expenses		**22,036**	19,899
PROFIT FROM OPERATIONS		**22,123**	19,238
Share of profit in associated company		**1,134**	961
PROFIT BEFORE TAXATION		**23,257**	20,199
Taxation – foreign units		**53**	(190)
NET PROFIT FOR THE YEAR		**23,310**	20,009
Basic earnings per share (BD)	20	**0.041**	0.035
Dividend per share (BD)	16	**0.030**	0.027

The attached notes 1 to 38 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

Year ended 31 December 2003

	2003 BD 000's	2002 BD 000's
OPERATING ACTIVITIES		
Profit for the year before taxation and minority interest	**23,257**	20,199
Adjustment for:		
Net provisions (write backs) relating to:		
Loans and advances to customers	**1,104**	3,272
Non-trading investment securities	**1,164**	-
Other assets and contingencies	-	(1,696)
Share of profit in associated company	**(1,134)**	(961)
Depreciation	**2,470**	2,094
Negative goodwill amortised	-	(37)
Realised (gains) losses on redemption of non-trading investments	**(2,633)**	(464)
Taxation of foreign units	**53**	(190)
(Increase) decrease in operating assets:		
Mandatory reserve deposits with central banks	**(2,095)**	(1,655)
Treasury bills maturing after 91 days	**(21,924)**	(17,581)
Trading investments	**(4,014)**	(440)
Deposits and due from banks and other financial institutions	**(48,797)**	5,065
Loans and advances to customers	**(123,392)**	(59,362)
Interest receivable and other assets	**1,581**	3,395
Kuwait Government bond	**7,498**	17,601
Increase in operating liabilities:		
Deposits and due to banks and other financial institutions	**8,849**	104,498
Borrowings under re-purchase agreements	**3,477**	-
Customers' current, savings and other deposits	**113,775**	6,713
Interest payable and other liabilities	**8,820**	235
Net cash (used in) from operating activities	**(31,940)**	(80,686)
INVESTING ACTIVITIES		
Purchase of non-trading investment securities	**(334,958)**	(231,523)
Maturities and redemptions of non-trading investment securities	**310,484**	189,668
Dividends received from associated company	**608**	572
Purchase of premises and equipment	**(1,757)**	(2,762)
Investment in subsidiary	-	(1,509)
Net cash from (used in) investing activities	**(25,623)**	(45,554)
FINANCING ACTIVITIES		
Medium term loans	**(47,125)**	-
Payment of dividend, directors' remunerations and donations	**(15,981)**	(14,812)
Net cash (used in) financing activities	**(63,106)**	(14,812)
Foreign exchange translation adjustment	**864**	752
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	**(119,805)**	21,072
Cash and cash equivalents at beginning of the year	**286,005**	264,933
CASH AND CASH EQUIVALENTS AT END OF THE YEAR (Note 22)	**166,200**	286,005

The attached notes 1 to 38 form part of these consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

Year ended 31 December 2003

	Notes	Share capital BD '000	Treasury stock BD '000	Statutory reserve BD '000	General reserve BD '000	Cumulative changes in fair values BD '000	Foreign currency translation adjustment BD '000	Retained earnings BD '000	Proposed appropriations BD '000	Total BD '000
Balance at 31 December 2001		56,906	(1,053)	16,674	20,000	50	(2,448)	20,825	14,812	125,766
Payment of dividend, directors' remunerations and donations		-	-	-	-	-	-	-	(14,812)	(14,812)
Net profit for the year – 2002		-	-	-	-	-	-	20,009	-	20,009
Difference arising on translation of operating assets and liabilities of overseas branches		-	-	-	-	-	752	-	-	752
Net movement in cumulative changes in fair values	15	-	-	-	-	(636)	-	-	-	(636)
Transfer to statutory reserve		-	-	2,001	-	-	-	(2,001)	-	-
Proposed dividend	16	-	-	-	-	-	-	(15,247)	15,247	-
Proposed directors' remuneration	16	-	-	-	-	-	-	(234)	234	-
Proposed donations	16	-	-	-	-	-	-	(500)	500	-
Balance at 31 December 2002		56,906	(1,053)	18,675	20,000	(586)	(1,696)	22,852	15,981	131,079
Payment of dividend, directors' remuneration and donations		-	-	-	-	-	-	-	(15,981)	(15,981)
Net profit for the year – 2003		-	-	-	-	-	-	23,310	-	23,310
Portion of realised gain on sale of investments (previously included in retained earnings on adoption of IAS 39)		-	-	-	-	-	-	(1,592)	-	(1,592)
Difference arising on translation of operating assets and liabilities of overseas branches		-	-	-	-	-	864	-	-	864
Net movement in cumulative changes in fair values		-	-	-	-	4,572	-	-	-	4,572
Transfer to statutory reserve		-	-	2,331	-	-	-	(2,331)	-	-
Proposed dividend	16	-	-	-	-	-	-	(16,941)	16,941	-
Proposed directors' remuneration	16	-	-	-	-	-	-	(260)	260	-
Proposed donations	16	-	-	-	-	-	-	(600)	600	-
Balance at 31 December 2003		**56,906**	**(1,053)**	**21,006**	**20,000**	**3,986**	**(832)**	**24,438**	**17,801**	**142,252**
Month end average equity – 2003										131,238
Month end average equity – 2002										124,243

The movement in foreign exchange translation adjustment represents the net foreign exchange translation gain arising from translating the financial statements of the Group's foreign entities into Bahraini dinars.

The attached notes 1 to 38 form part of these consolidated financial statements.

1 Activities

Bank of Bahrain and Kuwait B.S.C., (the Bank) a public shareholding company, was incorporated in the Kingdom of Bahrain by an Amiri Decree in March 1971 and registered with the Ministry of Commerce under Commercial Registration (CR) number 1234 dated 16 March 1971. The Bank operates in Bahrain under a commercial banking licence issued by the Bahrain Monetary Agency and is engaged in commercial banking activities. The overseas units operate under the laws of their respective countries. The Bank's registered office is at 43 Government Avenue, P O Box 597, Manama, Kingdom of Bahrain. The total number of employees of the Group as of 31 December 2003 is 712. (31 December 2002: 706).

2 Basis of Consolidation

The consolidated financial statements incorporate the financial statements of the Bank and its following subsidiaries, all of which have 31 December as the year end, (the 'Group'). All material intra-group transactions and balances have been eliminated on consolidation.

	Ownership	*Country of incorporation*	*Activity*
BBK Financial Services W.L.L. [dormant]	100%	Bahrain	Brokerage
Al Khaleej Islamic Investment Bank E.C. [dormant]	100%	Bahrain	Islamic banking
CrediMax B.S.C. (c)	100%	Bahrain	Credit card operations

3 Significant Accounting Policies

The significant accounting policies adopted in the preparation of consolidated financial statements are set out below:

Basis of preparation

The consolidated financial statements have been prepared in conformity with the Bahrain Commercial Companies Law and the Bahrain Monetary Agency Law and is in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB.

The accounting policies are consistent with those used in the previous year.

Accounting convention

The consolidated financial statements are prepared under the historical cost convention as modified by the remeasurement at fair value of derivatives and trading and available-for-sale investment securities. In addition, as more fully discussed below, assets and liabilities that are hedged are carried at fair value to the extent of the risk being hedged.

Trading investments

Trading investments are held for a short-term period and are carried at fair value with any gain or loss arising from a change in fair value being included in the consolidated income statement in the period in which it arises.

Deposits and due from banks and other financial institutions

Deposits and due from banks and other financial institutions are stated at cost less any amounts written off and provision for impairment. The carrying values of such assets, which are being effectively hedged for changes in fair value, are adjusted to the extent of the changes in the fair value being hedged.

Loans and advances to customers

Loans and advances to customers are stated net of any amounts written off and provision for impairment.

Projections of future cash flows relating to loans and advances to customers are made on the basis of a continuing appraisal of the lending portfolio having regard to the Group's previous experience and current economic conditions. The evaluations consider identified risks and potential impairment in the Group's individual and different portfolios of loans and advances to customers based on historical patterns of losses.

3 Significant Accounting Policies *(continued)*

Non-trading investment securities

These are classified as follows:

- Held-to-maturity
- Available-for-sale
- Originated by the Group

All non-trading investments are initially recognised at cost, being the fair value of the consideration given, including acquisition charges associated with the investment. These include bonds, equities, managed funds and other investments. Investments in managed funds comprise investments in mutual funds, private equity and credit structured products.

Premiums and discounts on non-trading investments are amortised on a systematic basis to maturity, using the effective interest rate method, and taken to interest income.

Held-to-maturity

Investments which have fixed or determinable payments and which are intended to be held to maturity are carried at amortised cost, less provision for impairment in value.

Available-for-sale

After initial recognition, investments which are classified as "available-for-sale" are re-measured at fair value. Unless unrealised gains and losses on re-measurement to fair value are part of an effective hedging relationship, they are reported as a separate component of equity until the investment is sold, collected or otherwise disposed of, or the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity along with any transition adjustment to retained earnings arising from the adoption of IAS 39, is included in the consolidated income statement for the period. Any gain or loss arising from a change in fair value of available-for-sale investments, which are part of an effective hedging relationship, is recognised directly in the consolidated income statement to the extent of the changes in fair value being hedged.

Originated by the Group

Investments in debt securities which are funded directly to the issuer are stated at amortised cost, less provision for impairment. An adjustment is made to such investments where effective fair value hedges have been made to adjust the value of the investment for the fair value being hedged, with the resultant gains or losses being recognised in the consolidated income statement.

Fair values

For investments traded in organised financial markets, fair value is determined by reference to quoted market bid prices for assets and quoted market offer prices for liabilities at the close of business on the balance sheet date.

For investments where there is no quoted market price a reasonable estimate of the fair value is determined by reference to the current market value of another similar instrument, or is based on the net present value of future cash flows.

The fair value of options is based on internal pricing models.

Investment in associated company

Associate is a company in which the Group has a long-term investment comprising an interest of 20% - 50% in the voting capital or over which it exerts significant influence, and are accounted for using the equity method.

Kuwait Government Bond

Kuwait Government Bond is stated at cost less impairment in value, if any.

Premises and equipment

All items of premises and equipment are initially recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment, other than freehold land which is deemed to have an indefinite life.

Collateral pending sale

The Group occasionally acquires real estate in settlement of certain loans and advances to customers. Real estate is stated at the lower of the net realisable value of the related loans, advances and overdrafts and the current fair value of such assets, assessed on an individual basis. Gains or losses on disposal, and unrealised losses on revaluation, are recognised in the consolidated income statement.

3 Significant Accounting Policies *(continued)*

Deposits

All money market and customer deposits are carried at amortised cost, less amounts repaid. An adjustment is made to these where effective fair value hedges have been made, to adjust the value of the deposit for the fair value being hedged, with the resultant gains or losses being recognised in the consolidated income statement.

Repurchase and resale agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date (repos) are not derecognised in the balance sheet and are measured in accordance with accounting policies for non-trading investment securities. The liability for amounts received under these agreements is shown as borrowings. The difference between sale and repurchase price is treated as interest expense using the effective interest method. Assets purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognised in the balance sheet, as the Group does not obtain control over the assets. Amounts paid under these agreements are included in deposits with banks and other financial institutions or loans and advances to customers, as appropriate. The difference between purchase and resale price is treated as interest income using the effective interest rate method.

Taxation

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on foreign operations is provided in accordance with the fiscal regulations of the respective countries in which the Group operates.

Employees' end of service benefits

Costs relating to employees' end of service benefits are accrued in accordance with actuarial and other valuations as required by regulations applicable in each location.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Treasury stock

Treasury stock is stated at cost adjusted for any gains or losses on sales.

Derivatives

The Group enters into derivative instruments including futures, forwards, swaps, and options in the foreign exchange and capital markets. Derivatives are stated at fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the consolidated balance sheet.

For the purposes of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (b) cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction.

In relation to fair value hedges, which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument to fair value is recognised immediately in the consolidated income statement. The hedged item is adjusted for fair value changes and the difference relating to the risk being hedged is recognised in the consolidated income statement.

In relation to cash flow hedges which meet the conditions for hedge accounting the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised initially in equity and the ineffective portion is recognised in the consolidated income statement. The gains or losses on effective cash flow hedges recognised initially in equity are either transferred to the consolidated income statement in the period in which the hedged transaction impacts the consolidated income statement or included in the initial measurement of the cost of the related asset or liability.

For hedges which do not qualify for hedge accounting, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated income statement for the period.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. For fair value hedges of

3 Significant Accounting Policies *(continued)*

Derivatives ***(continued)***

financial instruments with fixed maturities any adjustment arising from hedge accounting is amortised over the remaining term to maturity. For cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated income statement.

Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and are, accordingly, not included in the balance sheet.

Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated balance sheet when there is a legally enforceable right to set off the recognised amounts and the Group intends to settle on a net basis.

Revenue recognition

Interest income and loan commitment fees are recognised on a time proportion basis, taking account of the principal outstanding and the rate applicable. An amount is recognised as interest income on impaired loans and advances and other financial assets, through the process of amortisation, based on the rate of interest that was used to discount the anticipated future cash flows relating to these impaired assets.

Other fees receivable are recognised when earned. Dividend income is recognised when the right to receive payment is established.

Foreign currencies

Translation of foreign currency transactions

Monetary assets and liabilities in foreign currencies are translated into Bahraini Dinars at rates of exchange prevailing at the balance sheet date. Any gains or losses are taken to the consolidated income statement.

Translation of financial statements of foreign entities

The operations of overseas units are not deemed an integral part of the head office's operations as each is financially and operationally independent of the head office. The assets and liabilities of foreign entities are translated at rates of exchange ruling at the balance sheet date. Income and expense items are translated at average exchange rates for the period. Any exchange differences (including those on transactions which hedge such investments) are taken directly to "foreign currency translation adjustment" which forms part of equity.

Cash and cash equivalents

Cash and cash equivalents comprise those balances of the following maturing within ninety-one days of the date of acquisition: cash and balances with central banks (excluding mandatory reserve), treasury bills and deposits and due from banks and other financial institutions.

Impairment and uncollectability of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the net present value of future anticipated cash flows, including anticipated recoveries from guarantees and collateral, discounted at original effective interest rates, is recognised in the consolidated income statement.

The provision for impairment of loans and advances also covers losses where there is objective evidence that losses may be present in components of the loans and advances portfolio at the balance sheet date. These are estimated based on historical patterns of losses in each component, the credit ratings allotted to the borrowers and reflecting the current economic climate in which the borrowers operate.

Trade date accounting

All "regular way" purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

4 Cash and Balances with Central Banks

	2003 BD 000s	2002 BD 000s
Cash	**7,038**	7,623
Current accounts and placements with central banks	**16,104**	40,344
Mandatory reserve deposits with central banks	**19,004**	16,909
	42,146	64,876

5 Treasury Bills

These are short-term treasury bills issued by the Governments of the Kingdom of Bahrain, the State of Kuwait and the Republic of India and are carried at amortised cost.

6 Loans and Advances to Customers

	2003 BD 000s	2002 BD 000s
Commercial loans	**478,041**	390,342
Consumer loans	**100,494**	79,215
Overdrafts	**112,530**	102,629
Credit cards	**24,172**	22,263
Other	**22,822**	28,964
	738,059	623,413
Less: Provision for impairment	**(78,892)**	(86,533)
	659,167	536,880

a) The composition of the loans and advances to customers is as follows:

(i) Industry sector

	2003 BD 000s	2002 BD 000s
Trading and manufacturing	**221,032**	204,345
Banks and other financial institutions	**86,794**	85,038
Construction and real estate	**97,450**	88,922
Government and public sector	**65,773**	43,338
Individuals	**188,813**	152,834
Others	**78,197**	48,936
	738,059	623,413
Less: Provision for impairment	**(78,892)**	(86,533)
	659,167	536,880

(ii) Geographical region

	2003 BD 000s	2002 BD 000s
Gulf Co-operation Council countries	**652,333**	557,534
European Community countries	**11,711**	17,141
Asia	**67,902**	46,947
Others	**6,113**	1,791
	738,059	623,413
Less: Provision for impairment	**(78,892)**	(86,533)
	659,167	536,880

6 Loans and Advances to Customers *(continued)*

b) Movements in provisions for loan losses including interest in suspense are as follows:

	2003 BD 000s	2002 BD 000s
At 1 January	**86,533**	87,029
Charge for the year	**8,040**	9,233
Recoveries/write-backs	**(6,936)**	(5,961)
Interest suspended during the year, net	**3,443**	2,241
Amounts written off during the year, net	**(11,662)**	(5,625)
Interest recognised/amortised on impaired loans	**(658)**	(190)
Other movements	**132**	(194)
Balance at 31 December	**78,892**	86,533

Other movements include foreign exchange adjustments relating to loans and advances to customers denominated in foreign currencies.

c) As of 31 December 2003, gross loans and advances to customers which were classified as impaired amounted to BD 99.907 million (2002: BD 97.867 million). The total of provisions carried and the value of securities held for these loans amounted to BD 99.639 million (2002: BD 97.633 million).

d) As of 31 December 2003, balance of restructured loans amounted to BD 5.501 million (2002: BD 11.944 million). The restructured loans have no material impact on the current year's earnings or are expected to have no material adverse effect on future earnings.

7 Non-Trading Investment Securities

	Available-for-sale BD 000s	Held-to-maturity BD 000s	Originated by the Group BD 000s	Total 2003 BD 000s	Total 2002 BD 000s
Quoted investments					
Quoted equities	**21,495**	-	-	**21,495**	22,232
Quoted bonds	**97,655**	**34,958**	**40,189**	**172,802**	135,416
Managed funds	**991**	-	-	**991**	1,775
	120,141	34,958	40,189	**195,288**	159,423
Unquoted investments					
Government bonds	-	**1194**	**43,107**	**44,301**	75,060
Other bonds	**4,244**	**6,394**	**24,523**	**35,161**	12,269
Managed funds	**42,606**	-	-	**42,606**	41,855
Other investments	**6,874**	**2,920**	-	**9,794**	8,784
	173,865	45,466	107,819	**327,150**	297,391
Provision for impairment	(1,420)	(155)	(1,018)	**(2,593)**	(1,420)
Balance at 31 December 2003	**172,445**	**45,311**	**106,801**	**324,557**	
Balance at 31 December 2002	115,985	71,053	108,933		295,971

7 Non-Trading Investment Securities *(continued)*

The movements in provision for impairment of non-trading investment securities and other assets and contingencies were as follows:

	Available-for-sale BD 000s	Held-to-maturity BD 000s	Originated by the Group BD 000s	Total 2003 BD 000s	Total 2002 BD 000s
Non-trading investment securities					
Balance at 1 January	1,420	-	-	1,420	3,378
Charge for the year	-	146	1,018	1,164	-
Written off	-	-	-	-	(1,958)
Other movements	-	9	-	9	-
Balance at 31 December	1,420	155	1,018	2,593	1,420
Other assets and contingencies					
Balance at 1 January				-	1,696
Write-back				-	(1,696)
Amount settled				-	-
Balance at 31 December				-	-

Included under available-for-sale investments are unquoted equity investments amounting to BD 8.069 million (2002: BD 6.548 million) which are carried at cost. This is due to the unpredictable nature of their future cash flows and the lack of suitable alternate methods for arriving at a reliable fair value.

8 Investment in Associated Company

	2003		2002	
	% of interest held	BD 000s	% of interest held	BD 000s
Bahrain Commercial Facilities Company B.S.C.(Incorporated in the Kingdom of Bahrain)	20.25	5,081	20.25	4,936

9 Interest Receivable and Other Assets

	2003 BD 000s	2002 BD 000s
Interest receivable	6,362	6,359
Collateral pending sale	1,143	1,774
Accounts receivable	767	2,328
Positive fair value of derivatives (Note 24)	1,214	1,127
Other	4,502	3,263
	13,988	14,851

10 Kuwait Government Bond

The Central Bank of Kuwait purchased resident Kuwaiti customers' debts and resident debts of other Gulf Co-operation Council nationals held by the Kuwait branch of the Bank as of 1 August 1990 and related interest up to 31 December 1991 on behalf of the Government of Kuwait. The purchase value of these debts was settled by the issue of a bond with a value date of 31 December 1991. The bond matures over a maximum period of twenty years from the value date. Interest is payable semi annually in arrears at a rate specified for each six months by the Central Bank of Kuwait. The average interest rate for 2003 was 1.89% (2002: 2.67%). During 2003, there were redemptions of bond, net of foreign exchange adjustments, amounting to BD 7.498 million (2002: BD 17.601 million).

10 Kuwait Government Bond *(continued)*

Under the terms of the purchase agreement with the Central Bank of Kuwait, the amount of the bond will be adjusted, in respect of any differences arising, once the balances of the related debts have been agreed with the customers concerned. The Bank therefore has a contingent liability in this regard.

The Bank is required to manage the debts purchased by the Government of Kuwait without remuneration, in conformity with the regulations and instructions of the Central Bank of Kuwait.

11 Medium Term Loans

The medium term loans are unsecured facilities obtained for general financing purposes and comprise:

			Carrying amount	
Amount of facility US$ 000s	*Rate of interest*	*Maturity (Year)*	***2003 BD 000s***	*2002 BD 000s*
50,000	Libor + 0.55%	2003	-	18,850
75,000	Libor + 0.55%	2003	-	28,275
100,000	Libor + 0.50%	2004	**37,700**	37,700
			37,700	84,825

12 Interest Payable and Other Liabilities

	2003 BD 000s	*2002 BD 000s*
Interest payable	**2,278**	2,649
Accounts payable	**3,550**	3,063
Accrued expenses	**6,249**	2,196
Taxation	**3,270**	2,843
Negative fair value of derivates (Note 24)	**1,271**	2,384
Other	**6,411**	1,074
	23,029	14,209

13 Share Capital and Treasury Stock

	2003 BD 000s	*2002 BD 000s*
Share Capital		
Authorised: 1,000,000,000 shares of BD 0.100 each	**100,000**	100,000
Issued and fully paid: 569,062,500 shares of BD 0.100 each	**56,906**	56,906

Treasury stock

Treasury stock represents the purchase by the Bank, either directly or indirectly, of its own shares. At the end of the year, the Bank held 4,369,666 shares (2002: 4,369,666 shares) of its own shares. The shares are carried at cost adjusted for any gain or loss on sale. Treasury stock does not carry the right to voting or to dividends.

14 Reserves

Statutory reserve

The Statutory Reserve has been created in accordance with the Bahrain Commercial Companies Law. The Bank transfers 10% of its annual profits to its Statutory Reserve till such time as the Reserve equals 50% of the issued share capital of the Bank.

The Reserve is not available for distribution, except in circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Bahrain Monetary Agency.

14 Reserves *(continued)*

General reserve

The General Reserve has been built up in accordance with the provisions of the Bank's Articles of Association and underlines the shareholders' commitment to enhance the strong equity base of the Bank. The General Reserve is a distributable reserve, subject to the approval of the Bahrain Monetary Agency.

15 Cumulative Changes in Fair Values

	2003 BD 000s	*2002 BD 000s*
Available-for-sale investments		
At 1 January	**134**	50
Realised in the year	**(2,515)**	(462)
Change in unrealised fair values during the year	**6,751**	546
At 31 December	**4,370**	134
Cash flow hedges		
At 1 January	**(720)**	-
Change in unrealised fair values	**718**	(720)
Change in unrealised fair values – associated company	(382)	-
At 31 December	**(384)**	(720)
	3,986	(586)

16 Proposed Appropriations

	2003 BD 000s	*2002 BD 000s*
Dividend	16,941	15,247
Directors' remuneration	260	234
Donations	600	500
	17,801	15,981

The directors have proposed a cash dividend of 30% being BD 0.030 per share (2002: BD 0.027 per share) to be applied to the shares in issue, net of treasury stock, as of the balance sheet date.

The above appropriations will be submitted for formal approval at the Annual General Meeting to be held in March 2004.

17 Interest Income

	2003 BD 000s	*2002 BD 000s*
Treasury bills	**1,348**	4,630
Deposits and due from banks and other financial institutions	**5,233**	6,165
Loans and advances to customers	**29,974**	31,164
Non-trading investment securities	**10,766**	8,682
Kuwait Government Bond	**296**	650
	47,617	51,291

18 Interest Expense

	2003 BD 000s	2002 BD 000s
Deposits and due to banks and other financial institutions	**6,275**	6,691
Medium term loans	**704**	2,168
Customers' current, savings and other deposits	**14,561**	16,979
	21,540	25,838

19 Other Operating Income

	2003 BD 000s	2002 BD 000s
Dividend income	**2,193**	2,123
Realised gain on investments	**2,633**	464
Income from managed funds	**604**	197
Trading income	**702**	1,168
Gains on foreign exchange	**1,261**	1,630
Other	**709**	(125)
	8,102	5,457
Fees and commission income	**13,625**	10,905
Fees and commission expense	**(1,377)**	(1,102)
	12,248	9,803
	20,350	15,260

20 Basic Earnings per Share

Basic earnings per share at the year end are calculated by dividing the net profit for the year by the weighted average number of shares (net of Treasury stock) outstanding during the year as follows:

	2003	2002
Net profit for the year (BD 000s)	**23,310**	20,009
Weighted average number of shares, net of treasury stock, outstanding during the year	**564,692,834**	564,692,834
Basic earnings per share (BD)	**0.041**	0.035

No figure for diluted earnings per share has been presented as the Bank has not issued any instruments which would have an impact on earnings per share when exercised.

21 Segmental Information

Primary segment information

For management purposes the Group is organised into four major business segments:

Retail banking - Principally handling individual customer deposits and providing consumer finance type loans, overdrafts, credit facilities and funds transfer facilities, card businesses, foreign exchange and cash collateralised lending.

Corporate banking - Principally handling loans and other credit facilities, deposit and current accounts for corporate and institutional customers in Bahrain.

International banking - Principally handling loans and other credit facilities, deposit and current accounts for international corporate and institutional customers. This also covers the operations of the overseas units.

Investment and other activities - Principally providing money market, trading and treasury services as well as the management of the Group's funding operations. Investment activities involve handling investments in local and international markets, investment advisory services and funds management.

21 Segmental Information *(continued)*

Primary segment information *(continued)*

These segments are the basis on which the Group reports its primary segment information. Transactions between segments are conducted at estimated market rates on an arm's length basis. Interest is charged/credited to business segments based on a pool rate which approximates the marginal cost of funds.

Segment information for the year ended 31 December 2003 was as follows:

	Retail banking BD 000s	*Corporate banking BD 000s*	*International banking BD 000s*	*Investment and other activities BD 000s*	*Total BD 000s*
Operating income before provisions	17,459	8,265	9,931	10,772	46,427
Segment result	7,790	5,811	5,336	6,601	25,538
Common costs					(1,094)
Income from associate					1,134
Net provisions and taxation					(2,268)
Net profit for the year					23,310
Segment assets	146,349	220,222	518,687	413,981	1,299,239
Investment in associated company					5,081
Common assets					9,298
Total assets					1,313,618
Segment liabilities	279,931	279,704	390,579	207,840	1,158,054
Common liabilities					13,312
Total liabilities					1,171,366

Segment information for the year ended 31 December 2002 was as follows:

	Retail banking BD 000s	*Corporate banking BD 000s*	*International banking BD 000s*	*Investment and other activities BD 000s*	*Total BD 000s*
Operating income before provisions	13,781	6,761	10,264	9,907	40,713
Segment result	4,284	4,796	5,620	6,938	21,638
Common costs					(1,014)
Income from associate					961
Net provisions					(1,576)
Net profit for the year					20,009
Segment assets	120,341	197,737	540,829	339,575	1,198,482
Investment in associated company					4,936
Common assets					11,231
Total assets					1,214,649
Segment liabilities	252,894	225,423	450,305	149,602	1,078,224
Common liabilities					5,346
Total liabilities					1,083,570

Secondary segment information

Although the management of the Group is based primarily on business segments, the Group operates in two geographic markets; Middle East, which is designated as Regional, and North America, European Community countries, Asia and others, which are designated as International. The geographical analysis of operating income, segment results, total assets and total liabilities, is based primarily upon the domicile of the customer or the investment.

21 Segmental Information *(continued)*

Secondary segment information ***(continued)***

Geographical areas:	*Regional*		*International*		*Total*	
	2003 BD 000s	*2002 BD 000s*	***2003 BD 000s***	*2002 BD 000s*	***2003 BD 000s***	*2002 BD 000s*
Operating income before provisions	**35,453**	29,263	**10,974**	11,450	**46,427**	40,713
Total assets	**1,049,460**	937,005	**264,158**	277,644	**1,313,618**	1,214,649
Capital expenditure	**1,458**	2,682	**299**	80	**1,757**	2,762

22 Cash and Cash Equivalents

Cash and cash equivalents included in the consolidated statement of cash flows include the following balance sheet amounts:

	2003 BD 000s	*2002 BD 000s*	*Changes in the year BD 000s*
Cash and balances with central banks	**23,142**	47,967	(24,825)
Treasury bills maturing within ninety-one days	**33,462**	52,236	(18,774)
Deposits and due from banks and other financial institutions maturing within ninety-one days	**109,596**	185,802	(76,206)
Cash and cash equivalents	**166,200**	286,005	(119,805)

23 Related Party Transactions

Certain related parties (principally the associated company, directors and senior management of the Group, their families and companies of which they are principal owners) were customers of the Group in the ordinary course of business. The transactions with these parties were made on substantially the same terms, including interest rates, as those prevailing at the same time for comparable transactions with unrelated parties and did not involve more than a normal amount of risk.

Amounts outstanding as of the balance sheet date in respect of transactions entered into with related parties were as follows:

	2003		*2002*	
	Related companies BD 000s	***Others BD 000s***	*Related companies BD 000s*	*Others BD 000s*
Loans and advances to customers	**9,254**	**625**	3,013	1,529
Non-trading investment securities	**639**	**-**	574	-
Deposits	**3,710**	**1,643**	3,437	1,179
Contingent liabilities	**1,877**	**-**	5,759	-

The income and expenses in respect of related parties included in the consolidated income statement are as follows:

	2003 BD 000s	*2002 BD 000s*
Interest income on loans and advances to customers	**15**	84
Gain on managed funds	**73**	120
Interest expense on deposits	**247**	407

24 Derivatives

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instrument, reference rate or index. Derivative instruments include forwards, futures, swaps and options.

The table below shows the positive and negative fair values of derivative financial instruments together with the notional amounts analysed by the term to maturity. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at year end and are neither indicative of the market risk nor credit risk nor cash flows.

24 Derivatives *(continued)*

31 December 2003	*Positive fair value BD 000s*	*Negative fair value BD 000s*	*Notional amount Total BD 000s*	*Notional amounts by term to maturity: within 3 months BD 000s*	*3-12 months BD 000s*	*1-5 years BD 000s*
Derivatives held for trading:						
Interest rate swaps	187	199	43,963	4,126	15,080	24,757
Forward foreign exchange contracts	409	292	54,927	26,118	28,809	-
Options	171	146	15,104	13,973	1,131	-
Interest rate futures	37	10	18,550	-	18,550	-
Derivatives held as fair value hedges:						
Interest rate swaps	226	470	8,426	-	-	8,426
Forward foreign exchange contracts	184	152	110,602	110,602	-	-
Derivatives held as cash flow hedges:						
Interest rate swaps	-	2	37,700	37,700	-	-
	1,214	1,271	289,272	192,519	63,570	33,183

31 December 2002	*Positive fair value BD 000s*	*Negative fair value BD 000s*	*Notional amount Total BD 000s*	*Notional amounts by term to maturity: within 3 months BD 000s*	*3-12 months BD 000s*	*1-5 years BD 000s*
Derivatives held for trading:						
Forward rate agreements	5	-	7,540	-	-	7,540
Interest rate swaps	4	-	22,620	7,540	-	15,080
Forward foreign exchange contracts	176	199	96,269	64,568	31,701	-
Options	-	-	5,284	5,284	-	-
Derivatives held as fair value hedges:						
Interest rate swaps	411	667	10,688	-	2,262	8,426
Forward foreign exchange	531	798	88,638	54,856	33,782	-
Derivatives held as cash flow hedges:						
Interest rate swaps	-	720	37,700	-	-	37,700
	1,127	2,384	268,739	132,248	67,745	68,746

Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and interest rate futures are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. Forward rate agreements are effectively tailor-made interest rate futures which fix a forward rate of interest on a notional loan, for an agreed period of time starting on a specified future date.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency. For currency swaps, fixed or floating interest payments and notional amounts are exchanged in different currencies.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period. The Group does not engage in the writing of options.

24 Derivatives *(continued)*

Derivative-related credit risk

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Group. All of the Group's derivative contracts are entered into with other financial institutions.

Derivatives held or issued for trading purposes

Most of the Group's derivative trading activities relate to position taking and arbitrage. Position taking includes managing positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying and profiting from price differentials between markets or products.

Derivatives held or issued for hedging purposes

The Group has adopted a comprehensive system for the measurement and management of risk. Part of the risk management process involves managing the Group's exposure to fluctuations in foreign exchange rates (currency risk) and interest rates through asset and liability management activities. It is the Group's policy to reduce its exposure to currency and interest rate risks to acceptable levels as determined by the Board of Directors. The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits. The Board has established levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Assets and liabilities interest rate gaps are reviewed on a weekly basis and hedging strategies used to reduce the interest rate gaps to within the limits established by the Board.

As part of its asset and liability management, the Group uses derivatives for hedging purposes in order to reduce its own exposure to currency and interest rate risks. This is achieved by hedging specific financial instruments, forecasted transactions as well as strategic hedging against overall balance sheet exposures.

The Group uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks. In addition, the Group uses interest rate swaps and interest rate futures to hedge against the interest rate risk arising from specifically identified fixed interest rate assets. The Group also uses interest rate swaps to hedge against the cash flow risks arising on certain floating rate liabilities. In all such cases the hedging relationship and objective, including details of the hedged item and hedging instrument, are formally documented and the transactions are accounted for as fair value hedges.

Interest rate risk is managed by monitoring the repricing of assets and liabilities and entering into interest rate swaps and futures to hedge a proportion of the interest rate exposure. Since strategic hedging does not qualify for special hedge accounting related derivatives are accounted for as trading instruments.

25 Commitments and Contingent Liabilities

Credit-related commitments

Credit-related commitments include commitments to extend credit, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Group's customers.

Commitments to extend credit represents contractual commitments to make loans and revolving credits. Commitments generally have fixed expiration dates or other termination clauses. Since commitments may expire without being drawn upon, the total contracted amounts do not necessarily represent future cash requirements.

Letters of credit, guarantees (including standby letters of credit) and acceptances commit the Group to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract. Standby letters of credit, which are included under guarantees, would have market risk if issued or extended at a fixed rate of interest. However, these contracts are primarily made at a floating rate.

25 Commitments and Contingent Liabilities *(continued)*

Credit-related commitments ***(continued)***

The Group has the following credit-related commitments:

	2003 BD 000s	*2002 BD 000s*
Commitments on behalf of customers:		
Letters of credit	**40,287**	29,869
Guarantees	**125,953**	127,417
Acceptances	**9,254**	6,036
	175,494	163,322
Irrevocable commitments		
Undrawn loan commitments	**34,711**	40,655
Commitments in respect of investments	**8,418**	5,703
	43,129	46,358
	218,623	209,680
Irrecoverable commitments to extend credit:		
Original term to maturity of one year or less	**28,411**	-
Original term to maturity of more than one year	**14,718**	46,358
	43,129	46,358

The Group does not anticipate any significant losses arising from the above.

26 Credit Risk and Concentration of Credit Risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographical region, or have similar economic features that could cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location.

The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties, diversifying the lending activities to avoid undue concentrations of risks with individual or groups of customers in specific locations or businesses, and by obtaining security when appropriate. In addition to monitoring credit limits, the Group manages the credit exposure by entering into agreements and collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposure. In certain cases, the Group may close out transactions or assign them to other counterparties to mitigate credit risk.

All policies relating to credit are reviewed and approved by the Board of Directors. An Executive Committee, consisting of six senior members of the Board of Directors, reviews and approves larger credits. In addition, all larger credits in excess of approval authority of the Executive Committee are approved by the Board of Directors.

Credit limits are established for all customers, after a careful assessment of their creditworthiness and approval as per the levels of authority (approved by the Executive Committee and the Board of Directors). These are also subject to the Bahrain Monetary Agency's large credit exposure limit criteria. Standard procedures, outlined in the Bank's Credit Policies Manual, require that all credit proposals be subjected to a detailed scrutiny by a designated credit officer, who is part of a three-member approval committee.

Details of the composition of the loans, advances and overdrafts portfolio are set out in note 6 to the consolidated financial statements.

Details of the industry sector analysis and the geographical distribution of assets, liabilities and off balance sheet items are set out in note 27 to the consolidated financial statements.

27 Concentration of Assets, Liabilities and Off Balance Sheet Items

The distribution of assets (net% provisions), liabilities and off-balance sheet items by geographic region and industry sector was as follows:

	2003			2002		
	Assets BD 000s	*Liabilities BD 000s*	*Off balance sheet items BD 000s*	*Assets BD 000s*	*Liabilities BD 000s*	*Off balance sheet items BD 000s*
Geographical region:						
Gulf Co-operation Council Countries	**957,153**	**1,064,855**	**221,511**	937,005	1,010,755	216,588
North America	**61,297**	**4,421**	**19,216**	70,220	8,566	20,193
European Community Countries	**153,600**	**63,199**	**225,391**	88,668	34,461	172,942
Asia	**112,835**	**37,686**	**40,622**	86,698	26,632	68,524
Others	**28,733**	**1,205**	**1,155**	32,058	3,156	172
	1,313,618	**1,171,366**	**507,895**	1,214,649	1,083,570	478,419
Industry sector:						
Trading and manufacturing	**197,572**	**80,985**	**56,230**	239,520	47,815	73,111
Banks and other financial institutions	**479,623**	**444,945**	**382,069**	444,215	426,961	341,690
Construction and real estate	**137,645**	**10,597**	**27,965**	192,518	7,483	29,650
Government and public sector	**143,187**	**151,338**	**18,935**	76,882	131,279	837
Consumer	**168,006**	**36,184**	**6,256**	149,720	39,681	3
Others	**187,585**	**447,317**	**16,440**	111,794	430,351	33,128
	1,313,618	**1,171,366**	**507,895**	1,214,649	1,083,570	478,419
Month end average	**1,271,192**	**1,141,297**	**496,162**	1,204,782	1,079,964	396,116

28 Market Risk

Market risk is defined as the risk of losses in the Group's "on" or "off" balance sheet positions arising from movements in the interest rates, foreign exchange rates and equity prices.

The Group has clearly defined policies for conducting investment (including trading investment) and foreign exchange business which stipulates limits for these activities. Investments are made strictly in accordance with investment acceptance criteria which ensures that the investments are qualitative and liquid. The Group does not undertake any commodity trading activities.

The Bank computes Value-at-Risk ('VaR') for measuring general market risk in trading positions. The VaR model is approved by the Bahrain Monetary Agency. The capital allocated for market risk is based on the VaR calculated at a 99% confidence level on a 10-day holding period.

The Group's Risk Management Department conducts back testing in accordance with the Market Risk Capital Adequacy Regulations issued by the Bahrain Monetary Agency to ensure that the assumptions used for computing VaR are reasonable and result in a VaR number that is a reliable indicator of worst possible losses. The Bank also conducts stress testing to identify events or influences that could greatly impact material trading positions taken by the Bank.

29 Interest Rate Risk Management

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the value of financial instruments. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or reprice in a given period. The Group manages this risk by reviewing the repricing of assets and liabilities on a weekly basis.

Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

The Group's interest rate sensitivity position, based on the earlier of contractual repricing or maturity dates, is as follows:

As of 31 December 2003	*Less than one month BD 000s*	*One month to one year BD 000s*	*Over one year BD 000s*	*Not exposed to interest rate risk BD 000s*	*Total BD 000s*
Cash and balances with central banks	1,680	-	-	40,466	42,146
Treasury bills	18,740	54,227	-	-	72,967
Trading investments	4,454	-	-	-	4,454
Deposits and due from banks and other financial institutions	34,462	123,707	-	9,883	168,052
Loans and advances to customers	239,189	245,657	167,712	6,609	659,167
Non-trading investment securities	23,785	146,020	107,926	46,826	324,557
Investment in associated company	-	-	-	5,081	5,081
Interest receivable and other assets	-	-	-	13,988	13,988
Kuwait Government bond	-	7,833	-	-	7,833
Premises and equipment	-	-	-	15,373	15,373
Total assets	322,310	577,444	275,638	138,226	1,313,618
Deposits and due to banks and other financial institutions	206,987	112,794	6,337	8,867	334,985
Borrowings under repurchase agreements	3,477	-	-	-	3,477
Medium term loans	-	37,700	-	-	37,700
Customers' current, savings and other deposits	472,914	210,690	28,215	60,356	772,175
Interest payable and other liabilities	-	-	-	23,029	23,029
Equity	-	-	-	142,252	142,252
Total liabilities and shareholders' equity	683,378	361,184	34,552	234,504	1,313,618
On-balance sheet gap (a)	(361,068)	216,260	241,086		
Off-balance sheet gap (b)	-	2,884	(2,884)		
Total interest rate sensitivity gap	(361,068)	219,144	238,202		
Cumulative interest rate sensitivity gap	(361,068)	(141,924)	96,278		

29 Interest Rate Risk Management ***(continued)***

As of 31 December 2002	*Less than one month BD 000s*	*One month to one year BD 000s*	*Over one year BD 000s*	*Not exposed to interest rate risk BD 000s*	*Total BD 000s*
Cash and balances with central banks	37,146	-	-	27,730	64,876
Treasury bills	17,747	52,070	-	-	69,817
Trading investments	440	-	-	-	440
Deposits and due from banks and other financial institutions	61,590	103,603	-	30,268	195,461
Loans and advances to customers	71,042	193,859	260,373	11,606	536,880
Non-trading investment securities	6,512	138,595	134,291	16,573	295,971
Investment in associated company	-	-	-	4,936	4,936
Interest receivable and other assets	-	-	-	14,851	14,851
Kuwait Government bond	-	15,331	-	-	15,331
Premises and equipment	-	-	-	16,086	16,086
Total assets	194,477	503,458	394,664	122,050	1,214,649
Deposits and due to banks and other financial institutions	217,595	69,191	9,757	29,593	326,136
Medium term loans	-	84,825	-	-	84,825
Customers' current, savings and other deposits	448,274	167,550	4,406	38,170	658,400
Interest payable and other liabilities	-	-	-	14,209	14,209
Equity	-	-	-	131,079	131,079
Total liabilities and shareholders' equity	665,869	321,566	14,163	213,051	1,214,649
On-balance sheet gap (a)	(471,392)	181,892	380,501		
Off-balance sheet gap (b)	-	(40,584)	40,584		
Total interest rate sensitivity gap	(471,392)	141,308	421,085		
Cumulative interest rate sensitivity gap	(471,392)	(330,084)	91,001		

(a) The on-balance sheet gap represents the net amounts of on-balance sheet items.

(b) The off-balance sheet gap represents the net notional amounts of off balance sheet financial instruments such as interest rate swaps, which are used to manage interest rate risk.

The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is a historical rate for a fixed rate instrument carried at amortised cost and a current market rate for a floating rate instrument or an instrument carried at fair value.

29 Interest Rate Risk Management *(continued)*

The effective interest rates by major currencies for each of the monetary financial instruments are as follows:

	31 December 2003 Effective interest rate %			*31 December 2002 Effective interest rate %*		
	BD	*KD*	*US$*	*BD*	*KD*	*US$*
Assets						
Treasury bills	**1.1**	**2.7**	**-**	1.8	2.0	-
Deposits and due from banks and financial institutions	**1.3**	**2.3**	**1.3**	2.1	2.9	1.9
Loans and advances to customers(c)	**6.0**	**5.0**	**2.1**	6.2	8.5	2.5
Non-trading investment securities	**1.4**	**2.8**	**3.8**	2.4	3.8	4.9
Kuwait Government bond	**-**	**1.8**	**-**	-	2.3	-
Liabilities						
Deposits and due to banks and other financial institutions	**0.8**	**2.6**	**1.1**	1.7	2.7	2.5
Medium term loans	**-**	**-**	**1.8**	-	-	1.8
Customers' current, savings and other deposits (d)	**0.7**	**1.5**	**1.4**	1.2	2.5	2.1

(c) The effective interest rate for loans and advances to customers has been computed by excluding non-performing loans.

(d) The effective interest rates have been computed by excluding non-interest bearing accounts which form a small proportion of such deposits.

30 Currency Risk

The functional currency of the Group is the Bahraini Dinar.

The Group had the following net exposures denominated in foreign currencies as of the balance sheet date:

	2003 BD 000s equivalent long (short)	*2002 BD 000s equivalent long (short)*
US dollar	**60,853**	73,047
Euro	**302**	(10)
Japanese Yen	**126**	38
Pound Sterling	**(9)**	94
Kuwaiti Dinar	**(84)**	21
Omani Riyal	**89**	169
Saudi Riyal	**(168)**	(514)
Others	**361**	150

31 Equity Price Risk

Equity price risk arises from the change in fair values of equity investments. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

32 Liquidity Risk

Liquidity risk is the risk that the Group will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. To guard against this risk, management have diversified funding sources and assets are managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents, and readily marketable securities. In addition, the Group maintains various statutory deposits with central banks.

The table below summarises the maturity profile of the Group's assets and liabilities based on contractual repayment arrangements, and do not take into account the effective maturities as indicated by the Group's deposit retention history.

The maturity profile of the assets and liabilities at 31 December 2003 is as follows:

As of 31 December 2003	*Less than one month BD 000s*	*One month to one year BD 000s*	*1 - 5 Years BD 000s*	*5 - 10 years BD 000s*	*10 - 20 years BD 000s*	*More than 20 years BD 000s*	*Undated BD 000's*	*Total BD 000s*
Assets								
Cash and balances with central banks	23,432	840	430	14	-	-	17,430	42,146
Treasury bills	18,740	54,227	-	-	-	-	-	72,967
Trading investments	4,454	-	-	-	-	-	-	4,454
Deposits and due from banks and other financial institutions	38,421	129,631	-	-	-	-	-	168,052
Loans and advances to customers	93,298	119,450	233,780	131,915	24,349	56,375	-	659,167
Non-trading investment securities	4,613	78,779	125,130	81,746	-	-	34,289	324,557
Investment in associated company	-	-	-	-	-	-	5,081	5,081
Interest receivable and other assets	9,083	514	3,478	48	61	-	804	13,988
Kuwait Government bond	-	-	-	7,833	-	-	-	7,833
Premises and equipment	-	-	-	-	-	-	15,373	15,373
Total assets	192,041	383,441	362,818	221,556	24,410	56,375	72,977	1,313,618
Liabilities								
Deposits and due to banks and other financial institutions	213,068	101,924	14,124	5,869	-	-	-	334,985
Borrowings under repurchase agreements	3,477	-	-	-	-	-	-	3,477
Medium term loans	-	37,700	-	-	-	-	-	37,700
Customers' current, savings and other deposits	429,493	304,530	16,990	21,162	-	-	-	772,175
Interest payable and other liabilities	18,440	245	3,600	574	-	-	170	23,029
Total liabilities	664,478	444,399	34,714	27,605	-	-	170	1,171,366

32 Liquidity Risk ***(continued)***

As of 31 December 2002	*Less than one month BD 000s*	*One month to one year BD 000s*	*1 - 5 Years BD 000s*	*5 - 10 years BD 000s*	*10 - 20 years BD 000s*	*More than 20 years BD 000s*	*Undated BD 000's*	*Total BD 000s*
Assets								
Cash and balances with central banks	48,123	1,638	-	-	-	-	15,115	64,876
Treasury bills	17,747	52,070	-	-	-	-	-	69,817
Trading investments	440	-	-	-	-	-	-	440
Deposits and due from banks and other financial institutions	81,635	113,826	-	-	-	-	-	195,461
Loans and advances to customers	41,160	185,218	194,452	116,050	-	-	-	536,880
Non-trading investment securities	9,121	117,321	66,054	47,093	-	2,153	54,229	295,971
Investment in associated company	-	-	-	-	-	-	4,936	4,936
Interest receivable and other assets	10,633	358	3,253	52	81	474	-	14,851
Kuwait Government bond	-	-	-	15,331	-	-	-	15,331
Premises and equipment	-	-	-	-	-	-	16,086	16,086
Total assets	208,859	470,431	263,759	178,526	81	2,627	90,366	1,214,649
Liabilities								
Deposits and due to banks and other financial institutions	239,434	76,945	9,757	-	-	-	-	326,136
Medium term loans	-	47,125	37,700	-	-	-	-	84,825
Customers' current, savings and other deposits	484,925	166,260	7,215	-	-	-	-	658,400
Interest payable and other liabilities	10,348	15	2,937	361	-	548	-	14,209
Total liabilities	734,707	290,345	57,609	361	-	548	-	1,083,570

33 Legal Risk

Legal risk is the risk relating to losses due to legal or regulatory action that invalidates or otherwise precludes performance by the end user or its counterparty under the terms of the contract or related netting agreements.

The Group has developed sufficient preventive controls and formalised procedures to identify legal risks so that potential losses arising from non-adherence to laws and regulations, negative publicity, etc. are avoided. The Group also has well established legal procedures to scrutinise product offerings and manage risks arising out of its transactions.

34 Funds under Management

At 31 December 2003, clients' funds managed in a fiduciary capacity, without risk or recourse to the Bank, amounted to BD 44.014 million (31 December 2002: BD 24.291 million).

35 Fair Value of Financial Instruments

The table below sets out the estimated carrying values and fair values of those on and off balance sheet financial instruments where fair values are materially different from carrying amounts in the consolidated financial statements:

	31 December 2003			31 December 2002		
	Carrying value BD 000s	Fair value BD 000s	Difference BD 000s	Carrying value BD 000s	Fair value BD 000s	Difference BD 000s
Financial assets						
Non-trading investment securities	152,112	154,757	2,645	179,986	182,357	2,371

As explained in note 7, included under non-trading investments are unquoted equity investments with a value of BD 8.069 million (2002: BD 6.548 million) for which fair value cannot be reliably determined.

a) Loans and advances to customers:

Due to time and cost benefit constraints and the lack of a secondary market, it is not practicable to determine the fair value of loans and advances to customers.

b) Kuwait Government bond:

It is not practicable to determine the fair value of Kuwait Government bond with sufficient accuracy, as the future cash flows are not determinable.

36 Capital Adequacy

The risk asset ratio calculated in accordance with the capital adequacy guidelines approved by the Bahrain Monetary Agency, for the Group is as follows:

	2003 BD 000s	2002 BD 000s
Capital base:		
Tier 1 capital	**105,325**	101,297
Tier 2 capital	**32,582**	26,342
Total capital base (a)	**137,907**	127,639
Credit risk weighted exposure:		
On-balance sheet	**733,037**	675,251
Off-balance sheet	**95,441**	74,720
Total	**828,478**	749,971
Market risk weighted exposure:		
On-balance sheet	**-**	-
Off-balance sheet	**7,300**	9,600
Total	**7,300**	9,600
Total risk weighted exposure (b)	**835,778**	759,571
Capital adequacy (a/b * 100)	**16.5%**	16.8%
Minimum requirement	**12.0%**	12.0%

37 Legal Claims

As at 31 December 2003, there were 11 legal suits pending against the Bank, aggregating BD 1.297 million (2002: nil). Based on the opinion of the Group's legal counsel, the management believes that no liability is expected to arise from these cases and does not consider it necessary to make any provisions in this regard.

38 Comparatives

The comparative figures for the previous year have been reclassified where necessary to conform to the current year's presentation. Such reclassification has not affected the previous year's net income, total assets, total liabilities and shareholders' equity of the Group.