Annual Report 2012

اليوباف
alubaf
بنك اليوباف العربي الدولي ش.م.ب (م)
Alubaf Arab International Bank B.S.C (c)

الدولي ش.م.ب (م)

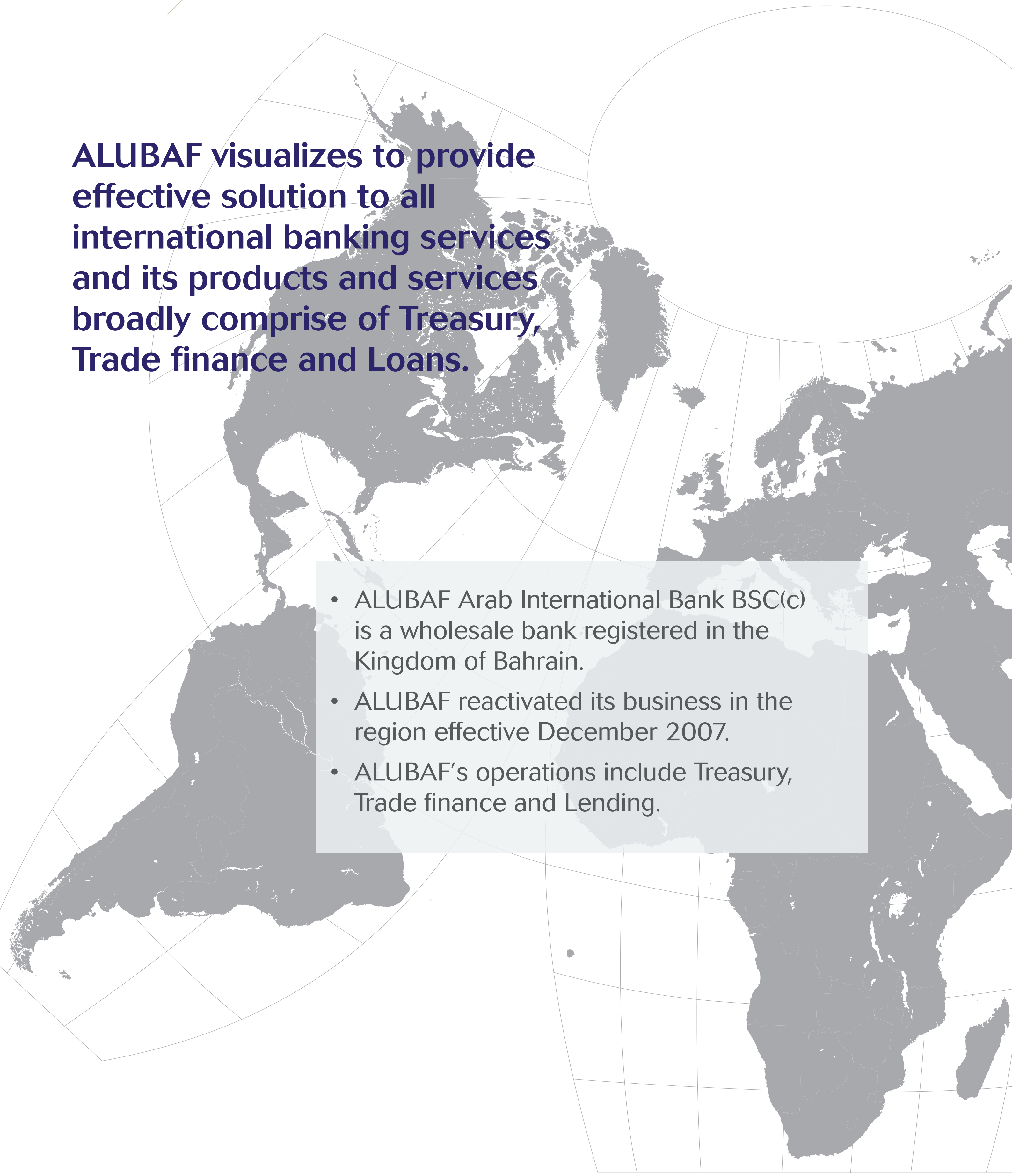
Alubaf/Arab Inter

Contents

Profile

ALUBAF visualizes to provide effective solution to all international banking services and its products and services broadly comprise of Treasury, Trade finance and Loans.

- ALUBAF Arab International Bank BSC(c) is a wholesale bank registered in the Kingdom of Bahrain.
- ALUBAF reactivated its business in the region effective December 2007.
- ALUBAF's operations include Treasury, Trade finance and Lending.



Vision/Mission

Vision

ALUBAF Bank visualizes to be a premier wholesale bank in providing effective banking solutions and bridge the gap between North Africa and Middle East.

Mission

To augment shareholder value with prudent financial management and to entrench a disciplined risk and cost management culture and be a premier provider of Trade finance.

Financial Highlights

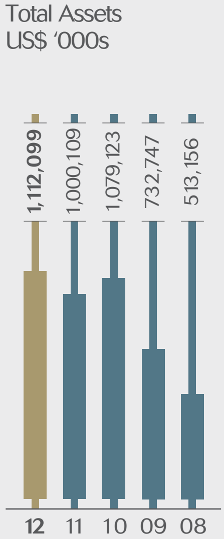
Despite the turbulent year for international banking activities, the bank made significant progress in its operations and achieved optimum results.

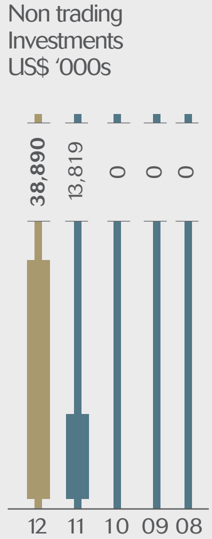
Total Assets

+11%

Non Trading Investments

+181%





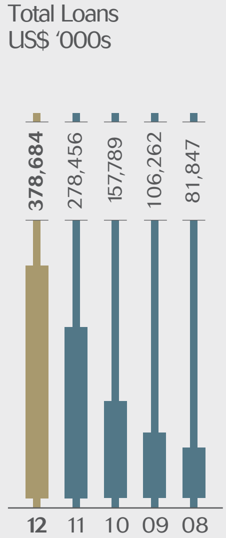
	2012 USD '000s	2011 USD '000s	2010 USD '000s	2009 USD '000s	2008 USD '000s
Financial Position					
Net Profit before appropriation	30,017	26,001	15,380	8,189	8,160
Total Assets	1,112,099	1,000,109	1,079,123	732,747	513,156
Non trading Investments	38,890	13,819	-	-	-
Total Loans	378,684	278,456	157,789	106,262	81,847
Total Liabilities	811,500	759,527	854,542	622,046	410,644
Total Equity	300,599	240,582	224,581	110,701	102,512
Ratios %					
Profitability					
ROAA -Return on Average Assets	3%	3%	2%	1%	3%
ROAE -Return on Average Equity	11%	11%	9%	8%	11%
Cost to Income	19%	18%	27%	29%	16%
Capital					
Capital Adequacy Ratio	50%	45%	43%	29%	44%
Equity Assets Ratio	27%	24%	21%	15%	20%
Asset Quality					
Loans to Total Assets	34%	26%	15%	15%	16%
Investments to Total Assets	3%	1%	-	-	-
Liquidity					
Liquid assets to Liabilities	83%	93%	104%	97%	103%

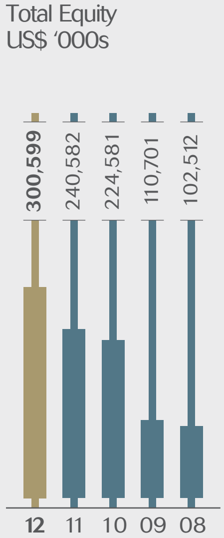
Total Loans

+36%

Total Equity

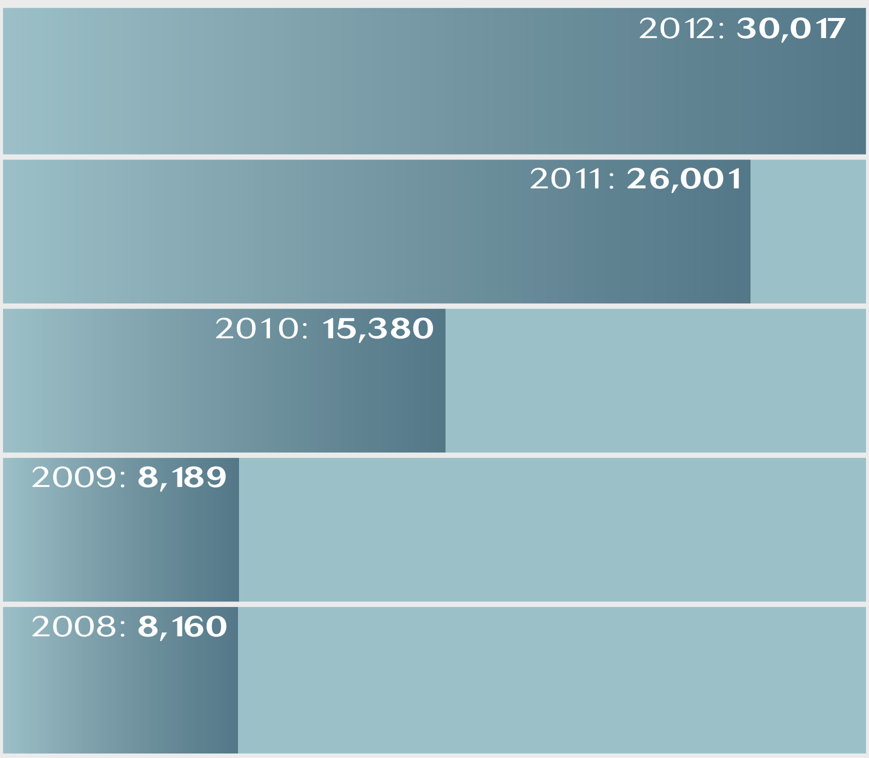
+25%





Net Profit

+15%



Board of Directors

From left to right: 5 - 3 - 4

1. Dr. Moraja Gaith Solaiman
Chairman (Effective January 2013)

Masters in Accounting from University of Hartford, USA. Deputy Finance Minister of Libya, since Transitional Government in 2011. Director of the Central Bank of Libya (since 2011).

Member of the General Commission for Supervision of Insurance Companies (since 2007).

Faculty member of Economics in University of Benghazi, Libya since 1982.

2. Dr. Mohamed Abdulla Bait Elmal
Chairman (From Dec. 2009 to 31 July 2012)

PhD in Accounting with over 30 years of experience in Finance and Banking.

Additionally, a Board member and Chairman of: Libyan Foreign Bank, Libya and British Arab Commercial Bank, London, UK. Formerly, Head of Auditor General, Libya and Minister of Finance, Libya.

3. Mr. Suleiman Esa Al Azzabi
Deputy Chairman

Masters in Banking and Finance, with over 20 years of experience

Additionally, a Board member of: Arab Financial Services Bahrain Also, General Manager of National Commercial Bank, Tripoli, Libya and Committee Member of Leasing Law, Libya.

4. Mr. Seyfullah Asaad Salim
Director

Masters in Banking and Finance and Bachelors in Accounting, with over 25 years of Banking experience

Manager, International Foreign Relations Department, Libyan Foreign Bank, Libya

Formerly, a Board member of Alubaf International Bank, Tunis.

5. Mr. Ali Makhzum Ben Hamza
Director

BA in Statistics, with over 25 years of Banking experience.

Manager of Training Department, Libyan Foreign Bank, Libya.

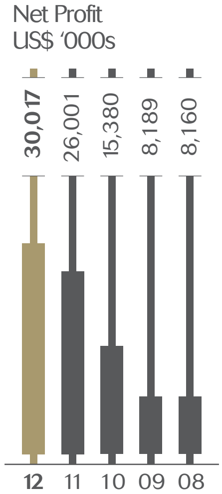
6. Mr. Fathi Ahmed Yahia
Director (Effective Dec. 2012)

Deputy Manager of Participations Department of Libyan Foreign Bank, Libya.

He has more than three decades of extensive experience in Banking. Formerly, a Board member of Alubaf International Bank, Tunis.

Report of the Board of Directors

Mr. Suleiman Esa Al Azzabi
Deputy Chairman



US$
30,017

The year 2012 was another year of strong performance and recorded remarkable results with a growth rate of 15% over last year 2011.

On behalf of the Board of directors of Alubaf International Bank, I am delighted to present the Annual report and audited financial statements for the year ended 31 December 2012.

Year 2012 marks the completion of 30 years for Alubaf Bank since its incorporation in 1982. Over the past 30 years Alubaf has experienced complete cycle of growth, downsize, dormancy and reactivation in 2007 with renewed vision and mission. Alubaf demonstrated this renewed goals by achieving exceptional results over the five years since reactivation in 2007. Alubaf's assets have grown from US$513 Million in 2008 to US$ 1,112 Million in 2012, increased by 117%; The year 2012 was another year of strong performance and recorded remarkable results with a growth rate of 15% over last year 2011.

Global and Banking scenario

Global economic scenario experienced a muted growth in 2012 with Asian countries performing better than Western economies and Europe, due to US coping with recession and Europe with Euro zone crisis and Sovereign debt issues. MENA region also experienced mixed results, with some countries grappling with Political stability and others recovering from the effect of Global financial crisis. With this back drop of Global scenario and after math of Financial crisis , Banking regulation and control strengthened in most of the regions, with stricter norms for Corporate Governance and Banks Compliance to regulation.

In the midst of these scenario, market conditions were highly volatile, which forced the Banking sector to adapt to the reality in business climate.

In 2012, Alubaf experienced changes in building its leadership team; Strong governance and strategic initiatives of the management played a significant role in achieving business objectives. Following the appointment of Chief Executive Officer Mr. Hasan AbdulHasan in fourth quarter 2012, significant strategic initiatives were taken by expanding in Investment activities, exploring new markets for existing core products and accelerating the performance of other related services.

With the above strides made in 2012 in its 30th year, Alubaf launched its new brand identity Logo.

Financial Highlights and Performance

The Bank posted a record growth of 15% for the year ended 2012 over last year figures, with net profit surging to US$ 30 Million in 2012 from US$ 26 Million in 2011.

Interest income was the main driver in 2012, which increased by 28%, compared to last year 2011. Interest earnings from Investments doubled in 2012. Moderate growth was observed in Fee and Commission, which increased by 5% in 2012, compared to 2011. Foreign exchange gains in 2012 increased by 13% as compared to last year 2011. Prudent management of balancing asset quality, efficient pricing of Loans and expanding its investment activity was the significant contributor in 2012. Overall, the Bank's operating income after due regulatory general provision stood at US$ 37 Million reflecting strong operational efficiency. Cost to income ratio, noted controlled increase and stood at 19%. Return on average equity was sustained at 11%.

Total assets in 2012 grew by 11% compared to last year 2011. Capital adequacy ratio remained high at 50% and liquidity ratio is adequate and comfortable at 83% as at 31 December 2012. Injection of US$ 50 Million in January 2012, also contributed to this comfortable capital adequacy ratio.

Dividend

Alubaf continues to be committed to its valued shareholders by ensuring record profit levels and good return to its shareholders. The Board of Directors is pleased to propose a dividend of US$ 4 per share, at 8% of Paid up Share capital, i.e., US$ 20 million for the year 2012.

Outlook for the year ahead

Outlook for 2013 remains positive, with strong capital adequacy and liquidity ratios and strategic initiatives of management to expand on income streams and new markets. Further, Alubaf's clear and sustained focus on achieving financial results without compromise on balanced asset quality, gives confidence for a positive outlook.

Acknowledgement

Finally, I would like to thank all the members of the Board, the Shareholders, the Ministry of Industry and Commerce in the Kingdom of Bahrain, Central bank of Bahrain and all Correspondent Banks and our Customers for their immense and continued support.

I also extend my appreciation and thanks to all employees for their dedication an commitment in achieving remarkable results.

Mr. Suleiman Esa Al Azzabi
Deputy Chairman

Executive Management

1. Mr. Hasan K. AbulHasan
Chief Executive Officer

Chief Executive Officer since October 2012. He holds a Bachelors degree in Statistics from Libya. Mr. Hasan AbulHasan is deputed from Libyan Foreign Bank, Libya to head Alubaf Arab International Bank, Bahrain.
He has held several senior top management position with Libyan Foreign Bank group and the last position held was Assistant General Manager at Libyan Foreign Bank, headquarters.
He brings with him strong and extensive experience in Banking sector that spans more than two decades.

2. Mr. Mohamed S. Ftera
Senior Deputy Chief Executive Officer

Bachelor in Business Administration. He held various positions in Libyan Foreign Bank and its participations, and brings in more than two decades of experience in International Banking, is deputed to head Finance, Operations and Information Technology.
He was for an interim period of six months in 2012 as Acting General Manager of Alubaf-Bahrain.

3. Mr. Mahmood A. Azzouz
Deputy Chief Executive Officer

A senior manager of Libyan Foreign Bank is deputed to head Business Development, Treasury and Trade Finance. He has held several senior position in varied departments in Libyan foreign Bank and its participations, brings in more than three decades of International banking experience in Trade Finance and Operations.

4. Mr. Ali Abdullah Dashti
Head of Treasury & Investments

A graduate of the Gulf Executive Development Program (Darden Business School – University of Virginia) with over 20 years experience in banking and financial markets. Prior to joining ALUBAF, he held various senior positions with both regional and global banks in the GCC, with a focus on Treasury & Capital Markets, Investment Banking and Business Development.

5. Mr. Mohamed A. Hameed A. Qader
Head of Risk and Compliance

Masters in Business Administration from University of Glamorgan, UK, B.Sc Accounting and Diploma in International Compliance from an International Compliance Association accredited by University of Manchester, UK. Prior to joining ALUBAF in 2009, he has served for more than ten years in Central Bank of Bahrain in Operations & Banking Supervision. He specializes in Risk management, regulatory compliance and Anti money laundering.

6. Mr. Saeed A. Nabi Al Banna
Head of Human Resources and Administration

B.Sc in Human Resources Management has served in various capacities in banking industry and has over 25 years of strong experience with specialization in compensation & benefits.

7. Ms. K.R.Usha
Head of Financial Control

An Associate member of Institute of Chartered Accountants of India and Institute of Cost and Works Accountants of India, with a strong Finance and Audit experience of more than 19 years and a Post qualification on Information Systems Audit from the Institute of Chartered Accountants of India.

8. Ms. Fatima Mohammed Bu-Ali
Head of Operations

Masters in Business Administration from University of Bahrain, affiliated with McMaster University-Canada with Intermediate Diploma in Banking and Finance. Also, holds an ACI Dealing certificate. She has over ten years of experience in Banking operations, Treasury and customer relationship management.

9. Hassan A.Rahman Al-Saffar
Head of Trade Finance

Diploma in Banking, with over 25 years in Bahrain Banking Industry. He brings with him strong experience in International Trade Finance and excellent depth of knowledge on UCP and relevant compliance issues on Documentary Credits.

10. Mr. Abbas Abdulla Al-Shamma
Head of Internal Audit

B.Sc. in Accounting and has Certified Information Systems Audit from the Information Systems Audit and Control Association, USA. He joined Alubaf in December 2009 and has more than 8 years experience in Internal and External Audit. Prior to joining Alubaf, he was an Auditor in Ernst and Young, Bahrain.

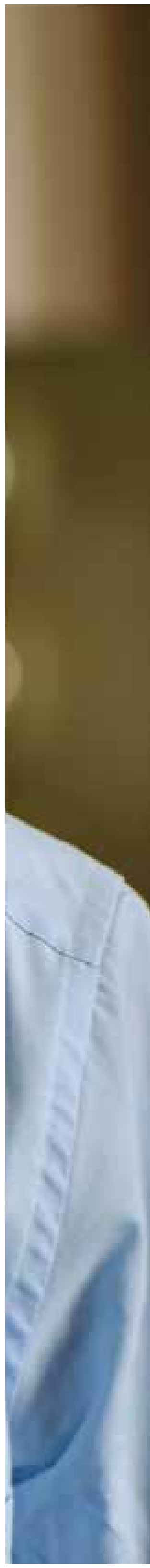
11. Mr. Ismaeel Omer Elnasri
Head of Legal

B.A in Law, (Honors), University of El Neelain, Khartoum – Sudan and an associate member of the Chartered Institute of Arbitrators (CIArb-UK). Prior to joining ALUBAF-Bahrain in May 2012, he has served seven years with Law Firms in Sudan and Bahrain and moved to Islamic Banking Sector "Investors Bank", where he served for four years. He specializes in corporate law, banking, and Islamic finance.

Review of the Chief Executive Officer

"Despite the turbulent year for international banking activities, the bank made significant progress in its operations and achieved optimum results."

Hasan K. Abulhasan
Chief Executive Officer



Operating income increased by 18% to

US$39.3m

I am glad to report that 2012 was a year of significant achievements with the highest profitability since inception. 2012 was an exceptional year with strong financial and operational performance reflecting the successful implementation of Bank's strategy of focusing on core business and competencies of trade finance products, credit related activities and treasury services.

Despite the turbulent year for international banking activities, the bank made significant progress in its operations and achieved optimum results. The operating income increased by 18% to US$39.3MM in 2012 compared to US$33.2MM in 2011. Our focus on traditional banking enabled us to achieve net profit of USD30MM in 2012 against USD26MM in 2011 with return on average equity of 11%, compares with the best amongst its peers in the industry.

The balance sheet growth reflects an increase by 11% from US$1 billion in 2011 to US$1.1 bn 2012. Loans and advances recorded a growth of 40% and stood at US$378MM in 2012 from US$269MM in 2011 with a low ratio of non performing loans to Gross loans at 1.67%. By continuing to adopt a conservative approach regarding provisioning for credit losses, the Bank provided an amount of US$2.3MM in 2012, as compared to US$1.5MM provided in previous year. The amount provided includes a mandatory collective provision.

Alubaf's liquidity position remained comfortable at the end of 2012 with strong liquid assets to liabilities ratio of 83% and liquid assets to total assets ratio of 60.42%. Deposits from banks and other financial institutions reached US$519MM in 2012 compared to US$470MM in 2011.

Shareholders fund increased to US$300.9MM in 2012, compared to US$ 240.5MM in 2011, subsequent to an injection of capital of US$50MM in 2012, by the Bank's major shareholders to support the continuity of our positive performance and expand our business activities. The risk asset ratio is solid with 50% Tier 1 Basel II capital, which provides adequate buffer against Bank's risk profile.

Chief Executive Officer Review
continued

We continued to support our clients in core markets and the variety of trade finance products offered by the bank has accommodated clients' requirements and performed to their satisfaction.

Year 2008
US$8m

Year 2009
US$8.2m

Year 2010
US$15.4m

Year 2011
US$26m

Year 2012
US$30m

Net profit

Operating expenses for 2012, rose by 23% to US$6.9MM, mainly due to increase in other operating costs. This increase can be justified by a significant increase in the operational efficiency. Significant strides were also made by Human resources to keep pace with operational requirements and providing manpower resources to enhance and improve operational efficiency.

The year 2012 was another successful year for trade finance. We continued to support our clients in core markets and the variety of trade finance products offered by the bank has accommodated clients' requirements and performed to their satisfaction.

Treasury management successfully improved the Bank's liquidity measures. Their services achieved good results despite falling interest rates and volatility in currency market. Prudent foreign exchange transactions management has mitigated foreign exchange risk and made considerable gains in 2012 at US$ 375 thousand compared to US$ 331 thousand. We look forward to develop our Treasury services, based on bank and clients needs.

Sound and effective risk management processes and procedures adequately assessed and monitored exposures. Compliance function has continued to adopt strong controls and oversight on regulatory risk, ensuring Bank activities are in compliance with regulations imposed by regulatory authorities and jurisdictions where we operate. The Bank has improved anti money laundering awareness through adequate staff training, which is provided as part of the Bank's commitment to uphold compliance standards and practices.

During 2012, the composition of our Board of Directors was changed and we are honored to welcome our new board members. We greatly appreciate those members who have served Alubaf and reiterate our sincere gratitude for their valuable contribution towards the Bank's success.

As we are stepping into the new financial year, the political and economic crisis will remain affecting the banking sector, especially, in our strategic market, the Middle East and North Africa regions. We expect a challenging year ahead. However, we foresee good potential to improve our strategic growth, we will review our business model to seize opportunities, enter new markets and offer new products in order to diversify our income streams. Indeed our solid financial position, expertise and values will play a vital role in achieving the optimum results.

The relocation of our office to our newly owned premises in Seef District, one of the most prestigious areas in Bahrain, will support our future growth plans and renew our commitment towards serving the region.

In a year of challenges for the banking community, we have witnessed outstanding results that sustained profitability and growth among many of our peers. These achievements could not have been made without the support of our clients, shareholders and dedicated staff members.

I would like to express my sincere gratitude and appreciation to the board of directors, the executive management team and staff of the bank for their significant contribution and critical role they played during the financial year 2012.

I extend my thanks to Central bank of Bahrain and the government of Kingdom of Bahrain for their ongoing support to Alubaf.

Hasan K. Abulhasan
Chief Executive Officer

Corporate Governance

Contents

1 GOVERNANCE

ALUBAF Arab International Bank ("the Bank") is committed to uphold the highest standard of corporate governance. The Board of Directors and management are fully committed to complying with established corporate governance and compliance with best practices in the Kingdom of Bahrain. This reflects the Bank's commitment to enhancing corporate governance, financial transparency and fairness in the disclosure of financial information for all stakeholders.

The Bank has endeavored to comply with the requirements of the Corporate Governance Code introduced by the Ministry of Industry and Commerce (MOIC) of Kingdom of Bahrain on March 2010 and the Central Bank of Bahrain's (CBB) Rulebook Module - High Level Controls (Module HC) effective from 1 January 2011.

According the Bank charter and the requirements set forth by the Code of Corporate Governance of the Kingdom of Bahrain, the Board has delegated specific responsibilities to a number of Board and Management Committees. Each Committee has its own formal written charter. The main Committees are:

1. Board of Directors Committees:
    - Audit, Risk & Compliance Committee (ARCC); and
    - Nomination & Remuneration Committee (NRC).
2. Management Committees:
    - Asset and liability Committee (ALCO);
    - Management Risk Committee (MRC); and
    - Human Resource and Compensation Committee (HRCC).

2 INDEPENDENCE AND AUTHORITY

Audit, Risk and Compliance maintain separate positions in order to ensure its independence. This ensures independent and objective monitoring and reporting of functions to senior Management and the Board. In this respect, the Audit, Risk and Compliance exercises direct access to the Audit, Risk & Compliance Committee (ARCC).

Furthermore, the independence of functions are maintained by requiring the respected staff to, perform only Audit, Risk and Compliance related responsibilities and not involving in any activities where there may be a probability of conflicts of interest. Audit and Compliance staff report directly to the Head of Department and are not involved by any means in the day-to-day business activities.

To carry out its duty both efficiently and effectively, the Audit and Compliance functions have the following privileges and authorities:

- To communicate (at any time and on its own initiative) with any staff member and obtain any records or files necessary to enable it to carry out its responsibilities;
- A direct line of communication with CBB, supervisory authorities and the Audit, Risk & Compliance Committee (ARCC); and
- Authority and resources (to include engaging outside specialists) to initiate and carry out / investigate possible breaches of laws and regulations and plan corrective actions, in case of exceptions.

The compliance function is also independent of the Internal Audit Department. To promote independency and objectivity of the functions, a separate audit programme covering the activities of the compliance function is undertaken by the Internal Audit department as part of its review.

Corporate Governance
continued

3 SHAREHOLDERS

The Bank is majority owned by Libyan Foreign Bank (LFB) by 99.50%, a Bank registered in Libya and 100% owned by the Central Bank of Libya.

The shareholding structure of the Bank as at 31st December 2012:

Name of Shareholder	Percentage Shareholding	Nationality
Libyan Foreign Bank	99.50%	Libyan
National Bank of Yemen	0.28%	Yemeni
Yemen Bank for Reconstruction & Development	0.22%	Yemeni
Total	**100%**	

As of 31st December 2012, the Bank's Directors and the Senior Management do not own any shares in the Bank on an individual basis.

4 THE BOARD OF DIRECTORS

4.1 Responsibilities of the Board

The Board of Directors is responsible for the overall business performance and strategy of the Bank. The Board's role and responsibilities include but are not limited to:

- Establishing the objectives of the Bank;
- Monitor management performance;
- Convene and prepare the agenda for the shareholder meetings;
- Monitoring conflict of interest and preventing abusive related party transactions;
- Adoption and annual review of strategy;
- Adoption and review of management structure and responsibilities;
- Adoption and review of the systems and controls framework;
- Monitoring the implementation of strategy by management; and
- Causing financial statements to be prepared which accurately disclose the Bank's Financial position.
- The Board sets the 'tone at the top' of the Bank, and has a responsibility to oversee compliance with various laws and regulations, such laws involve Bahrain Bourse Law, the Labour Law, the Commercial Companies Law and Central Bank of Bahrain rules and regulations.
- The Board shall ensure that processes are in place for maintaining the integrity and reputation of the Bank including Compliance with the laws, rules, regulations and internal policies governing the business of Bank.
- Review of internal control, processes & procedures is carried out by Internal Audit Department.

4.2 Composition of the Board

For the Financial year of 2012, the Bank's Board of Directors comprises of three independent Directors, and three non-executive Directors.

Board Members	Position	Type of Membership	Nationality	Appointment Date	Re-appointment Date	Resignation Date
Dr. Mohamed Abdulla Bait Elmal	Chairman	Independent	Libyan	26-Jun-08	6-Jun-11	14-Aug-12
Dr. Moraja Gaith Solaiman	Chairman	Independent	Libyan	1-Nov-12	-	-
Mr. Suleiman Esa Al Azzabi	Deputy Chairman	Independent	Libyan	26-Oct-08	6-Jun-11	-
Mr. Ali Makhzum Ben Hamza	Director	Non-Executive	Libyan	7-Jul-04	6-Jun-11	-
Mr. Seyfullah Asaad Salim	Director	Non-Executive	Libyan	16-Aug-07	6-Jun-11	-
Mr. Fathi Ahmed Yahia	Director	Non-Executive	Libyan	1-Nov-12	-	-

Bank is committed to uphold the highest standard of corporate governance.

4.3 Activities of the Board

As per CBB Rulebook, High-Level Control Module, section HC-1.3; the Board must meet frequently but in no event less than four times a year. Additionally, as per the Nomination and Remuneration Committee charter the committee shall meet at least twice a year, and as per the Audit, Risk and Compliance Committee charter the committee shall meet at least four times a year. During the year 2012, the Board met six times. In addition, Audit, Risk and Compliance Committee (ARCC) has met five times and Nomination & Remuneration Committee (NRC) has met four times.

The dates and attendance details of the Board meetings are given below:

	Date & Location of meeting	Names of Directors present	Names of Directors not present
1	31-January-2012 Held In Kingdom of Bahrain	Dr. Mohammed Abdulla Bait El Mal *	NONE
		Mr. Suleiman Isa Azzabi	
		Mr. Ali Makhzom Bin Hamza	
		Mr. Seyfullah Asaad Salim	
2	05-April-2012 Held In Kingdom of Bahrain	Dr. Mohammed Abdulla Bait El Mal	NONE
		Mr. Suleiman Isa Azzabi	
		Mr. Ali Makhzom Bin Hamza	
		Mr. Seyfullah Asaad Salim	
3	15-May-2012 Held In Kingdom of Bahrain	Dr. Mohammed Abdulla Bait El Mal	NONE
		Mr. Suleiman Isa Azzabi	
		Mr. Ali Makhzom Bin Hamza	
		Mr. Seyfullah Asaad Salim	
4	3/4-July-2012 Held In Kingdom of Bahrain	Dr. Mohammed Abdulla Bait El Mal	NONE
		Mr. Suleiman Isa Azzabi	
		Mr. Ali Makhzom Bin Hamza	
		Mr. Seyfullah Asaad Salim	
5	17/18-September-2012 Held In Kingdom of Bahrain	Mr. Suleiman Isa Azzabi	NONE
		Mr. Ali Makhzom Bin Hamza	
		Mr. Seyfullah Asaad Salim	
6	5/4- December-2012 Held In Kingdom of Bahrain	Mr. Suleiman Isa Azzabi	NONE
		Mr. Ali Makhzom Bin Hamza	
		Mr. Seyfullah Asaad Salim	
		Mr. Fathi Ahmed Yahia **	

** Dr. Mohamed Abdulla Bait Elmal has resigned on 14th August 2012.*

***Mr. Fathi Ahmed Yahia has been appointed on 1st November 2012.*

Corporate Governance
continued

4 THE BOARD OF DIRECTORS (continued)

4.3 Activities of the Board (continued)

The dates and attendance details of the Audit, Risk& Compliance Committee (ARCC) meetings are given below:

	Date & Location of meeting	Names of Directors present	Names of Directors not present
1	30-January-2012 Held In Kingdom of Bahrain	Mr. Suleiman Isa Azzabi	Mr. Sayfulla Asaad Salim
		Mr. Ali Makhzom Bin Hamza	
2	04-April-2012 Held In Kingdom of Bahrain	Mr. Suleiman Isa Azzabi	NONE
		Mr. Ali Makhzom Bin Hamza	
		Mr. Seyfullah Asaad Salim	
3	14-May-2012 Held In Kingdom of Bahrain	Mr. Suleiman Isa Azzabi	NONE
		Mr. Ali Makhzom Bin Hamza	
		Mr. Seyfullah Asaad Salim	
4	2-July-2012 Held In Kingdom of Bahrain	Mr. Suleiman Isa Azzabi	NONE
		Mr. Ali Makhzom Bin Hamza	
		Mr. Seyfullah Asaad Salim	
5	3-December-2012 Held In Kingdom of Bahrain	Mr. Suleiman Isa Azzabi	NONE
		Mr. Ali Makhzom Bin Hamza	
		Mr. Seyfullah Asaad Salim	

The dates and attendance details of the Nomination and Remuneration Committee (NRC) meetings are given below:

	Date & Location of meeting	Names of Directors present	Names of Directors not present
1	30-January-2012 Held In Kingdom of Bahrain	Dr. Mohamed Abdulla Bait Elmal*	NONE
		Mr. Ali Makhzum Ben Hamza	
		Mr. Seyfullah Asaad Salim	
2	14-May-2012 Held In Kingdom of Bahrain	Dr. Mohamed Abdulla Bait Elmal	NONE
		Mr. Ali Makhzum Ben Hamza	
		Mr. Seyfullah Asaad Salim	
3	2-July-2012 Held In Kingdom of Bahrain	Dr. Mohamed Abdulla Bait Elmal	NONE
		Mr. Ali Makhzum Ben Hamza	
		Mr. Seyfullah Asaad Salim	
5	3-December-2012 Held In Kingdom of Bahrain	Mr. Suleiman Isa Azzabi **	NONE
		Mr. Ali Makhzum Ben Hamza	
		Mr. Seyfullah Asaad Salim	

** Dr. Mohamed Abdulla Bait Elmal has resigned on 14th August 2012.*
*** Mr. Suleiman Isa Azzabi has chaired the fourth NRC meeting, subsequent to discharge of Chairman.*

4.4 Evaluation of the Board

4.4.1 Appointment of Directors

As per the Bank Article of Association, the Bank shall be administered by a Board of Directors compromising not less than 3 Directors and not more than 9 Directors, appointed at the Annual General Meeting by secret ballot. The Board is appointed for a term of three years commencing on the date of the previous Board election. The appointment of the Board of Directors shall be based on the provision of Bahrain Commercial Company Law. The Board shall elect by secret ballot from its Directors, a Chairman and Deputy Chairman for the tuner of the Board. Board members adhere to Bank's Article of Association, the Corporate Governance Code of Conduct and all applicable laws and regulations. Additionally, the Bank's Article of Association lists all the situations which results of the Board member service termination, such as the Director failure to attend four consecutive meetings of the Board without lawful excuse.

A necessarily information is provided to the directors subsequent to their appointment. The Board ensures that each new appointed Director receives all information to ensure his contribution to the Board from the commencement of his term, including meeting with senior management, presentations regarding the Bank's strategic plans, significant financial, accounting and risk management issues, compliance programs, its internal and independent auditors and legal counsel.

The Bank has a written appointment agreement with each Director, which recites the Directors' roles, duties, responsibilities and accountability, in addition to other aspects relating to their appointment including their terms, the time commitment envisaged, the committee assignments (if any), their remuneration & expense reimbursement entitlement, and access to independent professional advice as required.

4.4.2 Assessment of the Board

The Bank's Board mandate requires that the Board conducts an evaluation of its performance, including:

- An assessment of the Board's operation;
- Completion of self-assessment questionnaire by each member;
- Review of the self-assessment undertaken;
- Bank's strategies and risk assessments;
- Reviewing each Director's work, his attendance at Board and committee meetings, and his constructive involvement in discussions and decision making;
- Observation of stakeholders on the Bank's corporate governance performance; and
- Current and emerging trends and factors.

Board of Directors have conducted an independent self-assessment related to 2011, and the results have been forwarded to shareholders during the Annual General Meeting held on 16thMay 2012. The Board of Directors have conducted the same exercise during 2012 and the findings of the report will be submitted to the shareholders during the next Annual General Meeting.

Corporate Governance
continued

5 BOARD COMMITTEES

The Board has two committees namely the Audit, Risk & Compliance Committee (ARCC) and Nomination & Remuneration Committee (NRC). The ARCC consists of three members and NRC includes two members. All members of the committees are board members. In accordance with the CBB's rulebook (Volume 1), the majority members of Board committees should be independent directors. However, the CBB has exempted the Bank until 31st March 2012 to appoint more independent directors.

The compositions of the Board Committees as of 31st December 2012 are:

Board Committees	Member Name	Member Position	Type of Membership
Audit, Risk & Compliance Committee (ARCC)	Mr. Suleiman Esa El Azzabi	Chairman	Independent
	Mr. Seyfullah Asaad Salim	Director	Non-executive
	Mr. Ali Makhzum Ben Hamza	Director	Non-executive
Nomination & Remuneration Committee (NRC)	Dr. Mohamed Abdulla Bait Elmal*	Chairman	Independent
	Mr. Seyfullah Asaad Salim	Director	Non-executive

** Dr. Mohamed Abdulla Bait Elmal has resigned on 14th August 2012.*

5.1 Audit, Risk & Compliance Committee (ARCC)

The mandate of the Audit, Risk & Compliance Committee requires it, among other things, to:

- Assist the Board in fulfilling its statutory and fiduciary responsibilities with respect to internal controls, accounting policies, auditing and financial reporting practices;
- Assist the Board in its oversight of the integrity and reporting of the Bank's quarterly and annual financial statements;
- Review the performance and approve activities, staffing and organizational structure of the internal audit function;
- Oversee the independence and performance of the external auditors as well as recommending the appointment, replacement and compensation of external auditors;
- Review the adequacy and effectiveness of the Bank's system of financial, accounting and risk management controls and practices;
- Oversee the Bank's compliance with laws, regulations and supervisory and internal policies;
- Regularly report to the Board about the committee activities and related recommendations and review any reports the Bank issues that relate to the committee responsibility;
- Maintaining oversight of the Bank's internal risk and capital management framework and systems and to review on an annual basis, the effectiveness of its systems;
- Articulating the Bank's risk tolerance against which to compare the amount of capital at risk on a forward-looking basis, as determined by exposures to credit, market, liquidity, operational, concentration, settlement, reputational and business cycle risks;
- Ensuring that senior management continues to take necessary steps to monitor and control the Bank's exposures through appropriate risk assessment and compliance to risk management policies;
- Approve risk management objectives, strategies, policies and procedures that are in line with the Bank's business lines, risk profile and risk appetite and in compatibility with the CBB rules and regulations and review them on annual bases. The Committee's approvals shall be communicated to those who are responsible for the implementation of risk management policies;

- Ensure that the Bank's risk management framework includes methodologies to effectively assess and manage credit, market, liquidity, operational, legal, profit / rate of return, and reputational risks;
- Ensure the existence of clear lines of authority and accountability for managing, monitoring and reporting risks as preformed internally and as required by CBB;
- Ensure that the risk management function has adequate resources and appropriate access to information to enable it to perform its duties effectively;
- Overseeing the compliance function of the Bank;
- The Committee will review the effectiveness of the system for monitoring financial and disclosure compliance with legal and regulatory requirements, and the compatibility with the CBB rules and regulations that will be reviewed on annual bases and the results of management's investigations and follow-up (including disciplinary action) of any fraudulent actions or non-compliance;
- The Committee will ensure that the compliance function is adequately resourced, independent of business lines and is run by individuals not involved in day-to-day running of the various business areas;
- The Committee will ensure controls are instituted to manage the Bank's financial reporting quality and integrity;
- The Committee will ensure that management develops, implements and oversees the effectiveness of comprehensive know your customer standards, as well as ongoing monitoring of accounts and transactions, in keeping with the requirements of relevant regulations and best practice;
- Review the findings of any examinations by regulatory agencies.

5.2 Nomination & Remuneration Committee (NRC)

The mandate of the Nomination & Remuneration Committee requires it, among other things, to:

- Ensure a formal and transparent Board nomination process is in place;
- Give full consideration to succession planning for directors (in particular the Chairman and the Chief Executive Officer) and other senior management (such as the direct reports of the Chief Executive Officer);
- Ensure effective policies and processes are in place for ensuring that executive management have the necessary integrity, technical and managerial competence and experience;
- Periodically review the time required from non-executive directors. Performance evaluation should be used to assess whether the non-executive directors are spending enough time to fulfil their duties;
- Report annually to the Board with an assessment of the Board's performance;
- Determine and agree with the Board the framework or broad policy for the remuneration of the directors, the Chief Executive Officer and senior management;
- Review and assess the adequacy of the Bank's policies and practices on corporate governance and recommend any proposed changes to the Board for approval; and
- Review the adequacy of the charter adopted by NRC committee of the Board, and recommend changes whenever necessary.

Corporate Governance
continued

6 MANAGEMENT COMMITTEES

There are three management level committees namely Asset and liability Committee (ALCO), Management Risk Committee (MRC), and Human Resource and Compensation Committee (HRCC).

The Management Committee members are:

Management Committees	Member Position	Committee Member Position
Asset and liability Committee (ALCO)	Chief Executive Officer	Head
	Deputy Chief Executive Officer (Business Development, Trade Finance, Treasury & Investment)	Deputy Head
	Senior Deputy Chief Executive Officer	Member
	Head of Financial Control	Member
	Head of Business Development	Member
	Head of Treasury & Investments	Member
	Head of Risk Management and Compliance	Member
	Head of Operations	Representative
Management Risk Committee (MRC)	Chief Executive Officer	Head
	Senior Deputy Chief Executive Officer (Financial Control, Information Technology, Operations)	Deputy Head
	Deputy Chief Executive Officer	Member
	Head of Financial Control	Member
	Head of Business Development	Member
	Head of Operations	Member
	Head of Treasury & Investments	Member
	Head of Risk Management and Compliance	Representative
Human Resource and Compensation Committee (HRCC)	Chief Executive Officer	Head
	Senior Deputy Chief Executive Officer	Member
	Deputy Chief Executive Officer	Member
	Head of Human Resources and Administration	Member

6.1 Asset and Liability Committee (ALCO)

The mandate of the Asset and Liability Committee requires it, among other things, to:

- Active management of the balance sheet;
- Effectively manage the Bank's liquidity requirements to meet business needs during normal conditions and during times of crisis;
- Monitor asset/liability maturity profile taking into account economic developments, fluctuations in asset values and benchmark reference rates;
- Management of foreign exchange risks;
- Within Board approved parameters, develop asset and liability management strategies, including liquidity strategies, and short and long-term funding and leverage strategies in general;
- Review the Bank's capital adequacy position and address capital management strategies from an ICAAP perspective;
- Review and monitor all aspects of liquidity policy including contingency planning and limits to ensure management of liquidity crisis;
- Review and approve or reject breaches of ALCO limits; and
- Review of reports submitted by Risk and Compliance Department.

6.2 Management Risk Committee (MRC)

The mandate of the Management Risk Committee requires it, among other things, to:

- Determine key risk areas and adopt risk management practices that contribute to the Bank's objectives;
- Ensure actions required are given appropriate level of sponsorship and supported by adequate resources;
- Increase the awareness level of management and staff on business risks in the Bank;
- Review and recommend to the Board the risk tolerance of the Bank;
- Review the Bank's mitigation strategy for key risks;
- Review and recommend for approval the Bank's risk management framework;
- Review the capital adequacy of the Bank's capital from regulator's perspective;
- Review and assess the adequacy of the risk measurement methodologies;
- Review and assess various internal limits and make specific recommendations with respect to Economic Risk Capital, market risk limits, ALM limits, etc;
- Review other major risk concentration as deemed appropriate; and
- Approve Operational Risk framework and monitor the risk on ongoing basis.

6.3 Human Resources & Compensation Committee (HRCC)

The mandate of the Human Resources & Compensation Committee requires it, among other things, to:

- Review regularly and recommend Bank's executive/staff development for senior management positions, including performance and skills evaluation, training and succession planning;
- Develop, review and recommend the Bank's executive/staff compensation;
- Determine the bonus and other incentive;
- Review matters relating to executive management succession and executive organization development;
- Manage the administration function of the Bank's; and
- Prepare periodic reports for the Board regarding the above items.

7 APPROVAL AUTHORITY STRUCTURE

The materiality level for transactions that require Board approval varies for different activities and is governed by the Board approved Delegation of Authority document and Credit Facility Approval Authority Matrix.

- In addition, as per the Bank Board Charter, decisions made by the Board, other than those made at Annual General Meetings and Extraordinary General Meetings may be made through circulation. The Board's decisions shall be considered by a vote of the majority of the attending members or in accordance with regulatory requirements. In case of equality of votes, the Chairman of the Board shall have the casting vote. The dissenting member may record his/her dissent. In all such cases: The secretary shall ensure and confirm circulation of necessary information and documentation; and
- A decision through circulation will not be valid unless approved by majority.

Furthermore, the Bank has a proper credit due-diligence procedure for all type of facilities/exposures either with the transaction is being a related party or non-related party transaction.

Corporate Governance
continued

8 CODE OF CONDUCT AND CONFLICT OF INTEREST

The Bank has adopted Code of Conduct and other internal policies and guidelines designed to guide all employees and directors through best practices to fulfill their responsibilities and obligations towards the Bank's stakeholders in compliance with all laws, rules and regulations that govern the Bank's business operations. The Code of Conduct contains rules on conduct, ethics and on avoiding conflict of interest applicable to all the employees and directors of the Bank. The Code of Conduct is documented, published and communicated throughout the Bank. The Bank has an annual declaration of Conflict of Interest statement for Board members and approved persons. The Bank's website also contains the Board approved Code of Conduct.

In 2012, the Bank set up a Whistle-blowing framework that enhances good governance and transparency within the Bank. The Bank is committed in maintaining the highest possible standards of ethical and legal conduct while conduction its operations.

9 COMMUNICATIONS

In compliance with CBB regulations under PD Module of the Volume 1 of CBB Rulebook, the Bank has a Board approved public disclosure policy, that discloses material information about its activities to various stakeholders of the Bank.

The disclosure policy applies to all modes of communication to the public including written, oral and electronic communications. These disclosures are made on a timely basis in a manner required by applicable laws and regulatory requirements.

Management seeks to respond to shareholders' questions and concerns on a prompt basis, subject to the limitations imposed by law and the confidentiality of certain information. The Bank maintains a website at www.alubafbank.com, which includes information of interest to various stakeholders including the regulatory authorities. Information available on the website includes the Annual Report and reviewed quarterly financials of the Bank and others.

10 ANTI-MONEY LAUNDERING

The Bank's anti money laundering (AML) policy intended to ensure that the Bank has a comprehensive framework of policies and procedures including best practice standards for combating money laundering and terrorist financing. The policies and procedures are anticipated to prevent the Bank's operations activities from being used by others for unlawful purposes.

The Bank's policy prohibit and actively prevent money laundering and any activity that facilitate money laundering or funding of terrorist or criminal activities by comply with the AML laws and regulations of the jurisdiction in which it undertakes business activities and as per compliance program.

The Bank committed to provide periodic training and information to ensure that all affected employees are aware of their responsibilities under the AML law and Central Bank of Bahrain regulation. The Bank provides up to date AML training for relevant staff that is appropriate to the Bank's activities and its differing types of customers.

11 MAJOR DEVELOPMENT DURING 2012

- The Board of Directors have played a significant role through an extensive discussion regarding the Bank's Business Plan.
- The Board has discussed the impact of increasing the Bank's paid-up capital by US$ 50MM during the financial year 2012, as well as the capital allocation strategy for the capital increase. The capital increase has widened the Bank's ability to diversify its trading book and credit related activities which ultimately have been reflected on the Bank's year end profitability performance and the Bank's willingness to distribute cash dividends to its shareholders of US$ 20 million.
- The Board composition has changed during 2012 due to the changing in the Board's Chairman. In addition one new non-executive Director has been appointed as Board member.

12 REMUNERATION DISCLOSURES

In January 2011, the Central Bank of Bahrain issued its corporate governance principles "Principle of remunerate approved persons fairly and responsibly" which set out the CBB's principle regarding remuneration of senior management and Board of Directors.

The Board Nomination and Remuneration Committee is responsible to enforce remunerations principle. The required disclosure by this principle is as follows:

The Bank employed 41 members of staff as at 31st December 2012 (2011: 35 staff). The remuneration to Board of Directors and staff, including staff salaries are as follows:

	2012	2011
Staff costs:	USD'000s	USD'000s
Salaries	2,220	1,865
Remuneration of Board of Directors	577	255
Remuneration of Executive Management	436	453
Remuneration of Staff	464	415

Based on mentioned principle, it is required to disclose certain qualitative and quantitative remuneration items.

Governance at all matters related to remuneration within the Bank held with Board committee at Nomination and Remuneration committee.

The committee is composed of the independent chairman who has resigned on 14th August 2012, and one director who is regarded as being non independent. The committee members possess the necessary skills to exercise the appropriate judgment.

The Nomination and Remuneration committee has acted as per Bank approved Nomination and Remuneration committee charter by the Board of Directors and assisted by a management committee of Human Resource & Compensation Committee of which chaired by the Chief Executive Officer and membership of the Senior Deputy Chief Executive Officer and Deputy Chief Executive Officer as well as it has a membership of the Head of Human Resources & Administrations to provide recommendations to rewards the Bank staff.

The Bank has in place performance award schemes for the benefit of its staff. The scheme with rewards is closely linked to the Bank strategic achievements and long term return on shareholders funds, with also certain non-financial performance metrics (such as risk management & internal audit are assessed based on individual performance) being taken into account.

Performance awards under the policy qualify as remuneration. Directors, Executive Management and staff performance awards are payable in January following the year to which the reward relates.

Additionally, as per the Board charter, the Board, based upon the recommendation of the Nomination and Remuneration Committee and subject to the laws and regulations, determines the form and amount of director compensation. The Committee shall conduct an annual review of director compensation. Furthermore, as per the Bank's Article of Association, the General Assembly may prescribe the remuneration of the members of the Board of Directors, provided that total of such remuneration shall not exceed ten percent (10%) fo the net profit in any one financial year after allowing for the transfer to legal reserves and after allowing for the distribution to the shareholders of a dividend totaling not less than five percent (5%) of the capital of the company.

Corporate Governance
continued

12 REMUNERATION DISCLOSURES (continued)

The calculation of Performance awards for Individual is undertaken annually and is linked to five factors:

1) Individual Role level;
2) The Bank return on equity;
3) Assessed individual performance;
4) Assessed compliance with the Bank's documented core standards of conduct; and
5) The Bank's performance against the business plan prepared before the commencement of the year to which it relates.

The policy requires to identify relevant senior executives and designate them as "Approved Persons". The remuneration applies to twelve senior executives of the Bank as per the Bank policy including all members who have served on the management committees.

The Bank had 41 employees as of 31st December 2012 who are to be eligible for performance awards in respect of their service during 2012. The cost of performance awards payable to staff in respect of 2012 was US$ 900 thousand of which US$ 436 thousand allocated to the twelve approved persons and US$ 464 thousand was in respect of other staff.

The Bank policy for annual salary comprise of 13 months basic salaries and the Bank did not offer any shares incentive plan or any other rewards.

13 REMUNERATION TO EXTERNAL AUDITORS

In 2012, the Bank has paid its external auditors, Messers Ernst & Young, US$ 56 Thousand for audit and other audit related service fees (included prudential information reports reviews, quarterly reviews, anti money laundering review, public disclosures reviews). Messers Ernst & Young have expressed their willingness to continue as the auditors of the Bank for the Financial year ending 31st December 2013. The non audit services and other advisory services provided by the external auditors amounts to US$ 32 Thousand.

Break down of audit fee and other non–audit related services fee paid to external Auditors is given below:

	2012	**2011**
	USD'000s	USD'000s
Audit and other audit related service fee	56	56
Non Audit services fee	32	13
Total	**88**	**69**

14 FINANCIAL YEAR 2012 COMPLIANCE ENHANCEMENT UNDERTAKEN

The effort has continued to ensure the Bank compliance with all CBB rules and regulations, corporate governance standards and best practices.

During 2012, the main shareholder decided to discharge the Bank's chairman from his duties as a Board member of the Bank and has successfully appointed a new independent chairman named Mr. Moraja Gaith Solaiman on 1st November 2012. Furthermore, has also appointed Mr. Fathi Ahmed Yahia as non executive Board member on 1st November 2012. The appointed Board members will be circulated and announced to all shareholders during the Bank's next Annual General Meeting.

During 2012, the Board Nomination and Remuneration Committee (NRC) has undertaken an assessment evaluating each member of the Board member and will provide its recommendations to shareholders at the Annual General Meeting (AGM). The assessment measure how the Board operates, evaluate the performance of each committee in light of its purposes and responsibilities, it review individual director's performance, attendance and value-added provided by the Board.

Confidential communication channels have been afforded to employees enabling them to have access to the ARCC to raise concerns about possible improprieties in financial or legal matters. The Board has adopted a "whistleblower" program in which all employees can communicate their concerns directly to any ARCC member or, to an identified person who has access to the ARCC.

To ensure that all Board Members are up to date with all Corporate Governance issues and to ensure their ability to fulfill their duties with regards to all Corporate Governance requirements and procedures, the Bank has conducted an awareness workshop to all Board Members regarding all Corporate Governance principles and codes, the international best practices corporate governance standards set by bodies such as the Basel Committee for Banking Supervision, and all CBB's related high-level controls and policies.

The Bank has recently conducted an assessment of its compliance status with CBB module HC. The results of which will be presented at the Annual General Meeting (AGM) of this financial year. Items which remain outstanding to date have been provided in the following section below.

15 ONGOING REQUIREMENTS AND ENHANCEMENTS INITIATIVES

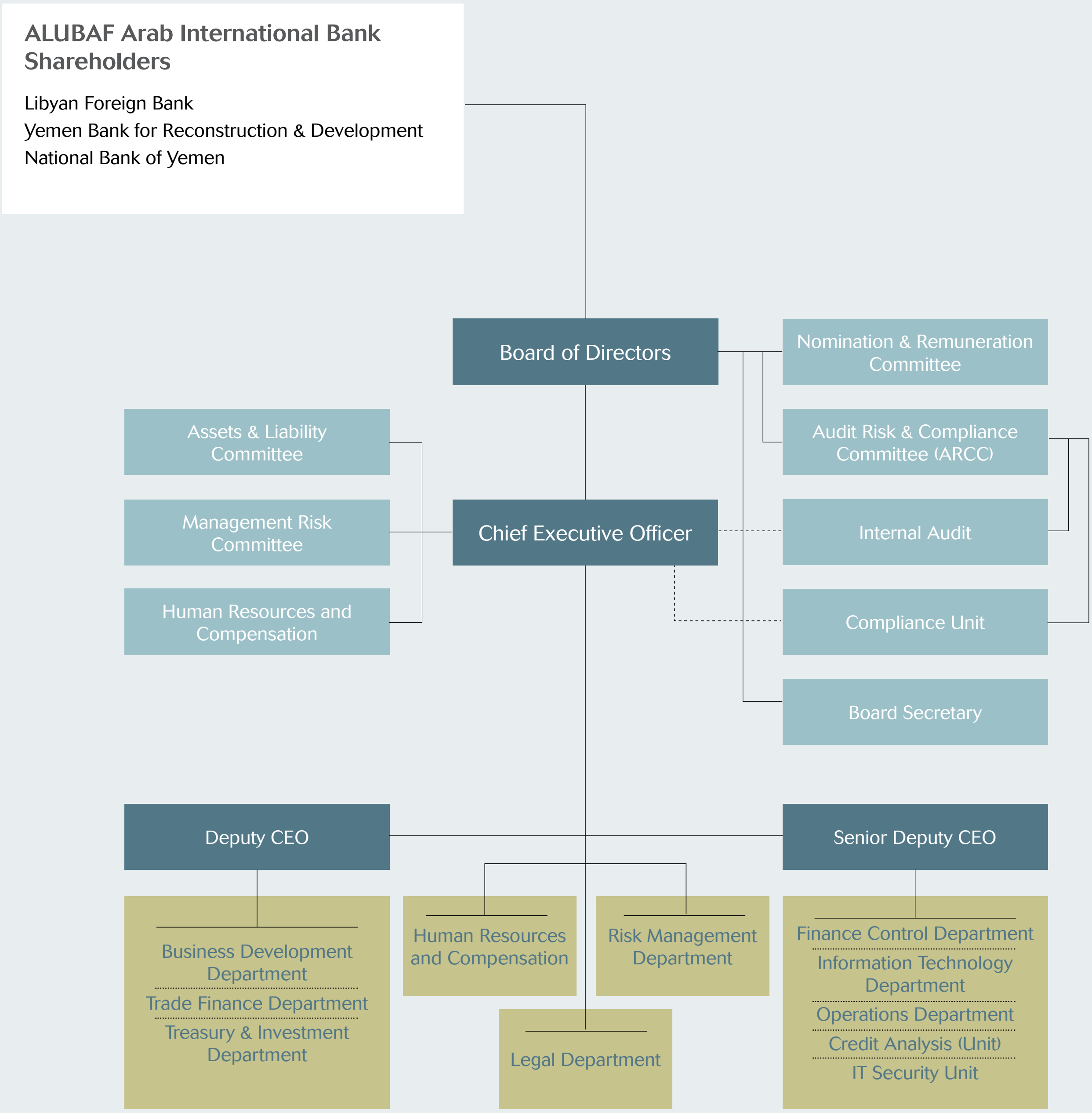
The Bank is complying with the CBB requirement set out in section HC-1.5.2 of the High Level Controls Module of the CBB Rulebook related to the level of independency of at least one third of the board members.

This level of independent directors have not enable the Bank to comply with the CBB requirements in sections HC-3.2.1, HC 4.2.1 & HC 5.2.1 related to Audit, Nomination & remuneration committees composition.

The change in Board composition has delayed the process of appointing new Board members but the Bank will take the necessary actions and initiatives to address the level of independent members within committees as well as will keep CBB informed at all times.

We are committed to adopt the best banking practice of governance and in our endeavors to be compliant with the HC Module of the Central Bank of Bahrain in the near future.

Corporate Governance Chart



Corporate Social Responsibilities

As part of Corporate Social responsibility, during 2012, Alubaf contributed to the University of Bahrain's Chemical Engineering department with twenty six Personal computers and an EZStat Pro potentiostat/galvanostat equipment to their computer applications lab. This lab is being named in University of Bahrain as "ALUBAF Computer Applications Lab".

Financial Statements 2012

Independent Auditors' Report to the Shareholders of
Alubaf Arab International Bank B.S.C. (c)

Report on the financial statements

We have audited the accompanying financial statements of the Alubaf Arab International Bank B.S.C. (c) ('the Bank'), which comprise the statement of financial position as at 31 December 2012 and the statements of comprehensive income, cash flows and changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the financial statements

The Bank's Board of Directors is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as the Board of Directors determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2012, its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on other regulatory matters

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (the CBB) Rule Book (Volume 1), we report that:

a) the Bank has maintained proper accounting records and the financial statements are in agreement therewith; and

b) the financial information contained in the Report of the Board of Directors is consistent with the financial statements.

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2012 that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests.

Ernst + Young

28 January 2013

Manama, Kingdom of Bahrain

Statement of Financial Position
At 31 December 2012

	Note	2012 US$ '000	2011 US$ '000
ASSETS			
Cash and balances with banks	3	7,102	44,670
Deposits with banks and other financial institutions	3,4	664,904	654,766
Investment held for trading	5	24	22
Non-trading investments	6	38,890	13,819
Loans and advances	7	378,684	269,260
Property, equipment and software	8	13,966	11,592
Interest receivable		8,034	5,114
Other assets		495	866
TOTAL ASSETS		1,112,099	1,000,109
LIABILITIES AND EQUITY			
LIABILITIES			
Deposits from banks and other financial institutions	9	519,017	470,302
Due to banks and other financial institutions	9	267,063	276,482
Due to customers	10	21,083	8,367
Interest payable		169	218
Other liabilities	11	4,168	4,158
Total liabilities		811,500	759,527
EQUITY			
Share capital	12	250,000	200,000
Statutory reserve	12	9,933	6,888
Retained earnings		20,666	13,694
Proposed dividend	13	20,000	20,000
Total equity		300,599	240,582
TOTAL LIABILITIES AND EQUITY		1,112,099	1,000,109

Mr. Sulieman Esa Al Azzabi
Deputy Chairman

Mr. Ali Makhzum Ben Hamza
Director

The attached notes 1 to 23 form part of these financial statements

Statement of Comprehensive Income
Year ended 31 December 2012

	Note	2012 US$ '000	2011 US$ '000
Interest and similar income	14	26,280	20,865
Interest expense	15	(2,472)	(2,297)
Net interest income		23,808	18,568
Fee and commission income	16	15,124	14,347
Changes in value of investment held for trading		4	(5)
Foreign exchange gain		375	331
Other income		20	-
OPERATING INCOME		39,331	33,241
Provision for loan losses	7	(2,322)	(1,580)
NET OPERATING INCOME		37,009	31,661
Staff costs		4,518	3,696
Depreciation	8	354	348
Other operating expenses	17	2,120	1,616
OPERATING EXPENSES		6,992	5,660
NET PROFIT AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR		30,017	26,001

Mr. Sulieman Esa Al Azzabi
Deputy Chairman

Mr. Ali Makhzum Ben Hamza
Director

The attached notes 1 to 23 form part of these financial statements

Statement of Cash Flows
Year ended 31 December 2012

	Note	2012 US$ '000	2011 US$ '000
OPERATING ACTIVITIES			
Net profit for the year		30,017	26,001
Adjustments for:			
Provision for loan losses	7	2,322	1,580
Depreciation	8	354	348
Write off of property, equipment and software		9	-
Changes in value of investment held for trading		(4)	5
Amortisation of assets reclassified as 'loans and advances' from trading investments		(509)	(468)
Gain on disposal of property, equipment and software		(20)	-
Operating income before changes in operating assets and liabilities		32,169	27,466
Changes in operating assets and liabilities:			
Deposits with banks and other financial institutions		(10,000)	15,000
Loans and advances		(111,237)	(121,737)
Interest receivable		(2,920)	(1,364)
Other assets		371	(492)
Deposits from banks and other financial institutions		48,715	(81,200)
Due to banks and other financial institutions		(9,419)	(15,951)
Due to customers		12,716	3,618
Interest payable		(49)	(63)
Other liabilities		10	(1,419)
Net cash used in operating activities		(39,644)	(176,142)
INVESTING ACTIVITIES			
Purchase of non-trading investments		(29,773)	(4,665)
Redemption of non-trading investments		4,702	-
Purchase of trading investment		(199)	-
Proceeds from disposal of trading investment		201	-
Purchase of property, equipment and software	8	(2,737)	(2,451)
Proceeds from disposal of property, equipment and software		20	-
Net cash used in investing activities		(27,786)	(7,116)
FINANCING ACTIVITIES			
Issue of share capital	12	50,000	-
Dividend paid	13	(20,000)	(10,000)
Net cash from / (used in) financing activities		30,000	(10,000)
DECREASE IN CASH AND CASH EQUIVALENTS		(37,430)	(193,258)
Cash and cash equivalents at 1 January		699,436	892,694
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	3	662,006	699,436

The attached notes 1 to 23 form part of these financial statements

Statement of Changes in Equity
Year ended 31 December 2012

	Note	Share capital US$ '000	Statutory reserve US$ '000	Retained earnings US$ '000	Proposed dividend US$ '000	Total US$ '000
Balance as of 1 January 2012		200,000	6,888	13,694	20,000	240,582
Increase in share capital	12	50,000	-	-	-	50,000
Dividend paid	13	-	-	-	(20,000)	(20,000)
Total comprehensive income for the year		-	-	30,017	-	30,017
Transfer to statutory reserve	12	-	3,045	(3,045)	-	-
Proposed dividend	13	-	-	(20,000)	20,000	-
Balance as of 31 December 2012		**250,000**	**9,933**	**20,666**	**20,000**	**300,599**
Balance as of 1 January 2011		200,000	4,262	10,319	10,000	224,581
Dividend paid	13	-	-	-	(10,000)	(10,000)
Total comprehensive income for the year		-	-	26,001	-	26,001
Transfer to statutory reserve	12	-	2,626	(2,626)	-	-
Proposed dividend	13	-	-	(20,000)	20,000	-
Balance as of 31 December 2011		200,000	6,888	13,694	20,000	240,582

The attached notes 1 to 23 form part of these financial statements

Notes to the Financial Statements

At 31 December 2012

1 ACTIVITIES

ALUBAF Arab International Bank B.S.C. (c) ("the Bank") is a closed Bahraini joint stock company incorporated in the Kingdom of Bahrain and registered with the Ministry of Industry and Commerce under Commercial Registration (CR) number 12819. The Bank operates under a wholesale banking license issued by the Central Bank of Bahrain under the new integrated licensing framework. The Bank's registered office is at the Wind Tower Building, 2nd Floor, Diplomatic Area, P O Box 11529, Manama, Kingdom of Bahrain.

The Bank is majority owned by Libyan Foreign Bank, a bank registered in Libya (refer note 12 for more details).

The financial statements for the year ended 31 December 2012 were authorised for issue in accordance with a resolution of the directors on 28 January 2013.

2 ACCOUNTING POLICIES

2.1 Basis of preparation

The financial statements have been prepared on a historical cost basis, as modified for investment held for trading which has been measured at fair value. The financial statements are presented in US Dollars which is the Bank's functional currency, and all values are rounded to the nearest thousand (US Dollar '000) except when otherwise indicated.

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and are in conformity with the Bahrain Commercial Companies Law ("BCCL") and the Central Bank of Bahrain's (the CBB) regulations (as contained in volume 1 of the CBB rulebook) and directives and Financial Institutions Law.

2.2 Significant accounting judgements and estimates

In the process of applying the Bank's accounting policies, management has exercised judgement and estimates in determining the amounts recognised in the financial statements. The most significant uses of judgement and estimates are as follows:

(i) Going concern

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Furthermore, the Board of Directors is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on a going concern basis.

(ii) Impairment and uncollectability of financial assets

Financial assets not carried at fair value are reviewed at each statement of financial position date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, any impairment loss is recognised in the statement of comprehensive income. For assets carried at amortised cost, impairment is based on estimated future cash flows discounted at the original effective interest rate.

(iii) Fair value of financial instruments

The fair value of interest-bearing financial assets and liabilities is estimated based on discounted cash flows using current market rates for financial instruments with similar terms and risk characteristics.

Estimates are made in determining the fair values of financial assets and derivatives that are not quoted in an active market. Such estimates are necessarily based on assumptions about several factors involving varying degrees of uncertainty and actual results may differ resulting in future changes in such amounts.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Notes to the Financial Statements

At 31 December 2012

2 ACCOUNTING POLICIES (continued)

2.3 Adoption of new and amended standards and interpretations

The accounting policies adopted are consistent with those of the previous financial year, except for the following new and amended IFRS and International Financial Reporting Interpretations Committee ("IFRIC") interpretations:

- *IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (Amendment) , 1 July 2011;*
- *IFRS 7 Financial Instruments: Disclosures (Amendment)*

The IASB issued an amendment to IFRS 7 on 7 October 2010. The amendment provides enhanced disclosures for 'transferred financial assets that are derecognised in their entirety 'and Transferred assets that are not derecognised in their entirety. The effective date is for annual periods beginning on or after 1 July 2011.

- *IAS 12 Income Taxes – Deferred Taxes: Recovery of Underlying Assets (Amendment), 1 July 2011.*

Adoption of these revised standards did not have any material effect on the financial statements of the Bank.

2.4 Summary of significant accounting policies

(i) Foreign currencies

Transactions in foreign currencies are initially recorded in the relevant functional currency rate of exchange ruling at the date of transaction.

Monetary assets and liabilities in foreign currencies are translated into United States Dollars at rates of exchange prevailing at the statement of financial position date. Any exchange gains and losses are taken to the statement of comprehensive income.

Non-monetary items in a foreign currency that are measured in terms of historical cost are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items in a foreign currency measured at fair value are translated using the exchange rates at the date when the fair value was determined.

(ii) Financial instruments - initial recognition and subsequent measurement

Date of recognition

All financial assets and liabilities are initially recognised on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. This includes "regular way trades": 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.

Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on the purpose and the management's intention for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus transaction costs, except in the case of financial assets held for trading.

Financial assets held-for-trading

These investments are subsequently measured at fair value with any realised and unrealised gains and losses arising from changes in fair values being included in the statement of comprehensive income in the period in which they arise. However, the acquisition expense are expensed when acquired. Interest earned and dividends received are included in interest income and dividend income respectively.

Held-to-maturity investments

These investments are subsequently measured at amortised cost using the effective interest rate. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The amortisation is included as 'interest income' in the statement of comprehensive income. The losses arising from impairment are recognised in the statement of comprehensive income.

Notes to the Financial Statements
At 31 December 2012

2 ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

(ii) Financial instruments - initial recognition and subsequent measurement (continued)

Other financial assets

Other financial assets are subsequently stated at amortised cost using effective interest rate method.

Impairment losses on financial assets carried at amortised cost

For financial assets carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of income statement. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Financial liabilities

Financial liabilities are subsequently carried at amortised cost.

(iii) Derecognition of financial assets and financial liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- The rights to receive cash flows from the asset have expired.
- The Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either:
- the Bank has transferred substantially all the risks and rewards of the asset, or
- the Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Financial liability

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

(iv) Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the statement of financial position when there is currently enforceable legal right to set off the recognised amounts and the Bank intends to settle on a net basis.

(v) Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with banks and deposits with banks and other financial institutions with original maturities of 90 days or less.

Notes to the Financial Statements
At 31 December 2012

2 ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

(vi) Property, equipment and software

Property, equipment and software is stated at cost, net of accumulated depreciation and/or accumulated impairment losses, if any. Such cost includes the cost of replacing part of the equipment if the recognition criteria are met. All other repair and maintenance costs are recognised in the statement of comprehensive income as incurred. Land is not depreciated. It is carried at cost less any impairment in value.

Depreciation is provided on a straight-line basis over the estimated useful lives of three years except for software which is depreciated over a period of five years.

An item of property, equipment and software is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset is included in the statement of comprehensive income in the year the asset is derecognised.

(vii) Capital work in progress

All costs and expenses, including payments to project asset suppliers and directly attributable expenses incurred in connection with the construction of the building and the related infrastructure costs are recognised as capital work in progress.

Upon completion of the project, capital work in progress is classified into relevant class of property and equipment.

(viii) Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event, and 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. The expense relating to any provision is presented in the statement of comprehensive income.

(ix) Contingent liabilities

Contingent liabilities are not recognised in the financial statements, but are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

(x) Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit and guarantees.

Financial guarantees are initially recognised in the financial statements at fair value, being the commission received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the un-amortised commission and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

(xi) Derivative financial instruments

The Bank uses derivative financial instruments as part of its currency risk management and enters into forward exchange contracts. Derivative financial instruments are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative.

(xii) Renegotiated loans

The Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original EIR.

Notes to the Financial Statements
At 31 December 2012

2 ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

(xiii) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Interest income

Interest income and fees which are considered an integral part of the effective yield of a financial asset, are recognised using the effective yield method, unless collectability is in doubt. The recognition of interest income is suspended when the loans become impaired, such as when overdue by more than 90 days.

Fee and commission income

Fee and commission income are recognised when earned.

Dividend income

Dividend income is recognised when the right to receive payment is established.

2.5 Standards, interpretations and amendments to approved accounting standards that are issued but not yet effective

New standards, amendments and interpretations issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

IFRS 1 – Government Loans

These amendments require first-time adopters to apply the requirements of IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, prospectively to government loans existing at the date of transition to IFRS. Entities may choose to apply the requirements of IFRS 9 (or IAS 39, as applicable) and IAS 20 to government loans retrospectively if the information needed to do so had been obtained at the time of initially accounting for that loan. The exception would give first-time adopters relief from retrospective measurement of government loans with a below-market rate of interest. The amendment is effective for annual periods on or after 1 January 2013. However, the amendment will not have any impact on the financial position or performance of the Bank.

IFRS 7 Disclosures Offsetting Financial Assets and Financial Liabilities

These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with IAS 32 Financial Instruments: Presentation. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. However, the amendment will not have any impact on the financial position or performance of the Bank and will become effective for annual periods beginning on or after 1 January 2013.

IFRS 9 - Financial instruments

IFRS 9, as issued, reflects the first phase of the IASB's work though the adoption date is subject to the recently issued Exposure Draft on the replacement of IAS 39 and applies to classification and measurement of financial assets and liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but Amendments to IFRS 9 Mandatory Effective Date of IFRS 9 and Transition Disclosures, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the Board will address impairment and hedge accounting. The Bank will quantify the effect of the adoption of the first phase of IFRS 9 in conjunction with the other phases, when issued, to present a comprehensive picture.

Notes to the Financial Statements

At 31 December 2012

2 ACCOUNTING POLICIES (continued)

2.5 Standards, interpretations and amendments to approved accounting standards that are issued but not yet effective (continued)

IFRS 10 – Consolidated financial statements

The standard becomes effective for annual periods beginning on or after 1 January 2013. It replaces the requirements of IAS 27 Consolidated and Separate Financial Statements that address the accounting for consolidated financial statements and SIC 12 Consolidation – Special Purpose Entities. What remains in IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. However, the amendment will not have any impact on the financial position or performance of the Bank.

IFRS 11 - Joint Agreements

The standard becomes effective for annual periods beginning on or after 1 January 2013. It replaces IAS 31 Interests in Joint Ventures and SIC 13 Jointly Controlled Entities – Non-monetary Contributions by Venturers. Because IFRS 11 uses the principle of control in IFRS 10 to define control, the determination of whether joint control exists may change. However, the amendment will not have any impact on the financial position or performance of the Bank.

IFRS 12 – Disclosure of interest in other entities

The standard becomes effective for annual periods beginning on or after 1 January 2013. It includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 Interests in Joint Ventures and IAS 28 Investment in Associates. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. One of the most significant changes introduced by IFRS 12 is that an entity is now required to disclose the judgements made to determine whether it controls another entity. Many of these changes were introduced by the IASB in response to the financial crisis. Now, even if the Bank concludes that it does not control an entity, the information used to make that judgement will be transparent to users of the financial statements to make their own assessment of the financial impact were the Bank to reach a different conclusion regarding consolidation.

The Bank will need to disclose more information about the consolidated and unconsolidated structure entities with which it is involved or has sponsored. However, the standard will not have any impact on the financial position or performance of the Bank.

IFRS 13 – Fair value measurement

The standard becomes effective for annual periods beginning on or after 1 January 2013. IFRS 13 does not change when an entity is required to use fair value, but rather, provides guidance on how to measure the fair value of financial and non-financial assets and liabilities when required or permitted by IFRS. There are also additional disclosure requirements. Adoption of the standard is not expected to have a material impact on the financial position or performance of the Bank.

IAS 1 Presentation of Items of Other Comprehensive Income – Amendments to IAS 1

The amendments to IAS 1 change the grouping of items presented in other comprehensive income (OCI). Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, net gains on hedges of net investments, exchange differences on translation of foreign operations, net movements on cash flow hedges and net losses or gains on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, actuarial gains and losses on defined benefit plans). The amendment affects presentation only and has no impact on the Bank's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

IAS 19 Employee Benefits (amendment)

The amendments to IAS 19 remove the option to defer the recognition of actuarial gains and losses, i.e., the corridor mechanism. All changes in the value of defined benefit plans will be recognised in profit or loss and other comprehensive income. The effective date of the standard is 1 January 2013.

Notes to the Financial Statements
At 31 December 2012

2 ACCOUNTING POLICIES (continued)

2.5 Standards, interpretations and amendments to approved accounting standards that are issued but not yet effective (continued)

The adoption of these amendments will require the Bank to recognise:

- A service cost and a net interest income or expense in profit or loss; and
- The re-measurements of the pension assets and liabilities, i.e., actuarial gains and losses in the other comprehensive income.

However, the amendment will not have any impact on the financial position or performance of the Bank.

IAS 27 Separate Financial Statements

As a consequence of the new IFRS 10 and IFRS 12, what remains in IAS 27 is limited to accounting for subsidiaries, jointly controlled entities and associates in separate financial statements. The amendment becomes effective for annual periods beginning on or after 1 January 2013. However, the amendment will not have any impact on the financial position or performance of the Bank.

IAS 28 Investments in Associates and Joint Ventures

As a consequence of the new IFRS 11 Joint Arrangements, and IFRS 12 Disclosure of Interests in Other Entities, IAS 28 Investments in Associates, has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. The revised standard becomes effective for annual periods beginning on or after 1 January 2013. However, the amendment will not have any impact on the financial position or performance of the Bank.

IAS 32 Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32

These amendments clarify the meaning of "currently has a legally enforceable right to set-off". It will be necessary to assess the impact to the Bank by reviewing settlement procedures and legal documentation to ensure that offsetting is still possible in cases where it has been achieved in the past. In certain cases, offsetting may no longer be achieved. In other cases, contracts may have to be renegotiated. The requirement that the right of set-off be available for all counterparties to the netting agreement may prove to be a challenge for contracts where only one party has the right to offset in the event of default.

The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. Offsetting on the grounds of simultaneous settlement is particularly relevant for the Bank as to where it engages in large numbers of sale and repurchase transactions. Currently, transactions settled through clearing systems are, in most cases, deemed to achieve simultaneous settlement. While many settlement systems are expected to meet the new criteria, some may not. Any changes in offsetting are expected to impact leverage ratios, regulatory capital requirements, etc. As the impact of the adoption depends on the Bank's examination of the operational procedures applied by the central clearing houses and settlement systems it deals with to determine if they meet the new criteria, it is not practical to quantify the effects.

These amendments become effective for annual periods beginning on or after 1 January 2014.

Annual improvements, May 2012

These improvements will not have an impact on the Bank, but include:

IFRS 1 First-time Adoption of International Financial Reporting Standards

This improvement clarifies that an entity that stopped applying IFRS in the past and chooses, or is required, to apply IFRS, has the option to re-apply IFRS 1. If IFRS 1 is not re-applied, an entity must retrospectively restate its financial statements as if it had never stopped applying IFRS.

Notes to the Financial Statements
At 31 December 2012

2 ACCOUNTING POLICIES (continued)

2.5 Standards, interpretations and amendments to approved accounting standards that are issued but not yet effective (continued)

IAS 1 Presentation of Financial Statements

This improvement clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative information is the previous period.

IAS 16 Property Plant and Equipment

This improvement clarifies that major spare parts and servicing equipment that meet the definition of property, plant and equipment are not inventory.

IAS 32 Financial Instruments, Presentation

This improvement clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 Income Taxes.

IAS 34 Interim Financial Reporting

The amendment aligns the disclosure requirements for total segment assets with total segment liabilities in interim financial statements. This clarification also ensures that interim disclosures are aligned with annual disclosures.

These improvements are effective for annual periods beginning on or after 1 January 2013.

3 CASH AND BALANCES WITH BANKS

	2012 US$ '000	2011 US$ '000
Cash	7	2
Money at call and short notice	6,983	27,035
Balances with other banks	112	17,633
Cash and balances with banks	7,102	44,670
Deposits with banks and other financial institutions with original maturities of 90 days or less (note 4)	654,904	654,766
Cash and cash equivalents	662,006	699,436

4 DEPOSITS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

Deposits with banks and other financial institutions represent interest bearing money market deposits held with banks and other financial institutions as at the statement of financial position date. Except for US$ 10 million (2011: nil) of deposits maturing in six months, all deposits have original maturities of 90 days or less (note 3).

5 INVESTMENT HELD FOR TRADING

Investment held for trading represents investment in equity shares held by the Bank for US$ 24 thousand (2011: US$ 22 thousand).

Notes to the Financial Statements
At 31 December 2012

6 NON TRADING INVESTMENTS

	2012 US$ '000	2011 US$ '000
Held-to-maturity:		
Debt securities (note 6.1)	35,890	13,819
Wakala units (note 6.2)	3,000	-
	38,890	13,819

6.1 Debt securities

	2012 US$ '000	2011 US$ '000
Sovereign	23,897	8,945
Corporate	11,993	4,874
	35,890	13,819

6.2 This represents participation made through an investment in wakala units having a fixed maturity.

7 LOANS AND ADVANCES

Loans and advances are stated net of provisions for loan losses and interest in suspense.

	2012 US$ '000	2011 US$ '000
Sovereign loan	42,085	41,576
Commercial loans	343,895	232,635
	385,980	274,211
Provision for loan losses and interest in suspense	(7,296)	(4,951)
	378,684	269,260

Movement in provision for loan losses and interest in suspense in relation to loans and advances were as follows:

	2012 US$ '000	2011 US$ '000
At 1 January	4,951	3,389
Provided during the year	2,322	1,580
Movement in interest in suspense	23	(18)
At 31 December	7,296	4,951

The breakup of provision for loan losses and interest in suspense in relation to loans and advances is as follows:

	2012 US$ '000	2011 US$ '000
Specific provision	3,867	3,500
Interest in suspense	229	206
Collective provision	3,200	1,245
At 31 December	7,296	4,951

Notes to the Financial Statements

At 31 December 2012

7 LOANS AND ADVANCES (continued)

Reclassification of financial assets:

In October 2008, the IASB issued amendments to IAS 39 “Financial Instruments: Recognition and Measurement” and IFRS 7 “Financial Instruments: Disclosures” titled “Reclassification of Financial Assets”. The amendments to IAS 39 permit reclassification of financial assets from the “trading investment” category to “loans and advances” category in certain circumstances.

The amendments to IFRS 7 introduce additional disclosure requirements if an entity has reclassified financial assets in accordance with the IAS 39 amendments. The amendments are effective retrospectively from 1 July 2008.

In accordance with the amendments to IAS 39 and IFRS 7, “Reclassification of Financial Assets” the Bank has reclassified investments in Iraq Notes with a carrying value of US $ 40.2 million, effective 1 July 2008 from ‘trading investment’ to ‘loans and advances’ pursuant to the amendment to IAS 39 and IFRS 7 issued by IASB in October 2008 and considering the global financial crisis as a rare circumstance in the financial sector.

The carrying values and fair values of the assets reclassified are as follows:

	2012 US$ ‘000	2011 US$ ‘000
Carrying value	42,085	41,576
Fair value	52,317	45,177

Additional fair value gain that would have been recognised in the statement of comprehensive income for the year ended 31 December 2012 had the trading investment not been reclassified amounts to US$ 6.6 million (2011: fair value loss of US$ 5.8 million).

The Bank earns an effective interest rate of 8.89% (2011: 8.89%) and expects to recover US $ 42 million (2011: US $ 41.5 million) on Iraq notes which were reclassified in 2008.

8 PROPERTY, EQUIPMENT AND SOFTWARE

	Freehold land US$ ‘000	Furniture, equipment and motor vehicles US$ ‘000	Software US$ ‘000	Capital work in progress US$ ‘000	Total US$ ‘000
Cost:					
At 1 January 2012	4,232	925	760	6,501	12,418
Additions during the year	-	62	10	2,665	2,737
Disposal during the year	-	(86)	-	-	(86)
At 31 December 2012	4,232	901	770	9,166	15,069
Depreciation:					
At 1 January 2012	-	599	227	-	826
Charge for the year	-	191	163	-	354
Disposal	-	(77)	-	-	(77)
At 31 December 2012	-	713	390	-	1,103
Net book value:					
At 31 December 2012	**4,232**	**188**	**380**	**9,166**	**13,966**
At 31 December 2011	4,232	326	533	6,501	11,592

The capital work in progress relating to the construction of the building has been completed in January 2013.

Notes to the Financial Statements

At 31 December 2012

9 DEPOSITS FROM AND DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

Deposits from banks and other financial institutions represent interest bearing money market deposits held with the Bank as at the statement of financial position date.

Due to banks and other financial institutions represent current account balances and cash collateral held with the Bank in relation to the letters of credit as at the statement of financial position date.

10 DUE TO CUSTOMERS

Due to customers represent current account balances and cash collateral held with the Bank in relation to the letters of credit as at the statement of financial position date.

11 OTHER LIABILITIES

	2012 US$ '000	2011 US$ '000
Accrued expenses	1,543	1,452
Unearned fee income	2,184	2,124
Retention money	168	561
Other	273	21
	4,168	4,158

12 SHARE CAPITAL

Following approval of the Bank's shareholders at an Extraordinary General Meeting (EGM) held on 6 June 2011, the Bank increased its authorised capital from US$ 200 million to US$ 500 million. The Bank also increased its issued and fully paid up share capital by US$ 50 million through issue of 1,000,000 ordinary shares of US$ 50 per share at par. The full amount of the capital issue has been received on 2 January 2012.

	2012 US$ '000	2011 US$ '000
Authorised:		
10,000,000 (2011: 4,000,000) Ordinary shares of US$ 50 each	500,000	200,000

	2012 US$'000	2011 US$'000
Issued and fully paid up:		
At beginning of the year: 4,000,000 Ordinary shares of US$ 50 each	200,000	200,000
Issued during the year: 1,000,000 Ordinary shares of US$ 50 each	50,000	-
At end of the year: 5,000,000 (2011: 4,000,000) Ordinary shares of US$ 50 each	250,000	200,000

Notes to the Financial Statements
At 31 December 2012

12 SHARE CAPITAL (continued)

Shareholders

	2012		2011	
	Percentage holding (%)	US$ '000	Percentage holding (%)	US$ '000
Libyan Foreign Bank	99.50	248,751	99.38	198,751
Yemen Bank for Reconstruction and Development	0.22	561	0.28	561
National Bank of Yemen	0.28	688	0.34	688
	100.00	250,000	100.00	200,000

Statutory reserve

As required by the Bahrain Commercial Companies Law (BCCL) and the Bank's articles of association, a statutory reserve has been created by transfer of 10% of its annual profit before deduction of Board of Directors' fee. The Bank may resolve to discontinue such transfers when the reserve totals 50% of the paid up capital. The reserve is not distributable except in such circumstances as stipulated in the BCCL and following approval of the Central Bank of Bahrain.

13 DIVIDENDS PAID AND PROPOSED

The Bank has proposed a dividend of US$ 20 million (US$ 4 per share) for the year ended 31 December 2012 (2011: US$ 20 million), which will be submitted for approval of the Bank's shareholders at the next Annual General Meeting subject to necessary regulatory approvals.

During the year, the dividend for the year ended 31 December 2011 amounting to US$ 20 million (US$ 5 per share) was paid, after the approval in the Annual General Meeting held on 16 May 2012.

14 INTEREST INCOME

	2012 US$ '000	2011 US$ '000
Loans and advances	18,720	14,485
Deposits with banks and other financial institutions	5,972	5,513
Non-trading investments	1,588	867
	26,280	20,865

15 INTEREST EXPENSE

	2012 US$ '000	2011 US$ '000
Deposits from and due to banks and other financial institutions	2,454	2,247
Due to customers	18	50
	2,472	2,297

Notes to the Financial Statements

At 31 December 2012

16 FEE AND COMMISSION INCOME

	2012 US$ '000	2011 US$ '000
Commission income from letters of credit	15,105	14,238
Commission income from letters of guarantee	19	109
	15,124	14,347

17 OTHER OPERATING EXPNESES

	2012 US$ '000	2011 US$ '000
Administrative and marketing expenses	1,118	1,057
Board of Directors' expenses	577	282
Professional services	179	75
Fees and other charges	182	121
Other	64	81
	2,120	1,616

18 COMMITMENTS AND CONTINGENT LIABILITIES

The Bank's commitments in respect of non-cancellable operating leases were as follows:

	2012 US$ '000	2011 US$ '000
Within one year	69	90
	69	90

Commitment on account of capital work in progress:

	2012 US$ '000	2011 US$ '000
Within one year	-	2,990
	-	2,990

Credit related contingencies:

	2012 US$ '000	2011 US$ '000
Letters of credit	250,045	451,769
Letters of guarantee	1,845	1,539
	251,890	453,308

Notes to the Financial Statements
At 31 December 2012

19 RISK MANAGEMENT

19.1 Introduction

Risk is inherent in the Bank's activities and is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The main risks to which the Bank is exposed are credit risk, liquidity risk, market risk and operational risk.

a) Risk management structure

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

Audit Risk and Compliance Committee

The Audit Risk and Compliance Committee (ARCC) of the Board is responsible for assessing the quality and integrity of financial reporting, effectiveness of systems monitoring financial and disclosure compliance with legal and regulatory requirements, supervision of compliance function and soundness of internal controls. The ARCC also obtains regular updates from management and the Bank's compliance officer regarding compliance matters, which may have a material impact on the Bank's financial statements and reviews the findings of any examinations by regulatory agencies.

Management Risk Committee

The Management Risk Committee has the overall responsibility for establishing the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Asset Liability Management Committee

The Asset Liability Management Committee's (ALCO) objective is to prudently direct and manage asset and liability allocation to achieve the Bank's strategic goals. The ALCO monitors the Bank's liquidity risks by ensuring that the Bank's activities are in line with the risk/reward guidelines approved by the Board.

Internal Audit

Internal control processes throughout the Bank are audited at least annually by the Internal Audit Department, based on the risk-based audit plan approved by the ARCC. Audit staff examine both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management and reports its findings and recommendations to the ARCC.

b) Risk measurement and reporting systems

Monitoring and controlling risks is primarily performed based on limits approved by the Board. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that it is willing to accept, with additional emphasis on selected industries. The Bank also monitors and measures the overall risk-bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

c) Excessive risk concentration

Concentrations 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 would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include guidelines to maintain a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Notes to the Financial Statements

At 31 December 2012

19 RISK MANAGEMENT (continued)

19.2 Credit risk

Credit risk is the risk that a customer or counterparty will fail to meet a commitment, resulting in financial loss to the Bank. Such risk arises from lending, treasury and other activities undertaken by the Bank. Credit risk is actively monitored in accordance with the credit policies which clearly define delegated lending authorities, and procedures. The Bank manages its credit risk by monitoring concentration of exposures by geographic location and adhering to approved limits formulated. The Bank limits its risk on off balance sheet items with adequate collateral.

a. Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the statement of financial position. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements. The net exposure represents gross exposure net of cash collateral against LC's.

	Gross maximum exposure 2012 US$ '000	Net maximum exposure 2012 US$ '000	Gross maximum exposure 2011 US$ '000	Net maximum exposure 2011 US$ '000
Balances with banks	7,095	7,095	44,668	44,668
Deposits with banks and other financial institutions	664,904	664,904	654,766	654,766
Non-trading investments	38,890	38,890	13,819	13,819
Loans and advances	378,684	316,455	269,260	215,850
Interest receivable	8,034	8,034	5,114	5,114
Other assets	263	263	697	697
Total funded credit risk exposure	1,097,870	1,035,641	988,324	934,914
Unfunded exposure on credit related contingencies	251,890	110,161	453,308	314,613
Total funded and unfunded credit risk exposures	1,349,760	1,145,802	1,441,632	1,249,527

The amount, type and valuation of collateral are based on guidelines specified in the risk management framework. The main types of collaterals accepted include cash collateral, residential and commercial real estate and securities.

b. Credit quality per class of financial assets

The table below presents an analysis of the financial assets exposed to credit risk and external rating designation at 31 December 2012 and 2011. The credit quality is graded based on external credit rating agencies- Standard & Poor, Fitch and Moody's and internal ratings are categorised as follows:

(i) High standard - Where external credit rating agency ratings are A and above.

(ii) Standard - Where external credit rating agency ratings are below A.

(iii) Watch list - Where the recoverability of loan is doubtful.

(iv) Past due and impaired - Where interest or principal sum of loan is due for more than 90 days.

Notes to the Financial Statements

At 31 December 2012

19 RISK MANAGEMENT (continued)

19.2 Credit risk (continued)

b. Credit quality per class of financial assets (continued)

	Neither past due nor impaired			
	High standard grade US$ '000	Standard grade US$ '000	Past due and individually impaired US$ '000	Total US$ '000
At 31 December 2012				
Balances with banks	3,634	3,461	-	7,095
Deposits with banks and other financial institutions	119,297	545,607	-	664,904
Non-trading investments	11,992	26,898	-	38,890
Loans and advances	-	379,529	6,451	385,980
Interest receivable	173	7,861	-	8,034
Other assets	-	263	-	263
Gross funded exposures	135,096	963,619	6,451	1,105,166
Less: Provision for loan losses and interest in suspense				
- Specific provision	-	(1,250)	(2,617)	(3,867)
- Interest in suspense	-	-	(229)	(229)
- Collective provision	-	-	(3,200)	(3,200)
Provision and interest in suspense	-	(1,250)	(6,046)	(7,296)
Net funded exposures	135,096	962,369	405	1,097,870
Credit related contingencies	-	251,890	-	251,890
Gross unfunded exposures	-	251,890	-	251,890
Net funded and unfunded exposures	135,096	1,214,259	405	1,349,760

	Neither past due nor impaired			
	High standard grade US$ '000	Standard grade US$ '000	Past due and individually impaired US$ '000	Total US$ '000
At 31 December 2011				
Balances with banks	12,453	32,215	-	44,668
Deposits with banks and other financial institutions	186,962	467,804	-	654,766
Non-trading investments	1,986	11,833	-	13,819
Loans and advances	-	271,755	2,456	274,211
Interest receivable	54	5,060	-	5,114
Other assets	-	697	-	697
Gross funded exposure	201,455	789,364	2,456	993,275
Less: Provision for loan losses and interest in suspense				
- Specific provision	-	(1,250)	(2,250)	(3,500)
- Interest in suspense	-	-	(206)	(206)
- Collective provision	-	(1,245)	-	(1,245)
Provision and interest in suspense	-	(2,495)	(2,456)	(4,951)
Net funded exposures	201,455	786,869	-	988,324
Credit related contingencies	-	453,308	-	453,308
Gross unfunded exposures	-	453,308	-	453,308
Net funded and unfunded exposures	201,455	1,240,177	-	1,441,632

Notes to the Financial Statements
At 31 December 2012

19 RISK MANAGEMENT (continued)

19.2 Credit risk (continued)

c. Concentration of maximum exposure to credit risk

The geographical distribution of gross credit exposures (net of provision for impairment) is presented below:

At 31 December 2012

	Bahrain US$ '000	Other GCC countries US$ '000	Other Middle- east and African countries US$ '000	Europe US$ '000	Rest of the world US$ '000	Total US$ '000
ASSETS						
Balances with banks	615	932	322	3,409	1,817	7,095
Deposits with banks and other financial institutions	235,354	174,765	97,200	157,585	-	664,904
Non-trading investments	18,296	11,993	8,601	-	-	38,890
Loans and advances	-	3,828	357,152	17,704	-	378,684
Interest receivable	366	201	7,384	83	-	8,034
Other assets	263	-	-	-	-	263
Gross funded exposures	254,894	191,719	470,659	178,781	1,817	1,097,870
Credit related contingencies	-	511	250,827	552	-	251,890
Gross unfunded exposures	-	511	250,827	552	-	251,890
Gross funded and unfunded exposures	254,894	192,230	721,486	179,333	1,817	1,349,760

At 31 December 2011

	Bahrain US$ '000	Other GCC countries US$ '000	Other Middle- east and African countries US$ '000	Europe US$ '000	Rest of the world US$ '000	Total US$ '000
ASSETS						
Balances with banks	833	3,371	26,439	4,435	9,590	44,668
Deposits with banks and other financial institutions	182,740	128,331	122,018	216,677	5,000	654,766
Non-trading investments	3,500	1,986	8,333	-	-	13,819
Loans and advances	-	3,785	265,475	-	-	269,260
Interest receivable	194	178	4,560	182	-	5,114
Other assets	697	-	-	-	-	697
Gross funded exposures	187,964	137,651	426,825	221,294	14,590	988,324
Credit related contingencies	-	424	452,884	-	-	453,308
Gross unfunded exposures	-	424	452,884	-	-	453,308
Gross funded and unfunded exposures	187,964	138,075	879,709	221,294	14,590	1,441,632

Notes to the Financial Statements
At 31 December 2012

19 RISK MANAGEMENT (continued)

19.2 Credit risk (continued)

c. Concentration of maximum exposure to credit risk (continued)

Sectoral classification of gross credit exposures is presented below:

At 31 December 2012

	Sovereign US$ '000	Banks and financial institutions US$ '000	Commercial, business and others US$ '000	Total US$ '000
ASSETS				
Balances with banks	-	7,095	-	7,095
Deposits with banks and other financial institutions	-	664,904	-	664,904
Non-trading investments	23,897	9,986	5,007	38,890
Loans and advances	42,085	329,067	7,532	378,684
Interest receivable	1,653	6,375	6	8,034
Other assets	-	37	226	263
Gross funded exposures	67,635	1,017,464	12,771	1,097,870
Credit related contingencies	-	248,288	3,602	251,890
Gross unfunded exposures	-	248,288	3,602	251,890
Gross funded and unfunded exposures	67,635	1,265,752	16,373	1,349,760

At 31 December 2011

	Sovereign US$ '000	Banks and financial institutions US$ '000	Commercial, business and others US$ '000	Total US$ '000
ASSETS				
Balances with banks	-	44,668	-	44,668
Deposits with banks and other financial institutions	-	654,766	-	654,766
Non-trading investments	8,945	4,874	-	13,819
Loans and advances	41,576	223,899	3,785	269,260
Interest receivable	1,453	3,660	1	5,114
Other Assets	-	-	697	697
Gross funded exposures	51,974	931,867	4,483	988,324
Credit related contingencies	-	453,308	-	453,308
Gross unfunded exposures	-	453,308	-	453,308
Gross of funded and unfunded exposures	51,974	1,385,175	4,483	1,441,632

19.3 Market risk

Market risk is the risk of potential financial loss that may arise from adverse changes in the value of a financial instrument or portfolio of financial instruments due to movements in interest rates, foreign exchange rates and equity. This risk arises from asset - liability mismatches, changes that occur in the yield curve and foreign exchange rates. Given the Bank's low risk strategy, aggregate market risk levels are considered very low.

Notes to the Financial Statements

At 31 December 2012

19 RISK MANAGEMENT (continued)

19.3.1 Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities that mature or reprise in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through a number of means. The Bank's interest rate sensitivity position as of 31 December, is as follows:

Sensitivity analysis - interest rate risk

	Impact on statement of comprehensive income	
	2012 US$ '000	2011 US$ '000
25 bps increase/decrease		
US Dollar	(+)(-)70	(+)(-)66
Euro	(+)(-)193	(+)(-)244

19.3.2 Currency risk

Currency risk arise from the movement of the rate of exchange over a period of time. The Bank's currency risk is limited to assets and liabilities denominated in GBP and Euro. The following table demonstrates the sensitivity to a reasonable possible change in foreign exchange rates, with all other variables held constant, on the Bank's statement of comprehensive income:

	Change in rate	Effect on net income for the year	
		2012 US$ '000	2011 US$ '000
Euro	5%	(+)(-)8	(+)(-)5
GBP	5%	(+)(-)3	(+)(-)2

As other GCC currencies to which the Bank is exposed are pegged to the US Dollar, their balances are not considered to represent significant currency risk.

19.3.3 Equity price risk

Equity price risk arises from the change in fair values of equity investments. The Bank's exposure to equity price risk is insignificant.

19.4 Liquidity risk

Liquidity risk is the risk that the Bank 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 limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind, and monitors liquidity on a daily basis. This incorporates an assessment of expected cash flow and the availability of high grade collateral which would be used to secure additional funding if required.

Notes to the Financial Statements

At 31 December 2012

19 RISK MANAGEMENT (continued)

19.4 Liquidity risk (continued)

The maturity profile of the assets and liabilities at 31 December 2012 given below reflects the management's best estimates of the maturities of assets and liabilities that have been determined on the basis of the remaining period at the balance sheet date.

	Up to 1 year						
At 31 December 2012	Up to 1 month US$ '000	1 to 3 months US$ '000	3 to 12 months US$ '000	Total US$ '000	More than 1 year US$ '000	No specific maturity US$ '000	Total US$ '000
ASSETS							
Cash and balances with banks	7,102	-	-	7,102	-	-	7,102
Deposits with banks and other financial institutions	473,572	181,332	10,000	664,904	-	-	664,904
Investment held for trading	-	-	-	-	-	24	24
Non-trading investments	-	-	-	-	38,890	-	38,890
Loans and advances	42,725	62,874	226,736	332,335	46,349	-	378,684
Property, equipment and software	-	-	-	-	-	13,966	13,966
Interest receivable	2,939	1,147	3,948	8,034	-	-	8,034
Other assets	6	88	197	291	204	-	495
Total assets	526,344	245,441	240,881	1,012,666	85,443	13,990	1,112,099
LIABILITIES							
Deposits from banks and other financial institutions	305,546	81,471	132,000	519,017	-	-	519,017
Due to banks and other financial institutions	75,643	157,593	33,827	267,063	-	-	267,063
Due to customers	21,083	-	-	21,083	-	-	21,083
Interest payable	109	18	42	169	-	-	169
Other liabilities	147	-	3,725	3,872	42	254	4,168
Total liabilities	402,528	239,082	169,594	811,204	42	254	811,500
Net liquidity gap	123,816	6,359	71,287	201,462	85,401	13,736	300,599
Cumulative liquidity gap	123,816	130,175	201,462	-	286,863	300,599	-

Notes to the Financial Statements
At 31 December 2012

19 RISK MANAGEMENT (continued)

19.4 Liquidity risk (continued)

At 31 December 2011	Up to 1 year: Up to 1 month US$ '000	Up to 1 year: 1 to 3 months US$ '000	Up to 1 year: 3 to 12 months US$ '000	Up to 1 year: Total US$ '000	More than 1 year US$ '000	No specific maturity US$ '000	Total US$ '000
ASSETS							
Cash and balances with banks	44,670	-	-	44,670	-	-	44,670
Deposits with banks and other financial institutions	595,036	59,730	-	654,766	-	-	654,766
Investment held for trading	-	-	-	-	-	22	22
Non-trading investments	2,887	-	-	2,887	10,932	-	13,819
Loans and advances	49,613	55,410	121,155	226,178	43,082	-	269,260
Property, equipment and software	-	-	-	-	-	11,592	11,592
Interest receivable	3,214	1,029	871	5,114	-	-	5,114
Other assets	229	-	406	635	178	53	866
Total assets	695,649	116,169	122,432	934,250	54,192	11,667	1,000,109
LIABILITIES							
Deposits from banks and other financial institutions	399,157	46,527	24,618	470,302	-	-	470,302
Due to banks and other financial institutions	234,153	16,907	25,422	276,482	-	-	276,482
Due to customers	8,367	-	-	8,367	-	-	8,367
Interest payable	168	50	-	218	-	-	218
Other liabilities	1,228	244	1,875	3,347	577	234	4,158
Total liabilities	643,073	63,728	51,915	758,716	577	234	759,527
Net liquidity gap	52,576	52,441	70,517	175,534	53,615	11,433	240,582
Cumulative liquidity gap	52,576	105,017	175,534	-	229,149	240,582	-

Notes to the Financial Statements

At 31 December 2012

19 RISK MANAGEMENT (continued)

19.4 Liquidity risk (continued)

The maturity profile of the financial and contingent liabilities as at 31 December 2012 based on contractual undiscounted repayment amounts is as follows:

At 31 December 2012	Up to 1 year: Up to 1 month US$ '000	Up to 1 year: 1 to 3 months US$ '000	Up to 1 year: 3 to 12 months US$ '000	Up to 1 year: Total US$ '000	More than 1 year US$ '000	No specific maturity US$ '000	Total US$ '000
LIABILITIES							
Deposits from banks and financial institutions	305,633	81,540	132,449	519,622	-	-	519,622
Due to banks and other financial institutions	75,664	157,727	33,942	267,333	-	-	267,333
Due to customers	21,089	-	-	21,089	-	-	21,089
Other Liabilities	256	18	3,767	4,041	42	254	4,337
Total funded exposures	402,642	239,285	170,158	812,085	42	254	812,381
Credit related contingencies	19,323	91,066	138,705	249,094	2,796	-	251,890
Total unfunded exposures	19,323	91,066	138,705	249,094	2,796	-	251,890
Total financial and contingent liabilities	421,965	330,351	308,863	1,061,179	2,838	254	1,064,271

At 31 December 2011	Up to 1 year: Up to 1 month US$ '000	Up to 1 year: 1 to 3 months US$ '000	Up to 1 year: 3 to 12 months US$ '000	Up to 1 year: Total US$ '000	More than 1 year US$ '000	No specific maturity US$ '000	Total US$ '000
LIABILITIES							
Deposits from banks and financial institutions	399,300	46,577	24,724	470,601	-	-	470,601
Due to banks and other financial institutions	234,237	16,925	25,531	276,693	-	-	276,693
Due to customers	8,370	-	-	8,370	-	-	8,370
Other liabilities	1,396	294	1,875	3,565	577	234	4,376
Total funded exposures	643,303	63,796	52,130	759,229	577	234	760,040
Credit related contingencies	549	21,875	430,884	453,308	-	-	453,308
Total unfunded exposures	549	21,875	430,884	453,308	-	-	453,308
Total financial and contingent liabilities	643,852	85,671	483,014	1,212,537	577	234	1,213,348

Notes to the Financial Statements
At 31 December 2012

19 RISK MANAGEMENT (continued)

19.5 Fair value of financial instruments

Financial instruments

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable and willing parties in an arm's length transaction. Consequently, differences can arise between carrying values and fair value estimates.

The fair values of financial instruments are not significantly different from the carrying values included in the financial statements except as mentioned in note 7 to the financial statements.

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

As at 31 December 2012, the Bank's only financial instrument carried at fair value was investment held for trading of US$ 24 thousand (2011: 22 thousand) which falls into Level 1 (2011: Level 1) of the fair value hierarchy.

There were no investments qualifying for level 2 and 3 fair value disclosures.

20 DERIVATIVE FINANCIAL INSTRUMENTS

As part of its currency risk management, the Bank enters into forward exchange contracts. These contracts are settled on a net basis. Depending on currency movements, the contracts may result in either a net asset or a net liability. The following table shows the material outstanding contracts as at 31 December:

	2012		2011	
Currency of the contract	Notional amount '000	Gain / (loss) US$ '000	Notional amount '000	Gain / (loss) US$ '000
Euro	-	-	10,000	228
GBP	1,000	(1)	-	-
Qatari Riyal	72,000	(3)	-	-
		(4)		228

Notes to the Financial Statements

At 31 December 2012

21 TRANSACTIONS WITH RELATED PARTIES

Related parties represent associated companies, shareholders, directors and key management personnel of the Bank, and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Bank's management.

Transactions with related parties included in the statement of comprehensive income and statement of financial position are as follows:

	2012 US$ '000	2011 US$ '000
Statement of comprehensive income		
Interest income	447	335
Interest expense	703	608
Fee and commission income	1,172	36
Statement of financial position		
Assets		
Cash and balances with banks	2,055	10,075
Deposit with banks and financial institutions	100,700	169,955
Interest receivable	50	82
Other assets	41	22
Liabilities		
Deposits from banks and other financial institutions	249,673	229,756
Due to banks and other financial institutions	15,144	51,098
Interest payable	99	94
Other liabilities	164	21
Contingent liabilities - Letters of credit (fully secured by deposit takings)	13,625	113,453

Compensation paid to the Board of Directors and key management personnel:

	2012 US$'000	2011 US$'000
Short term benefits*	1,326	979
End of term benefits	107	55
Total compensation	1,433	1,034

* Includes accrual for sitting fee and bonus of US$ 436 thousand (2011: US$ 179 thousand) and the reimbursement of travel, accommodation and other expenses paid to Board of Directors amounting to US$ 141 thousand (2011: US$ 103 thousand). The accrual is subject to approval by the Bank's shareholders in the next Annual General Meeting.

Notes to the Financial Statements

At 31 December 2012

22 CAPITAL ADEQUACY

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities.

The risk asset ratio, calculated in accordance with the capital adequacy guidelines, under Basel II, approved by the Central Bank of Bahrain.

	2012 US$ '000	2011 US$ '000
Capital base:		
Tier 1 capital	300,599	240,582
Total capital base (a)	300,599	240,582
Risk weighted assets (b)	599,925	536,892
Capital adequacy (a/b * 100)	50.11%	44.81%
Minimum requirement	12.00%	12.00%

23 COMPARATIVES

Certain of the prior year's figures have been reclassified to conform to the presentation adopted in the current year. Such reclassification did not affect previously reported income or shareholders' equity. The effect of the above reclassifications in the statement of financial position for 31 December 2011 is as follows:

	US$ 000
Decrease in cash and balances with banks (note 3)	(4,623)
Increase in non trading investments (note 6)	13,819
Decrease in loans and advances (note 7)	(9,196)

Basel II Pillar III disclosures

31 December 2012

Contents

Basel II Pillar III disclosures

31 December 2012

1. Introduction

Central Bank of Bahrain ("CBB"), the regulating body for Banks and Financial Institutions in the Kingdom of Bahrain, provides a common framework for the implementation of Basel II accord.

The Basel II framework is based on three pillars:

- Pillar I defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk. The requirement of capital has to be covered by own regulatory funds.
- Pillar II addresses the Bank's internal processes for assessing overall capital adequacy in relation to risks (ICAAP). Pillar II also introduces the Supervisory review and Evaluation Process (SREP), which assesses the internal capital adequacy.
- Pillar III complements the other two pillars and focuses on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy.

This document gathers together all the elements of the disclosure required under Pillar III and complies with the public disclosure module of CBB, in order to enhance corporate governance and financial transparency. This disclosure report is in addition to the financial statements presented in accordance with International Financial Reporting Standards (IFRS).

2. Corporate Structure

ALUBAF Arab International Bank B.S.C. (c) ("the Bank") is a closed Bahraini joint stock company incorporated in the Kingdom of Bahrain and registered with the Ministry of Industry and Commerce under Commercial Registration (CR) number 12819. The Bank operates under a wholesale banking license issued by the Central Bank of Bahrain under the new integrated licensing framework. The Bank's registered office is at Wind Tower Building, 2nd Floor, Diplomatic Area, P O Box 11529, Manama, Kingdom of Bahrain.

The Bank is majority owned by Libyan Foreign Bank (Shareholding 99.50%), a bank registered in Libya.

3. Capital Structure

The Bank's capital base comprise of Tier I Capital, which includes share capital, statutory reserve and retained earnings.

The issued and paid up share capital of the Bank was US $ 250 million as at 31 December 2012 comprising of 4 million shares of US$ 50 each.

Break down of Capital Base

	US$ '000 Tier I
Share capital	250,000
Statutory reserve	9,933
Retained earnings	40,666
Tier I Capital base	**300,599**
Less: Regulatory deductions	-
Net Available Capital Base	**300,599**

ALUBAF recorded a net profit of US$ 30,017 thousand for the year ended 31 December 2012 and transferred 10% of profits (US$ 3,045 thousand) towards Statutory reserve.

The Bank proposed a dividend of US$ 20,000 thousand, i.e. US$ 4.00 per Ordinary share for the year 2011.
The Bank increased its Paid up share capital in January 2012 to USD 250 Million, pursuant to the approval in Annual general meeting held on 6th June 2011 and lifting of UN Sanctions on major shareholder Libyan Foreign Bank on 16th December, 2011.

Basel II Pillar III disclosures
31 December 2012

4. Capital Adequacy Ratio (CAR)

The purpose of capital management at the Bank is to ensure the efficient utilization of capital in relation to business requirements and growth, risk profile and shareholders' returns and expectations.

The Bank manages its capital structure and makes adjustments in the light of changes in economic conditions and risk characteristics of its activities.

Capital adequacy ratio calculation:

	US$ '000
Tier I Capital Base	**300,599**
Risk weighted assets (RWA)	
Credit risk	556,381
Market risk	300
Operational risk	43,244
	599,925
Capital adequacy ratio	**50.11%**

The Bank's capital adequacy ratio of 50.11% is well above the minimum regulatory requirement of 12%.

5. Profile of risk-weighted assets and capital charge

The Bank has adopted the standardized approach for credit risk, market risk and the Basic indicator approach for operational risk for regulatory reporting purposes. The Bank's risk weighted capital requirement for credit, market and operational risks are given below:

5.1 Credit risk

Definition of exposure classes per Standard Portfolio

The Bank has funded and unfunded credit portfolio. The exposures are classified as per the Standard portfolio approach mentioned under the CBB's Basel II capital adequacy framework covering the standardized approach for credit risk.

The descriptions of the counterparty classes along with the risk weights used to derive the risk weighted assets are as follows:

(a) Claims on sovereigns

These pertain to exposures to governments and their central banks. Claims on Bahrain are risk weighted at 0%, while claims on other sovereigns, denominated in a non-relevant currency and unrated are assigned a risk weight of 100%.

(b) Claims on banks

Claims on Banks are risk weighted based on the ratings assigned to them by external rating agencies. However, short term claims on locally incorporated banks and claims maturing within three months and denominated in Bahrain Dinars or US Dollars are risk weighted at 20%. Other claims on banks, which are in foreign currency, are risk weighted using standard risk weights ranging from 20% to 100%. Unrated claims on banks are assigned a risk weight of 20% & 50% respectively.

(c) Claims on corporate portfolio

Claims on corporate portfolio are risk weighted based on external credit ratings and are assigned a risk weight of 100% for unrated corporate portfolio.

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5. Profile of risk-weighted assets and capital charge (continued)

5.1 Credit risk (continued)

(d) Past due exposure

Past due exposures include Loans and advances of which interest or repayment of principal are due for more than 90 days; Past due exposures, net of specific provisions are risk weighted as follows:

(a) 150% risk weight, when specific provisions are less than 20% of the outstanding amount of loan.

(b) 100% risk weight, when specific provisions are greater than 20% of the outstanding amount of the loan.

(e) Equity portfolios

Investments in listed equities are risk weighted at 100%.

(f) Other exposures

These are risk weighted at 100%.

Credit exposure and risk weighted assets — **US$ '000**

	Funded exposures	Unfunded exposures	Gross credit exposures	Eligible collateral	Risk weighted assets	Capital charge
Claims on sovereigns	67,635	-	67,635	-	49,642	5,957
Claims on banks	1,017,022	248,288	1,265,310	111,875	476,807	57,217
Claims on corporate	12,546	3,602	16,148	721	10,040	1,205
Past due	3,605	-	3,605	-	5,408	649
Equity portfolio	24	-	24	-	24	3
Other exposures	14,460	-	14,460	-	14,460	1,735
Total	**1,115,292**	**251,890**	**1,367,182**	**112,596**	**556,381**	**66,766**

Gross credit exposure before credit risk mitigation — **US$ '000**

	Gross credit exposure	Average monthly gross exposure
Claims from Sovereigns	67,635	55,843
Claims from Banks	1,017,022	962,694
Claims on Corporate	12,546	17,003
Past due	3,605	3,605
Equity Portfolio	24	24
Other exposures	14,460	14,322
Total funded exposure	**1,115,292**	**1,053,491**
Unfunded exposures	**251,890**	**298,438**
Gross credit exposures	**1,367,182**	**1,351,929**

Average monthly balance represents the average of the sum of twelve month end balance for the year ended 31 December 2012.

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5.2 Market risk

The Bank's capital requirement for market risk in accordance with the standardised methodology is as follows:

US$ '000

	Risk weighted exposures	Capital charge	Maximum value	Minimum value
Foreign exchange risk	300	36	3,225	50

5.3 Operational risk

In accordance with the Basic indicator approach, the total capital charge in respect of operational risk was US$ 5,189 thousand on operational risk weighted exposure of US$ 43,244 thousand. This operational risk weighted exposure is computed using the Basic indicator approach, where a fixed percentage (Alpha), which is 15% of the average previous three year annual gross income, is multiplied by 12.5 operational capital charge; years with positive gross income are counted for computation of capital charge. This computation is as per CBB Capital adequacy rulebook.

6. Risk Management

Risk is inherent in the Banks business activities and is managed through a process of on- going identification, measurement, controlling and monitoring. The Bank is exposed primarily to credit risk and to a limited extent to market and operational risk. Risk strategies of the Bank to mitigate the various risks were effective throughout the year.

Following is the Risk and Capital Management Structure:

Board of Directors
Board Audit, Risk & Compliance Committee
Management Risk Committee
Asset Liability Management Committee

The Board of Directors is responsible for the best practice management and risk oversight. Board of Directors defines the risk appetite and risk tolerance standards and oversees that risk process standards are in place. At the second level, Executive management is responsible for the identification and evaluation on a continuous basis of all significant risks to the business and implementation of appropriate internal controls to minimize them. Senior management is responsible for monitoring credit lending portfolio, country limits and interbank limits and general credit policy matters, which are reviewed and approved by the Board of Directors.

Independent internal audit of risk management process are audited and reported to the Audit , Risk and Compliance Committee, which is appointed by the Board of Directors.

6.1 Credit risk concentrations and thresholds

The first level of protection against undue credit risk is through country and industry threshold limits, together with individual borrower threshold limits. Single name concentrations are monitored on an individual basis. Under the CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's approval for any planned exposure to a single counterparty or group of connected counterparties exceeding 15% of the regulatory capital base.

As at 31 December 2012, the Bank's exposure in excess of 15% of the obligor limits to individual counterparties is shown below:

US $ '000	Funded exposure	Unfunded exposure	Total
Counterparty A *	65,000	Nil	65,000

* These are interbank deposits maturing within 6 months from 31 December 2012.

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6. Risk Management (continued)

6.1 Credit risk concentrations and thresholds (continued)

Risk mitigation – collateral

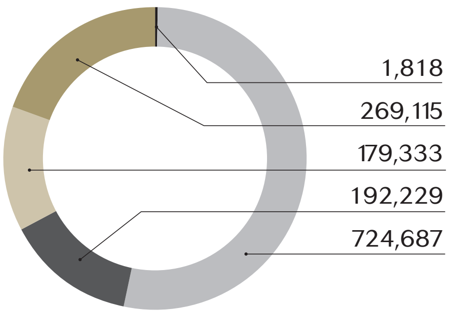
The amount and type of collateral depends on an assignment of the credit risk, credit rating and market conditions of the counterparty. The types of collateral mainly include cash collaterals for both funded and unfunded credit exposures, which is liquidated on maturity/expiry date. However, impact on cash collateral will be nil with credit downgrade.

Majority of the collateral taken by the Bank is in cash; therefore, concentration risk on collateral is not significant. For further details on refer note 19.2 of the annual audited financial statements for the year ended 31 December 2012.

6.2 Geographical distribution of exposures based on residence is summarized below:

US$'000	Gross credit exposure	Funded exposure	Unfunded exposure
Bahrain	269,116	269,116	-
Other GCC Countries	192,230	191,719	511
Other Middle east & Africa	724,686	473,859	250,827
Europe	179,333	178,781	552
Rest of the world	1,817	1,817	-
Total	**1,367,182**	**1,115,292**	**251,890**

Geographic exposures (US$'000s)



The geographical distribution of gross credit exposures by major type of credit exposures can be analyzed as follows:

US$ '000	Bahrain	Other GCC Countries	Other Middle East and Africa	Europe	Rest Of the world	Total
Claims from Sovereigns	15,505	-	52,130	-	-	67,635
Claims from Banks	239,127	182,880	418,124	175,074	1,817	1,017,022
Claims on Corporate	-	8,839	-	3,707	-	12,546
Past due	-	-	3,605	-	-	3,605
Equity Portfolio	24	-	-	-	-	24
Other exposures	14,460	-	-	-	-	14,460
Total funded exposure	**269,116**	**191,719**	**473,859**	**178,781**	**1,817**	**1,115,292**
Unfunded exposures	**-**	**511**	**250,827**	**552**	**-**	**251,890**
Gross credit exposures	**269,116**	**192,230**	**724,686**	**179,333**	**1,817**	**1,367,182**

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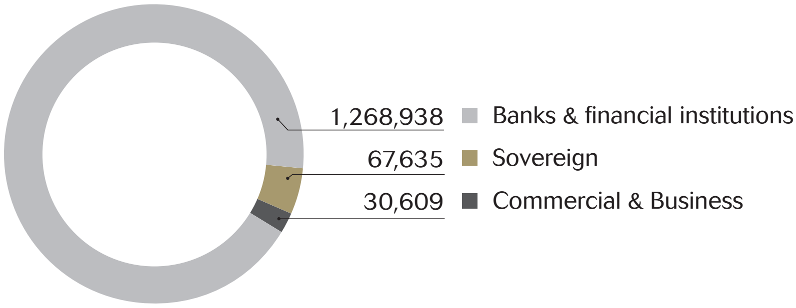
31 December 2012

6. Risk Management (continued)

6.3 Industrial sector analysis of exposures is summarized below:

US$'000	Gross credit exposure	Funded exposure	Unfunded exposure
Sovereign	67,635	67,635	-
Banks & financial institutions	1,268,938	1,020,650	248,288
Commercial & Business	30,609	27,007	3,602
Total	**1,367,182**	**1,115,292**	**251,890**

Sectoral exposures (US$'000s)



The industrial sector analysis of gross credit exposures by major types of credit exposures can be analyzed as follows :

USD '000s	Financial	Government	Other Sector	Total
Claims from Sovereigns	-	67,635	-	67,635
Claims from Banks	1,017,022	-	-	1,017,022
Claims on Corporate	-	-	12,546	12,546
Past due	3,605	-	-	3,605
Equity Portfolio	24	-	-	24
Other exposures	-	-	14,460	14,460
Total funded exposure	**1,020,651**	**67,635**	**27,006**	**1,115,292**
Unfunded exposures	**248,287**	**-**	**3,603**	**251,890**
Gross credit exposures	**1,268,938**	**67,635**	**30,609**	**1,367,182**

6.4 Exposure by external credit rating

The Bank uses external credit ratings from Standard & Poors, Moodys and Fitch ratings, which are accredited External Credit Assessment Institutions (ECAI's). The Bank assigns the risk weights through the mapping process provided by CBB to the rating grades. The Bank uses the highest risk weight associated, in case of two or more eligible ECAI's are chosen. The breakdown of the Bank's exposure into rated and unrated categories is as follows:

US$ '000	Funded exposure	Unfunded exposure	Rated-High standard grade exposure	Rated-Standard grade exposure	Unrated exposure
Claims on sovereigns	67,635	-	-	20,481	47,154
Claims on banks	1,017,022	248,288	130,084	343,282	791,944
Claims on corporate	12,546	3,602	5,011	-	11,138
Past Due	3,605	-	-	-	3,605
Equity portfolio	24	-	-	24	-
Other exposures	14,460	-	-	-	14,460
Total	**1,115,292**	**251,890**	**135,095**	**363,787**	**868,301**

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6. Risk Management (continued)

6.5 Maturity analysis of funded exposures

Residual contractual maturities of the Bank's exposures are as follows:

US$ '000	Within 1 month	1-3 months	3-12 months	Total within 1 year	1-10 years	10-20 years	Undated	Total
Claims on Sovereigns	1,439	-	213	1,652	23,898	42,085	-	67,635
Claims on Banks	524,890	245,284	236,862	1,007,036	6,986	3,000	-	1,017,022
Claims on Corporate	-	70	5	75	7,465	5,006	-	12,546
Past Due	-	-	3,605	3,605	-	-	-	3,605
Equity Portfolio	-	-	-	-	-	-	24	24
Other exposures	5	88	197	290	204	-	13,966	14,460
Total	**526,334**	**245,442**	**240,882**	**1,012,658**	**38,553**	**50,091**	**13,990**	**1,115,292**

6.6 Maturity analysis of unfunded exposures

US$ '000	Notional principal	Within 1 month	1-3 months	3-12 months	Total within 1 year	Over one year	Total
Claims on Banks-contingent items	251,890	19,323	91,066	138,705	249,094	2,796	251,890

Credit-related contingent items:

Credit related contingent items comprise letters of credit confirmations, acceptance and guarantees. For credit-related contingent items, the nominal value is converted to an exposure through the application of a credit conversion factor (CCF). The CCF applied is at 20% to convert off balance sheet notional amounts into an equivalent on balance sheet exposure.

6.7 Impairment of assets

The Bank makes an assessment at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, an impairment loss is recognized in the statement of comprehensive income.

Evidence of impairment may include indications that a borrower is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that the borrower will enter bankruptcy or other financial re-organisation and where, observable data indicates, that there is a measurable decrease in the estimated future cash flows such as changes in arrears or economic conditions that correlate with defaults.

The Bank provides sufficiently by specific provision for any impairment and additionally, makes a collective provision required by regulatory at 1% of the net loans portfolio.

Refer Disclosures made under 7.2 for details of Impaired loans and relative specific provision made during 2012.

6.8 Market Risk

Market risk is the risk of potential financial loss that may arise from adverse changes in the value of a financial instrument or portfolio of financial instruments due to movements in interest rates, foreign exchange rates and equity prices. This risk arises from asset - liability mismatches, changes that occur in the yield curve and foreign exchange rates. Given the Bank's low risk strategy, aggregate market risk levels are considered very low.

Interest rate risk on the Banking book arises from the possibility that changes in interest rates will affect the value of financial instruments. The Bank 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 Bank manages this risk by matching the repricing of assets and liabilities through basis point value approach, which measures changes in economic value resulting from changes in interest rates. The Bank's interest rate sensitivity position as of 31 December 2012 for a change in 200 basis points will result in an increase or decrease on statement of income by +/(-) US$ 56 thousand for US$ denominated and US$ 154 on Euro denominated financial instruments.

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31 December 2012

6. Risk Management (continued)

6.8 Market Risk (continued)

Currency risk arises from the movement of the rate of exchange over a period of time. The Banks currency risk is limited to Euro denominated assets and liabilities, as Bahrain Dinars and GCC Currencies (except Kuwaiti Dinars) are pegged to US Dollars. The Bank limits this risk by monitoring positions on a regular basis. Thus, the Banks exposure to currency risk is minimal and insignificant.

Liquidity risk is the risk that the Bank 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. During 2012, the Bank depended mainly on its own capital and assets were managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents and deposits with banks.

6.9 Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes or systems, or from external events. Operational risk is inherent in all business activities and can never be eliminated entirely, however shareholder value can be preserved and enhanced by managing, mitigating and, in some cases, insuring against operational risk. To achieve this goal, the Bank intends to make operational risk transparent throughout the enterprise, to which end processes are being developed to provide for regular reporting of relevant operational risk management information to senior management and the Board of Directors.

Operational functions of booking, recording and monitoring of transactions are carried by staff that are independent of the individuals initiating the transactions. Each business line including Operations, Information Technology, Human Resources, Compliance and Financial Control – is further responsible for employing the aforementioned framework processes and control programmes to manage its operational risk within the guidelines established by the Bank policy, and to develop internal procedures that comply with these policies.

6.10 Capital management:

Internal Capital Adequacy Assessment Process (ICAAP)

The Bank's capital management aims to maintain an optimum level of capital to enable it to pursue the Bank's corporate strategies whilst meeting regulatory ratio requirements.

Comprehensive assessment of economic capital, i.e., credit, market and operational risks and processes relating to other risks such as liquidity, is made, reviewed and monitored regularly. The Bank's capital adequacy ratio of 50.11% is well above the regulatory requirement and provides a healthy cushion against any stress conditions.

Supervisory Review and Evaluation Process (SREP):

Central Bank of Bahrain (CBB) is the regulator for the Bank and sets the minimum capital requirement. CBB requires the Bank to maintain a 12% minimum ratio of total capital to risk weighted assets, taking into account both on balance sheet and off balance sheet exposures. The Bank maintains a strong and healthy capital adequacy ratio.

7 Other Disclosures

7.1 Related Party transactions

Related party represents major shareholders, directors, key management personnel and entities significantly influenced by such parties. Pricing policies are at arm's length and approved by executive management and Board of Directors.

	31 December 2012 US$ '000
Exposures to related parties:	102,755
Liabilities to related parties:	
Connected deposits	249,673

For further detail refer note 21 of the annual audited financial statements for the year ended 31 December 2012.

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7 Other Disclosures (continued)

7.2 Impaired loans and relative provision:

	31 December 2012 US$ '000
Gross impaired loans	6,451
Less: Specific provision	(2,846)
Net impaired loans	**3,605**
Less: Collective provision	(3,200)
Net Impaired loans after collective provision	**405**

Movement in impairment provision:

US$ '000	Specific	Collective	Total
Opening Provision	3,500	1,245	4,745
Charge for the year	367	1,955	2,322
Closing Specific Provision	**3,867**	**3,200**	**7,067**

The impaired loans and provisions against it relates to commercial and business loans in Middle east and Other GCC Country. The collaterals consist of securities and properties which are managed by the syndicated agent and valued on an annual basis.

Past due loans are impaired and are past due for a period more than 60 days to three years.

For policies and processes for collateral valuation refer note 19.2 of the annual audited financial statements for the year ended 31 December 2012.

Table of Past due and impaired loans, age analysis and by counterparty type and geographical area:

US$'000s	Other GCC Countries <= 3 years	Middle east & North africa More than 60 days	Total
Claims on corporate	2,479	-	2,479
Claims on Banks	-	3,972	3,972
Total	**2,479**	**3,972**	**6,451**
Less: Specific Provision	**(2,479)**	**(367)**	**(2,846)**
Net Impaired loans	**-**	**3,605**	**3,605**
Less: Collective Provision	**-**	**(3,200)**	**(3,200)**
Net impaired loans after collective provision	**-**	**405**	**405**

7.3 Restructured facilities: None during the year.

7.4 Assets sold under recourse agreements: The Bank did not enter into any recourse agreements during the year ended 31 December 2012.

7.5 Equity positions in the banking book:

	31 December 2012 US$ '000
Equity	24

The Bank's exposure to equity price risk is insignificant.

Corporate Directory

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