ALUBAF Arab International Bank B.S.C. (c)

FINANCIAL STATEMENTS

31 DECEMBER 2012

ERNST & YOUNG

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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.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ALUBAF ARAB INTERNATIONAL BANK B.S.C. (c) (continued)

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

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. Salieman 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

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

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.

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.

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.

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-amoritsed 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.

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.

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.

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.

2 ACCOUNTING POLICIES (continued)

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

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.

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).

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

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.

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

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

12 SHARE CAPITAL (continued)

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	*2011*
	US$ '000	*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	*2011*
	US$ '000	*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

16 FEE AND COMMISSION INCOME

	2012	*2011*
	US$ '000	*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

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.

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.

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

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

ASSETS	*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*
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

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 RISK MANAGEMENT (continued)

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.

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	*2011*
	US$ '000	*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	*2011*
		US$ '000	*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.

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**	**-**

19 RISK MANAGEMENT (continued)

19.4 Liquidity risk (continued)

At 31 December 2011	*Up to 1 year*						
	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	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	-

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	***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***
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	*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*
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

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

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	*2011*
	US$ '000	*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	*2011*
	US$ 000	*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.

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	*2011*
	US$ 000	*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)