2012
ANNUAL REPORT

WISDOM OF EXPERIENCE – ENERGY OF YOUTH

NBB

PROFILE

Established in 1957 as Bahrain's first locally owned Bank, NBB has grown steadily to become the country's leading provider of retail and commercial banking services.

With a major share of the total domestic commercial banking market and the largest network of 25 branches and 59 ATMs, the Bank plays a key role in the local economy.

At the same time, the Bank continues to diversify and develop capabilities to capture business opportunities in the Gulf region and international markets. Our branches in Abu Dhabi and Riyadh lead the way in this initiative.

Publicly listed on the Bahrain Bourse, the Bank is owned 51% by private shareholders, mainly Bahrainis, and 49% by Bahrain Mumtalakat Holding Company, which is 100% owned by the Government of the Kingdom of Bahrain.

Market driven and customer led, the Bank harnesses the latest technology to people skills, enabling its 561 employees to deliver highly professional services for retail and corporate customers.

His Royal Highness
Prince Khalifa bin Salman
Al Khalifa
Prime Minister

His Royal Majesty
King Hamad bin Isa
Al Khalifa
King of The Kingdom of Bahrain

His Royal Highness
Prince Salman bin Hamad
Al Khalifa
The Crown Prince, Deputy
Supreme Commander

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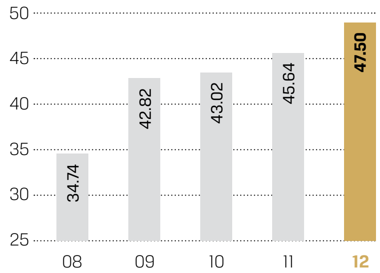
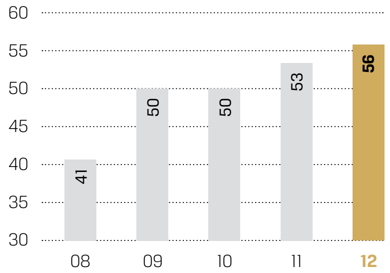
FINANCIAL SUMMARY

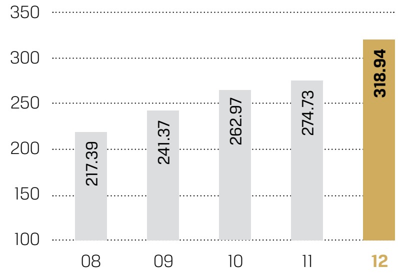
	2012	2011	2010	2009	2008
Earnings (BD millions)					
Net interest income	**61.92**	55.37	48.70	49.02	46.06
Other income	**24.69**	24.55	23.18	23.26	16.60
Operating expenses	**27.34**	26.61	25.83	25.78	24.01
Net income	**47.50**	45.64	43.02	42.82	34.74
Cash Dividend	**21.39**	25.66	23.33	27.22	23.33
Financial Positions (BD millions)					
Total assets	**2,654.56**	2,388.65	2,274.05	2,117.75	2,034.10
Loans and advances	**888.25**	972.07	950.80	1,151.42	1,095.71
Investment securities	**757.83**	650.21	656.22	483.12	399.18
Earning Assets	**2,512.78**	2,259.50	2,151.00	2,007.20	1,922.30
Total deposits	**2,321.85**	2,103.10	2,000.30	1,865.79	1,805.03
Customers' deposits	**2,077.90**	1,905.49	1,768.47	1,480.39	1,519.25
Shareholders' equity	**318.94**	274.73	262.97	241.37	217.39
Key Performance Indicators					
Earnings					
Return on average equity	**16.00%**	16.98%	17.06%	18.67%	14.88%
Return on average assets	**1.88%**	1.96%	1.96%	2.06%	1.76%
Earnings per share (fils)	**56**	53	50	50	41
Cost-to-income ratio	**31.57%**	33.30%	35.93%	35.67%	38.32%
Earnings per employee (BD 000's)	**85**	80	74	72	59
Capital					
Shareholders' equity as per cent of total assets	**12.01%**	11.50%	11.56%	11.40%	10.69%
Total liabilities to shareholders' equity (times)	**7.32**	6.61	6.91	7.53	8.36
Average total liabilities to average equity (times)	**6.99**	6.76	7.20	7.92	7.43
Capital adequacy (Basel II)	**27.86%**	25.05%	22.85%	22.30%	19.30%



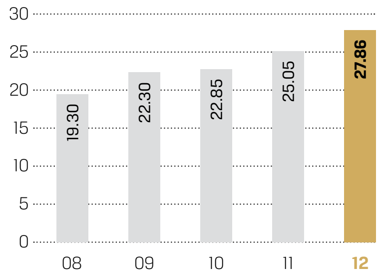
PROFIT FOR THE YEAR
BD Millions



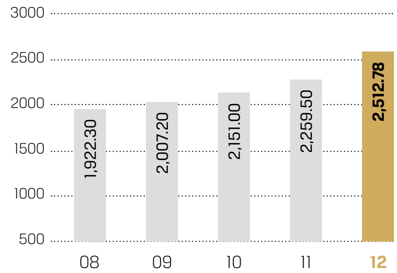
EARNINGS PER SHARE
Bahraini Fils



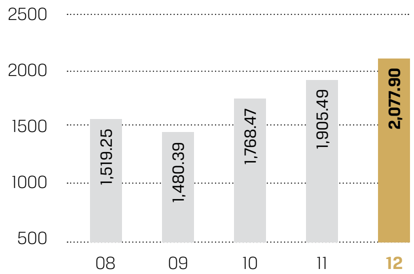
EQUITY
BD Millions



CAPITAL ADEQUACY
Per cent



EARNINGS ASSETS
BD Millions

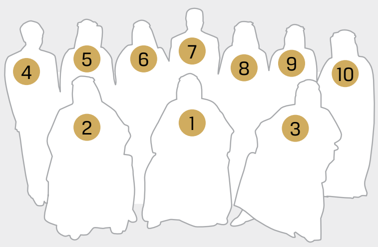


CUSTOMERS' DEPOSITS
BD Millions

RATINGS				
		FOREIGN CURRENCY		
Moody's	FSR	Long Term	Short Term	
	C-	**Baa1**	**P2**	
FITCH	Viability Rating	Long Term	Short Term	Support
	bbb	**BBB**	**F3**	**2**
Capital Intelligence	Financial Strength	Long Term	Short Term	Support
	A	**BBB+**	**A2**	**1**

WITH YOU EVERY STEP OF THE WAY...

BOARD OF DIRECTORS



1. **FAROUK YOUSUF KHALIL ALMOAYYED**
   Chairman

2. **Dr. ESSAM ABDULLA FAKHRO**
   Deputy Chairman

3. **ABDULLA YOUSIF AKBAR ALIREZA**
   Deputy Chairman

4. **ABDUL RAZAK ABDULLA HASSAN AL QASSIM**
   Director

5. **KHALID YOUSIF ABDUL RAHMAN**
   Director

6. **FAWZI AHMED KANOO**
   Director

7. **ALI HUSSAIN YATEEM**
   Director

8. **MOHAMMED MUBARAK AL SULAITI**
   Director

9. **Dr. ABDULLA AHMED MANSOOR RADHI**
   Director

10. **HUSSAIN SULTAN AL GHANEM**
    Director

FAROUK YOUSUF KHALIL ALMOAYYED
Chairman
Non-independent and Non-executive
Appointed to the Board in 1997
Member of Nomination & Remuneration Committee

Chairman: Y. K. Al Moayyed & Sons; Al Moayyed International Group; Ashrafs; Bahrain Duty Free; Gulf Hotel Group; Ahlia University; National Finance House; Board of Trustees of Ibn Khuldoon School
Director: Investcorp Bank B.S.C., Bahrain Insurance Holding Company

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DR. ESSAM ABDULLA FAKHRO
Deputy Chairman
Non-independent and Non-executive
Appointed to the Board in 2008
Chairman: Executive Committee

Chairman: Bahrain Chamber of Commerce & Industry; Bahrain Cinema Company
President: Federation of GCC Chamber of Commerce
Director: Economic Development Board; Bahrain Mumtalakat Holding Company BSC (c); Bahrain Bourse

ABDULLA YOUSIF AKBAR ALIREZA
Deputy Chairman
Independent and Non-executive
Appointed to the Board in 1984
Chairman: Nomination & Remuneration Committee; Audit Committee

Chairman: Yousuf Akbar Alireza and Sons
Director: Bahrain Ship Repair and Engineering Company Co BSC.

ALI HUSSAIN YATEEM
Director
Independent and Non-executive
Appointed to the Board in 1985
Member of Executive Committee
Member of Nomination & Remuneration Committee

Vice Chairman: Ali & Mohamed Yateem Group of Companies W.L.L.

MOHAMMED MUBARAK AL SULAITI
Director
Non-independent and Non-executive
Appointed to the Board in 1993
Member of Executive Committee

Chief Executive Officer for the Future Generation Reserve

DR. ABDULLA AHMED MANSOOR RADHI
Director
Non-independent and Non-executive
Appointed to the Board in 1993

Vice Chairman: Bahrain Flour Mills Company

KHALID YOUSIF ABDUL RAHMAN
Director
Independent and Non-executive
Appointed to the Board in 2001
Deputy Chairman: Audit Committee

Chairman: Food Supply Company
Deputy Chairman: Awal Dairy Company
Director and Member of the Executive Committee: Bahrain Ship Repair and Engineering Company
Director: Bahrain Saudi Transport Company

HUSSAIN SULTAN AL GHANEM
Director
Non-independent and Non-executive
Appointed to the Board in 2004
Member of Audit Committee

Undersecretary, Human Resources; Prime Minister's Court

ABDUL RAZAK ABDULLA HASSAN AL QASSIM
Director
Non-independent and Executive
Appointed to the Board in 2009
Member of the Executive Committee

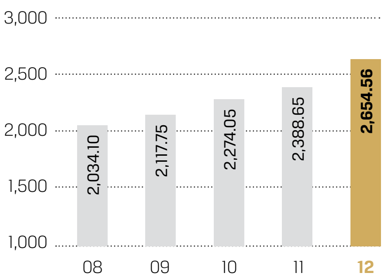
Chairman: Benefit Company; Board of Trustee of Ahlia University
Deputy Chairman of Oasis Capital Bank B.S.C
Member of Nomination & Compensation Committee of Oasis Capital Bank B.S.C
Deputy Chairman and Chairman of Executive Committee of the Arab Academy for Education and Research
Board Member and Chairman of Executive Committee of Bahrain Telecommunication Company
Board Member of Umniah

FAWZI AHMED KANOO
Director
Independent and Non-executive
Appointed to the Board in 2010
Member of Executive Committee
Member of Audit Committee

Chairman: Abdulrahman Jassim Kanoo Co WLL
Deputy Chairman: Yusuf Bin Ahmed Kanoo Group, Bahrain
Director: Bahrain Hotels Company, Aluminum Bahrain (Alba)
Executive Director: Bahrain Ship Repairing & Engineering Co BSC.

BOARD OF DIRECTORS' REPORT

FAROUK YOUSUF KHALIL ALMOAYYED
Chairman



TOTAL ASSETS
BD Millions

GENERAL OPERATING ENVIRONMENT

2012 has been a year of weak economic growth for the global economy with the sovereign debt crisis in Europe and policy uncertainties in the U.S impacting investment and business sentiment. The slowing of global economy and unresolved domestic fiscal policy issues impacted growth in the U.S, although some encouraging trends have emerged towards the later part of the year with resurgence in the housing sector, decline in unemployment rates and the likely resolution of the fiscal cliff. Euro Zone on the other hand has slipped into recession and efforts are focused on containing the sovereign debt crisis with bailout packages and austerity measures. Growth in developing countries has also slowed down significantly due to lower demand in advanced economies and policy tightening initiatives in earlier years.

The GCC economies, though not immune to the effects of the global slowdown, have performed reasonably well in comparison as a result of government sponsored infrastructure projects, taking advantage of the significant government revenue and sovereign wealth funds.

Bahrain's economy has seen favorable trends emerging based on the data available for the first two quarters of 2012, which points to a broad based recovery. Most sectors have experienced a clear rebound since last year, including mainstays such as construction, manufacturing and hotels and restaurants. The Economic Development Board forecasts a GDP growth of 2.4per cent for the year 2012 driven by increased manufacturing and government spending.

OVERALL PERFORMANCE

2012 has been another successful year for the Bank with a Net Profit of BD 47.50 million (US$ 126.33 million), an increase of 4.1 per cent over 2011. Strong growth in revenue and careful expense management resulted in an Operating Profit before Provisions of BD 59.27 million (US$ 157.63 million) for 2012, an increase of 11.2 per cent over the previous year. These results are a testimony to the resilience of the Bank's business model which focuses on strong domestic growth while selectively seeking new business opportunities in the region. Return on Equity at 16.00 per cent and Return on Assets at 1.88 per cent remains strong by regional and international standards. The Bank remains well capitalized with strong liquidity and a well diversified asset portfolio.

Customer deposits at BD 2,077.90 million (US$ 5,526.34 million) showed a growth of 9.0 percent reflecting the continued success of our deposit mobilisation initiatives. Total Earning Assets increased from BD 2,259.50 million (US$ 6,009.31 million) at the end of 2011 to BD 2,512.78 million (US$ 6,682.93 million) at the end of 2012, as the Bank cautiously added new loans that met with our well established risk reward criteria while the surplus funds were invested in bonds and money market. Capital Adequacy continues to remain at a healthy level of 27.9 percent.

NBB has been an integral part of the growth of the Kingdom of Bahrain and has played a strategic role in the development of the nation. In meeting with this objective, the Bank took several initiatives during the year. The focus of the Domestic Banking group was to further enhance product and service offerings besides strengthening customer relationships and expanding distribution network. Regionally, the Bank's strategy of selective expansion is progressing as planned with the branches at Abu Dhabi and Riyadh achieving increased level of business and profitability. Treasury's concentration during the year was on efficient deployment of the Bank's liquidity besides participating in several domestic and regional issues.

The prospects for 2013 appear promising although there are significant challenges

The Board of Directors of National Bank of Bahrain takes pleasure in presenting the 56th Annual Report of the Bank together with the financial statements for the year ended 31 December 2012.

facing the global economy. We hope the authorities in developed countries continue their relentless efforts to overcome the hurdles facing their economy which will have significant impact on the growth prospects for the region. NBB's business strategy places us in a comfortable position to capitalize on new business opportunities as they emerge and increase our market presence in the domestic economy besides seeking selective opportunities in the region. We remain fully committed to participate in the development of the nation besides meeting the expectations of our customers.

Details of the Bank's financial position and performance are elaborated in the Financial Review section and the Financial Statements.

RECOMMENDED APPROPRIATIONS

Based on the results, the Board of Directors has recommended for approval by the shareholders the following appropriations:

	Bahraini Dinars
Adjusted retained earnings as at 1 January 2012	87,462,627
2011 appropriations	(27,942,599)
2012 Net income	47,499,235
Total	**107,019,263**
Cash Dividend (25%)	21,384,000
Donations and contributions	2,374,962
General Reserve	12,830,400
Retained earnings carried forward after 2012 appropriations	70,429,901
Total	**107,019,263**

The Board has also proposed to the shareholders a bonus share issue of BD 8.55 million at the rate of one additional share for every ten shares held (10%). Consequently, the issued and fully paid share capital of the Bank is proposed to be increased to BD 94.09 million from BD 85.54 million. The shares will rank pari passu with all other shares for future dividends and distribution. The bonus share issue is proposed to be made through utilisation of BD 8.55 million from General Reserve.

The Board has further proposed for approval by the shareholders, the transfer of BD 4.28 million from the General Reserve to the Statutory Reserve.

DONATIONS AND CONTRIBUTIONS

The Board is recommending the allocation of BD 2.37 million to the Donations and Contributions programme, representing 5 per cent of 2012 profits available for distribution. The cumulative allocation under the programme, since its inception in 1980, is now BD 31.77 million.

Details of the Bank's Donations & Contribution programme are contained in the Corporate Social Responsibility section of the Annual Report.

CORPORATE GOVERNANCE

The Board recognizes that good governance is a vital ingredient in the success of any organization and is fully committed to protect the interest of all its stakeholders. The Bank is in compliance with the requirements of the Code of Corporate Governance issued by the Ministry of Industry and Commerce and the CBB's Rulebook. A detailed report on the Bank's compliance with the Corporate Governance Code is elaborated in the Corporate Governance Report section of the Annual Report.

ACKNOWLEDGEMENTS

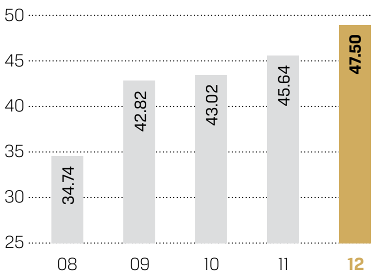
The Directors, on behalf of the shareholders, take this opportunity to express their gratitude and sincere appreciation to His Majesty King Hamad bin Isa Al Khalifa - the King of Bahrain, His Royal Highness Shaikh Khalifa bin Salman Al Khalifa - the Prime Minister, His Royal Highness Shaikh Salman bin Hamad Al Khalifa - the Crown Prince and Deputy Supreme Commander, Government ministries and institutions-especially the Ministry of Finance and the Central Bank of Bahrain, for their guidance, kind consideration and support.

The Directors also extend their thanks and appreciation to the staff of the Bank whose dedicated service and commitment has played a vital role in the achievements of the Bank over the years and to all our valued customers and friends for their continuous support and the confidence reposed by them in the National Bank of Bahrain.

FAROUK YOUSUF KHALIL ALMOAYYED
Chairman
21 January 2013

STATEMENT OF THE CHIEF EXECUTIVE OFFICER

ABDUL RAZAK ABDULLA HASSAN AL QASSIM
Chief Executive Officer & Director



PROFIT FOR THE YEAR
BD Millions

National Bank of Bahrain achieved record performance for the year 2012 resulting from the Bank's strategic focus of further consolidating its dominant position in the domestic market while selectively seeking new business opportunities in the region. Key performance indicators showed steady progress as the Bank continues to enhance products and services offering to its customers.

Global economic recovery was slower than anticipated due to the sovereign debt crisis in Europe and domestic fiscal policy issues in the United States. In comparison, the GCC economies did well although growth was impacted by the global slowdown. Bahrain economy showed tentative signs of improvement while growth remains modest compared to other GCC economies.

The Bank maintained its growth momentum during the year with a strong increase in business volumes and operating revenue while maintaining strict control on operating costs. Net Profit for the year reached to a record level of BD 47.50 million (US$ 126.33 million) for the year compared to BD 45.64 million (US$ 121.38 million) for 2011, an increase of 4.1 per cent.

Net Interest Income for the year was BD 61.92 million, (US$ 164.68 million) an increase of 11.8 percent over the previous year and Other Income at BD 24.69 million (US$ 65.66 million) reflected an increase of 0.6 per cent over the previous year. The impetus during the year was to selectively expand the loan book while efficiently deploy surplus liquidity in other earning assets both domestically and in the region. While revenue showed strong growth, we continue to maintain strict vigil on operating expenses with several cost rationalization measures, thereby reducing the cost to income ratio from 33.30 percent in 2011 to 31.57 percent in 2012.

The Bank's business model is built on sound and prudent business practices with a well balanced asset profile. The Total Balance Sheet of the Bank increased by 11.1 percent to BD 2,654.56 million (US$ 7,060.00 million) as at 31st December 2012. Total Earning Assets stood at BD 2,512.78 million (US$ 6,682.93 million) in a well diversified portfolio of loans, investments, Treasury Bills and Bank placements. Liquidity position remains comfortable with Liquid Assets (Cash and balances with central banks, Treasury Bills and Placements) representing 36.6 percent of Total Assets.

NBB's strategic plan and balance sheet is well positioned to capitalize on opportunities to achieve stronger growth in the coming years.

Significant progress was achieved in implementing the medium term strategic plan of the Bank. Several initiatives were undertaken during the year both domestically and at the overseas branches to meet the objectives of the strategic plan.

Personal Banking maintained its leadership position in the domestic market. This was done through expansion of the distribution network, renovation of the branch network, introduction / repackaging of several retail banking products in line with the changing preferences of customers. The Bank is well positioned to leverage on the largest network of branches and other delivery channels to target new business opportunities and cross-sell products to existing customers.

Business Banking focused on relationship management and kept close contact with customers which resulted in tailor made solutions being offered to individual customers to meet their specific requirements in a difficult year. The Division also acquired new customers and increased exposures to existing customers who meet the Bank's stringent risk parameters. On the liabilities side, the division was successful in attracting new deposits by leveraging on the Bank's image as a safe and sound financial institution in the Kingdom of Bahrain.

One of the key objectives of the strategic plan is to selectively expand the Bank's regional presence. In Abu Dhabi, the focus is on developing bilateral relationship with strong local corporates. The Bank's organisation structure was further strengthened during the year with the appointment of a new Country Manager. In Riyadh, the focus during the year was on increasing the Loan portfolio and non funded business. Both the overseas branches showed healthy improvement in their underlying profitability during 2012. In line with our medium term strategic plan, we will strengthen our attention on further developing business in these two largest economies in the GCC.

The Treasury and Investments Group's priority during the year was to efficiently deploy the surplus funds while maintaining a tight focus on liquidity. The Division participated in several domestic and regional debt issues thereby successfully deploying the surplus liquidity at the same time improving the overall yield and maintaining a well diversified asset portfolio. The Division was also successful in generating increased revenue through gapping activities in GCC / international currencies and higher FX business.

Bahrain government is committed to improving the well being of its citizens and is taking several initiatives to stimulate domestic growth. We are optimistic about the growth prospects that these initiatives will offer for the financial services industry. NBB's strategic plan and balance sheet is well positioned to capitalize on these opportunities to achieve stronger growth in the coming years. We will leverage on the largest network of branches, ATMs and other delivery channels in the Kingdom of Bahrain to cross sell our products and services to our valued customers both in the retail and corporate segments. Over the years we have built a strong reputation as a sound and safe institution following a path of prudent growth. This together with the well established business franchise, strong capital base and adequate liquidity will enable us to achieve our strategic business priorities as we emerge from what has been a difficult and challenging period.

ABDUL RAZAK ABDULLA HASSAN AL QASSIM
Chief Executive Officer & Director

CORPORATE GOVERNANCE

Maintaining the best standards of corporate governance has provided the Bank's customers, counterparties, shareholders, regulators, employees and rating agencies with a high degree of confidence in our institution

The Board of Directors is responsible for the overall governance of National Bank of Bahrain. The Board ensures that high ethical standards are established across the Bank and regularly reviews the Bank's compliance with Central Bank of Bahrain (CBB) regulations regarding corporate governance. The Board recognizes that good corporate governance is a vital ingredient in the creation of sustainable shareholder value and protecting the interests of all stakeholders.

Maintaining the best standards of corporate governance has provided the Bank's customers, counterparties, shareholders, regulators, employees and rating agencies with a high degree of confidence in our institution; achieved an appropriate balance between long-term growth and short-term objectives; created a sound portfolio of assets, a stable customer base, income diversity as well as the ability and resources to face economic cycles and uncertainties. The Board has set the moral tone for the Bank with a high degree of intolerance for any instances of malpractice, fraud and unethical behaviour and ensured the highest degree of adherence to laws, rules and regulations.

BOARD OF DIRECTORS

The Board comprises of ten members and its composition is governed by the Bank's Memorandum and Articles of Association. Four members of the Board of Directors are appointed by Bahrain Mumtalakat Holding Company, which holds 49% of the Bank's share capital. The remaining six members of the Board of Directors are elected by secret ballot at the ordinary general meeting of the shareholders, by a simple majority of valid votes. The six members of the Board of Directors elected by the shareholders remain in office for a term not exceeding three years, which may be renewed. In order to be eligible for being nominated for directorship, the individuals concerned should meet the 'fit and proper' criteria established by the Central Bank of Bahrain and their appointment is subject to prior approval by the Central Bank of Bahrain. The present Board of Directors was elected at the Annual General Meeting in 2012 and their term expires at the Annual General Meeting to be held in 2015.

On joining NBB's Board, all Directors are provided with a "Directors Kit" which covers key issues like the Bank's strategy, brief overview of the Bank and its business profile, key policies, terms of reference of the Board and its sub-committees and Corporate Governance guidelines. Induction sessions are also held with the Chairman and Chief Executive Officer which focuses on business profile, opportunities, challenges and risks faced by the Bank

In accordance with the definitions stipulated by the CBB, Directors are categorised as executive, non-executive, independent and non-independent. The Board currently comprises of nine non-executive Directors, out of which four are independent, and one executive director who is designated as the Chief Executive Officer and Director. The roles of the Chairman and the Chief Executive Officer are separate and exercised by different persons.

The Board's primary responsibility is to deliver sustainable value to all stakeholders by charting the strategic direction of the Bank as well as setting the risk appetite and the overall capital structure of the Bank. The Board is also responsible for monitoring Management's running of the business within the agreed framework. The Board seeks to ensure that

the Management strikes an appropriate balance between long-term growth and short-term objectives. The Board is ultimately accountable and responsible for the affairs and performance of the Bank. Accordingly, the main functions of the Board are:

- Maintain an appropriate Board Structure.
- Maintain an appropriate management and organization structure in line with the Bank's business requirements.
- Plan the strategic future of the Bank, approve annual business plans, approve and monitor major initiatives.
- Monitor the operations framework of the Bank and the integrity of internal controls.
- Ensure compliance with laws and regulations.
- Monitor the Bank's performance and approve financial results, ensure transparency and integrity in stakeholders reporting including financial statements.
- Evaluate periodically the Board's own performance including that of Board sub-committees.
- Assure equitable treatment of all shareholders including minority shareholders.

The Chairman is mainly responsible for the leadership of the Board, ensuring that it operates effectively and fully discharges its legal and regulatory responsibilities.

The Board of Directors meets regularly throughout the year and maintains full and effective control over strategic, financial, operational, internal control and compliance issues. As per its terms of reference, the Board shall meet at least once every calendar quarter.

In its role as the primary governing body, the Board of Directors provides oversight for the Bank's affairs and constantly strives to improve and build on the Bank's strong corporate governance practices. The business performance of the Bank is reported regularly to the Board of Directors. Performance trends as well as performance against budget and prior periods are closely monitored. Financial information is prepared using appropriate accounting policies, in accordance with International Financial Reporting Standards as promulgated by the International Accounting Standards Board and are consistently applied. Operational procedures and controls have been established to facilitate complete, accurate and timely processing of transactions and the safeguarding of assets.

The Board of Directors has unlimited authority within the overall regulatory framework. The Board has delegated approval authorities to its sub-committees and members of Management; all transactions falling outside the delegated limits are referred to the Board for approval. In addition, the Board approves on a yearly basis the annual budget, risk strategy and operating limits for various activities of the Bank.

COMMITTEE OF THE BOARD OF DIRECTORS

The Board has set up several sub-committees which provide effective support to the full Board in carrying out its responsibilities. These include the Executive Committee, the Audit Committee and the Nomination & Remuneration Committee.

EXECUTIVE COMMITTEE

The Executive Committee comprises of not more than five Board members selected and appointed by the Board, with at least two of the members being independent directors. The Committee shall meet at least four times a year. The role of the Committee is to assist the Board of Directors in fulfilling its responsibilities with regard to lending, investment, as well as any other matters not delegated to a specific Board Committee. Accordingly, the Committee is empowered to approve specific credit and investment proposals, review budgets, plans, major initiatives for eventual submission to the Board for approval, and to monitor the Bank's performance against business plan objectives.

AUDIT COMMITTEE

The Audit Committee comprises of four Board members selected and appointed by the Board, three of which are independent directors. The Committee shall meet at least four times a year. The primary function of the Committee is to reinforce the internal and external audit process and assist the Board of Directors in fulfilling its responsibility in ensuring an effective system of internal control and risk management. In addition, the Committee is also responsible for reviewing and recommending changes to the Bank's corporate governance policy framework based on regulatory requirements or industry best practices. The Audit Committee is responsible for overseeing the selection of the external auditors for appointment and approval at the shareholders' meeting, reviewing the integrity of the Bank's financial reporting, reviewing the activities and performance of internal audit function and reviewing compliance with relevant laws, regulations and code of conduct.

The Audit Committee is supported by the Internal Audit Department, which regularly monitors the system of internal controls. Monitoring includes an assessment of the risks and controls in each operating unit and matters arising there from are reported to the Audit Committee on a regular basis.

CORPORATE GOVERNANCE

NOMINATION & REMUNERATION COMMITTEE

The Nomination & Remuneration Committee comprises of three Board members selected and appointed by the Board, two of which are independent directors. The Committee shall meet at least twice a year. The role of the Committee is to assist the Board in fulfilling its responsibilities with regard to the nomination and remuneration policy of the Bank. The Nomination & Remuneration Committee has the mandate for identifying persons qualified to become members of the Board, CEO, CFO, corporate secretary, and any other officers as considered appropriate by the Board and recommending them to the Board. The Committee also has the responsibility of reviewing and recommending the remuneration policies for the board of directors and senior management.

BOARD MEETINGS AND ATTENDANCE

The Board of Directors and the sub-committees of the Board meet regularly to effectively discharge their responsibilities. For meeting the requirements of the Corporate Governance Code and the CBB Rulebook, the Bank considers attendance of Directors at Board and sub-committee meetings. A summary of the Board meetings and sub-committee meetings held during the year 2012 and attendance are detailed below:

Name of Director	Board		Executive Committee		Audit Committee		N & RC		Total		
	Total No. of meetings	Meetings Attended	Total No. of meetings	Meetings Attended	Total No. of meetings	Meetings Attended	Total No. of meetings	Meetings Attended	Total No. of meetings	Meetings Attended	% of Meetings attended
Farouk Yousuf Khalil Almoayyed Chairman	7	7					2	2	9	9	100.0%
Dr. Essam Abdulla Fakhro Deputy Chairman	7	7	3	3					10	10	100.0%
Abdulla Yousif Akbar Alireza Deputy Chairman	7	7			4	4	2	2	13	13	100.0%
Ali Hussain Yateem Director	7	7	3	3			2	2	12	12	100.0%
Mohammed Mubarak Al Sulaiti Director	7	6	3	3					10	9	90.0%
Dr. Abdulla Ahmed Mansoor Radhi Director	7	6			1	1			8	7	87.5%
Khalid Yousif Abdul Rahman Director	7	7			4	4			11	11	100.0%
Hussain Sultan Al Ghanem Director	7	7			4	4			11	11	100.0%
Abdul Razak Abdulla Hassan Al Qassim Chief Executive Officer & Director	7	7	3	3					10	10	100.0%
Fawzi Ahmed Kanoo Director	7	7	3	3	3	3			13	13	100.0%

Includes attendance through conference calls

Abdulla Ahmed Mansoor Radhi left the audit committee starting from the second meeting (i.e.19.4.2012) and Fawzi Ahmed Kanoo joined the audit committee starting from second meeting (i.e.19.4.2012)

The Board's primary responsibility is to deliver sustainable value to all stakeholders by charting the strategic direction of the Bank as well as setting the risk appetite and the overall capital structure of the Bank.

DATES OF MEETINGS AND ATTENDANCE DETAILS:
Board Meeting: Total number of meetings held: 7

Members	Meeting Dates						
	22/1/2012	7/3/2012	19/04/2012	23/05/2012	11/7/2012	10/10/2012	21/11/2012
Farouk Yousuf Khalil Almoayyed, Chairman	✓	✓	✓	✓	✓	✓	✓
Dr. Essam Abdulla Fakhro, Deputy Chairman	✓	✓	✓	✓	✓	✓	✓
Abdulla Yousif Akbar Alireza, Deputy Chairman	✓	✓	✓	✓	✓	✓	✓
Ali Hussain Yateem, Director	✓	✓	✓	✓	✓	✓	✓
Mohammed Mubarak Al Sulaiti, Director	✓		✓	✓	✓	✓	✓
Dr. Abdulla Ahmed Mansoor Radhi, Director	✓	✓	✓	✓	✓		✓
Khalid Yousif Abdul Rahman, Director	✓	✓	✓	✓	✓	✓	✓
Hussain Sultan Al Ghanem, Director	✓	✓	✓	✓	✓	✓	✓
Abdul Razak Abdulla Hassan Al Qassim Chief Executive Officer & Director	✓	✓	✓	✓	✓	✓	✓
Fawzi Ahmed Kanoo, Director	✓	✓	✓	✓	✓	✓	✓

Includes attendance through conference calls

Executive Committee Meetings: Total number of meetings held: 3
(the 4th meeting of the Executive Committee was upgraded to a full Board meeting and held on May 23, 2012).

Members	Meeting Dates		
	21/3/2012	25/09/2012	19/11/2012
Dr. Essam Abdulla Fakhro, Deputy Chairman & Chairman of Executive Committee	✓	✓	✓
Ali Hussain Yateem, Director	✓	✓	✓
Mohammed Mubarak Al Sulaiti, Director	✓	✓	✓
Abdul Razak Abdulla Hassan Al Qassim, Chief Executive Officer & Director	✓	✓	✓
Fawzi Ahmed Kanoo, Director	✓	✓	✓

Includes attendance through conference calls

CORPORATE GOVERNANCE

Audit Committee Meetings: Total number of meetings held: 4

Members	Meeting Dates			
	19/1/2012	19/4/2012	11/07/2012	10/10/2012
Abdulla Yousif Akbar Alireza, Deputy Chairman & Chairman of Audit Committee	✓	✓	✓	✓
Dr. Abdulla Ahmed Mansoor Radhi, Director	✓			
Khalid Yousif Abdul Rahman, Director & Deputy Chairman of Audit Committee	✓	✓	✓	✓
Hussain Sultan Al Ghanem, Director	✓	✓	✓	✓
Fawzi Ahmed Kanoo, Director		✓	✓	✓

Includes attendance through conference calls

Abdulla Ahmed Mansoor Radhi left the audit committee starting from the second meeting (i.e.19.4.2012) and Fawzi Ahmed Kanoo joined the audit committee starting from second meeting (i.e.19.4.2012)

Nomination & Remuneration Committee Meetings: Total number of meetings held: 2

	Meeting Date	Meeting Date
	10/10/2012	21/11/2012
Abdulla Yousif Akbar Alireza, Deputy Chairman & Chairman of N&R Committee	✓	✓
Farouk Yousuf Khalil Almoayyed, Chairman	✓	✓
Ali Hussain Yateem, Director	✓	✓

Includes attendance through conference calls

MANAGEMENT STRUCTURE

The Board has established a management structure that clearly defines roles, responsibilities and reporting lines, the details of which are annexed to this report.

Within the management structure there are separate committees responsible for Business Review, Development and Planning; Credit; Asset/Liability Management; Human Resources; Operational Risk Management and Business Continuity Planning. These committees, comprising of members of the senior management, meet on a regular basis to discuss and decide on the various strategic and tactical issues within their respective areas.

NBB restructured the organization during the year in order to implement best practices with respect to the Bank's internal systems and controls. The Compliance Officer reports directly to the CEO and continues to have direct access to the Board of Directors through the Audit Committee. The "Management Internal Control" (MIC) department has been renamed as "Internal Audit" department in order to better reflect the roles & responsibilities carried out by the department. The Corporate Secretary has direct access to the Board of Directors as per the requirements of Corporate Governance. In order to further strengthen the role of anti money laundering, the AML function has been brought under the direct supervision of General Manager – Risk Group.

In addition to the above, the Commercial Banking Department and Corporate Banking Department have now been brought under the umbrella of Business Banking Division, in order to create essential strategic focus on the activities performed by these departments and to leverage synergies between the two. This newly created division will strive to grow the Bank's business in these strategically important market segments.

PERFORMANCE EVALUATION OF BOARD AND SUB-COMMITTEES

The Board of Directors has conducted a self evaluation of the performance of the Board and its sub-committees for the year 2012. This was carried out through the completion of a structured questionnaire on the effectiveness and contribution of each member against certain pre-defined criteria as per the mandate of the Board and each Board sub-committee. The Nomination and Remuneration Committee is responsible for overseeing the process and the findings were presented to the Board of Directors in Jan 2013 which confirms that NBB's Board and its sub-committees continue to operate with a high level of effectiveness.

RELATED PARTY TRANSACTIONS AND CONFLICT OF INTEREST

Directors have a duty under CBB regulations as well as the Bank's corporate governance policy to avoid situations in which they may have conflicts of interest with those of the Bank, unless they are specifically authorized by the Board of Directors. This includes potential conflicts that may arise when a Director takes up a position with another company or has any material transactions with the Bank.

The Bank has policies and procedures for handling related party transactions including loans and advances to directors, senior management and their related parties, as well as transactions and agreements in which a director or an employee has a material interest. In addition, exposures to directors and senior management are governed by the regulations of the CBB. Details of related party transactions are disclosed in Note 26 of the financial statements.

As per the Bank's policy, the Directors concerned do not participate in decisions in which they have or may have a potential conflict of interest. Having reviewed all such transactions during 2012, it was concluded that there were no transactions involving potential conflict of interest which need to be brought to the attention of the shareholders.

CODE OF CONDUCT

The Board has adopted a comprehensive Code of Conduct that provides a framework for directors, officers and employees on the conduct and ethical decision making integral to their work. All officers and employees subscribe to this Code and are expected to observe high standards of integrity and fairness in their dealings with customers, regulators and other stakeholders.

WHISTLE BLOWER POLICY

The Board has adopted a Whistle blower policy which provides all employees with the opportunity to report in good faith, any instances they observe regarding unethical and improper practices or any other wrongful conduct of a financial or legal nature in the Bank. The policy is available on the website of the Bank.

COMMUNICATION STRATEGY

The Bank has a public disclosure policy approved by the Board of Directors. The Bank is committed to support the timely and accurate disclosure of material information in accordance with the requirements set out in the rules and regulations of the CBB and the Bahrain Bourse as well as other applicable laws, to facilitate efficient capital market activities. The Bank believes in the principle of transparency about its financial performance thus enabling all stakeholders to have access to such information on a timely basis. The external auditors review the system of internal controls considered necessary for them to form an opinion on the financial statements. In addition to the annual audit, the external auditors conduct reviews on the Bank's quarterly financial statements. These statements are subsequently published in the newspapers and posted on the Bank's website in accordance with regulatory requirements. The annual report including the complete financial statements for the current financial year and a minimum of three preceding financial years are provided on the Bank's website.

CORPORATE GOVERNANCE

DIRECTORS AND SENIOR MANAGEMENT INTERESTS

The number of shares held by directors, senior management and their related parties as at 31 December is as follows:

Name	Type of shares	**31 Dec 2012**	31 Dec 2011
Farouk Yousuf Khalil Almoayyed, Chairman	Ordinary	**14,064,448**	14,064,448
Dr. Essam Abdulla Fakhro, Deputy Chairman	Ordinary	**7,204,813**	7,204,813
Abdulla Yousif Akbar Alireza, Deputy Chairman	Ordinary	**9,082,520**	9,082,520
Ali Hussain Yateem, Director	Ordinary	**29,735,896**	29,735,896
Mohammed Mubarak Al Sulaiti, Director	Ordinary	**71,578**	71,578
Dr. Abdulla Ahmed Mansoor Radhi, Director	Ordinary	**-**	-
Khalid Yousif Abdul Rahman, Director	Ordinary	**12,096,987**	11,022,914
Hussain Sultan Al Ghanem, Director	Ordinary	**-**	-
Abdul Razak Abdulla Hassan Al Qassim, Chief Executive Officer & Director	Ordinary	**126,522**	126,522
Fawzi Ahmed Kanoo,Director	Ordinary	**49,207**	48,207
Total		**72,431,971**	71,356,898
As a % of the total number of shares		**8.5%**	8.3 %

DIRECTORS AND SENIOR MANAGEMENT TRADING DURING THE YEAR 2012

The details of trading in the Bank's shares during the year by Directors, senior management and their related parties are as follows:

Name	**Type of shares**	**Purchase / Sale**	**No of shares**	**Date of transaction**
Khalid Yousif Abdul Rahman, Director	Ordinary	Purchase	152,740	26/02/2012
	Ordinary	Purchase	100,000	01/03/2012
	Ordinary	Purchase	150,000	04/03/2012
	Ordinary	Purchase	45,820	15/05/2012
	Ordinary	Purchase	165,005	31/05/2012
	Ordinary	Purchase	136,380	07/06/2012
	Ordinary	Purchase	100,000	24/07/2012
	Ordinary	Purchase	100,000	31/07/2012
	Ordinary	Purchase	76,576	02/08/2012
	Ordinary	Purchase	47,552	07/08/2012
Fawzi Ahmed Kanoo,Director	Ordinary	Purchase	1,000	02/11/2012

REMUNERATION

Board of Directors Remuneration Policy

The Board of Directors is paid an annual remuneration as approved by the shareholders at the Annual General Meeting. While the amount of remuneration is not directly linked to the performance of the Bank, factors such as the Bank's performance, industry comparison and the time and effort committed by the directors to the Bank, are considered for determining the total remuneration. Directors remuneration is accounted as an expense as per International Accounting Standards and CBB regulations, the payment of which is subject to approval by the shareholders at the Annual General Meeting. In addition, the members are paid sitting fees for the various sub-committees of the Board of Directors.

Employees Remuneration Policy

As the quality of human capital is fundamental to success, the Bank's remuneration policy is to attract, retain and motivate the best talent. In line with this strategy, employee remuneration and benefits are reviewed and revised annually in the context of business performance, industry and local practices. While a major component of employee remuneration consists of fixed monthly salaries and allowances, employees are provided with several other benefits like performance bonus, medical, life insurance cover, retirement benefits and employee savings scheme. The Bank does not have any share based incentive schemes at present.

Remuneration of Board members, senior management and fees paid to external auditors

The aggregate remuneration paid to board members and senior management personnel are disclosed in Notes 26 of the Financial Statements. KPMG Fakhro was the Bank's external auditors for the financial year ended 31 December 2012. The details of fee paid to the auditors during the year 2012 for audit and other services are held at the Bank's premises, which is available to eligible shareholders upon specific request.

Status of compliance with CBB's Corporate Governance guidelines (High Level Controls Module)

Banks are required to comply with the High Level Controls (HC) Module of the CBB Rulebook, which became effective from 01 January 2011 with full compliance mandated by the financial year end 2011. The HC Module contains both Rules and Guidance; Rules must be complied with, but Guidance may either be complied with or non-compliance explained by way of an annual report to the shareholders and to the CBB.

CORPORATE GOVERNANCE

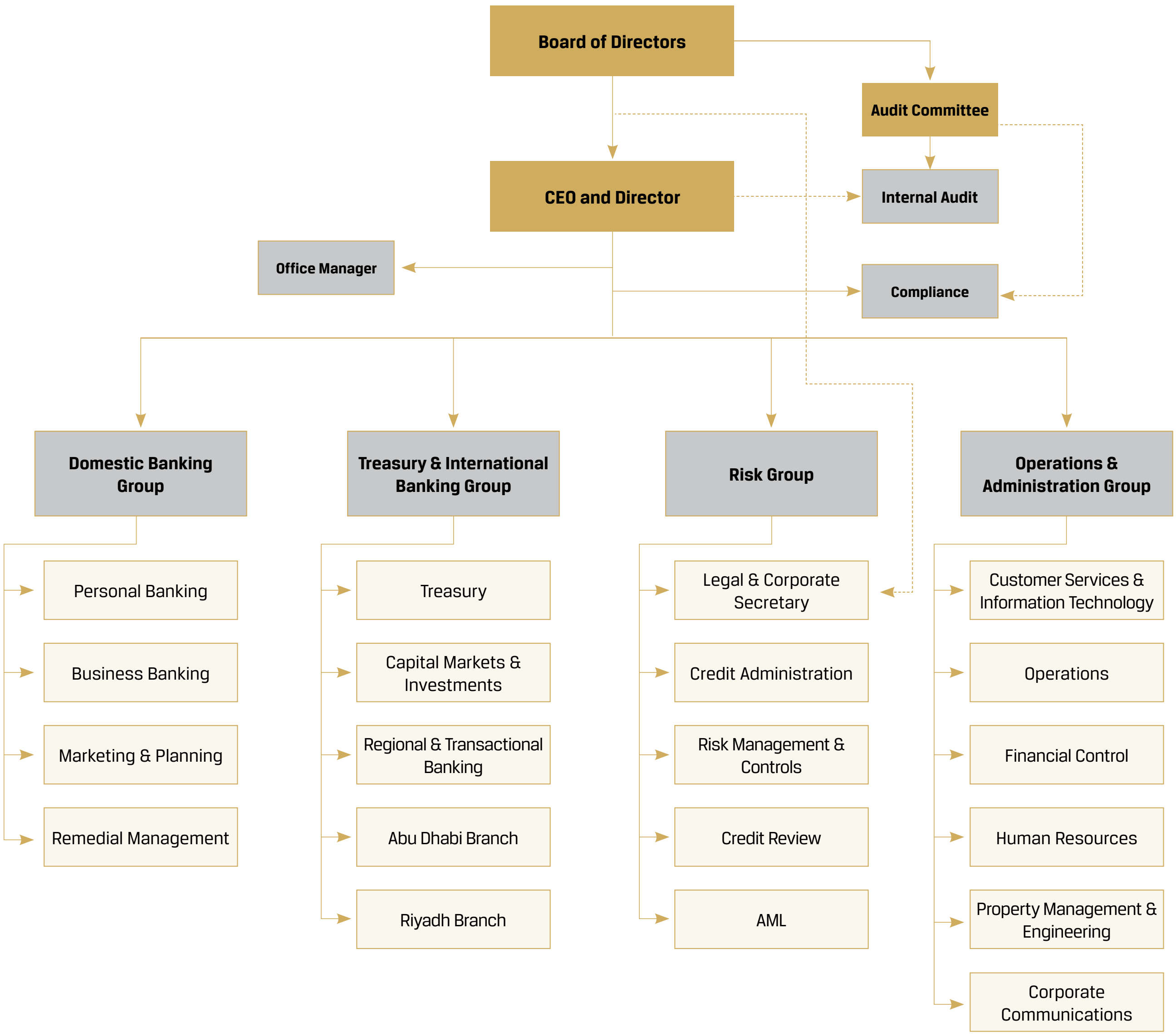
The Board has adopted a comprehensive Code of Conduct that provides a framework for directors, officers and employees on the conduct and ethical decision making integral to their work.

The Bank is in compliance with the requirements of the HC Module except for the following Guidance:

1. HC 1.3.13 states that no director of a bank should hold more than 3 directorships in public companies in Bahrain, with the provision that no conflict of interest may exist, and the Board should not propose the election or re-election of any director who does. Two of the Bank's Directors, Mr. Farouk Almoayyed and Mr. Fawzi Kanoo hold more than 3 directorships in public companies in Bahrain. However, the Bank is of the opinion that this does not impact the effectiveness and efficiency of the Board of Directors, as the Directors concerned provide adequate attention to their responsibilities as Directors of the Bank, and there are no conflicts of interest between their other directorships and that of the Bank.

2. HC 1.4.6 states that the Chairman of the Board of Directors should be an independent director. The Bank's Chairman, Mr. Farouk Almoayyed is not treated as an independent director, taking into account the business transactions that the Bank has with the Almoayyed Group controlled by Mr. Farouk Almoayyed. The Bank is of the view that this does not compromise the high standards of corporate governance that the Bank maintains as (i) the business transactions are entered into on 'arms length' basis following transparent tendering and approval processes (ii) the Bank follows strict policies to manage conflicts of interest in Board decisions (iii) Directors who are interested parties in business proposals considered by the Bank do not participate in decisions related to such proposals.

ORGANISATION STRUCTURE



EXECUTIVE MANAGEMENT

ABDUL RAZAK ABDULLA HASSAN AL QASSIM
Chief Executive Officer and Director

Master's degree in Management Sciences and a Sloan Fellowship from MIT (Massachusetts Institute of Technology, USA). Mr. Al Qassim joined NBB in 1977 after nine years with Chase Manhattan Bank and Standard Chartered Bank.
Member of Asset/Liability Committee, Business Review, Development and Planning Committee, Credit Committee and Human Resources Committee.
Chairman of Benefit Company; Chairman of Board of Trustee of Ahlia University;
Deputy Chairman of Oasis Capital Bank B.S.C, Member of Nomination and Compensation Committee of Oasis Capital Bank B.S.C;
Deputy Chairman and Chairman of Executive Committee of the Arab Academy for Education and Research;
Board Member and Chairman of Executive Committee Member of Bahrain Telecommunication Company;
Board Member of Umniah.
He assumed his present position in 2008.

ABDUL AZIZ ABDULLA AL AHMED
General Manager – Domestic Banking Group

Executive Diploma from University of Virginia, USA. He also attended a number of training courses inside the Kingdom of Bahrain and abroad. Mr. Abdul Aziz joined NBB in 1974.
Member of Asset/Liability Committee, Business Review, Development and Planning Committee and Credit Committee.
Board Member of Bahrain Commercial Facilities Company (BCFC) and National Motor Company.
Mr. Abdul Aziz has over 39 years of banking experience.
He assumed his present position in 2011.

HUSSAIN SAYED ALI AL HUSSAINI
General Manager – Treasury & International Banking Group

MBA in Marketing and Management, DePaul University, USA; PMD (Programme for Management Development) from Harvard Business School, Boston, USA; B.A. in Economics, Concordia University, Canada.
Mr. Al Hussaini joined NBB in 1982.
Member of Asset/Liability Committee, Business Review, Development and Planning Committee, Business Continuity Planning Committee and Credit Committee.
Vice Chairman of the Board of Directors and Vice Chairman of the Executive Committee of Securities and Investment Company (SICO),
Board Member and Investment Committee Member of Esterad Investment Company.
Member of Delta Mu Delta - Chicago USA, Interarab Cambist Associations, International Securities Market Association, Harvard Business School – Alumni Club, USA, Bahrain Financial Market Association.
He assumed his present position in 2011.

KHALID ALI JUMA
General Manager – Operations & Administration Group

Executive Diploma from University of Virginia, USA. He also attended a number of training courses inside the Kingdom of Bahrain and abroad.
Mr. Juma joined NBB in 1972.
Member of Asset/Liability Committee, Business Review, Development and Planning Committee, Business Continuity Planning Committee and Human Resources Committee.
Board member of Benefit Company.
He assumed his present position in 2011.

RAVEENDRA KRISHNAN
General Manager - Risk Group

Masters Degree in Finance, University of Mumbai; Certified Associate of the Indian Institute of Bankers. Mr. Krishnan joined NBB in 1996 after several years with the State Bank of India and Oman International Bank.
Member of Asset/Liability Committee, Business Review, Development and Planning Committee, Business Continuity Planning Committee, Operational Risk Management Committee and Credit Committee.
He assumed his present position in 2011

ABDUL MONEM YOUSIF AL BANNA
Executive Assistant General Manager –Internal Audit

CPA from Illinois, USA; BS in Accounting, University of Bahrain.
Mr. Al Banna joined NBB in 1989.
Member of Business Review, Development and Planning Committee, Business Continuity Planning Committee and Operational Risk Management Committee.
Secretary of the Audit Committee of NBB's Board of Directors.
He assumed his present position in 2011.

ABDULLA ABDUL RAHMAN HUSSAIN
Executive Assistant General Manager – Customer Services & IT

Harvard Business School Graduate of Advanced Management Programme; Master of Business Administration in Marketing from University of Bahrain, Post Graduate Diploma in Finance from University of Bahrain, Bachelor of Science in Computer Sciences from St. Edwards University, Austin, US.

Mr. Hussain joined NBB in 2008 after more than 23 years of experience in Banking, professional services, technology, project management and e-Business.
Member of Asset/Liability Committee, Business Review, Development and Planning Committee, Business Continuity Planning Committee and Operational Risk Management Committee.
Board member and Chairman of Executive Committee of Benefit Company.
He assumed his present position in 2011.

NADER KARIM AL MASKATI
Assistant General Manager – Regional & Transactional Banking

Executive Management Diploma from Darden Graduate School of Business Administration, USA. Master Degree in Finance and Post Graduate Diploma in Marketing from Bahrain University. B.Sc in Economics & Political Sciences from Cairo University.
Mr. Maskati joined NBB in 1993 after several years experience with National Bank of Abu Dhabi.
Member of the Credit Committee.
He assumed his present position in 2009.

FAROUK ABDULLA KHALAF
General Manager - Riyadh Branch

Member of the Chartered Institute of Management Accountants, U.K.
Mr. Farouk joined NBB in 1986 after several years experience with Gulf International Bank, Aluminum Bahrain (ALBA) and British Bank of the Middle East, Bahrain.
Member of the Credit Committee.
He assumed his present position in 2012.

ROY S. SAMA
General Manager – Abu Dhabi Branch

Post Graduate Diploma in Banking & Finance from Monash University, Melbourne, Australia.
Mr. Sama joined NBB in 2012 after 5 years with HSBC Bank Middle East in Abu Dhabi and more than 15 years with various banks in Australia.
Member of the Credit Committee.
Fellow of the Australasian Institute of Banking & Finance.
He assumed his present position in 2012.

JASSIM MOHAMED AL HAMMADI
Assistant General Manager – Central Operations

Master of Business Administration, University of Glamorgan, UK.
Mr. Al Hammadi joined NBB in 1974.
He has several years of experience in Financial Control, Customer Services, Card Business, Retail Banking, Operations and Anti-money laundering.
Member of Business Review, Development and Planning Committee, Business Continuity Planning Committee and Operational Risk Management Committee
Member of the Bankers Society of Bahrain-ATM Security Committee.
He assumed his present position in 2007.

AHMED JASIM MURAD
Assistant General Manager – Business Banking

Executive Management Diploma from Darden Graduate School of Business. Bachelor of Business Marketing, St. Edward's University – Austin, Texas, USA. Associate Diploma in Commercial Studies, University of Bahrain. Mr. Murad joined NBB in 1997 and has acquired working experience in different departments such as Retail, Commercial, and Corporate Banking. Moreover, he attended number of training courses inside the Kingdom of Bahrain and abroad.
Member of the NBB Credit Committee.
Director of Ghetha Fund Company B.S.C (c).
He assumed his present position in 2012.

REYAD NASSER AL NASSER
Assistant General Manager – Riyadh Branch

Master of Business Administration from Dublin University, USA and Accounting Diploma from University of Bahrain. Advance Diploma in Banking from BIBF.
Mr. Nasser joined NBB in 1981 and worked extensively in various NBB branches in the capacity of Branch Manager.
He assumed his present position in 2011.

THROUGH LIFE'S ADVENTURES

REVIEW OF OPERATIONS

KHALID ALI JUMA
General Manager
Operations & Administration Group

INFORMATION TECHNOLOGY

Information Technology department's strategic projects and initiatives for the year 2012, concentrated primarily to enhance core banking systems functionality, upgrade IT Infrastructure and to develop satellite systems, to achieve the objective of a strategically planned migration toward technology services, enhance our customer services and ensure compliance for regulatory requirements as well as compliance for internal control.

NBB customer delivery systems were enhanced to provide our customers with more facilities, enriching their banking experience. NBB IT has implemented a state-of-art Internet Banking service for its Corporate and Commercial segment of customers, who can conduct their banking transactions on a real-time basis from their locations. The bank successfully implemented the Cheque Truncation & Electronic Clearing (CTS) system, a national project coordinated by BENEFIT Company, to improve customers' service that assures same day credit for clearing cheques deposited by customers. In an effort to support the "Go Green" initiative, IT has implemented systems that enable sending customer accounts statements via e-mails. Straight through processing (STP) of both the inward and the outward remittances have been implemented providing thereby a real-time transfer of funds facilities for our customers.

Credit card customers' service has been extended and NBB customers can now pay their credit card bills through our vast network of ATMs. Further, credit card bill payments reflect repayment in a real-time mode. IT successfully completed the project of issuance of EMV cards for our Abu Dhabi and Riyadh branch customers after obtaining certification from the card franchises.

During the year, the bank committed resources to enhance protection of its customer information, embarking on projects that were aimed at augmenting the network security framework and to restructure the security architecture. Besides, to protect our Internet Banking customers from phishing attempts, NBB has periodically conducted customer awareness campaigns. In an effort to protect our customers, coupled with the CBB mandate, NBB IT has implemented SMS alerts for customers' card based transactions.

Treasury Systems were enhanced to enable dealers conduct their activities in an improved manner. The dealing system was upgraded to EIKON feed from REUTERS in an effort to facilitate our dealing room with all the interfaces to Financial Information systems and NBB back-end systems with no down-time. Cash management was automated to reflect real-time global positions enabling Treasury perform their transactions in a controlled manner. New suite of applications was successfully implemented to provide credit department perform the credit appraisal function with up-to-the minute financial data of the customer. In-house developed credit product modules were enhanced to reflect market value of all collaterals in comparison to the outstanding which has enabled the Financial controls publish the latest information to the regulators.

NBB core IT data network infrastructure components underwent a tactical and technological upgrade in an effort to focus on enhancing network and systems performances, resulting in an improved and efficient service to our customers. This upgrade made NBB core infrastructure more robust, resilient and expandable.

In line with NBB strategy to concentrate and expand on regional operations and to comply with SAMA mandate, NBB implemented a localized Core system installation with its own hardware and infrastructure in our branch in Riyadh, KSA. The core system will drive other systems locally in KSA and further enhance the security and confidentiality of all our KSA customers' information.

NBB's disaster recovery capabilities were pro-actively perfected based on the periodic mock drills conducted to assess bank's readiness to switch over to the DR site addressing Business continuity requirements.

CALL CENTRE

NBB Call Centre manages service delivery of Inbound / Outbound voice operations with a multitalented team of customer service associates. The year 2012 has been a very customer and sales centric year for NBB`s Call Centre. The key thrusts of this year were to augment Customer Experience, service efficiency and cost rationalization.

The Call Centre has always led from the front in information dissemination and to continue on the same spirit this year the centre initiated a satisfaction survey.

The Call Centre aims to become a profit centre and therefore one of our focus was to augment sales and work hand in hand with Direct Sales staff. The call centre associates strongly cross and up sold NBB`s products on inbound calls and we generated 5000 plus leads in this year. Direct sales complemented our efforts by successfully closing a lot of the generated leads.

After the successful training and implementation of workflow system within the cards center on 2011; Call Center's challenge for the year 2012 was to implement the workflow for all NBB branches and Merchant Sales and Support. The purpose of workflow is to identify the exact statistics of customer requests, enquires and complaints. This will lead us to identify the weakness of the current procedures and processes

A periodical training and coaching of all call center agents was conducted in through BIBF. The training helped in increasing the department's selling and cross selling statistics

Another achievement this year is the customer satisfaction survey. The call centre conducted customer satisfaction survey by calling NBB customers. The purpose of conducting the survey was to gauge the satisfaction level of our customers and to find gaps in our services. The survey analysis will also help us in thrusting right products for the demographic group.

Overall it was a challenging year and we hope to continue our efforts in providing unparallel customer satisfaction.

CARD CENTRE

2012 was a distinguished year for cardholders with NBB Card Centre implementing several enhanced services for customers and launch of new products. The NBB Card Centre successfully implemented the payment of credit cards through any of NBB ATMs. To further enhance the service levels, credit card payments from any channel (viz. Branches, ATMs, IB, IVR) would be credited to the cardholders card promptly (going a step further from the same day payment implemented last year), giving customers the freedom to spend and load the cards 24 X 7, especially the pre-paid Taabeya products.

NBB launched the prestigious Titanium card in association with MasterCard, providing the cardholders with a host of services that include unlimited lounge facilities at 6 airports in the Middle East region. The Bank also benefitted from better Interchange rate that resulted in increased profitability.

EMV compliant Credit / Debit cards and ATMs were launched for Overseas branches in KSA & UAE to provide cardholders with the freedom to use their cards anywhere in the world along with the best of security features. This greatly helped the Bank to expand their business in these markets and also helped the Bank to be compliant with the requirements of the Central Banks of these countries.

Compliance to CBB mandates has been paramount to NBB's operational endeavours. SMS messages for transactions on Debit cards were launched to ensure compliance and improve the transactional security for cardholders.

Changes were incorporated to the card management system (Prime Module) in order to be PCI DSS compliant. Operational support was provided to other functional areas for the UAT(User Accepting Testing) and upgradation of infrastructure i.e. Card Prime Hardware System upgrades, Operating System and Database upgrade etc. which provided customers a faster and more reliable service.

Training to merchants (for Hotel Kempinski, Sheraton Hotel, K Hotel, Moda Mall merchants and Kooheji group etc) on best practices and fraud detection were conducted periodically to ensure smoother operational efficiency.

REVIEW OF OPERATIONS

CENTRAL OPERATIONS

NBB has always strived to maintain the highest standards of services in funds transfer operations and in 2012, the Bank remained committed to this strategic initiative. In recognition of its consistent, high-quality performance and standard in the fund transfer operations, the Bank was awarded the JP Morgan Quality Recognition Award 2012 for excellence in US Dollar processing. JP Morgan presents this award to selected U.S. Dollar clearing clients who achieve outstanding straight-through results by properly formatting their Swift payments. Less than one percent of JP Morgan's total funds transfer clients are able to meet the criteria for this award. This is the 12th consecutive year that NBB has earned this recognition which not only illustrates NBB's leading presence in the global financial services market but also aptly demonstrates the Bank's long-term commitment to maintain highest standard of quality.

In 2012 the Bank successfully implemented the BCTS (Bahrain Cheque Truncation System) the requirements of which have been introduced by the Central Bank of Bahrain. This national project was introduced and implemented with objective to modernize the manual cheque clearing process to an electronic imaging technology where cheques are cleared same day compared with two to three days through manual clearing process. The ultimate objective of such transition is to provide optimum service to customers and modernize the banking service to boost Bahrain economy.

The Bank also successfully implemented an STP system (Straight Through Processing). The implementation of such system is mainly aimed at providing much better customer services by enhancing the process efficiency of the incoming and outgoing wire transfers were incoming wire transfers are automatically credited to customer's account instantly once are received. The outgoing payments are also handled in a better efficient methodology. This implementation is considered as one of the most important bank's implementations that enhances the operations process, eliminating human errors and ultimately providing best customer's services.

HUMAN RESOURCES

During 2012, competency building process was at the core of HR priorities. Enabling staff to deliver best in class customer service and prudent financial advice was the mandate behind the design & development of various training programs, which were targeted at the front-end customer facing staff. The competencies built through these training programs are part of the Bank's Core Competency framework, which is linked to the performance management system. Through this integrated approach efforts are being put to focus the staff on the Bank's values and key strategic priorities of the Bank.

Developing the business in middle market segment (Small & Medium Enterprises - SME), is one of the strategic priorities for the Bank. To this effect, the Bank is looking at converting some of its branches in to Commercial Branches in order to reach out to the customers. Hence building new competencies in the Branch Heads to handle the requirements of Commercial clients was imperative. This priority resulted in the development of SME financing training program for Branch Heads. The program was delivered at BIBF covering all Branch Heads, who were subjected to evaluation after completion of the training program. The evaluation was used as a basis for selecting best Branch Heads to lead the SME initiative. Another development initiative targeted at the front-end staff was Customer Service

& Sales training program, which covered all sales & service staff including Direct Sales representatives and Call Centre agents and Tellers. This program was designed to inculcate key values in the staff so that they can serve the customers effectively while growing Bank's business.

Financial Advise Program (FAP) was delivered during the year to enhance skills of Relationship Managers. The objective behind this program was to ensure that the Relationship Managers provide prudent financial advice to our customers. FAP was also a certification program and the certification was done on the basis of participant's performance in the test conducted at the end of the program. This enabled the Bank to assess level of knowledge and skills gained by the Relationship Managers.

In addition to the above initiatives, the Executive Trainee Program remained at the forefront of HR priorities. A group of Executive Trainees will graduate from the program in February 2013. These trainees will be given key responsibilities in various departments of the Bank and their progress will be closely monitored by HR for further fast-track career growth. The next Executive Trainee Program will be launched in 2013 with fresh batch of young & promising Bahraini candidates.

Under the Leadership Development initiative, 2 promising Bahraini staff members were nominated for the Leadership Development Program at Darden Business School. In 2013, a new Leadership Development Program in being planned for the Bahraini staff at supervisory level. This program will enhance the managerial skills of staff, so that they are prepared to handle subordinates and other managerial responsibilities effectively.

With these conscious efforts to develop Bahraini staff members, the Bank has achieved Bahrainization of over 92% during 2012. The staffing and development initiatives will continue throughout 2013 in order to prepare NBB for facing increasingly difficult market conditions and new challenges thrown up by competition.

CORPORATE SOCIAL RESPONSIBILITY

The National Bank of Bahrain has always been dedicated to enhancing the community where the organization is present and conducts its business. NBB has, at all times, believed inherently in the value live and work. We strongly believe in the value of contributing, not only financially, but also as responsible citizens of the Kingdom of Bahrain.

NBB's approach to corporate social responsibility has been multi dimensional right from its inception. The Bank believes in growing its business in a socially responsible way while addressing the legitimate interests of our stakeholders. The Bank adopts a stringent policy of involving itself with the community whereby the organization undertakes an active role in helping local communities achieve their aspirations. A combination of volunteer work and patronage is followed to sustain this objective.
NBB ultimately owes its success to its customers and to the communities in which it operates. As the Bank is proud to be a successful part of the social fabric, the organization is also determined to promote public inclusion, helping to bring vulnerable and under privileged groups into the vibrant social and economic interaction.

The Bank is resolute that the community it serves also benefits from the success and translate that determination to practice by setting aside a percentage of the Bank's annual net profit for allocation among various programmes and foundations/projects aimed at social welfare, health care and the underprivileged sections of our society. This dates back to 1980 when the Bank's Donation and Contribution Porgramme was conceived.

In 2012 the Bank contributed BD 1.29 million, through the donations and contributions programme, primarily directed towards health care, social welfare, supporting educational institutions including government schools, research studies and in ensuring that the less privileged among us are put on the path to a more secure future. The Bank has appropriated BD 31.77 million since the inception of the Donation and Contributions programme in 1980.

The Bank's employees also make significant contributions as volunteers sharing their skills, financial and business knowledge and the benefit of their experience with the student community. This includes participating in a broad range of training seminars and work-shops, for the benefit of students from educational establishments, particularly those enrolled in H.H. The Crown Prince's Scholarship programme that is aimed at the development of vision and leadership capabilities among Bahrain's future government and business leaders.

Since 1957, the community has warmly welcomed us to be a part of their lives and has placed their trust in NBB. The Bank has strived to ensure that it supports the nation in its march forward. The Bank has always endevoured to remember, that while we have been fortunate with our success we also need to provide for those among us who are less privileged and those with special needs to ensure a better society and a more prosperous Bahrain.

REVIEW OF OPERATIONS

MAJOR 2012 PROJECTS

Support for merchants at the Isa Town Market

As a responsible corporate citizen and a leading Bank in the development of the Kingdom of Bahrain, National Bank of Bahrain assisted the traders and small business enterprises affected by the fire that devastated Isa Town market with a contribution of BD 400,000. This initiative is part of joint effort with the Bahrain Chamber of Commerce and Industry (BCCI) which donated BD 100,000 for the same cause. This generous contribution went to the eligible parties in order to enable them to resume their business in a better shape as soon as possible. The financial assistant was given out after obtaining a list of affected traders and businessmen detailing the type and scope of the damage and the social condition of each case by which the method of the aid and amount was determined accordingly. This contribution is a great example of partnership and responsible community work and is also a testament of NBB commitment towards contributing actively in building stronger community socially and economically.

Crown Prince's International Scholarship Programme

In 2006 NBB joined the Crown Prince International Scholarship Programme (CPISP) as a Gold sponsor and made a commitment to contribute BD 500,000 to the programme over a five-year period. Subsequently the Bank upgraded its sponsorship level to Platinum in 2009 whereby the Bank committed to contribute BD 1,000,000 to the programme over a five year period. NBB has already made contribution of BD 1.1 million towards the programme. The sponsorship reflects the Banks continuing support to human resources development in the country and in particular, programmes that support Bahraini students to develop and improve their academic qualifications, including doctorate and master's degrees.

Charity Funds Support

2012 was the sixteenth consecutive year that the Bank has provided assistance to all the local charity funds registered with the Ministry of Social Development. During the past sixteen years about BD 1.53 million has been contributed by the Bank to the local charity funds that provide basic sustenance to poor families and under privileged people across the Kingdom. This year, during the Holy Month of Ramadan, the Bank distributed nearly 7,700 coupons to purchase foodstuffs totaling BD 150,000.The amount was allocated to local charitable societies and organization, who in turn distributed these coupons to those families who are in dire need for help and support.

On the occasion of Eid Al Adha and Eid Al Fitr, the Bank organised the purchase and distribution of gift items for occupants and staff of the NBB Home for the Aged, NBB Home for Disabled Children, Bahrain Mobility International as well as for the children in the Hope Institute for the Blind and the Bahraini Institute for the Blind.

Support to government School Students

In 2012, more than 20,000 needy government school students benefited from the annual winter clothing donation programme. NBB allocated BD 150,000 this year for the programme, which covered all government schools in the Kingdom of Bahrain.

Sponsorship

NBB has demonstrated a leading role in supporting a unique number of important activities and events. Major activities in which the Bank participated as a key sponsor during 2012 were:

- Support the Bahrain International Air Show
- Support the Bahrain Animal Production Show (Mara'ee)
- IMF/World Bank Meetings – Tokyo, Japan. (Banks in Bahrain Showcase Reception) organized by the Banker's Society of Bahrain and Economic Development of Bahrain

Included among the major beneficiaries of the Donations and Contributions programme this year were:

- NBB Home for the Aged
- Rehabilitation Centre for Handicapped Children
- Bahrain Cancer society
- Bahrain Philanthropic Society
- Bahrain Red Crescent Society
- Bahrain Diabetes Society
- Al Rahma Centre
- Mother & Child Information Centre
- Bahrain Down Syndrome Society
- Al Manar Parents Care Centre
- Bahrain Society for Child Development
- Child Care Home
- Children & Mother Welfare Society
- Hope Institute for Handicapped
- Sultan Bib A. Aziz Centre for Hearing and Speech
- UCO Parents Care Centre
- Bahrain TV
- Husan Al Jawar Society
- Injaz Bahrain
- Minors Estate Directorate

- Bahrain Association for Intellectual Disability & Autism
- Bahrain Association for Parents & Friends of Disabled
- Bahrain Historical & Archaeological Society

MAJOR PROJECTS

Major projects financed , and contributions made, since the beginning of the donations and contributions programme:

Health Services:

- Building and equipping NBB Dair health centre.
- Financing and furnishing the NBB Arad health centre and physiotherapy wing.
- Providing Salmaneya Medical Centre with two advanced general purpose x-rays, an ambulance, dialysis machines and a urology endoscopy system.
- New eco cardiogram machine for Shaikh Mohamed Bin Khalifa cardiac centre.
- Annual financial support to Shaikh Mohammed Bin Khalifa Cardiac Centre at the Bahrain defence force hospital.
- Upgradation of BDF's computer systems.

Social Welfare Schemes

- Building and furnishing the NBB home for the aged.
- Building and furnishing the friendship Kindergarten for the Blind.
- Building and furnishing the NBB home for disabled children and providing a bus with special equipment.
- Supplying 3 specially manufactured buses for Bahrain mobility international and Muharraq
- Social Welfare Centre.
- Annual financial support to all the facilities built by the Bank.

Educational facilities

- Construction of administration and registration buildings for the University of Bahrain
- Building and furnishing the NBB public library in Muharraq.
- Providing the University of Bahrain with "horizon", a fully automated library system and 2
- PC laboratories, the e-learning centre in addition to annual financial support for many years
- Contribution to the new Shaikh Isa library
- Installation of air conditioning in all government primary schools.
- Annual financial support to the university student fund.
- Computerised library system for Women and children information centre.
- Construction of shades for the Pakistan Urdu School.

REVIEW OF OPERATIONS

ABDUL AZIZ ABDULLA AL AHMED
General Manager
Domestic Banking Group

CORPORATE AND COMMERCIAL BANKING

In 2012, the market showed signs of improvement in the later part of the year. However, in the first half of 2012 business activity in the market was limited, and the market was characterized by dwindling working capital funding requirements. As the Holy month of Ramadan also fell between the second and third quarter of 2012, the market was not able to strongly recover from the slow start experienced in the first half of 2012.

The year has therefore seen significant challenges. NBB's Corporate and Commercial Banking Unit continued to face not only difficult business conditions at the local market level but also growing competition from hard pressed traditional and non-traditional institutions operating in the domestic market. Through this difficult phase, the Bank has stream-lined business, maintained strong financial position and continued to be a market leader in serving customers by all means possible.

In an environment which has challenged even well established players, the Bank has revised the products and services together with our delivery channels on a regular basis, and where possible has made the necessary changes to strengthen business propositions in the prevailing market condition. For example, with cash flows of most entities being squeezed, the Bank extended the tenor on loans to enable customers to better weather the conditions that they were experiencing. Most companies, irrespective of the sector in which they operate experienced shrinkage in their turnover/receivables, so the offer of longer tenor went a long way in smoothing their cash flows.

The Bank has kept in close contact with customers throughout the year in order to better understand how they are being affected and what is sought by them to roll things over. Based on this information, wherever possible, the Bank has endeavored to "tailor make products" which met the customer's requirements during this demanding period.

NBB's commitment to the local economy is reflected by the booking of new assets (loans) during the year. We firmly believe that the Kingdom is not only well positioned to withstand the prevailing economic conditions but come out of this as a much stronger economy based on the knowledge and experience gained during this difficult period.

The Bank has witnessed a gradual pickup in the local economy during the fourth quarter of 2012, which is a good sign for 2013 and beyond. These included syndication deals from local corporates which has been missing for the past few years. Also a number of club deals and bi-lateral transaction(s) have emerged during the fourth quarter of 2012. While some of these will not be reflected in our books for this year as the required due diligence analysis needs to be thoroughly conducted, we expect these to provide a healthy deal flow in 2013 (this pipeline had been missing in the previous two years).

On the liabilities side, the Bank continued to attract new deposits resulting in significant growth. We leveraged on the sound reputation of the Bank, and depositors where inclined to place their deposits with NBB despite better rates being available elsewhere in the market. The delivery channels of the Bank will also be enhanced shortly with the introduction of Corporate Internet banking (CIB), which is being pilot tested currently.

Corporate and Commercial Banking Unit continued to improve their products and services for the benefit of the customers of the Bank. The unit looks forward to 2013 with optimism, based on improving market situation and strong deal flows in the pipeline. The Bank is confident that it is strongly positioned to meet customers' needs in 2013 and beyond.

PERSONAL BANKING

The year continued to present challenges for the business. The operating environment had still not fully recovered from last year's disturbances and the effect of the same was felt through the whole economy in the initial part of the year. There was pricing pressure on both assets and liabilities as banks scrambled for market-share to compensate for the reduced business opportunities. Some banks (specially Islamic banks) continued to offer high rates to attract deposits. Banks with better liquidity and lower cost of funds reduced pricing on retail loans, as a relatively lower risk option. Operating within these tough market parameters, new packages and campaigns were launched aimed at individuals, while existing ones were streamlined. The bank took a price leadership positioning in retail loans and offered rates that were very competitive to customers. This strategy was well supported through below the line campaigns, through branch merchandising, bulk messaging and data mining to cross sell to existing customer base. This strategy helped the division in enhancing booking volumes and income.

The bank's flagship saving scheme "Al Watani Savings" was revamped and creatively structured to generate top-of-the-mind recall among customers. An attractive tagline message encouraged the saving habit amongst customers. A distinguished campaign was created which was promoted through various media including prime outdoor locations.

The prestigious NBB Titanium MasterCard was launched as a premium convenience and lifestyle product for the Bank's discerning customers. The new card offers a range of benefits from free access to select airport lounges in the region to exclusive deals and offers on hotels and internationally known brand names. Select existing NBB cardholders are proactively being sent the Titanium card as an upgrade on their existing card.

The Bank tied up with various merchant partners to bring special offers and add value to its cardholders. During the course of the year, various offers and promotions were made available to NBB cardholders by participating partner organizations like supermarkets, car dealerships, consumer durables outlets and amusement parks.

The unit communicated its products through strategic outdoor locations across some of the major business areas in the Kingdom. Branch merchandising was also fully leveraged as a cost-effective communication medium. Other non-conventional means (statements inserts, envelopes) were used to effectively reach out to customers and generate enquiries and leads for our sales teams.

In an effort to bring banking services nearer to customers, the direct sales distribution channel was strengthened and used as an effective sales tool. By offering customers service at their door-step, the direct sales team was able to canvass business from a growing number of customers. Sales desks were set up in various Ministries and Government offices to interact directly with customers and potential customers.

The Bank's ATM network was significantly enhanced through installation of three new offsite ATMs in various convenient locations across the Kingdom. One more location has been readied and is expected to go live shortly.

In our continued efforts to enhance customer experience at branches, the initiative to redesign branches was continued, with two more branches at East Riffa and Muharraq Souq being under renovation and expected to start offering services from revamped premises shortly. The branch at Jidhafs was renovated and is expected to commence operations in a short while. In order to further enhance convenience and bring banking services closer to our customers, work on a new branch in Riffa was started and is expected to open for customers shortly.

Technology was leveraged to significantly enhance service levels for credit card customers. Functionality of payment of credit card bills was added to our ATM network. Additionally, systems were enhanced to ensure that payments made through any channel (branch, ATM, IVR, Internet Banking) were immediately reflected in the card account, instead of on the next working day as earlier. The Bank also extended the facility of the credit card 'payment gateway' to new customers, which will enhance business for both the merchant partner and the Bank when customers start using this channel for payments.

REVIEW OF OPERATIONS

HUSSAIN SAYED ALI AL HUSSAINI
General Manager
Treasury & International Banking Group

INTRODUCTION

Plagued by uncertainty and fresh setbacks global economies have weakened further in 2012 and are forecast to grow slowly next year. Forecasts are that the world's economies expanded 3.3% in 2012 from 4% in 2011. Global efforts to ease credit and increase the amount of money for lending are seen as stabilizing factors but appear to be yielding diminishing returns. U.S. growth forecast for 2012 is 2.2% up from 1.5% in 2011 and the Euro zone is expected to contract 0.4% due to outright contractions in smaller economies. The overall economic malaise is spreading to more dynamic emerging economies such as China.

Oil exporting economies in the MENA region experienced lower growth rates in 2012. Forecasts are for growth of around 3.9% in 2012 from 4.9% in 2011. The primary causes of slower growth are cuts in oil prices and increased government spending in the wake of the Arab Spring.

The European sovereign debt crisis continued to be the main focus of the financial markets in 2012. European Finance ministers approved a 130 billion euro rescue package for Greece and private investors agreed to restructure 85% of debt. Meanwhile Spain and Italy are also facing high debt levels with no prospect of economic growth due to tough austerity programs. Again this has lead to volatile periods of risk on/risk off in the market place throughout the year. An ECB plan to buy unlimited amounts of European sovereign debt of struggling nations has brought some stability and tightening of sovereign spreads in the marketplace.

Weakness in global economies coupled with the continued European sovereign crisis has forced advanced economy central banks to continue to lower or maintain benchmark interest rates at historically low levels for much of the year. The U.S. Fed and ECB have embarked on unprecedented bond buying programs forcing global rates across the yield curve to historic lows. The unprecedented liquidity injected in the global markets has lead investors to search for yield and global credit spreads have tightened approximately 100bps. European and U.S equity markets have also reacted positively to the stimulus rallying 10-15% for the year.

MARKETABLE SECURITIES UNIT

The unit continued to take advantage of the low interest rate and spread tightening environment throughout the year. As short term interest rates approached zero or traded negative due to flight to quality concerns the unit liquidated our positions in front end G-7 governments taking sizable capital gains. The unit also took capital gains in certain credit positions due to regional out performance and reinvested in securities deemed to have better relative value. During risk adverse market environments the unit added to our high grade credit portfolio at extremely attractive levels. As loan growth has been slow to accelerate we continued to invest in high grade regional and corporate credits.

During 2012 the unit began a strategy which effectively hedges out the portfolios long term fixed rate interest rate risk, and replaces it with floating rate risk. We have begun to strategically lock in our long term funding

rates for approximately 30% of the fixed rate portfolio. This is implemented using very liquid vanilla interest rate swaps with very strong counterparties. Though we expect rates to remain low in the foreseeable future, prudent risk management dictates we take these steps.

Market timing strategies where also utilized to take full advantage of the volatility producing capital gains throughout the year. These strategies coupled with a high level of diversification provided the unit with above average returns.

FOREIGN EXCHANGE & MONEY MARKETS UNIT

Increased market uncertainties coupled with banking credit downgrades, and depressingly low interest rates during 2012 resulted in an extremely challenging year for the FX & Money Market unit. Nevertheless, despite these hurdles the unit managed to lucratively exceed its targeted budget.

During 2012, the unit succeeded in cautiously implementing a prudent yet advantageous management stratagem, by profitably augmenting a number of gapping activities in both GCC and international currencies.

However, in adherence to our conservative approach and relevant to arising credit concerns during the course of the year, the unit elected to adopt a cautious cash management approach, with liquidity being maintained on a relatively short-term basis.

Additionally, the unit continued to enhance the bank's economic contribution by aggressively participating in the short-term government of Bahrain sovereign, conventional and Islamic issues, which effectively improved overall return.

TREASURY MARKETING & SALES UNIT

Determined to protect the bank's market share in FX operations, the unit has effectively acquired steady FX turnovers throughout the year which enabled it to achieve the budgeted income for 2012.

Moreover, the unit has built upon the bank's market share of products & services offered to our customers via executing large number of forward tickets at profitable prices.

The unit has succeeded in maintaining high volumes of customers' deposits with good size of amounts booked for long tenors with the bank at competitive rates.

The unit has coordinated efficiently with Business Banking & Investment Unit to structure long term investment products for customers with hedging requirements.

With the bank investing in modernizing the dealing room, the Treasury Division was provided with the latest dealing desk and fittings that facilitate the traders to carry out their daily activities in a convenient way and enabled the bank to utilize available equipments and technology at the most cost effective manner. This was reflected positively on the work atmosphere and the process and quality of the work flow.

FUNDS & INVESTMENT UNIT

The year 2012 was another challenging year for investment markets as fear of European sovereign debt contagion and continued economic uncertainty has been impacting investors sentiment negatively. On the proprietary book front, the Bank continued to adopt a cautious approach to its investment activities and hence the Bank has not deployed any new funds for proprietary book during 2012. Alternatively, the Bank continued to accumulate more of capital protected notes, as their yields to maturity and risk reward were attractive. Despite adopting a conservative approach due to increasing markets uncertainty, the Bank will remain open for any investment opportunities in local and regional markets.

On the client business front, investors continued to stick to cautious stance towards the markets, hence demand on investment products contracted. On the custody services side, which allow clients to invest in bonds and Sukuks instruments, and as a result of active marketing and sales efforts, the Unit has been able to grow the assets under management significantly beyond those figures achieved in 2011, and will continue to achieve a robust growth in the coming years as part of its future plans.

REVIEW OF OPERATIONS

INTERNATIONAL BANKING

ABU DHABI BRANCH

Throughout the year, the Branch continued to work to strengthen relationships with existing customers and targeted new to bank customers. It has also continued the efforts in providing strong support to Bahraini or Bahraini linked companies working or planning to enter the UAE market.

During the second part of the year, a new GM was appointed with focus to review the NBB strategy for the UAE with a view to identifying the target market, segments and geography in line with the economic status of each of the Emirates and the pace of recovery from the global economic/Euro-zone crisis.

Along with the strategic review, a review of the branch organisation chart was undertaken with the aim of establishing/ strengthening the corporate team. The branch started to build a promising deal pipeline, of particular note is the branch's success in providing facilities for non-borrowing corporate customers availing facilities with other banks.

In addition to growing the branch's loan book a strong focus was also placed on improving the operational effectiveness of the branch with a view to eliminating waste/ wasted effort, employing more advanced technology, motivating employees and having a greater insight into managing particular activities. Launching of new products such as Corporate Internet Banking and E-statements was initiated and rolled out in Q4. IT upgrades / enhancement was also another key focus for the branch to improve customer service and to provide convenient banking options for customers outside of Abu Dhabi. Opening a second branch in the UAE and the setting up of Electronic Banking Centres are initiatives under review.It is expected that the branch staffing / IT upgrade requirements will be fully met by the 1st quarter in 2013 enabling Abu Dhabi branch to fully exploit the ample opportunities in the UAE market and to live up to its full potential.

RIYADH BRANCH

NBB Riyadh Branch continued to focus on implementation of the 3 Year Business Plan (2010-2012) that called for aggressive tapping of rewarding opportunities in the Kingdom within target sectors to achieve specific goals and objectives attached thereto.

During 2012, on the corporate side, the branch attracted more selective customers through bilateral relationships to make the book more diversified while enhancing relationships with existing ones.

The branch achieved good growth in the loans and advances portfolio, the deposit book and the contingent business where the branch exceeded the target increase in terms of size, fee income and return on

risk assets. Meanwhile, the Bank revisited the strategy for retail and set the stage for a selective growth in this sector in 2013 and beyond by investing significantly in selecting, testing and installing a new IT core system that would be implemented early 2013. The Bank completed the plan to enhance delivery channels in 2013 through availing Internet Banking to both sectors of Retail and Corporate.

The branch also selected limited Islamic Banking Products and Services for launching the same during 2013 following an initial introduction of Murabaha products for the corporate sector during 2012 that was well received. The Bank revisited the criteria for Retail to attract desired customers falling in the target" niche" market within the ever-growing Retail Sector in Saudi so as to realize the goals and objectives.

During 2012, NBB Riyadh Branch organized training of nearly all staff to attend courses at the Institute of Banking to enhance their knowledge related to the current rules and procedures of SAMA and AML. Selected Saudi staff was also recommended to attend courses and seminars to acquire more skills in credit, operations, trade finance and information technology.

The branch sees 2013 being a challenging year for Riyadh Branch and Riyadh Branch being well prepared for it.

REGIONAL & TRANSACTIONAL BANKING

During 2012, Regional & Transactional Banking Unit continued to focus on both local and regional markets soliciting one-off transactions as well as managing the relationship with local, regional and international financial institutions.

The Unit played a major role in leading a group of local banks to structure a term loan facility of BD 100 million to Eskan Bank for financing social housing schemes. The Unit worked extensively for a number of months in order to reach the financial close of this transaction which was achieved in mid 2012. Furthermore, the Unit worked on other transactions for major corporate names such as ALBA and Bahrain Mumtalakat Holding Company.

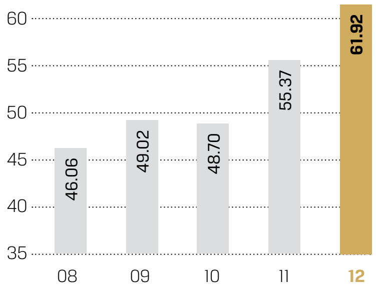
The Unit continued its strong relationship with local banks and financial institutions and succeeded to put in place a number of bilateral facilities at attractive terms and conditions to support the activities of these institutions.

In the Gulf region, the Unit focused on pursuing transactions for top tier banks such as Qatar National Bank in Qatar (for which NBB participated in its new U.S.$ 1.8 billion facility), and First Gulf Bank in UAE (for which we participated in its new U.S.$ 900 million facility). In Oman, we provided short term loans to support Asset/Liability management of Omani banks.

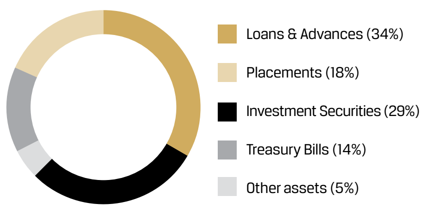
The Unit continued its collaboration with international banks in soliciting trade products such as confirmation of Letters of Credit issued in favor of local exporters and the issuance of Letters of Guarantee with respect to contracts awarded in Bahrain during the year.

Throughout the year, the Unit provided technical support to other business units such as Corporate Banking, Retail Banking and Treasury Operations. In addition, the Unit provided logistical and administrative support to our Abu Dhabi branch on a special assignment basis.

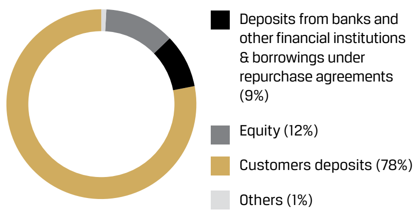
FINANCIAL REVIEW



NET INTEREST INCOME
BD Millions



COMPOSITION OF TOTAL ASSETS
Per cent



COMPOSITION OF TOTAL LIABILITY AND EQUITY
Per cent

OVERVIEW

The financial position of the Bank remains strong with a steady and consistent improvement in the overall performance during the year 2012. While the external environment remains challenging and difficult due to global economic slowdown, the Bank focused on a balanced growth while maintaining prudent risk management principles. This resulted in the Bank achieving a net Profit of BD 47.50 million for 2012, compared to BD 45.64 million for 2011, an increase of 4.1 percent.

At year-end 2012, the Bank's Total Balance Sheet stood at BD 2,654.56 million, compared to BD 2,388.65 million at year-end 2011. The growth was attributable mainly due to increase in Customer Deposits which grew by 9.0 per cent to reach BD 2,077.90 million at year-end 2012. While Loans and advances showed a decline due to certain major repayments, the available funds were efficiently deployed in Bank Placements and Investment securities to maintain the overall interest margin.

Key performance indicators continue to remain strong with Return on Average Equity at 16.00 per cent and a Return on Assets of 1.88 percent for the year 2012. Earnings Per Share improved from 53.4 fils in 2011 to 55.5 fils for 2012. Efficiency Ratio improved from 33.30 percent in 2011 to 31.57 percent for the year 2012. The Bank continues to have a strong capital adequacy ratio of 27.9 percent calculated in accordance with Basel 2 and Central Bank of Bahrain guidelines. Liquidity continues to be comfortable with liquid assets (Cash and balances with central banks, Treasury bills and Placement with financial institutions) representing 36.6 per cent of total assets.

NET INTEREST INCOME

Net Interest Income at BD 61.92 million for the year reflects a steady growth 11.8 percent over 2011. The increase is on account of growth in earning assets supported by a strong growth in customer deposits which was prudently invested in bonds and money market besides improved yield on the bond portfolio. As a result, the net interest margin, on average total assets, stands at 2.46 per cent in 2012 compared to 2.38 per cent in 2011.

OTHER INCOME

Total Other Income for the year was BD 24.69 million, marginally higher than BD 24.55 million recorded in the previous year. Higher commission income on loans and advances due to increased volume of business and higher volume of foreign exchange business was partly off-set by lower level of dividend on the Bank's equity investments resulting in a modest increase in total Other Income.

Details of Other Income, with comparative figures for the previous year, are set out in Note 23 to the Financial Statements.

OPERATING EXPENSES

Operating Expenses at BD 27.34 million showed an increase of 2.7 percent over the previous year actual of BD 26.61 million. Staff Expenses increased marginally from BD 19.23 million in 2011 to BD 19.59 million in 2012 mainly on account of annual salary increases and general business requirements. Other Operating Expenses increased to BD 7.75 million in 2012 from BD 7.38 million in 2011 as the Bank continued with the branch refurbishment programme and other information technology initiatives to improve operational efficiency and enhance customer service. The Bank's focus on cost management resulted in the operating efficiency ratio improving from 33.30 percent in 2011 to 31.57 percent for the year 2012.

PROVISIONS

In accordance with International Accounting Standard 39, the Bank follows a model-based

approach for assessing the adequacy of provisions for loan losses. Provisions for individually impaired credit exposures are determined by discounting expected future cash flows. Impairment and uncollectability is also measured on a portfolio basis, for a homogenous group of loans and advances not individually identified as impaired, on the basis of estimates of incurred losses inherent within the loans and advances portfolio that have not been specifically identified at the balance sheet date. The estimates are based on internal risk ratings, historical default rates adjusted considering current observable data, rating migrations, loss severity, macroeconomic outlook and other relevant factors that reflect the effect of current conditions on the loan book. Based on the ongoing assessment of the provision requirement and the Bank's continued emphasis on having a strong balance sheet, an amount of BD 9.21 million was provided towards impairment on loans and advances during the year. Further, a provision of BD 2.56 million was made for impairment on equity investments due to declining domestic stock market valuations.

Non-performing loans amount to BD 69.76 million at the end of 2012 compared to BD 17.96 million at the end of 2011, the increase being mainly on account of one exposure where scheduled repayments have not been met and for which the Bank holds adequate security. Details of the Bank's non-performing loans, provisions and movements therein during the year are detailed in Note 7 to the Financial Statements

ASSETS

Total Assets at BD 2,654.56 million, reflecting an increase of 11.1 percent over 2011, is attributable mainly to a growth of BD 227.38 million in Placements with banks and financial institutions, BD 107.62 million in Investment securities partly offset by decrease of BD 83.82 million in Loans and advances. Total Earning Assets stood at BD 2,512.78 million as at 31 December 2012 compared to BD 2,259.50 million as at the previous year end, reflecting a strong growth of 11.2 percent. The Bank has a well diversified asset profile with Loans and Advances representing 33.5 percent of the total assets, while Treasury Bills represents 14.3 percent, Placements with Banks & Financial Institutions represent 18.3 percent and Investment securities represent 28.5 percent of the total assets.

The loan book portfolio is diversified with widespread participation in domestic market and broadening of business relationships in Bahrain in line with the Bank's strategy of focusing on the active sectors of the domestic economy. Loans and Advances portfolio is concentrated principally in Bahrain and other GCC countries. Based on contractual maturity terms, 34.5 per cent of the current portfolio matures within one year and 66.6 per cent is due to mature within 3 years of the balance sheet date.

At the year-end, the Bank's Investment portfolio of BD 757.83 million (2011: BD 650.21 million) consisted of Available-for-Sale investments that comprised debt and equity securities while a small portion (BD 4.60 million) represents investments in mutual funds and capital protected notes designated at Fair Value Through Profit or Loss. A substantial portion i.e. 98.3 per cent of the total debt portfolio is in investment grade securities.

Notes 28 and 29 to the Financial Statements provide details of the distribution of Total Assets by geographical region and industry.

LIABILITIES

Customer Deposits grew by 9.0 per cent to BD 2,077.90 million at the end of 2012, from BD 1,905.49 million at the end of 2011. The Bank continues to be successful in generating customer deposits resulting from its dominant position in the domestic market and leveraging its image as a safe and sound financial institution in the Kingdom of Bahrain.

Borrowings under repurchase agreements and Due to banks and financial institutions stood at BD 243.95 million at year-end 2012, compared to BD 197.61 million as at year-end 2011. Customers Deposits continue to be the major source of funding with the ratio of Customers' Deposits to Total Liabilities at 89.0 percent at year-end 2012.

CAPITAL STRENGTH

Shareholders' Equity, inclusive of proposed appropriations, reflected a balance of BD 318.94 million. At the year-end, Shareholders' Equity as a percentage of Total Assets was 12.0 per cent.

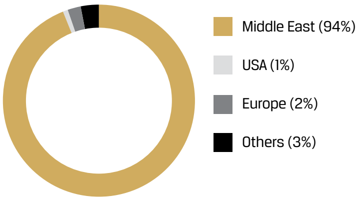
The Bank's capital adequacy ratio at the balance sheet date was 27.9 per cent with Tier 1 ratio at 25.8 per cent. The ratios have been calculated in accordance with the Basel 2 and Central Bank of Bahrain guidelines.

The Bank's capital adequacy ratio, encompassing credit, operational and market risk, is well above the Basel requirement of 8 per cent and also comfortably above the minimum level of 12 per cent set by the Central Bank of Bahrain. Note 40 to the Financial Statements and Basel 2 – Pillar III disclosures provide further details on capital adequacy. The main factors that contribute to the Bank's strong capital adequacy ratio are high capital base, low risk profile of on-balance sheet and off-balance sheet exposures which includes significant exposures to low risk weighted assets namely governments, public sector undertakings, banks and financial institutions.

SUPPORTING YOUR NEEDS

RISK MANAGEMENT

RAVEENDRA KRISHNAN
General Manager
Risk Group



GEOGRAPHICAL DISTRIBTUTION OF ASSETS
Per cent

RISK MANAGEMENT

In a world characterised by high integration of global financial markets, innovation in financial products, extensive use of derivatives, market volatility and large scale regulatory changes, the management of risk is a key issue for every bank. NBB has over the years, developed risk management into a core competence and remains well positioned to meet these challenges. The Bank evaluates risk in terms of the impact on income and asset values. The evaluation reflects the Bank's assessment of the potential impact on its business on account of changes in political, economic and market conditions and in the credit worthiness of its clients. Risk management at NBB has always been prudent and proactive with the objective of achieving the optimum balance between risk appetite and expected returns.

Risk arises from the Bank's lending and investment activities as carried out by the various units. CorporateBanking is responsible for lending to large corporate entities in Bahrain. RegionalBanking handles credit facilities to leading corporates in other countries of the GCC. The Trade Finance and Financial Institutions unit is involved in identifying and financing trade flows between the GCC region and the rest of the world. CommercialBanking's responsibilities cover the borrowing requirements of small to medium-sized companies based in Bahrain. PersonalBanking handles lending to individuals in Bahrain and other retail services. Treasury and Investments is responsible for all the treasury and capital market related activities of the Bank, and the Abu Dhabi and Riyadh Branches serve the UAE and Saudi Arabian markets respectively.

The overall authority for risk management in the Bank is vested in the Board of Directors. The Board authorises appropriate credit and market risk policies as well as suitable operational guidelines based on the recommendation of Management. Approval authorities are delegated to different functionaries in the hierarchy depending on the amount, type of risk and collateral security. The Bank has established committees that decide on all risk issues and authorities are properly structured.

Integral to the Bank's risk management system is the internal audit department that plays a role in evaluating the independence and overall effectiveness of the Bank's risk management functions. A periodic review of risk assets is conducted by the department to confirm that established policies, procedures and approved terms are complied with, and to review asset quality and highlight areas of concern so that corrective action can be taken in time.

The Risk Group of the Bank provides the necessary support to Senior Management and the business units in all areas of risk management. This division functions independently of the business units to analyse risks and put forth its recommendations prior to approval by the delegated authorities. The Bank promotes healthy debate among the business units and Risk Group to achieve an optimum balance between risk and return.

The Bank's risk management process encompasses the various dimensions of risk as follows:

CREDIT RISK

Credit Risk represents the potential financial loss as a consequence of a customer's inability to honour the terms and conditions of the credit facility. Such risk is measured with

respect to counterparties for both on-balance sheet assets and off-balance sheet items. The Bank has well laid out procedures, not only to appraise but also to regularly monitor credit risk. Regular reviews are carried out for each account and risks identified are mitigated in a number of ways, which include obtention of collateral, counter-guarantees from shareholders and/or third parties. Adequate margins are maintained on the collateral to provide a cushion against adverse movement in the market price of collateral.

In addition to rigorous credit analysis, the terms and conditions of all credit facilities are strictly implemented by the Credit Administration Department. An internal grading system and review process ensures prompt identification of any deterioration in credit risk and consequent implementation of corrective action. The Bank's internal ratings are based on a 10-point scale that takes into account the financial strength of a borrower as well as qualitative aspects, to arrive at a comprehensive snapshot of the risk of default associated with the borrower. Ratings are further sub-divided into categories which reflect estimates of the potential maximum loss if default occurs. Risk Ratings assigned to each borrower are reviewed at least on an annual basis. Regular monitoring of the portfolio enables the Bank to weed out accounts that evidence deterioration in risk profile.

The Bank follows stringent criteria in setting credit limits for countries and international financial institutions. Prudent norms have also been implemented to govern the Bank's investment activities. Not only are regular appraisals conducted to judge the credit worthiness of the counterparty but day-to-day monitoring of financial developments across the globe ensures timely identification of any event affecting the risk profile.

The Bank enters into derivative contracts in the normal course of business to meet customer requirements and to manage its own exposure to fluctuations in interest and exchange rates. The credit risk arising from a derivative contract is calculated by taking the cost of replacing the contract, where its mark to market value is positive, together with an estimate for the potential future change in the value of the contract. The credit risk on contracts with a negative mark to market value is restricted to the potential future change in their market value. Details of derivative contracts are contained in Note 16 to the Financial Statements.

The Bank has systems and procedures in place to generate alerts in case of past dues in any account. A stringent classification process is followed for all accounts with past dues of over 90 days. The Bank applies rigorous standards for provisioning and monitoring of non- performing loans. Level of provisions required is determined based on the security position, repayment source, discounted values of cash flows, etc. Adequate provisions are carried to guard against inherent risks in the portfolio.

LEGAL RISK

Legal Risk management systems supplement the above credit procedures and guard against the inability of the Bank to enforce claims against counterparties and borrowers. In-house expertise together with firms of international repute retained by the Bank ensures that the facility documentation encompasses eventualities that might affect the implementation of stipulated terms and conditions.

LIQUIDITY RISK

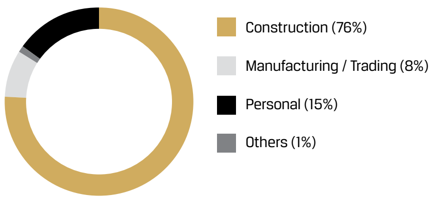
Liquidity Risk is classified as the potential inability of the bank to meet its financial obligations on account of a maturity mismatch between assets and liabilities. Liquidity risk management ensures that funds are available at all times to meet the funding requirements of the Bank.

The assets/liabilities management policies of the Bank define various liquidity criteria that need to be complied with, such as minimum level of liquid assets, gap limits, ratio of liquid assets to total assets, etc..

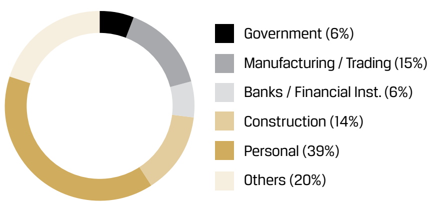
The Bank maintains adequate investments in liquid assets such as inter-bank placements and treasury bills. In addition, the Bank also relies on trading assets and other marketable securities to provide secondary sources of liquidity. The ratio of liquid assets to total assets as at 31 December 2012 was 36.6 per cent. The high level of liquidity enables the Bank to meet fluctuating customer borrowings and drawdowns comfortably.

The Bank's ability to maintain a stable liquidity profile is primarily on account of its success in retaining and growing its customer deposit base. The marketing strategy of the Bank has ensured a balanced mix of demand and time deposits. As a result of its successful deposit and asset-liability management strategies, the Bank is a net placer of funds in the interbank market and is not dependent on volatile short-term borrowings.

RISK MANAGEMENT



SECTOR PROFILE OF NON-PERFORMING LOANS AND ADVANCES
Per cent



SECTOR PROFILE OF LOAN & ADVANCES
Per cent

The Treasurer closely monitors the maturity profile of assets and liabilities so that adequate liquidity is maintained at all times. The asset and liability maturity profile by individual asset and liability category based on contractual repayment arrangements is detailed in Note 34 to the Financial Statements. As at 31 December 2012, 39.3 per cent of assets were scheduled to mature within three months. Substantial investment securities with contractual maturities of more than three months can also be readily liquidated. Considering the effective maturities of deposits based on retention history and in view of the ready availability of liquid investments, the Bank is able to ensure that sufficient liquidity is always available. Proper contingency plans exist and can be implemented on a timely basis to minimise the risk associated with dramatic changes in market conditions. The Asset Liability Committee (ALCO) chaired by the Chief Executive Officer, reviews the liquidity gap profile, liquidity scenarios and projections, and addresses strategic issues concerning liquidity.

INTEREST RATE RISK

Interest Rate Risk is measured by the extent to which changes in market interest rates impact margins, net interest income and the economic value of the Bank's equity. The Bank's asset and liability management process is utilised to manage interest rate risk through the structuring of on-balance sheet and off-balance sheet portfolios. Net interest income will be affected as a result of volatility in interest rates to the extent that the repricing structure of interest bearing assets differs from that of liabilities. The Bank's goal is to achieve stable earnings growth through active management of the assets and liabilities mix while selectively positioning itself to benefit from near-term changes in interest rate levels.

The Bank uses interest rate gap analysis to measure the interest rate sensitivity of its annual earnings due to repricing mismatches between rate sensitive assets, liabilities and derivatives positions. The interest rate sensitivity graph illustrates the Bank's repricing gap structure as at 31 December 2012. A negative gap denotes liability sensitivity and a positive gap denotes asset sensitivity. Note 31 to the Financial Statements gives details of the Bank's exposure to interest rate risk.

Duration analysis is used to measure the interest rate sensitivity of the fixed income portfolio. Modified Duration gives the percentage change in value of the portfolio following a 1per cent change in yield. Modified Duration of the Bank's fixed income portfolio was 3.39 per cent on 31.12.2012. This implies that a 1per cent parallel upward shift in the yield curve could result in a drop in the value of the portfolio by BD 22.4 million. Interest rate swaps and forward rate agreements are used to manage the interest rate risk. The Treasurer is primarily responsible for managing interest rate risk. Reports on overall positions and risks are submitted to senior management for review and positions are adjusted if deemed necessary. In addition, ALCO regularly reviews the interest rate sensitivity profile and its impact on earnings. Strategic decisions are made with the objective of producing a strong and stable interest income over time.

MARKET RISK

Market Risk is classified as the risk to the value of the trading portfolio arising from changes in interest rates, foreign exchange, commodities and equity prices. The Bank's trading activities are governed by conservative policies, adherence to limits set annually and regular reviews. Quality and rating are the main criteria in selecting a trading asset.

Using the Standardised Method, the Bank calculates the capital that is required to be held on account of the various risk factors affecting the trading book and currency positions. Capital requirement on account of interest rate risk, foreign exchange risk, equity risk, commodity risk and options risk are calculated separately and then summed up to arrive at the total market risk capital requirement of the Bank. The following table shows the capital charges as at 31 December 2012:

Particulars (BD 000,0)	Capital Charge
Interest Rate Risk	1,043.3
Equities Risk	83.7
Foreign Exchange Risk	52.9
Commodities Risk	-
Options Risk	-
Total minimum capital required for market risk	1,179.9
Multiplier	12.5
Market Risk weighted exposure under the Standardized Method	**14,749**

During the period January to December 2012, the maximum capital requirement as per Standardized Method was BD 2.8 million on 4th January 2012 while the minimum capital requirement was BD 0.9 million on 23rd January 2012.

OPERATIONAL RISK

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The Bank has well laid out procedures and systems that set out the methodologies for carrying out specific tasks. These systems and procedures are constantly reviewed and revised to address potential risks.

The Operational Risk Management department within the Risk Management Group independently monitors and manages all aspects of operational risk on a bank wide basis. The Bank has established an Operational Risk Management Committee (ORMC) to supervise, monitor and review operational risk issues and ensure that adequate mitgants are developed and implemented for all operational risk issues. The Risk and Control Self Assessment (RCSA) programme provides the ORMC with a compact and comparative view of operational risks along with their measure in terms of likelihood of occurrence and probable impact across various units of the Bank, and also provides a basis to evaluate and prioritise the requirement of control enhancements and new mitigation approaches in a structured manner.

In addition to the RCSA programme, the Bank also uses Key Risk Indicators (KRIs) as a tool to monitor operational risk. KRIs are statistics and /or metrics which provide insight into the Bank's operational risk position. KRIs have been designed with thresholds that indicate increasing level of risk, thereby providing an indication of severity and the requirement to take corrective action. KRI results are tracked regularly by the Operational Risk department and reviewed by the ORMC.

The scope of the Bank's internal audit department encompasses audits and reviews of all business units, support services and branches. The internal audit process focuses primarily on assessing risks and controls and ensuring compliance with established policies, procedures and delegated authorities. New products and services are also reviewed by the internal audit department and assessed for operational risk prior to their implementation. The internal audit department is operationally independent and reports significant internal control deficiencies to the Audit Committee.

The Bank has a well-established off-site computer back-up centre that provides full system support to the Bank's operations in case of an emergency in the information technology systems. The computer back-up centre is regularly tested to ensure its readiness for seamless switchover in case of any emergency.

Necessary procedures and systems have been put in place to protect the Bank from money laundering activities.

All the aspects of risk mentioned above are reviewed regularly at each meeting of the Board of Directors and the Executive Committee based on a comprehensive risk report. This integrated approach to risk management also serves the Bank in achieving its objective of protecting the interests of shareholders and customers.

FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of National Bank of Bahrain BSC ("the Bank"), which comprise the statement of financial position as at 31 December 2012, and the statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

RESPONSIBILITY OF THE BOARD OF DIRECTORS FOR THE FINANCIAL STATEMENTS

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

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

OPINION

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

REPORT ON OTHER REGULATORY REQUIREMENTS

As required by the Bahrain Commercial Companies Law and Volume 1 of the Central Bank of Bahrain (CBB) Rule Book, we report that: the Bank has maintained proper accounting records and the financial statements are in agreement therewith; the financial information contained in the directors' report 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, applicable provisions of Volume 6 and CBB directives), the CBB Capital Markets regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association having occurred during the year that might have had a material adverse effect on the business of the Bank or on its financial position; and satisfactory explanations and information have been provided to us by the management in response to all our requests.

KPMG

21 January 2013
Kingdom of Bahrain

STATEMENT OF FINANCIAL POSITION

As at 31 December 2012

		2012		2011	
	Note	**BD millions**	**US$ millions**	BD millions	US$ millions
Assets					
Cash and balances at central banks		**106.51**	**283.26**	96.90	257.70
Treasury bills	4	**380.11**	**1,010.94**	377.88	1,005.00
Placements with banks and other financial institutions	5	**486.07**	**1,292.74**	258.69	688.00
Trading securities	6	**0.52**	**1.39**	0.65	1.74
Loans and advances	7	**888.25**	**2,362.37**	972.07	2,585.31
Investment securities	8	**757.83**	**2,015.50**	650.21	1,729.27
Interest receivable and other assets	9	**20.48**	**54.46**	16.57	44.07
Property and equipment	18	**14.79**	**39.34**	15.68	41.70
Total assets		**2,654.56**	**7,060.00**	2,388.65	6,352.79
Liabilities					
Due to banks and other financial institutions	10	**168.53**	**448.22**	127.23	338.36
Borrowings under repurchase agreements	11	**75.42**	**200.59**	70.38	187.19
Customers' deposits	12	**2,077.90**	**5,526.34**	1,905.49	5,067.80
Interest payable and other liabilities	13	**13.77**	**36.61**	10.82	28.77
Total liabilities		**2,335.62**	**6,211.76**	2,113.92	5,622.12
Equity					
Share capital	19	**85.54**	**227.49**	85.54	227.49
Statutory reserve	20	**42.77**	**113.75**	42.77	113.74
General reserve	20	**32.40**	**86.17**	32.40	86.17
Other reserves and retained earnings	20	**158.23**	**420.83**	114.02	303.27
Total equity		**318.94**	**848.24**	274.73	730.67
Total liabilities and equity		**2,654.56**	**7,060.00**	2,388.65	6,352.79

The Board of Directors approved the financial statements consisting of pages 50 to 90 on 21 January 2013 and signed on their behalf by :

Farouk Yousuf Khalil Almoayyed
Chairman

Abdul Razak A. Hassan Al Qassim
Chief Executive Officer & Director

The accompanying notes 1 to 42 are an integral part of these financial statements.

INCOME STATEMENT

For the year ended 31 December 2012

	Note	2012 BD millions	2012 US$ millions	2011 BD millions	2011 US$ millions
Interest income	22	**78.31**	**208.27**	69.48	184.79
Interest expense	22	**(16.39)**	**(43.59)**	(14.11)	(37.53)
Net interest income		**61.92**	**164.68**	55.37	147.26
Other income	23	**24.69**	**65.66**	24.55	65.29
Total operating income		**86.61**	**230.34**	79.92	212.55
Staff expenses	24	**19.59**	**52.10**	19.23	51.15
Other expenses		**7.75**	**20.61**	7.38	19.62
Total operating expenses		**27.34**	**72.71**	26.61	70.77
Profit before provisions		**59.27**	**157.63**	53.31	141.78
Impairment provisions for loans and advances	7	**(9.21)**	**(24.49)**	(2.92)	(7.77)
Impairment provisions for investments		**(2.56)**	**(6.81)**	(4.75)	(12.63)
Profit for the year		**47.50**	**126.33**	45.64	121.38
Basic and diluted earnings per share	37	**55.5 fils**	**15 cents**	53.4 fils	14 cents

Farouk Yousuf Khalil Almoayyed
Chairman

Abdul Razak A. Hassan Al Qassim
Chief Executive Officer & Director

The accompanying notes 1 to 42 are an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2012

	2012		2011	
	BD millions	**US$ millions**	BD millions	US$ millions
Profit for the year	**47.50**	**126.33**	45.64	121.38
Other comprehensive income:				
Foreign currency translation movement	**0.03**	**0.08**	(0.01)	(0.03)
Fair Value reserve (available-for-sale investments):				
Net change in fair value	**22.66**	**60.26**	(11.33)	(30.13)
Net amount transferred to profit or loss	**0.97**	**2.58**	3.30	8.78
Total other comprehensive income for the year	**23.66**	**62.92**	(8.04)	(21.38)
Total comprehensive income for the year	**71.16**	**189.25**	37.60	100.00

The accompanying notes 1 to 42 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2012

For the year ended 31 December 2012

In BD Millions	Note	Share capital	Statutory reserve	General reserve	Fair Value reserve	Donation and charity reserve	Retained earnings*	Total BD Millions	Total US$ Millions
At 1 January 2012		85.54	42.77	32.40	18.44	8.16	87.42	274.73	730.67
2011 appropriations (approved by the shareholders)									
Dividend at 30%		-	-	-	-	-	(25.66)	(25.66)	(68.25)
Donation and charity		-	-	-	-	2.28	(2.28)	-	-
Balance after 2011 appropriations		85.54	42.77	32.40	18.44	10.44	59.48	249.07	662.42
Total comprehensive income for the year:									
Profit for the year		-	-	-	-	-	47.50	47.50	126.33
Other comprehensive income:									
Foreign currency translation movement		-	-	-	-	-	0.03	0.03	0.08
Fair value reserve (available-for sale investments):									
Net change in fair value		-	-	-	22.66	-	-	22.66	60.26
Net amount transferred to profit or loss		-	-	-	0.97	-	-	0.97	2.58
Total comprehensive income for the year		-	-	-	23.63	-	47.53	71.16	189.25
Utilization of donation and charity reserve		-	-	-	-	(1.29)	-	(1.29)	(3.43)
At 31 December 2012	**19-21**	**85.54**	**42.77**	**32.40**	**42.07**	**9.15**	**107.01**	**318.94**	**848.24**

* The appropriations for the year 2012 will be submitted to the shareholders for approval at the annual general meeting. These appropriations include BD 21.38 million for cash dividend at 25 % (2011: 30%), BD 2.37 million for donations and contributions and a transfer of BD 12.83 million from retained earnings to general reserve. The Board of Directors has also proposed a one for ten bonus issue through utilization of BD 8.55 million from general reserve and the transfer of BD 4.28 million from General Reserve to Statutory Reserve.

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2012

For the year ended 31 December 2011

In BD Millions	Note	Share capital	Statutory reserve	General reserve	Fair value reserve	Donation and charity reserve	Retained earnings	Total BD Millions	Total US$ Millions
At 1 January 2011		77.76	38.88	32.40	26.47	8.52	78.94	262.97	699.39
2010 appropriations (approved by the shareholders)									
Dividend at 30%		–	–	–	–	–	(23.33)	(23.33)	(62.05)
Donation and charity		–	–	–	–	2.15	(2.15)	–	–
Transfer to general reserve		–	–	11.67	–	–	(11.67)	–	–
Bonus shares issued		7.78	–	(7.78)	–	–	–	–	–
Transfer to Statutory reserve		–	3.89	(3.89)	–	–	–	–	–
Balance after 2010 appropriations		85.54	42.77	32.40	26.47	10.67	41.79	239.64	637.34
Total comprehensive income for the year:									
Profit for the year		–	–	–	–	–	45.64	45.64	121.38
Other comprehensive income:									
Foreign currency translation movement		–	–	–	–	–	(0.01)	(0.01)	(0.03)
Fair value reserve (available-for sale investments):									
Net change in fair value		–	–	–	(11.33)	–	–	(11.33)	(30.13)
Net amount transferred to profit or loss		–	–	–	3.30	–	–	3.30	8.78
Total comprehensive income for the year		–	–	–	(8.03)	–	45.63	37.60	100.00
Utilization of donation and charity reserve		–	–	–	–	(2.51)	–	(2.51)	(6.67)
At 31 December 2011	19-21	85.54	42.77	32.40	18.44	8.16	87.42	274.73	730.67

The accompanying notes 1 to 42 are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2012

	Note	2012 BD millions	2012 US$ millions	2011 BD millions	2011 US$ millions
CASH FLOWS FROM OPERATING ACTIVITIES:					
Profit for the year		**47.50**	**126.33**	45.64	121.38
Adjustments to reconcile net income to net cash from operating activities :					
Depreciation		**2.13**	**5.66**	2.01	5.35
Impairment provisions for loans and advances	7	**9.21**	**24.49**	2.92	7.77
Impairment provisions for investments		**2.56**	**6.81**	4.75	12.63
		61.40	**163.29**	55.32	147.13
CHANGES IN OPERATING ASSETS AND LIABILITIES					
Balances with central banks (mandatory cash reserves)		**(11.27)**	**(29.97)**	(4.30)	(11.44)
Treasury bills		**(48.48)**	**(128.94)**	(169.38)	(450.46)
Placement with banks and other financial institutions		**(49.64)**	**(132.02)**	(4.54)	(12.07)
Trading securities		**0.13**	**0.35**	(0.46)	(1.22)
Loans and advances		**74.60**	**198.40**	(24.19)	(64.34)
Investments designated at fair value through profit or loss		**2.03**	**5.40**	1.31	3.48
Available-for-sale investments		**(95.23)**	**(253.27)**	(1.42)	(3.78)
Interest receivable and other assets		**(3.91)**	**(10.40)**	(4.89)	(13.01)
Due to banks and other financial institutions		**41.30**	**109.84**	1.99	5.29
Borrowings under repurchase agreements		**5.04**	**13.40**	(36.21)	(96.30)
Customers' deposits		**172.41**	**458.54**	137.02	364.43
Interest payable and other liabilities		**2.95**	**7.84**	0.04	0.11
Net cash generated from / (used in) operating activities		**151.33**	**402.46**	(49.71)	(132.18)
CASH FLOWS FROM INVESTING ACTIVITIES:					
Purchase of property and equipment, net		**(1.22)**	**(3.24)**	(1.57)	(4.18)
Net cash used in investing activities		**(1.22)**	**(3.24)**	(1.57)	(4.18)
CASH FLOWS FROM FINANCING ACTIVITIES:					
Dividends paid		**(25.66)**	**(68.25)**	(23.33)	(62.05)
Donations and charities paid during the year		**(1.29)**	**(3.43)**	(2.51)	(6.67)
Net cash used in financing activities		**(26.95)**	**(71.68)**	(25.84)	(68.72)
Net increase / (decrease) in cash and cash equivalents		**123.16**	**327.54**	(77.12)	(205.08)
Cash and cash equivalents at 1 January	14	**426.85**	**1,135.25**	503.97	1,340.33
Cash and cash equivalents at 31 December	14	**550.01**	**1,462.79**	426.85	1,135.25

The accompanying notes 1 to 42 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

1. ACTIVITIES

National Bank of Bahrain BSC, a public shareholding company, was incorporated in the Kingdom of Bahrain by an Amiri decree in January 1957. The Bank is licensed by Central Bank of Bahrain as a conventional retail bank.

The overseas branches in Abu Dhabi (United Arab Emirates) and Riyadh (Kingdom of Saudi Arabia) operate under the laws of those respective countries. The Bank is principally engaged in providing retail and wholesale commercial banking services, treasury and investment activities and investment advisory services.

The Bank's registered address is National Bank of Bahrain BSC, P.O.Box 106, NBB Tower, Government Avenue, Manama, Kingdom of Bahrain. The shares of the Bank are listed on the Bahrain Bourse, Manama, Kingdom of Bahrain.

2. SIGNIFICANT ACCOUNTING POLICIES

a. Statement of Compliance

The financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS), the requirements of the Bahrain Commercial Companies Law 2001 and the Central Bank of Bahrain and Financial Institutions Law 2006.

b. Basis of preparation

The financial statements of the Bank are presented in Bahraini Dinar (BHD) being the functional currency of the Bank. The US Dollar (US$) amounts are presented for the convenience of the reader. The Bahraini Dinar has been translated to US dollar at the rate of BHD 0.376 to US$ 1 (2011: BHD 0.376 to US$ 1).

The financial statements have been prepared on the historical cost convention except for financial instruments at fair value through profit or loss, available-for-sale investments and derivative financial instruments which are measured at fair value. The principal accounting policies applied in the preparation of these financial statements have been consistently applied to all the years presented except as described below:

i) New standards, amendments and interpretations effective from 1 January 2012:

The following standards, amendments and interpretations, which became effective as of 1 January 2012, are relevant to the Bank:

a) IFRS 7 (amendment) – Disclosures: Transfer of financial assets

The amendments to IFRS 7 introduces new disclosure requirements about transfers of financial assets including disclosures for financial assets that are not derecognised in their entirety; and financial assets that are derecognised in their entirety but for which the entity retains continuing involvement.

The adoption of this amendment had no significant impact on the Bank's financial statements.

b) Improvements to IFRSs (2011)

Improvements to IFRS issued in 2011 contained numerous amendments to IFRS that the IASB considers non-urgent but necessary. 'Improvements to IFRS' comprise amendments that result in accounting changes to presentation, recognition or measurement purposes, as well as terminology or editorial amendments related to a variety of individual IFRS standards. There were no significant changes to the current accounting policies of the Bank as a result of these amendments.

ii) New standards, amendments and interpretations issued but not yet effective

The following standards and interpretations have been issued and are expected to be relevant to the Bank in future periods, with effective dates on or after 1 January 2013.

a) IAS 1 (amendment) - Presentation of items of other comprehensive income

The amendments to IAS 1 require that an entity present separately the items of other comprehensive income that would be reclassified to profit or loss in the future if certain conditions are met from those that would never be reclassified to profit or loss.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

The amendment is effective for annual periods beginning after 1 July 2012. The application of this amendment will have no significant impact on the financial statements of the Bank

b) Amendments to IFRS 7 and IAS 32 on offsetting financial assets and financial liabilities (2011)

Disclosures – Offsetting Financial Assets and Financial Liabilities (amendments to IFRS 7) introduces disclosures about the impact of netting arrangements on an entity's financial position which requires entities to provide information about what amounts have been offset in the statement of financial position and the nature and extent of rights of set off under master netting arrangements or similar arrangements.

Offsetting Financial Assets and Financial Liabilities (amendments to IAS 32) clarify the offsetting criteria by explaining when an entity currently has a legally enforceable right to set off and when gross settlement is equivalent to net settlement.

The amendments to IFRS 7 are effective on or after 1 January 2013 and the amendments to IAS 32 are effective on or after 1 January 2014. The application of these amendments will have no significant impact on the financial statements of the Bank.

c) IFRS 9 - Financial Instruments

IFRS 9 – Financial Instruments is part of a wider project to replace IAS 39 – Financial Instruments: recognition and measurement.

The IFRS 9 (2009) requirements represent a significant change from the existing requirements in IAS 39 in respect of financial assets. The standard contains two primary measurement categories for financial assets: amortised cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset.

IFRS 9 (2010) introduces a new requirement in respect of financial liabilities designated under the fair value option to generally present fair value changes that are attributable to the liability's credit risk in other comprehensive income rather than in profit or loss.

For an investment in an equity instrument which is not held for trading, the standard permits an irrevocable election, on initial recognition, on an individual share-by-share basis, to present all fair value changes from the investment in other comprehensive income. No amount recognised in other comprehensive income would ever be reclassified to profit or loss at a later date. However, dividends on such investments are recognised in profit or loss, rather than other comprehensive income unless they clearly represent a partial recovery of the cost of the investment. Investments in equity instruments in respect of which an entity does not elect to present fair value changes in other comprehensive income would be measured at fair value with changes in fair value recognised in profit or loss.

The IASB currently has an active project to make limited amendments to the classification and measurement requirements of IFRS 9 and add new requirements to address the impairment of financial assets and hedge accounting.

IFRS 9 is effective for annual periods beginning on or after 1 January 2015. The Bank is awaiting finalisation of the limited amendments before evaluating the potential impact of this standard.

d) IFRS 12 - Disclosures of interests in other entities

IFRS 12 brings together into a single standard all the disclosure requirements about an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. It requires the disclosure of information about the nature, risks and financial effects of these interests.

The standard is effective for annual periods beginning on or after 1 January 2013. The application of this standard will have no significant impact on the financial statements of the Bank.

e) IFRS 13 - Fair value measurement

IFRS 13 provides a single source of guidance on how fair value is measured and replaces the fair value measurement guidance that is currently dispersed throughout IFRS.

IFRS 13 is effective for annual periods beginning on or after 1 January 2013. The application of this standard will have no significant impact on the financial statements of the Bank.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

iii) Early adoption of standards

The Bank did not early adopt new or amended standards/interpretations in 2012.

c. Foreign currencies

Foreign currency transactions:

Foreign currency transactions are initially recorded at rates of exchange prevailing at the value date of the transactions. Monetary assets and liabilities in foreign currencies are translated to respective functional currencies at the rates of exchange prevailing at the statement of financial position date. Realised and unrealised exchange gains or losses are recognised in the income statement and included in "other Income".

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in income statement, except for differences arising on the retranslation of available-for-sale equity instruments which are recognised directly in other comperhensive income as part of fair value changes.

Foreign Operations:

The assets and liabilities of the overseas branches are translated into Bahraini Dinar at spot exchange rate at the reporting date. The income and expenses of these overseas branches for the period are translated into Bahraini Dinar at average exchange rates. Differences resulting from the translation of the opening net investment in these overseas branches are recognised in other comprehensive income.

d. Use of estimates and management judgement

The Bank's financial statements and its financial results are influenced by accounting policies, assumptions, estimates and management judgement, which necessarily have to be made in the course of preparation of the financial statements.

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities. All estimates and assumptions required in confirmity with IFRS are best estimates undertaken in accordance with the application of standard. Estimates and judgements are evaluated on a continuous basis, and are based on past experience and other factors, including expectations with regard to future events.

The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgements as to whether there is any observable data indicating an impairment trigger followed by measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the Bank. Management uses estimates based on historical loss experience for assets within credit risk characteristics and objective evidence of impairment similar to those in the portfolio to assess impairment.

The Bank classifies some non-derivative financial assets with fixed or determinable payments and fixed maturity as held to maturity. This classification requires significant judgement. In making this judgement, the Bank evaluates its intention and ability to hold such investments to maturity. If the Bank fails to keep these investments to maturity other than for the specific circumstances – for example selling an insignificant amount close to maturity - the Bank is required to reclassify the entire category as available-for-sale. Accordingly, the investments would be measured at fair value instead of amortized cost.

The Bank considers that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below cost. The determination of significant or prolonged decline requires judgement. In making this judgement, the Bank evaluates among other factors, the normal volatility in share price for the specific equity instrument and also the general market index. In addition, the Bank considers impairment when there is evidence of deterioration in the financial health of the investee company, industry and sector performance, changes in technology and operational and financing cash flows.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised, if the revision affects only that period or in the period of the revision and future period if the revision affects both current and future periods.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

e. Accounting for income and expenses

i) Interest income and expenses are recognised in the income statement on an accrual basis using the effective interest rate method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial asset or liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or liability. The application of the effective interest rate method has the effect of recognising interest income and interest expense evenly in proportion to the amount outstanding over the period to maturity or repayment. In calculating the effective interest rate, cash flows are estimated taking into consideration all contractual terms of the financial instrument but excluding future credit losses.

ii) Fees and commissions that are integral to the effective interest rate of a financial asset or liability are included in the calculation of the effective interest rate. Other fees and commissions are recognised as the related services are performed or received, and are included in fee and commission income.

iii) Dividend income is recognised when the right to receive a dividend is established.

iv) Short term employee benefit obligations are measured on an undiscounted basis and are expensed as the related services are provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit sharing plans if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

The Bank has different retirement benefit schemes for its employees in Bahrain and its overseas branches, which are in accordance with the relevant labour laws of the respective countries. The retirement benefit scheme is in the nature of a 'Defined Contribution Plan' for employees who are covered by the social insurance pension schemes in Bahrain and the overseas branches. Other employees are entitled to leaving indemnities payable in accordance with the employment agreements or under the respective labour laws, based on length of service and final remuneration. This liability, which is unfunded, is considered as a 'Defined Benefit Plan' which represents a defined benefit scheme under IAS 19, and is provided for on the basis of the cost had all such employees left at the statement of financial position date. The cost of providing these retirement benefits is charged to the income statement.

The Bank has a voluntary employees saving scheme. The Bank and the employees contribute monthly on a fixed percentage of salaries basis to the scheme. The scheme is managed and administered by a board of trustees who are the employees of the Bank. The Bank's share of contribution to this scheme is charged to the income statement.

v) Other expenses are recognised in the period in which they are incurred on an accrual basis.

f. Financial assets and liabilities

i) Investments at fair value through profit or loss

These comprise investments designated at inception at fair value though profit or loss and trading investments.

Investments designated at fair value through profit or loss: Investment securities which are acquired with an intent to hold for an indefinite period of time, and are managed, evaluated and reported internally on a fair value basis are designated as investments at fair value through profit or loss. These investments are carried at fair value based on quoted market prices, fund manager quotes or amounts derived from cash flow models as appropriate. Any unrealised gains and losses arising from changes in fair value are recognised in the income statement.

Trading Securities: Securities which are either acquired for the purpose of generating profit from short-term fluctuations in price or are included in a portfolio in which a pattern of short-term profit taking exists are categorised as trading securities. These securities are initially recognised at fair value and subsequently measured at fair value based on quoted market bid prices. Realised and unrealised gains and losses on trading securities are included in the income statement.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

ii) Held-To-Maturity Investments

Held-to-maturity investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank positively intends, and is able, to hold until maturity. Held to maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method, less any impairment losses.

iii) Available-for-Sale Investments

Investments which are non-derivative and which are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity, changes in interest rates or concerns with respect to credit deterioration are categorised as available-for-sale investments. Available-for-sale investments which comprise both debt and equity investments are initially recognised at fair value, including transaction costs, and subsequently measured at fair value based on quoted market prices, brokers quotes or amounts derived from cash flow models as appropriate. Unrealised gains and losses arising from changes in the fair values of available-for-sale investments are recognised in other comprehensive income. The cumulative fair value adjustments on available-for-sale investments which are sold or otherwise disposed of and which had previously been recognised in other comprehensive inome are transferred to the income statement.

iv) Investment securities measured as at amortised cost

Investments measured as at amortised cost are those non-derivative financial assets that have fixed or determinable payments that are not quoted in an active market. Investment securities measured as at amortised cost are stated at amortised cost, less provision for impairment.

v) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances are stated at amortised cost, adjusted for changes in fair value under any effective hedging arrangement, less provision for impairment.

vi) Customer deposits

Customer deposits are initially recognised at their fair value and subsequently measured at their amortised cost using the effective interest method.

vii) Financial guarantees

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specific debtor fails to make payment when due in accordance with the contractual terms.

Financial guarantees are initially recognised at fair value (which is the premium received on issuance). The premium received is amortised over the life of the financial guarantee. The guarantee liability (the notional amount) is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). The unamortised portion of the premium on these financial guarantees is included under other liabilities.

viii) Derivative financial instruments

All derivative financial instruments are initially recognised at cost, being the fair value at contract date, and are subsequently re-measured at their fair values. Fair values are obtained from quoted market prices in active markets including recent market transactions, and valuation techniques including discounted cash flow models and option pricing models as appropriate. Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in same income statement line as the hedged item. In the case of fair value hedges that meet the criteria for hedge accounting, any gain or loss arising from remeasuring the hedging instruments to fair value as well as the related changes in fair value of the item being hedged are recognised in the Income Statement under Other Income.

In the case of cash flow hedges that meet the criteria of hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion, if any, is recognised in the income statement.

All derivative financial instruments are recognised in the statement of financial position as either assets (positive fair values) or liabilities (negative fair values).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

ix) Repos and Reverse repos

Where securities are sold subject to a commitment to repurchase them at a specified future date (repo) and at a predetermined price, they are not derecognised and the consideration received is classified as Borrowings under Repurchase Agreements. The difference between the sale and repurchase price is treated as an interest expense and accrued over the life of the repo agreement using the effective yield method. Conversely, securities purchased under a commitment to resell them at a specified future date (reverse repo) and at a predetermined price are not recognised on the statement of financial position and the consideration paid is recorded in Placements with banks and other financial institutions. The difference between the purchase and resale price is treated as an interest income and accrued over the life of the reverse repo agreement using the effective yield method.

x) Cash and cash equivalents

Cash and cash equivalents comprise cash, balances at Central banks excluding mandatory cash reserves, Placements with banks and other financial institutions that mature within three months of the date of placement, and short-term highly liquid investments that are readily convertible to cash and which are subject to an insignificant risk of change in value and mature within three months of the date of acquisition and are used by the Bank in the management of its short term committments.

xi) Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method.

xii) Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Bank measures the fair value of a financial instrument using quoted market prices in an active market for that instrument. This includes listed equity and debt securities. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

For unlisted debt securities fair value is based on brokers quotes, recent arm's length transactions between knowledgeable, willing parties (if available) and discounted cash flow analyses with accepted economic methodologies for pricing financial instruments.

xiii) Categorisation of financial assets

The categorisation of financial assets into fair value through profit or loss, available-for-sale and held-to-maturity is done on the basis of the management intent at the time these securities are acquired and laid down investment policies.

xiv) Identification and measurement of impairment

The carrying amount of the Bank's financial assets is reviewed at each reporting period to determine whether there is objective evidence that a specific asset may be impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reasonably. If any such evidence exists, the recoverable amount of the asset is estimated to determine the extent of impairment.

Impairment losses on assets carried at amortised cost are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset shall be reduced directly or through use of an allowance account. The amount of the loss shall be recognized in Income Statement. When subsequent event causes the amount of impairment losses to decrease, the impairment loss is reversed through Income Statement.

Provision for impairment, pertaining to individually significant impaired loans and advances, is determined based on the difference between the net carrying amount and the estimated recoverable amount of the loans and advances, measured at the present value of estimated future cash flows from such loans and advances and discounting them based on their original effective interest rate. If a loan has a floating interest rate, the discount rate is the current effective rate determined under the contract. Impairment and uncollectability

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

is also measured and recognised on a portfolio basis for a group of loans and advances with similar credit risk characteristics, that are not individually identified as impaired, on the basis of estimates of losses that have been incurred but not yet specifically identified within the loans and advances portfolio at the statement of financial position date. The estimates are based on internal risk ratings, historical default rates, rating migrations, loss severity, macroeconomic and other relevant factors with historic loss experience being adjusted to reflect the effect of prevailing economic and credit conditions.

Loans and advances are written off after all reasonable attempts at restructuring and possible courses of action to achieve recovery have been exhausted and the possibility of any further recovery is considered to be remote.

In case of debt securities classified as available-for-sale, the bank assesses individually whether there is an objective evidence of impairment based on the same criteria as financial assets carried at amortised cost. The amount of impairment loss is the difference between the acquisition cost, net of any principle repayment and amortisation, and the current fair value, less impairment loss previously recognised in the income statement. If, in subsequent period, the fair value of an impaired available –for-sale debt security increases and the increase can be objectively related to a credit event occurring after the impairment loss was recognised in the income statement, then the impairment loss is reversed through the income statement.

For an investment in equity security classified as available-for-sale, a significant or prolonged decline in fair value below cost is an objective evidence of impairment. Where there is an objective evidence of impairment, the amount of impairment loss is measured as the difference between the acquisition cost and the current fair value, less any impairment loss previously recognised in the income statement. Any subsequent recovery in fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

xv) De-recognition of financial assets and liabilities

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognized 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 (a) the Bank has transferred substantially all the risks and rewards of the asset, or (b) the Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

g. Impairment of non-financial assets

At each statement of financial position date, the Bank reviews the carrying amounts of its non-financial assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the assets is estimated in order to determine the extent of the impairment loss, if any. Where it is not possible to estimate the recoverable amount of an individual asset, the Bank estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount.

An impairment loss is recognised in the income statement, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease. Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognized in the income statement, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

h. Investment in associates

Associates are those entities in which the Bank has significant influence, but not control, over their financial and operating policies. Significant influence is presumed to exist when the Bank holds between 20 and 50 percent of the voting power of another entity. Associates are accounted for using the equity method and are recognised initially at cost. The financial statements of the Bank include its share of the income and expenses and equity movements of associates, after adjustments to align the accounting policies with those of

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

the Bank, from the date that significant influence commences until the date that significant influence ceases. When the Bank's share of losses exceeds its interest in an associate, the carrying amount of that interest is reduced to nil and the recognition of further losses is discontinued except to the extent that the Bank has an obligation or has made payments on behalf of the associate.

i. Property and equipment

Property and equipment are initially recorded at cost and subsequently stated at cost less accumulated depreciation and impairment losses. Land is not depreciated and is stated at cost at the date of acquisition. Where an item of property and equipment comprises major components having different useful lives, they are accounted for separately. The cost of an item of property and equipment comprises its purchase price and any costs directly attributable to bringing the asset to the location and condition necessary for it to be put to its intended use. Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the property and equipment. The estimated useful lives are as follows:

Buildings	20 to 40 years
Furniture and Equipment	3 to 8 years

The residual value and the useful life of property and equipment are reviewed periodically and, if expectations differ from previous estimates, the change is recognised prospectively in the income statement over the remaining estimated useful life of the property and equipment.

j. Other provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

k. Off-setting

Financial assets and financial liabilities are only set-off and the net amount reported in the statement of financial position when there is a legally enforceable right to set-off the recognised amounts and the Bank intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

l. Settlement date accounting

All "regular way" purchases and sales of financial assets except for derivatives are recognised on the settlement date i.e. the date the Bank receives or delivers the asset. Regular way purchases and sales are those that require delivery of assets within the time frame generally established by regulation or convention in the market place. Derivative transactions are recognised on trade date i.e. the date the bank contracts to purchase or sell.

m. Proposed appropriations

Dividends and other proposed appropriations are recognised as a liability in the period in which they are approved by the shareholders.

n. Remuneration policy

Board of Directors - The remuneration of the Board of Directors is approved by the shareholders. In addition, directors are paid nominal fees for attending meetings of the sub-committees of Board.

Employees - The Bank's remuneration policies, which are approved by the Board of Directors, is applicable for all employees including the Chief Executive Officer. The remuneration primarily consists of monthly salaries and allowances. The Bank also has a discretionary profit sharing scheme based on the net income for the year and considering the employees' performance during the year.

o. Segment reporting

An operating segment is a component of the Bank that engages in business activities from which it may earn revenue and incur expenses, including revenues and expenses that relate to transactions with any of the other components of the Bank. All operating results of the operating segments are reviewed regularly by the Chief Executive Officer to make decisions about resource allocation and assess its performance, and for which discrete financial information is available.

p. Earnings per share

The Bank presents basic earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares.

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q. Income tax liability

The Bank's operations in Bahrain and Abu Dhabi are not liable to income tax. Riyadh branch is subject to income tax in accordance with the Saudi Income Tax Law. Income Tax, if any, is charged to the statement of comprehensive income.

r. Repossessed property

In certain circumstances, property is repossessed following the foreclosure on loans and advances that are in default. Repossessed properties are measured at the lower of carrying amount and fair value less costs to sell and reported within 'other assets'.

s. Fund administration

The Bank acts as a trustee/manager and in other capacities that result in holding or placing of assets on behalf of trust or other institutions. These assets and income arising thereon are not included in the Bank's financial statements as they are not assets of the Bank.

3. FINANCIAL RISK MANAGEMENT

The Bank is exposed to the following types of risks:

- credit risk
- liquidity risk
- market risk
- operational risk

Risk Management Framework

The overall authority for risk management in the Bank is vested in the Board of Directors. The Board authorises appropriate credit, liquidity and market risk policies as well as operational guidelines based on the recommendation of Management. The Bank has established various committees that review and assess all risk issues. Approval authorities are delegated to different functionaries in the hierarchy depending on the amount, type of risk and nature of operations or risk. The Risk Group (RG) of the Bank provides the necessary support to Senior Management and the business units in all areas of risk management. This Group functions independent of the business units and reports directly to the Chief Executive Officer.

The Audit Committee of the Board is responsible for monitoring compliance with the Bank's policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by the internal audit department, which undertakes both regular and adhoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee and to Management.

The Bank's risk management policies are established to identify and analyse the risk faced by the Bank, to set appropriate limits and controls, and to monitor risk and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Bank's activities. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

Credit Risk

Credit risk represents the potential financial loss as a consequence of a customer's inability to honour the terms and conditions of a credit facility. Such risk is measured with respect to counterparties for both on-balance sheet assets and off-balance sheet items.

The Bank has well laid out procedures, not only to appraise but also regularly monitor credit risk. Credit appraisal is based on the financials of the borrower, performance projections, market position, industry outlook, external ratings (where available) track record, account conduct, repayment sources and ability, tangible and intangible security, etc. Regular reviews are carried out for each account and risks identified are mitigated in a number of ways, which include obtention of collateral, counter-guarantees from shareholders and/or third parties. Adequate margins are maintained on the collateral to provide a cushion against adverse movement in the market price of collateral.

The Credit Review Department of the Bank analyses risks and puts forth its recommendations prior to approval by the appropriate authorities. In addition to rigorous credit analysis, the terms and conditions of all credit facilities are strictly implemented by the Credit Administration Department. An internal grading system and review process ensures prompt identification of any deterioration in credit risk and consequent implementation of corrective action.

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The Bank's internal ratings are based on a 10-point scale, which takes into account the financial strength of a borrower as well as qualitative aspects to arrive at a comprehensive snapshot of the risk of default associated with the borrower. Ratings are further sub-divided into categories, which reflect estimates of the potential maximum loss in an event of default. Risk Ratings assigned to each borrower are reviewed at least on an annual basis. Regular monitoring of the portfolio enables the Bank to identify accounts, which witness deterioration in risk profile. Consumer credit facilities which are granted based on pre-defined criteria such as salary assignment, maximum repayment obligation as a percentage of salary etc., are excluded from this rating system.

The Bank also uses the ratings by established rating agencies, viz., Moody's, Standard & Poor and Fitch as part of the appraisal process while considering exposures to rated entities.

Liquidity Risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk management ensures that funds are available at all times to meet the funding requirements of the Bank.

The asset/liabilities management policies of the Bank define the proportion of liquid assets to total assets with the aim of minimising liquidity risk. The Bank maintains adequate liquid assets such as inter-bank placements, treasury bills and other readily marketable securities, to support its business and operations. The Treasury department monitors the maturity profile of assets and liabilities so that adequate liquidity is maintained at all times. The Asset Liability Committee (ALCO) chaired by the Chief Executive Officer reviews the Liquidity Gap Profile and the Liquidity scenario and addresses strategic issues concerning liquidity.

Market Risk

Market Risk is the risk of potential losses arising from movements in market prices of interest rate related instruments and equities in the trading portfolio and foreign exchange and commodities holdings throughout the Bank. The Bank's trading activities are governed by conservative policies that are clearly documented, by adherence to comprehensive limit structures set annually and by regular reviews. Quality and rating are the main criteria in selecting a trading asset. The Bank uses the standardized method for allocating market risk capital based on the risk assessed for underlying factors of interest rate risk, equity risk, foreign exchange risk, options risk and commodity risk. Daily reports in this regard are submitted to senior management for review and decision making purposes.

Operational Risk

Operational Risk is the risk of monetary loss on account of human error, fraud, systems failures or the failure to record transactions. The Bank has well laid out procedures and systems that set out the methodologies for carrying out specific tasks. These systems and procedures are constantly reviewed and revised to address any potential risks.

The scope of the Bank's internal audit department encompasses audits and reviews of all business units, support services and branches. The internal audit process focuses primarily on assessing risks and controls and ensuring compliance with established policies, procedures and delegated authorities. New products and services are reviewed by the internal audit department and assessed for operational risks prior to their implementation. The internal audit department is operationally independent and reports significant internal control deficiencies to the Audit Committee.

Capital Management

The Bank's policy is to maintain sufficient capital to sustain investor, creditor and market confidence and to support future development of the business. The impact of the level of capital on return on shareholder's equity is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Central Bank of Bahrain's (CBB) Basel II guidelines outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1st January 2008. The Bank ensures that the capital adequacy requirements are met on a consolidated basis and also with local regulator's requirements, if any, in countries in which the Bank has branches. The Bank has complied with regulatory capital requirements throughout the year.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

4. TREASURY BILLS

Treasury bills are short-term and issued by the Government of Bahrain, Government of Saudi Arabia and short-term Islamic sukuk issued by the Government of Bahrain.

	2012		2011	
As at 31 December	BD '000	US$ '000	BD '000	US$ '000
Government of Bahrain	370,079	984,253	367,832	978,277
Government of Saudi Arabia	10,035	26,689	10,046	26,718
Total	**380,114**	**1,010,942**	377,878	1,004,995

5. PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

Placements with banks and other financial institutions is part of the Bank's money market activities and comprises short-term lending to banks and other financial institutions.

	2012		2011	
As at 31 December	BD '000	US$ '000	BD '000	US$ '000
Placements with banks	464,424	1,235,170	258,688	688,000
Placements with other financial institutions	21,647	57,572	-	-
Total	**486,071**	**1,292,742**	258,688	688,000

	2012		2011	
As at 31 December	BD '000	US$ '000	BD '000	US$ '000
Current and call accounts	9,471	25,189	9,280	24,681
Placements-Term	476,600	1,267,553	249,408	663,319
Total	**486,071**	**1,292,742**	258,688	688,000

6. TRADING SECURITIES

	2012		2011	
As at 31 December	BD '000	US$ '000	BD '000	US$ '000
Equity securities	523	1,391	653	1,737
Total	**523**	**1,391**	653	1,737

7. LOANS AND ADVANCES

	2012		2011	
a) As at 31 December	BD '000	US$ '000	BD '000	US$ '000
Loans and advances to non-banks	870,214	2,314,399	930,885	2,475,758
Loans and advances to banks	45,807	121,827	59,907	159,327
Less: Provision for impairment	(27,769)	(73,854)	(18,717)	(49,779)
Total	**888,252**	**2,362,372**	972,075	2,585,306

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

7. LOANS AND ADVANCES (CONTINUED)

b) Loans and advances are of a floating rate nature, since as per the Bank's loan agreements, the Bank reserves the right to change the rate of interest at any time in the event of money market fluctuations and/or other credit/banking considerations which may be set out from time to time by the Bank and/or any governmental or regulatory authority.

c) As at 31 December 2012, the amount of floating rate loans for which interest was being reset by the Bank on agreed dates and based on an agreed fixed margin over a benchmark interest rate, amounted to BD 426.2 million (US$ 1,133.5 million) [31 December 2011: BD 495.3 million (US$ 1,317.3 million)].

d) In accordance with the Bank's policy and the Central Bank of Bahrain guidelines, loans on which payments of interest or repayments of principal are 90 days past due, are defined as non-performing. The following is the ageing schedule of non-performing and other impaired and past due loans and advances. The table shows the time period since the date of last repayment of principal or interest by the customer.

	2012		2011	
As at 31 December	**BD '000**	**US$ '000**	BD '000	US$ '000
Over 3 months to 1 year	**60,647**	**161,295**	11,676	31,053
1 to 3 years	**4,882**	**12,984**	2,409	6,407
Over 3 years	**4,229**	**11,247**	3,878	10,314
Total	**69,758**	**185,526**	17,963	47,774

As at 31 December 2012, loans on which payments of interest or repayments of principal are overdue up to 90 days but not impaired amounted to BD 2.82 million (US$ 7.51 million) [31 December 2011: BD 11.60 million (US$ 30.84 million)].

As at 31 December 2012, the principal outstanding of the non-performing loans portfolio on which interest is not being accrued amounted to BD 58.44 million (US $ 155.43 million) [31 December 2011: BD 10.74 million (US $ 28.56 million)].

e) During 2012, credit facilities amounting to BD 43.22 million (US $ 114.95 million) were restructured [2011: BD 41.91 million (US $ 111.46 million)]. Restructuring concessions mainly related to deferral of loan installments to assist customers overcome temporary cash crunch situations or to realign the repayment with the borrowers'/projects' revised cash flow projections. Due to the minor nature of concessions, there was no significant impact on the Bank's provisions for loans and advances impairment and present and future earnings.

f) The Bank holds collateral against loans and advances to customers in the form of lien over deposits, mortgage over properties and/or shares and sovereign/ bank guarantees. As at 31 December 2012, loans and advances amounting to BD 318.6 million (US $ 847.3 million) [31 December 2011: BD 323.1 million (US $ 859.3 million)] was fully collateralized and loans and advances amounting to BD 6.4 million (US $ 17.0 million) [31 December 2011: BD 5.9 million (US $ 15.7 million)] was partly collateralized with a collateral value of BD 2.4 million (US $ 6.4 million) [31 December 2011: BD 2.6 million (US $ 6.9 million)].

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

7. LOANS AND ADVANCES (CONTINUED)

g) Exposure to credit risk

As at 31 December	2012 BD '000	2012 US$ '000	2011 BD '000	2011 US$ '000
TOTAL CARRYING AMOUNT	**888,252**	**2,362,372**	972,075	2,585,306
1. Individually impaired				
Substandard	**57,204**	**152,138**	7,225	19,215
Doubtful	**4,449**	**11,832**	461	1,226
Loss	**14,539**	**38,668**	14,367	38,210
Gross amount	**76,192**	**202,638**	22,053	58,651
Interest in suspense	**(6,434)**	**(17,112)**	(4,090)	(10,878)
Individually impaired net of interest in suspense	**69,758**	**185,526**	17,963	47,773
Specific provision for impairment	**(16,016)**	**(42,596)**	(10,946)	(29,112)
Individually impaired carrying amount	**53,742**	**142,930**	7,017	18,661
2. Past due below 90 days but not impaired				
Gross amount	**2,823**	**7,508**	11,595	30,838
Collective impairment provision	**(39)**	**(104)**	(93)	(247)
Past due but not impaired carrying amount	**2,784**	**7,404**	11,502	30,591
3. Neither past due nor impaired by internal rating				
Rated 1	**33,908**	**90,181**	62,381	165,907
Rated 2	**30,237**	**80,418**	36,752	97,745
Rated 3	**135,877**	**361,375**	110,882	294,899
Rated 4	**210,593**	**560,088**	208,681	555,003
Rated 5	**44,970**	**119,601**	91,708	243,904
Rated 6	**38,169**	**101,513**	78,873	209,769
Rated 7	**60,852**	**161,840**	70,009	186,194
Not rated *	**288,834**	**768,176**	301,948	803,053
Gross amount	**843,440**	**2,243,192**	961,234	2,556,474
Collective impairment provision	**(11,714)**	**(31,154)**	(7,678)	(20,420)
Carrying amount of neither past due nor impaired	**831,726**	**2,212,038**	953,556	2,536,054
Total carrying amount	**888,252**	**2,362,372**	972,075	2,585,306

* Includes mainly consumer loans and other facilities that are not assigned any ratings at inception.

h) Impairment provisions for loans and advances

Movements during the year Amounts in BD 000's	**Specific Impairment Provision** 2012	2011	**Collective Impairment Provision** 2012	2011	**Total Impairment Provisions** 2012	2011	**Interest in Suspense** 2012	2011
At 1 January	**10,946**	6,809	**7,771**	9,101	**18,717**	15,910	**4,090**	3,545
Charge & transfers for the year	**5,681**	4,485	**9,202**	2,869	**14,883**	7,354	**2,737**	770
Amounts written off against provision	**(167)**	(102)	**-**	(9)	**(167)**	(111)	**(208)**	(8)
Recoveries, transfers & write backs	**(444)**	(246)	**(5,220)**	(4,190)	**(5,664)**	(4,436)	**(185)**	(217)
At 31 December	**16,016**	10,946	**11,753**	7,771	**27,769**	18,717	**6,434**	4,090

The provisions and interest in suspense relate to loans and advances to non-banks.

In accordance with the Central Bank of Bahrain guidelines, interest on non-performing loans is reversed from income and is accounted for on a cash basis.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

8. INVESTMENT SECURITIES

Investment securities comprises of the following:

As at 31 December	2012 BD '000	2012 US$ '000	2011 BD '000	2011 US$ '000
Available-for-sale securities	**747,502**	**1,988,037**	641,976	1,707,383
Provision for impairment on available-for-sale securities	**(10,271)**	**(27,316)**	(12,329)	(32,790)
	737,231	**1,960,721**	629,647	1,674,593
Investments designated at fair value through profit or loss	**4,604**	**12,245**	6,625	17,620
Investment securities measured as at amortized cost	**15,991**	**42,529**	13,935	37,061
Total investment securities	**757,826**	**2,015,495**	650,207	1,729,274

A) Available for sale securities

i. Breakdown of quoted and unquoted securities

As at 31 December	2012 BD '000	2012 US$ '000	2011 BD '000	2011 US$ '000
Quoted:				
Debt securities	**432,264**	**1,149,638**	429,987	1,143,582
Equity securities	**54,435**	**144,774**	51,272	136,362
Total	**486,699**	**1,294,412**	481,259	1,279,944
Provision for impairment on available for sale securities	**(10,217)**	**(27,173)**	(12,275)	(32,646)
Total net quoted securities	**476,482**	**1,267,239**	468,984	1,247,298
Unquoted:				
Debt securities	**246,809**	**656,407**	146,115	388,604
Equity securities	**13,994**	**37,218**	14,602	38,835
Total	**260,803**	**693,625**	160,717	427,439
Provision for impairment on available for sale securities	**(54)**	**(143)**	(54)	(144)
Total net unquoted securities	**260,749**	**693,482**	160,663	427,295
Total available-for-sale securities	**737,231**	**1,960,721**	629,647	1,674,593

Available-for-sale securities at 31 December 2012 include securities amounting to BD 75.42 million (US$ 200.59 million) [31 December 2011:BD 70.38 million (US $ 187.19 million)], sold under agreement to repurchase.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

8. INVESTMENT SECURITIES (CONTINUED)

ii. Breakdown between fixed rate and floating rate available-for-sale debt securities (net of provision for impairment)

As at 31 December	2012 BD '000	2012 US$ '000	2011 BD '000	2011 US$ '000
Fixed rate debt securities	**442,852**	**1,177,798**	428,562	1,139,793
Floating rate debt securities	**236,221**	**628,247**	142,927	380,125
Total	**679,073**	**1,806,045**	571,489	1,519,918

iii. Breakdown of available-for-sale debt securities by rating (net of provision for impairment). The ratings given below are by established rating agencies.

As at 31 December	2012 BD '000	2012 US$ '000	2011 BD '000	2011 US$ '000
AAA	**75,445**	**200,652**	107,508	285,926
AA	**37,593**	**99,981**	53,044	141,075
A	**97,418**	**259,090**	105,112	279,553
BBB	**457,125**	**1,215,758**	291,670	775,718
BB+	**1,501**	**3,992**	1,354	3,601
B+	**-**	**-**	1,762	4,686
Not-rated	**9,991**	**26,572**	11,039	29,359
Total	**679,073**	**1,806,045**	571,489	1,519,918

B) Investments designated at fair value through profit or loss

Fair value through profit or loss investment securities comprise investments as under:

As at 31 December	2012 BD '000	2012 US$ '000	2011 BD '000	2011 US$ '000
Investments in managed funds	**912**	**2,426**	889	2,365
Investments in capital protected notes	**3,692**	**9,819**	5,736	15,255
Total	**4,604**	**12,245**	6,625	17,620

9. INTEREST RECEIVABLE AND OTHER ASSETS

As at 31 December	2012 BD '000	2012 US$ '000	2011 BD '000	2011 US$ '000
Interest receivable	**12,694**	**33,761**	7,421	19,737
Accounts receivable & prepayments	**2,150**	**5,718**	1,226	3,261
Others *	**5,632**	**14,979**	7,925	21,077
Total	**20,476**	**54,458**	16,572	44,075

* Others include investment of BD 3.05 million (US$ 8.11 million) [2011: BD 2.46 million (US$ 6.54 million)] in an associate company - The Benefit Company BSC (c) in which the Bank has an interest of 34.84 %. The carrying amount represents the cost of the investment and the share of profits less dividends received.

* Others include BD 1.29 million (US $ 3.43 million) [2011 : BD 1.29 million (US $ 3.43 million)] in respect of land and buildings acquired from customers and now held for disposal. The land and buildings are stated at lower of cost and fair value less cost to sell.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

10. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

Due to banks and other financial institutions consists of short-term borrowings from banks and financial institutions.

	2012		2011	
As at 31 December	BD '000	US$ '000	BD '000	US$ '000
Current and call accounts	29,852	79,394	28,888	76,830
Term deposits	138,677	368,822	98,337	261,535
Total	**168,529**	**448,216**	127,225	338,365

11. BORROWINGS UNDER REPURCHASE AGREEMENTS

Borrowings under repurchase agreements represent available-for-sale investments of BD 75.42 million (US $ 200.59 million) [2011: available-for-sale investments of BD 70.38 million (US $ 187.19 million)] sold under agreement to repurchase.

12. CUSTOMERS' DEPOSITS

	2012		2011	
As at 31 December	BD '000	US$ '000	BD '000	US$ '000
Repayable on demand or at short notice	962,131	2,558,859	1,038,982	2,763,250
Term deposits	1,115,773	2,967,481	866,512	2,304,553
Total	**2,077,904**	**5,526,340**	1,905,494	5,067,803

13. INTEREST PAYABLE AND OTHER LIABILITIES

	2012		2011	
As at 31 December	BD '000	US$ '000	BD '000	US$ '000
Interest payable	5,009	13,322	2,629	6,992
Creditors & account payables	2,716	7,223	2,449	6,513
Deferred income	1,678	4,463	752	2,000
Employee benefits	4,139	11,008	4,272	11,362
Others	224	596	715	1,902
Total	**13,766**	**36,612**	10,817	28,769

14. CASH AND CASH EQUIVALENTS

	2012		2011	
As at 31 December	BD '000	US$ '000	BD '000	US$ '000
Cash and balances at central banks*	17,328	46,085	18,986	50,495
Treasury bills	144,694	384,824	190,941	507,822
Placements with banks and other financial institutions	387,986	1,031,878	210,243	559,157
Investment securities	-	-	6,684	17,777
Total	**550,008**	**1,462,787**	426,854	1,135,251

* Exclude balances with central banks of BD 89.18 million (US$ 237.18 million) [2011: BD 77.91 million (US$ 207.21 million)] maintained for the purpose of the cash reserve ratio requirement set by the central banks.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

15. CONTINGENT LIABILITIES AND BANKING COMMITMENTS

The Bank issues commitments to extend credit and guarantees the performance of customers by issuing standby letters of credit and guarantees to third parties. For these instruments, the contractual amount of the financial instrument represents the maximum potential credit risk if the counterparty does not perform according to the terms of the contract. The credit exposure for the contingent liabilities is reduced by obtaining counter guarantees and collateral from third parties. A large majority of these expire without being drawn upon, and as a result, the contractual amounts are not representative of the actual future credit exposure or liquidity requirements of the Bank.

Based upon the level of fees currently charged, taking into account maturity and interest rates together with any changes in the credit worthiness of counter parties since origination, the Bank has determined that the fair value of contingent liabilities and undrawn loan commitments is not material.

	2012		2011	
As at 31 December	**BD '000**	**US$ '000**	BD '000	US$ '000
Contingent liabilities				
Liabilities on confirmed documentary credits	**53,600**	**142,553**	58,410	155,346
Guarantees:				
Counter guaranteed by banks	**21,309**	**56,673**	21,907	58,263
Others	**59,798**	**159,037**	46,172	122,798
Sub-total	**134,707**	**358,263**	126,489	336,407
Banking commitments				
Undrawn loan commitments	**16,797**	**44,673**	131	348
Forward commitments:				
Securities purchased	**-**	**-**	15	40
Interbank takings	**9,000**	**23,936**	9,293	24,715
Sub-total	**25,797**	**68,609**	9,439	25,103
Total	**160,504**	**426,872**	135,928	361,510

As at 31 December 2012, the remaining period to the contractual date for the forward commitments was within 14 days. On the contractual date these commitments were carried out, and resulted in cash flows in and out of the Bank as represented by the notional principal amount.

16. DERIVATIVE AND FOREIGN EXCHANGE FINANCIAL INSTRUMENTS

The Bank utilises various derivative and foreign exchange financial instruments for trading, asset/liability management and hedging risks. These instruments primarily comprise futures, forwards, swaps and options.

Futures and forward contracts are commitments to buy or sell financial instruments or currencies on a future date at a specified price or yield, and may be settled in cash or through delivery. Swap contracts are commitments to settle in cash on a future date or dates, interest rate commitments or currency amounts based upon differentials between specified financial indices, as applied to a notional principal amount. Option contracts give the acquirer, for a fee, the right but not the obligation, to buy or sell within a limited period a financial instrument or currency at a contracted price.

In respect of the derivative and foreign exchange financial instruments, the contract/notional principal amounts do not represent balances subject to credit or market risk. Contract/notional principal amounts represent the volume of outstanding transactions and are indicators of business activity. These amounts are used to measure changes in the value of derivative products and to determine the cash flows to be exchanged. The replacement cost is the cost of replacing those financial instruments with a positive market value, together with an estimate for the potential future change in the value of the contract, and reflects the maximum credit loss for the Bank had all these counterparties defaulted. For written options, there is no credit risk, as they represent obligations of the Bank. The fair value represents the aggregate of the positive and negative cash flows which would have occurred if the rights and obligations arising from the instrument were extinguished by the Bank in an orderly market as at the reporting date. The fair values of derivative financial instruments such as interest rate swaps and forward rate agreements were calculated using discounted cash flow models based on current market yields for similar types of instruments and the maturity of each instrument. The futures contracts, foreign exchange contracts and interest rate options were revalued using market prices and option valuation models as appropriate.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

16. DERIVATIVE AND FOREIGN EXCHANGE FINANCIAL INSTRUMENTS (CONTINUED)

a) The following table summarises for each type of derivative and foreign exchange financial instrument, the aggregate notional amounts, the replacement cost and the fair value :

Amounts in BD'000	Notional principal amount		Replacement cost		Fair value	
As at 31 December	**2012**	2011	**2012**	2011	**2012**	2011
Interest rate contracts						
Interest rate swaps	**183,436**	56,400	**28**	-	**(2,254)**	(406)
Sub-total	**183,436**	56,400	**28**	-	**(2,254)**	(406)
Foreign exchange contracts						
Outright spot and forward contracts	**154,191**	282,022	**227**	651	**51**	(262)
Swap agreements	**319,041**	272,235	**2,109**	5,194	**793**	4,426
Sub-total	**473,232**	554,257	**2,336**	5,845	**844**	4,164
Total	**656,668**	610,657	**2,364**	5,845	**(1,410)**	3,758

b) The remaining maturity profile by each class of derivative and foreign exchange financial instrument based on contract/notional principal amounts is as follows:

Amounts in BD'000	**2012**			2011		
As at 31 December	**Up to 1 year**	**More than 1 year**	**Total**	Up to 1 year	More than 1 year	Total
Interest rate contracts						
Interest rate swaps	**18,800**	**164,636**	**183,436**	-	56,400	56,400
Sub-total	**18,800**	**164,636**	**183,436**	-	56,400	56,400
Foreign exchange contracts						
Outright spot and forward contracts	**154,191**	**-**	**154,191**	282,022	-	282,022
Swap agreements	**319,041**	**-**	**319,041**	272,235	-	272,235
Sub-total	**473,232**	**-**	**473,232**	554,257	-	554,257
Total	**492,032**	**164,636**	**656,668**	554,257	56,400	610,657

17. CAPITAL COMMITMENTS

At 31 December 2012 commitments for capital expenditure amounted to BD 1.05 million (US $ 2.79 million) [31 December 2011:BD 0.80 million (US $ 2.13 million)].

18. PROPERTY & EQUIPMENT

	Land		**Buildings**		**Furniture and equipment**		**Total**	
	BD'000	**US$'000**	**BD '000**	**US$'000**	**BD'000**	**US$'000**	**BD'000**	**US$'000**
Cost	**761**	**2,024**	**25,245**	**67,141**	**13,344**	**35,489**	**39,350**	**104,654**
Accumulated depreciation	**-**	**-**	**(14,262)**	**(37,931)**	**(10,297)**	**(27,386)**	**(24,559)**	**(65,317)**
Net book value at 31 December 2012	**761**	**2,024**	**10,983**	**29,210**	**3,047**	**8,103**	**14,791**	**39,337**
Net Book value at 31 December 2011	761	2,024	11,542	30,697	3,378	8,984	15,681	41,705

The depreciation charge for 2012 amounted to BD 2.13 million (US $ 5.66 million) [2011: BD 2.01 million (US $ 5.35 million)].

The above includes capital work in progress at cost. When the asset is ready to use, the same is capitalised and depreciated in accordance with the Bank's policies.

NOTES TO THE FINANCIAL STATEMENTS

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19. SHARE CAPITAL

	2012		2011	
	BD '000	**US$ '000**	BD '000	US$ '000
Authorised share capital				
1,500,000,000 (2011: 1,500,000,000) ordinary shares of 100 fils each	**150,000**	**398,936**	150,000	398,936
Issued and fully paid share capital				
At 1 January: 855,360,000 ordinary shares of 100 fils each				
(2011: 777,600,000 ordinary shares of 100 fils each)	**85,536**	**227,489**	77,760	206,808
Bonus Issue (one for ten shares held)	**-**	**-**	7,776	20,681
At 31 December: 855,360,000 ordinary shares of 100 fils each	**85,536**	**227,489**	85,536	227,489

* The Board of Directors has proposed to increase the issued and fully paid capital of the Bank to BD 94.09 million by the issue of bonus shares at the rate of one additional share for every ten shares held amounting to BD 8.55 million. These shares will rank pari passu with all other shares for future dividends and distribution. This bonus issue is proposed to be made through utilisation of BD 8.55 million from General Reserve.

The distribution of ordinary shares, setting out the number of shares and shareholders and percentage of total outstanding shares in the following categories is shown below:

As at 31 December	2012			2011		
	Number of shares	**Number of shareholders**	**% of total outstanding shares**	Number of shares	Number of shareholders	% of total outstanding shares
Less than 1%	**274,882,264**	**1,159**	**32.1%**	274,822,170	1,146	32.1%
1% up to less than 5%	**100,731,112**	**6**	**11.8%**	100,791,206	6	11.8%
5% up to less than 10%	**60,620,224**	**1**	**7.1%**	60,620,224	1	7.1%
10% up to less than 20%	**-**	**-**	**-**	-	-	-
20% up to less than 50%	**419,126,400**	**1**	**49.0%**	419,126,400	1	49.0%
More than 50%	**-**	**-**	**-**	-	-	-
Total	**855,360,000**	**1,167**	**100.0%**	855,360,000	1,154	100.0%

The distribution of ordinary shares ownership based on nationality of the shareholder is shown below:

As at 31 December	2012			2011		
	Number of shares	**Number of shareholders**	**% of total outstanding shares**	Number of shares	Number of shareholders	% of total outstanding shares
Bahraini	**800,177,490**	**1,047**	**93.5%**	798,296,403	1,024	93.3%
Other GCC countries	**54,619,384**	**90**	**6.4%**	56,247,161	96	6.6%
Others	**563,126**	**30**	**0.1%**	816,436	34	0.1%
Total	**855,360,000**	**1,167**	**100.0%**	855,360,000	1,154	100.0%

49% of the Bank's share capital is held by the Bahrain Mumtalakat Holdings Co, that is 100% owned by the Government of Bahrain, 7.1% of the share capital is owned by Social Insurance Organisation. The rest of the share capital is widely held primarily by the citizens of and entities incorporated in the Kingdom of Bahrain.

NOTES TO THE FINANCIAL STATEMENTS

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20. RESERVES

a) Statutory reserve

In accordance with the Bahrain Commercial Companies Law 2001, 10 percent of net profit is appropriated to a statutory reserve, which is not normally distributable except in accordance with Article 224 of the law. Such appropriations may cease when the reserve reaches 50 percent of paid up share capital. The Board of Directors has proposed to the shareholders to appropriate BD 4.28 million from General Reserve to Statutory Reserve. The proposed increase in the Statutory Reserve results from the proposed increase in the share capital through bonus issue.

b) General reserve

The reserve has been created in accordance with the Bank's articles of association and underlines the shareholders' commitment to enhance the strong equity base of the Bank.

c) Fair value reserve

The fair value reserve includes the cumulative net change in fair value of available-for-sale investments, excluding impairment losses, until the investment is derecognised or impaired.

d) Donation and charity reserve

Based on the recommendations of the Board of Directors, upon shareholders approval an amount is transferred from the profit for the year to this reserve. The reserve represents the uncommitted amount of the donations and charities approved by the Shareholders.

21. APPROPRIATIONS

The appropriations relating to the year 2011 were approved at the last annual general meeting held on 7 March 2012.

22. INTEREST INCOME / INTEREST EXPENSES

a) Interest income

	2012		2011	
For the year ended 31 December	**BD '000**	**US$ '000**	BD '000	US$ '000
Loans and advances to customers	**46,912**	**124,766**	45,897	122,066
Loans and advances to banks	**772**	**2,053**	1,148	3,053
Treasury bills	**6,543**	**17,402**	2,301	6,120
Placement with banks & financial institutions	**3,360**	**8,936**	2,990	7,952
Investment securities	**20,205**	**53,737**	16,891	44,923
Derivative assets held for risk management	**518**	**1,378**	257	684
Total	**78,310**	**208,272**	69,484	184,798

b) Interest Expense

	2012		2011	
For the year ended 31 December	**BD '000**	**US$ '000**	BD '000	US$ '000
Deposits from customers	**14,094**	**37,484**	11,555	30,731
Deposits from banks and other financial institutions	**736**	**1,957**	622	1,654
Borrowings under repurchase agreements	**338**	**899**	429	1,141
Derivative liabilities held for risk management	**1,219**	**3,242**	1,505	4,003
Total	**16,387**	**43,582**	14,111	37,529

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For the year ended 31 December 2012

23. OTHER INCOME

	2012		2011	
For the year ended 31 December	**BD '000**	**US$ '000**	BD '000	US$ '000
a) Fees and commission income				
Fees and commission on loans and advances	**9,017**	**23,981**	7,939	21,114
Commission on sale of managed funds	**48**	**128**	85	226
Other fees and commission	**6,357**	**16,907**	5,908	15,713
Less: fees and commision paid	**(3,038)**	**(8,080)**	(2,472)	(6,574)
Sub-total	**12,384**	**32,936**	11,460	30,479
b) Other operating income				
Profit on sale of available for sale investments	**2,285**	**6,077**	2,106	5,601
Gain on fair value through profit or loss investments	**183**	**487**	5	13
Share dividend income	**3,475**	**9,242**	4,623	12,295
Profit on exchange dealing and transactions	**4,908**	**13,053**	4,672	12,426
Loss on trading securites and derivatives	**(127)**	**(338)**	(257)	(684)
Other income*	**1,577**	**4,198**	1,939	5,158
Sub-total	**12,301**	**32,719**	13,088	34,809
Total other income	**24,685**	**65,655**	24,548	65,288

* Other Income includes BD 0.75 million (US$ 1.99 million) [2011 :BD 0.56 million (US $ 1.49 million)] representing the Bank's share of profits from associate recognised during the year.

24. STAFF EXPENSES

	2012		2011	
For the year ended 31 December	**BD '000**	**US$ '000**	BD '000	US$ '000
Salaries, allowances and bonuses	**15,669**	**41,673**	15,153	40,301
Social Security & Gratuity	**2,062**	**5,484**	2,131	5,668
Housing & other benefits	**1,584**	**4,213**	1,690	4,495
Others	**275**	**731**	257	684
Total	**19,590**	**52,101**	19,231	51,148

25. SIGNIFICANT NET OPEN FOREIGN CURRENCY POSITIONS

	2012		2011	
As at 31 December	**BD '000**	**US$ '000**	BD '000	US$ '000
US Dollar (long position) - unhedged	**163,966**	**436,080**	398,721	1,060,428
UAE Dirhams (long position) - unhedged	**17,023**	**45,274**	45,146	120,069
Saudi Riyal (long position) - unhedged	**5,063**	**13,465**	65,810	175,027
Qatari Riyal (long position) - unhedged	**107,287**	**285,338**	74,563	198,306

The Bahraini dinar has a fixed rate of exchange against the US dollar.

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For the year ended 31 December 2012

26. RELATED PARTY DISCLOSURES

Certain related parties (major shareholders, directors of the Bank and families and companies of which they are principal owners, key management personnel) were customers of the Bank in the ordinary course of business.

The transactions with these parties were made on an arm's length basis. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Bank. Typically, key management personnel include the Chief Executive Officer and persons directly reporting to him. Balances at the reporting date in regard to related parties and transactions during the year with related parties comprised the following:

Amounts in BD'000	**Majority Shareholder**		**Directors**		**Key Management Personnel**	
As at 31 December	**2012**	2011	**2012**	2011	**2012**	2011
Loans and advances	**60,133**	108,776	**10,010**	7,469	**5**	19
Treasury bills and bonds	**809,465**	639,332	**-**	-	**-**	-
Customers' deposits	**294,843**	219,979	**27,829**	22,866	**4,579**	4,178
Contingent liabilities for irrevocable commitments, guarantees and other contingencies	**41,149**	48,655	**3,496**	2,917	**-**	-
For the year ended 31 December	**2012**	2011	**2012**	2011	**2012**	2011
Loans advanced	**13,660**	2,122	**1,869**	318	**4**	-
Loans repaid	**35,467**	67,671	**4,684**	4,947	**18**	46
Net increase / (decrease) in overdrafts	**(26,836)**	11,166	**5,356**	793	**-**	-
Treasury bills and bonds purchased	**1,121,656**	931,769	**-**	-	**-**	-
Treasury bills and bonds matured/sold	**951,523**	656,803	**-**	-	**-**	-
Interest income	**24,468**	15,360	**290**	357	**-**	2
Interest expense	**1,723**	1,567	**188**	104	**50**	39
Directors' remuneration & sitting fees	**166**	168	**231**	229	**42**	43
Short term employee benefits	**-**	-	**-**	-	**3,401**	3,374
Post employment retirement benefits	**-**	-	**-**	-	**718**	681

No impairment losses have been recorded during the year against balances outstanding with related parties and no specific allowance has been made for impairment losses on balances with related parties at the year end.

27. FUND ADMINISTRATION

Third party funds under administration held in trust or in fiduciary capacity are not treated as assets of the Bank and are, accordingly, not included in the statement of financial position. At 31 December 2012, third party funds under administration amounted to BD 14.63 million (US $ 38.92 million) [31 December 2011 :BD 22.31 million (US $ 59.34 million)].

28. GEOGRAPHICAL DISTRIBUTION

Amounts in BD'000	**Assets**		**Liabilities**		**Contingent liabilities and banking commitments**	
As at 31 December	**2012**	2011	**2012**	2011	**2012**	2011
Middle East	**2,479,814**	2,146,947	**2,234,067**	2,024,432	**363,984**	385,847
U.S.A.	**35,692**	81,333	**703**	665	**183,587**	56,434
Europe	**59,713**	134,860	**79,437**	82,935	**268,644**	290,230
Rest of the World	**79,342**	25,510	**21,410**	5,886	**957**	14,074
Total	**2,654,561**	2,388,650	**2,335,617**	2,113,918	**817,172**	746,585

NOTES TO THE FINANCIAL STATEMENTS

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29. DISTRIBUTION BY SECTOR

Amounts in BD'000	Assets		Liabilities		Contingent liabilities and banking commitments	
As at 31 December	**2012**	2011	**2012**	2011	**2012**	2011
Government	**971,357**	885,023	**312,872**	240,346	**55,862**	49,430
Manufacturing / trading	**142,009**	183,925	**152,216**	151,386	**26,756**	27,838
Banks / financial institutions	**816,733**	603,296	**641,507**	565,349	**691,413**	643,923
Construction	**125,110**	148,538	**37,226**	25,347	**27,463**	18,958
Personal	**342,829**	329,685	**1,067,222**	981,591	**1,814**	1,494
Others	**256,523**	238,183	**124,574**	149,899	**13,864**	4,942
Total	**2,654,561**	2,388,650	**2,335,617**	2,113,918	**817,172**	746,585

30. CONCENTRATION OF CREDIT RISK

The following is the concentration of credit risk by industry and geographical regions:

a) By Industry

Amounts in BD'000 As at 31 December 2012	Government Bahrain	Government Other countries	Manufacturing/ trading	Banks/ financial institutions	Construction	Personal	Others	Total
Assets								
Balances at central banks	-	-	-	91,523	-	-	-	91,523
Treasury bills	370,079	10,035	-	-	-	-	-	380,114
Placements with banks and other financial institutions	-	-	-	486,071	-	-	-	486,071
Loans and advances	57,100	119	130,915	57,151	120,484	342,213	180,270	888,252
Investment securities	439,386	90,545	4,238	136,015	-	-	29,484	699,668
Interest receivable and other assets	3,777	316	732	2,742	3,386	616	5,299	16,868
Total assets	**870,342**	**101,015**	**135,885**	**773,502**	**123,870**	**342,829**	**215,053**	**2,562,496**
Contingent liabilities and banking commitments	**55,862**	**-**	**26,756**	**34,745**	**27,463**	**1,814**	**13,864**	**160,504**
Derivatives (notional)	**-**	**-**	**-**	**656,668**	**-**	**-**	**-**	**656,668**

NOTES TO THE FINANCIAL STATEMENTS

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30. CONCENTRATION OF CREDIT RISK (CONTINUED)

a) By Industry

Amounts in BD'000 As at 31 December 2011	Government Bahrain	Other countries	Manufacturing/ trading	Banks/ financial institutions	Construction	Personal	Others	Total
Assets								
Balances at central banks	-	-	-	85,048	-	-	-	85,048
Treasury bills	367,832	10,046	-	-	-	-	-	377,878
Placements with banks and other financial institutions	-	-	-	258,688	-	-	-	258,688
Loans and advances	109,486	1,205	156,811	72,620	146,907	328,918	156,128	972,075
Investment securities	271,500	122,510	17,242	147,428	-	-	33,369	592,049
Interest receivable and other assets	1,409	1,035	516	1,658	768	767	7,241	13,394
Total assets	750,227	134,796	174,569	565,442	147,675	329,685	196,738	2,299,132
Contingent liabilities and banking commitments	49,430	-	27,838	33,266	18,958	1,494	4,942	135,928
Derivatives (notional)	-	-	-	610,657	-	-	-	610,657

The balances at the end of the year are representative of the position during the year and hence average balances have not been separately disclosed.

The above includes certain exposures to customers / counter parties which are in excess of 15% of the Bank's capital base. These have the approval of the Central Bank of Bahrain or are exempt exposures under the large exposures policy of the Central Bank of Bahrain. The table below gives details of these exposures as at 31 December 2012:

Amounts in BD'000 **Counterparty**	**Counterparty type**	**Total Exposure**
Counterparty A	Sovereign	827,979
Counterparty B	Sovereign	414,897
Counterparty C	Sovereign	86,549
Counterparty D	Corporate	60,114
Counterparty E	Sovereign	56,667
Counterparty F	Corporate	49,763

(b) By geographical regions:

Amounts in BD'000 As at 31 December 2012	**Middle East**	**USA**	**Europe**	**Rest of the World**	**Total**
Assets					
Balances at central banks	**91,523**	**-**	**-**	**-**	**91,523**
Treasury bills	**380,114**	**-**	**-**	**-**	**380,114**
Placements with banks and other financial institutions	**443,061**	**4,089**	**38,381**	**540**	**486,071**
Loans and advances	**888,252**	**-**	**-**	**-**	**888,252**
Investment securities	**569,682**	**31,560**	**19,964**	**78,462**	**699,668**
Interest receivable and other assets	**15,114**	**44**	**1,368**	**342**	**16,868**
Total assets	**2,387,746**	**35,693**	**59,713**	**79,344**	**2,562,496**
Contingent liabilities and banking commitments	**142,024**	**151**	**17,566**	**763**	**160,504**
Derivatives (notional)	**221,960**	**183,436**	**251,078**	**194**	**656,668**

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For the year ended 31 December 2012

30. CONCENTRATION OF CREDIT RISK (CONTINUED)

(b) By geographical regions continued:

Amounts in BD'000 As at 31 December 2011	Middle East	USA	Europe	Rest of the World	Total
Assets					
Balances at central banks	85,048	-	-	-	85,048
Treasury bills	377,878	-	-	-	377,878
Placements with banks and other financial institutions	212,144	4,324	41,961	259	258,688
Loans and advances	969,867	-	-	2,208	972,075
Investment securities	401,277	76,940	91,705	22,127	592,049
Interest receivable and other assets	11,868	69	1,194	263	13,394
Total assets	2,058,082	81,333	134,860	24,857	2,299,132
Contingent liabilities and banking commitments	115,662	34	19,552	680	135,928
Derivatives (notional)	270,185	56,400	270,678	13,394	610,657

31. INTEREST RATE RISK

Interest Rate Risk is measured by the extent to which changes in the market interest rates impact margins, net interest income and the economic value of the Bank's equity. Net interest income will be affected as a result of volatility in interest rates to the extent that the re-pricing structure of interest bearing assets differs from that of liabilities. The Bank's goal is to achieve stable earnings growth through active management of the assets and liabilities mix while, selectively, positioning itself to benefit from near-term changes in interest rate levels. The treasurer is primarily responsible for managing the interest rate risk. Reports on overall position and risks are submitted to senior management for review and positions are adjusted if deemed necessary. In addition, ALCO regularly reviews the interest rate sensitivity profile and its impact on earnings.

The Bank's asset and liability management process is utilised to manage interest rate risk through the structuring of on-balance sheet and off-balance sheet portfolios. The Bank uses various techniques for measuring and managing its exposure to interest rate risk. Duration analysis is used to measure the interest rate sensitivity of the fixed income portfolio. Duration of the portfolio is governed by economic forecasts, expected direction of interest rates and spreads. Modified duration gives the percentage change in value of the portfolio following a 1% change in yield. Interest rate swaps and forward rate agreements are used to manage the interest rate risk. The Bank uses interest rate gap analysis to measure the interest rate sensitivity of its annual earnings due to repricing mismatches between rate sensitive assets, liabilities and derivatives' positions.

Assets and liabilities are placed in maturity buckets based on the remaining period to the contractual repricing or maturity dates, whichever is earlier. Customers' deposits for which no specific contractual maturity or repricing dates exist are placed in ladders based on the Bank's judgement concerning their most likely repricing behaviour.

NOTES TO THE FINANCIAL STATEMENTS

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31. INTEREST RATE RISK (CONTINUED)

The repricing profile and effective interest rate of the various asset and liability categories are as follows:

Amounts in BD'000 As at 31 December 2012	**Effective interest rate %**	**Up to 3 months**	**3 to 6 months**	**6 to 12 months**	**1 to 5 years**	**More than 5 years**	**Rate insensitive**	**Total**
Assets								
Cash and balances at central banks	**-**	**-**	**-**	**-**	**-**	**-**	**106,508**	**106,508**
Treasury bills	**1.29%**	**274,423**	**80,437**	**25,254**	**-**	**-**	**-**	**380,114**
Placements with banks and other financial institutions	**0.83%**	**441,225**	**19,731**	**15,644**	**-**	**-**	**9,471**	**486,071**
Trading securities	**-**	**-**	**523**	**-**	**-**	**-**	**-**	**523**
Loans and advances	**4.64%**	**358,964**	**31,619**	**61,298**	**345,145**	**91,226**		**888,252**
Investment securities	**4.09%**	**61,281**	**3,920**	**19,859**	**414,799**	**195,205**	**62,762**	**757,826**
Interest receivable and other assets	**-**	**-**	**-**	**-**	**-**	**-**	**20,476**	**20,476**
Property and equipment	**-**	**-**	**-**	**-**	**-**	**-**	**14,791**	**14,791**
Total assets		**1,135,893**	**136,230**	**122,055**	**759,944**	**286,431**	**214,008**	**2,654,561**
Liabilities and equity								
Due to banks and other financial institutions	**0.45%**	**136,045**	**2,632**	**-**	**-**	**-**	**29,852**	**168,529**
Borrowings under repurchase agreements	**0.87%**	**75,418**	**-**	**-**	**-**	**-**	**-**	**75,418**
Customers' deposits	**0.72%**	**942,658**	**342,236**	**30,156**	**2,743**	**-**	**760,111**	**2,077,904**
Interest payable and other liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**13,766**	**13,766**
Equity	**-**	**-**	**-**	**-**	**-**	**-**	**318,944**	**318,944**
Total liabilities and equity		**1,154,121**	**344,868**	**30,156**	**2,743**	**-**	**1,122,673**	**2,654,561**
On-Balance sheet interest rate sensitivity gap		**(18,228)**	**(208,638)**	**91,899**	**757,201**	**286,431**	**(908,665)**	**-**
Off-Balance sheet interest rate gap		**145,836**	**37,600**	**(18,800)**		**(164,636)**	**-**	**-**
Cumulative interest rate sensitivity gap		**127,608**	**(43,430)**	**29,669**	**786,870**	**908,665**	**-**	**-**

Amounts in BD'000 As at 31 December 2011	Effective interest rate %	Up to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	More than 5 years	Rate insensitive	Total
Assets								
Cash and balances at central banks	-	-	-	-	-	-	96,896	96,896
Treasury bills	1.20%	294,557	83,321	-	-	-	-	377,878
Placements with banks and other financial institutions	0.86%	242,138	7,270	-	-	-	9,280	258,688
Trading securities	-	-	-	-	-	-	653	653
Loans and advances	5.02%	443,954	89,997	51,226	295,174	91,724	-	972,075
Investments securities	3.61%	107,305	26,358	51,667	302,236	97,858	64,783	650,207
Interest receivable and other assets -	-	-	-	-	-	16,572	16,572	
Property and equipment	-	-	-	-	-	-	15,681	15,681
Total assets	-	1,087,954	206,946	102,893	597,410	189,582	203,865	2,388,650
Liabilities and equity								
Due to banks and other financial institutions	0.60%	95,923	2,632	-	-	-	28,670	127,225
Borrowings under repurchase agreements	0.35%	70,382	-	-	-	-	-	70,382
Customers' deposits	0.66%	1,126,704	125,838	24,798	1,358	-	626,796	1,905,494
Interest payable and other liabilities	-	-	-	-	-	-	10,817	10,817
Equity	-	-	-	-	-	-	274,732	274,732
Total liabilities and equity		1,293,009	128,470	24,798	1,358	-	941,015	2,388,650
On-Balance sheet interest rate sensitivity gap		(205,055)	78,476	78,095	596,052	189,582	(737,150)	-
Off-Balance sheet interest rate gap		18,800	37,600	-	(18,800)	(37,600)	-	-
Cumulative interest rate sensitivity gap		(186,255)	(70,179)	7,916	585,168	737,150	-	-

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32. MARKET RISK

a) The Bank uses the Standardised Method for allocating market risk capital.

The following table shows the capital charges as at 31 December

Amounts in BD'000 **Risk Type**	**2012**	2011
Interest Rate Risk	**1,043.3**	2,482.6
Equities Risk	**83.7**	106.8
Foreign Exchange Risk	**52.9**	100.0
Commodities Risk	**-**	-
Options Risk	**-**	-
Total minimum capital required for market risk	**1,179.9**	2,689.4
Multiplier	**12.5**	12.5
Market Risk weighted exposure under the Standardized Method	**14,749**	33,617

b) The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in future cash flows or fair values of financial instruments because of changes in market interest rates. The interest rate risk management process is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to an interest rate shock of 200bps increase/decrease. An analysis of the Bank's sensitivity to an increase or decrease in market interest rates (assuming no asymmetrical movement in yield curves and a constant balance sheet position) is as follows:

	2012		2011	
Amounts in BD'000	**200 bps parallel increase**	**200 bps parallel decrease**	200 bps parallel increase	200 bps parallel decrease
At 31 December	**(44,823)**	**44,823**	(13,285)	13,285
Average for the year	**(31,993)**	**31,993**	(15,712)	15,712
Minimum for the year	**(26,000)**	**26,000**	(13,285)	13,285
Maximum for the year	**(45,744)**	**45,744**	(17,481)	17,481

c) The Bank holds investments in quoted equities as part of the available for sale investments. Equity risk is the potential adverse impact due to movements in individual equity prices or general market movements in stock markets. The Bank manages this risk through diversification of investments in terms of geographical distribution and industrial concentration.

Overall non-trading interest rate risk positions are managed by the Treasury division, which uses investment securities, placements with banks, deposits from banks and derivative instruments to manage the overall position arising from the Bank's non-trading activities. The use of derivatives to manage interest rate risk is described in note 16.

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33. SEGMENT INFORMATION

For management purposes, the Bank is organised into the following main strategic business units (SBUs) - Personal Banking, Bahrain Business Banking and Treasury & International Banking. These SBUs are the basis on which the Bank reports its operating segment information.

The Personal Banking and Bahrain Business Banking SBUs provide various banking products and services to the Bank's customers in Bahrain . The SBUs are differentiated based on their respective customer segments. Personal Banking caters to individuals. Bahrain Business Banking caters to government, corporates, small & medium enterprises.

The Treasury & International Banking SBU has the overall responsibility of managing the Bank's liquidity, interest rate, foreign exchange and market risk and provide various banking products and services to Bank's customers outside Bahrain.

Financial information about the operating segments is presented in the following table:

Amounts in BD'000	**Personal Banking**		**Bahrain Business Banking**		**Treasury & International Banking**		**Total**	
For the year ended 31 December	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
Interest income	**23,967**	23,956	**19,906**	19,935	**34,437**	25,593	**78,310**	69,484
Interest expense	**(4,067)**	(3,744)	**(9,235)**	(7,299)	**(3,085)**	(3,068)	**(16,387)**	(14,111)
Inter-segment interest income/(expense)	**4,560**	3,072	**7,801**	5,087	**(12,361)**	(8,159)	**-**	-
Net interest income	**24,460**	23,284	**18,472**	17,723	**18,991**	14,366	**61,923**	55,373
Other income	**8,750**	8,388	**1,702**	2,902	**14,232**	13,258	**24,684**	24,548
Operating income	**33,210**	31,672	**20,174**	20,625	**33,223**	27,624	**86,607**	79,921
Result	**20,635**	17,727	**6,720**	14,674	**23,277**	16,622	**50,632**	49,023
Unallocated corporate expenses							**(3,133)**	(3,387)
Profit for the year							**47,499**	45,636
Other information:								
Segment assets	**369,485**	357,052	**419,961**	490,340	**1,865,115**	1,541,258	**2,654,561**	2,388,650
Segment liabilities & Equity	**804,993**	762,353	**1,274,346**	1,129,105	**575,222**	497,192	**2,654,561**	2,388,650
Depreciation for the year	**751**	799	**249**	298	**362**	372	**1,362**	1,469
Provision for impaired assets	**1,527**	3,342	**7,256**	(99)	**2,988**	4,430	**11,771**	7,673

During 2012, the total capital expenditure amounted to BD 1.22 million (US$ 3.24 million) [2011: BD 1.57 million (US$ 4.18 million)].

Segment revenues and expenses are directly attributable to the business segments. The benefit of the Bank's capital has been distributed among the segments in proportion to their total assets employed. Expenses of departments whose services are jointly utilised by more than one segment have been allocated to the relevant segments on an appropriate basis.

Inter-segment interest income and expense represent the interest cost on the excess funds which are automatically transferred by all the other business segments to Treasury and International Banking. The interest rate for calculating interest of such transfers is set once every three months separately for local and foreign currency and is based on the weighted average of market rates for various maturities for each currency.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

33. SEGMENT INFORMATION (CONTINUED)

While the Bank conducts its Banking business primarily through its strategic Business units, it operates from various geographical locations:

(I) Domestic operations, through its network of branches in the Kingdom of Bahrain and
(ii) Overseas operations through its branches in the United Arab Emirates and Saudi Arabia.

Financial information about geographical locations is presented in the following table:

Amounts in BD 000's	Domestic		Overseas		Total	
For the year ended 31 December	**2012**	2011	**2012**	2011	**2012**	2011
Operating income	**83,752**	78,109	**2,855**	1,812	**86,607**	79,921
Profit for the year	**47,049**	46,054	**450**	(418)	**47,499**	45,636
At 31 December						
Segment assets	**2,549,112**	2,249,879	**105,449**	138,771	**2,654,561**	2,388,650
Segment liabilities & Equity	**2,549,112**	2,249,879	**105,449**	138,771	**2,654,561**	2,388,650

34. MATURITY PROFILE AND LIQUIDITY RISK

a) Maturity Profile

The table below shows the maturity profile of total assets and liabilities and equity based on contractual terms, except for Asset Backed securities and Mortgage Backed securities which are based on expected weighted average tenor as it is better representative of the product's maturity profile considering the inherent nature of the products.

Amounts in BD'000 As at 31 December 2012	Up to 3 months	3 to 6 months	6 to 12 months	1 to 3 years	3 to 5 years	5 to 10 years	10 to 20 years	Over 20 years	Total
Assets									
Cash and balances at central banks	106,508	-	-	-	-	-	-	-	106,508
Treasury bills	274,423	80,437	25,254	-	-	-	-	-	380,114
Placements with banks and other financial institutions	450,696	19,731	15,644	-	-	-	-	-	486,071
Trading securities	-	523	-	-	-	-	-	-	523
Loans and advances	177,213	41,073	88,156	285,429	155,195	110,809	29,723	654	888,252
Investment securities	26,465	3,920	31,700	302,511	138,157	196,869	-	58,204	757,826
Interest receivable & other assets and property & equipment	6,895	334	335	4,110	1,166	3,390	-	19,037	35,267
Total assets	**1,042,200**	**146,018**	**161,089**	**592,050**	**294,518**	**311,068**	**29,723**	**77,895**	**2,654,561**
Liabilities and equity									
Due to banks and other financial institutions	165,897	2,632	-	-	-	-	-	-	168,529
Borrowings under repurchase agreements	75,418	-	-	-	-	-	-	-	75,418
Customers' deposits	1,702,748	342,249	30,162	2,745					2,077,904
Interest payable & other liabilities	10,521	954	232	2,059	-	-	-	-	13,766
Equity	21,384	-	-	-	-	-	-	297,560	318,944
Total liabilities and equity	**1,975,968**	**345,835**	**30,394**	**4,804**	**-**	**-**	**-**	**297,560**	**2,654,561**

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

34. MATURITY PROFILE AND LIQUIDITY RISK (CONTINUED)

Amounts in BD'000 As at 31 December 2011	Up to 3 months	3 to 6 months	6 to 12 months	1 to 3 years	3 to 5 years	5 to 10 years	10 to 20 years	Over 20 years	Total
Assets									
Cash and balances at central banks	96,896	-	-	-	-	-	-	-	96,896
Treasury bills	294,557	83,321	-	-	-	-	-	-	377,878
Placements with banks and other financial institutions	251,418	7,270	-	-	-	-	-	-	258,688
Trading securities	653	-	-	-	-	-	-	-	653
Loans and advances	173,661	79,538	109,874	282,161	161,773	131,993	32,220	855	972,075
Investment securities	15,365	31,392	77,959	205,297	159,344	102,559	-	58,291	650,207
Interest receivable & other assets and property & equipment	9,196	209	846	2,235	340	-	-	19,427	32,253
Total assets	841,746	201,730	188,679	489,693	321,457	234,552	32,220	78,573	2,388,650
Liabilities and equity									
Due to banks and other financial institutions	124,593	2,632	-	-	-	-	-	-	127,225
Borrowings under repurchase agreements	70,382	-	-	-	-	-	-	-	70,382
Customers' deposits	1,750,509	126,255	26,241	2,150	41	298	-	-	1,905,494
Interest payable & other liabilities	9,971	370	114	362	-	-	-	-	10,817
Equity	25,661	-	-	-	-	-	-	249,071	274,732
Total liabilities and equity	1,981,116	129,257	26,355	2,512	41	298	-	249,071	2,388,650

b) Liquidity risk

The table below shows the undiscounted cash flows of the Bank's financial liabilities and undrawn loan commitments on the basis of their earliest contractual liability. The Bank's expected cash flows on these instruments vary significantly from this analysis; for example customers are expected to maintain stable or increased balances in demand deposits and not all undrawn loan commitments are expected to be drawn down immediately. For derivatives that have simultaneous gross settlement (e.g. Forward exchange contracts and currency swaps) the gross nominal undiscounted cash inflow/(outflow) are considered while in the case of derivatives that are net settled the net amounts have been considered.

Amounts in BD'000 As 31 December 2012	**Carrying amount**	**Gross nominal inflow/(outflow)**	**Less than 3 months**	**3 to 6 months**	**6 months to 1 year**	**1 to 5 years**	**More than 5 years**
Non derivative liabilities							
Due to Banks and other financial institutions	**168,529**	**168,761**	**166,092**	**2,669**	**-**	**-**	**-**
Borrowings under repurchase agreements	**75,418**	**75,491**	**75,491**	**-**	**-**	**-**	**-**
Customers' deposits	**2,077,904**	**2,083,479**	**1,704,982**	**346,063**	**29,530**	**2,904**	**-**
Total non derivative liabilities	**2,321,851**	**2,327,731**	**1,946,565**	**348,732**	**29,530**	**2,904**	**-**
Derivative liabilities							
Trading: outflow	**-**	**(473,232)**	**(341,239)**	**(52,976)**	**(79,017)**	**-**	**-**
Trading: inflow	**2,336**	**475,568**	**343,575**	**52,976**	**79,017**	**-**	**-**
Risk management: outflow	**-**	**(183,436)**	**-**	**(18,800)**	**-**	**-**	**(164,636)**
Risk management: inflow	**28**	**183,436**	**-**	**18,800**	**-**	**-**	**164,636**
Total derivative liabilities	**2,364**	**2,336**	**2,336**	**-**	**-**	**-**	**-**
Banking commitments	**-**	**(7,797)**	**9,000**			**(16,797)**	**-**
Financial guarantees	**-**	**(3,881)**	**(2,449)**	**(323)**	**(680)**	**(429)**	**-**

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

34. MATURITY PROFILE AND LIQUIDITY RISK CONTINUED

b) Liquidity risk continued

Amounts in BD'000 As 31 December 2011	Carrying amount	Gross nominal inflow/(outflow)	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	More than 5 years
Non derivative liabilities							
Due to Banks and other financial institutions	127,225	(127,437)	(124,768)	(2,669)	-	-	-
Borrowings under repurchase agreements	70,382	(70,401)	(70,401)	-	-	-	-
Customers' deposits	1,905,494	(1,909,227)	(1,756,640)	(126,212)	(24,955)	(1,420)	-
Total non derivative liabilities	2,103,101	(2,107,065)	(1,951,809)	(128,881)	(24,955)	(1,420)	-
Derivative liabilities							
Trading: outflow	-	(554,257)	(331,155)	(191,610)	(31,492)	-	-
Trading: inflow	5,845	560,102	337,000	191,610	31,492	-	-
Risk management: outflow	-	-	-	-	-	-	-
Risk management: inflow	-	-	-	-	-	-	-
Total derivative liabilities	5,845	5,845	5,845	-	-	-	-
Banking commitments	-	9,148	9,279	-	-	(131)	-
Financial guarantees	-	(3,783)	(2,237)	(269)	(882)	(395)	-

35. RETIREMENT BENEFIT COSTS

The Bank's obligations to defined contribution pension plans for employees who are covered by the social insurance pension scheme in Bahrain and its overseas branches are recognized as an expense in the income statement. The Bank's contribution for 2012 amounted to BD 0.87 million (US$ 2.31 million) [2011: 0.88 million (US$ 2.34 million)].

Other employees are entitled to leaving indemnities payable in accordance with the employment agreements or under the respective labour laws. The movement in the provision for leaving indemnities during the year is as follows:

Provision for leaving indemnities

Movements during the year	**2012**		2011	
	BD 000's	**US$ 000's**	BD 000's	US$ 000's
At 1 January	**3,841**	**10,215**	2,678	7,122
Charge for the year	**1,117**	**2,970**	1,249	3,322
Paid during the year	**(1,280)**	**(3,405)**	(86)	(229)
At 31 December	**3,678**	**9,780**	3,841	10,215

The Bank has a voluntary Staff Savings Scheme for Bahraini employees. The employees and the Bank contribute monthly on a fixed-percentage-of-salaries basis to the Scheme. The Scheme is managed and administrated by a board of trustees who are the employees of the Bank. The Bank's contribution to the Scheme for 2012 amounted to BD 0.72 million (US $ 1.91 million) [2011:BD 0.62 million (US $ 1.65 million)]. As at 31December 2012, after considering the employer's and employees' contributions, net income accretions and net pay-outs from the Scheme, the net balance of the Scheme, amounted to BD 8.97 million (US $ 23.86 million) [31 December 2011: BD 7.96 million (US $ 21.17 million)].

36. LEGAL CLAIMS

As at 31 December 2012, legal suits pending against the Bank aggregated to BD 0.39 million (US $ 1.04 million) [2011: BD 0.07 million (US$ 0.20 million)]. Based on the opinion of the Bank's legal advisors, management believes that no liability is likely to arise from the suits and does not consider it necessary to carry any specific provision in this respect.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

37. EARNINGS AND DIVIDEND PER SHARE

	2012		2011	
	BD millions	US$ millions	BD millions	US$ millions
Profit for the year	47.50	126.33	45.64	121.38
Dividend proposed at 25% (2011: 30%)	21.38	56.87	25.66	68.24
Weighted average number of shares issued (millions)				
Ordinary shares as at 1 January	855.4	855.4	777.6	777.6
Effect of bonus shares issued during 2011	-	-	77.8	77.8
Weighted average number of ordinary shares (millions) as at 31 December	855.4	855.4	855.4	855.4
Earnings per share	55.5 fils	15 cents	53.4 fils	14 cents
Dividend per share	25 fils	7 cents	30 fils	8 cents

Diluted earnings per share is same as basic earnings per share as the Bank does not have any potential dilutive instruments in issue.

38. ACCOUNTING CLASSIFICATION AND FAIR VALUES

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Quoted market prices, when available, are used to measure fair value. In cases where quoted market prices are not available, fair values are based on present value estimates or other appropriate valuation techniques.

a) The following table provides disclosure of the accounting classification and estimated fair value of financial instruments, for which it is practical to estimate fair value:

Amounts in BD 000's At 31 December 2012	Trading	Designated at fair value through profit or loss	Loans and receivables	Available for sale	Others at amortised cost	Total carrying amount	Fair value
Cash and balances at central banks	-	-	106,508	-	-	106,508	106,508
Treasury bills	-	-	380,114	-	-	380,114	380,114
Placements with banks and other financial institutions	-	-	486,071	-	-	486,071	486,071
Trading securities	523	-	-	-	-	523	523
Loans and advances	-	-	888,252	-	-	888,252	888,252
Investment securities	-	4,604	15,991	737,231	-	757,826	757,826
Interest receivable & other assets -	-	-	17,427	-	-	17,427	17,427
Total	523	4,604	1,894,363	737,231	-	2,636,721	2,636,721
Due to banks and other financial institutions	-	-	-	-	168,529	168,529	168,529
Borrowings under repurchase agreements	-	-	-	-	75,418	75,418	75,418
Customers' deposits	-	-	-	-	2,077,904	2,077,904	2,077,904
Accrued interest payable & other liabilities	-	-	-	-	9,627	9,627	9,627
Total	-	-	-	-	2,331,478	2,331,478	2,331,478

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

38. ACCOUNTING CLASSIFICATION AND FAIR VALUES CONTINUED

Amounts in BD 000's At 31 December 2011	Trading	Designated at fair value through profit or loss	Loans and receivables	Available for sale	Others at amortised cost	Total carrying amount	Fair value
Cash and balances at central banks	-	-	96,896	-	-	96,896	96,896
Treasury bills	-	-	377,878	-	-	377,878	377,878
Placements with banks and other financial institutions	-	-	258,688	-	-	258,688	258,688
Trading securities	653	-	-	-	-	653	653
Loans and advances	-	-	972,075	-	-	972,075	972,075
Investment securities	-	6,625	13,935	643,582	-	664,142	664,142
Interest receivable & other assets	-	-	14,114	-	-	14,114	14,114
Total	653	6,625	1,733,586	643,582	-	2,384,446	2,384,446
Due to banks and other financial institutions	-	-	-	-	127,225	127,225	127,225
Borrowings under repurchase agreements	-	-	-	-	70,382	70,382	70,382
Customers' deposits	-	-	-	-	1,905,494	1,905,494	1,905,494
Accrued interest payable & other liabilities	-	-	-	-	6,545	6,545	6,545
Total	-	-	-	-	2,109,646	2,109,646	2,109,646

(i) Cash and balances with central Banks and placements with Banks and other financial institutions: The fair value is considered to approximate their respective book values due to their short-term nature and negligible probability of credit losses.

(ii) Treasury bills: The fair value of unquoted treasury bills is considered to approximate their respective book values due to their short-term nature and negligible probability of credit losses.

(iii) Securities: The fair value of the listed debt and equity securities are based on market prices. The fair value of unqouted debt securities are based on brokers quotes or amounts derived from cash flow models as appropriate. The fair value of unquoted securities are estimated with reference to the financial performance and other relevant available financial and economic data.

(iv) Loans and Advances : The Bank has reviewed the loans and advances portfolio and estimates that the fair value of the portfolio approximates its carrying value, since the majority of loans are floating rate loans which have been disbursed at market rates, and adequate provisions have been taken for those loans with doubt as to collectibility.

(v) Other financial assets: The fair value of other financial assets including accrued interest receivable approximate their respective book values due to their short term nature. Derivatives with positive fair values are included in other assets. The fair value of derivatives is based on market prices and or valuation models as appropriate.

(vi) Due to Banks and other financial institutions and borrowings under repurchase agreements: the fair value is considered to approximate their respective book values due to their short term nature.

(vii) Customers' deposits : The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is deemed to equal the amount repayable on demand, which is represented by the carrying value of the deposits. For interest bearing fixed maturity deposits, the Bank estimates that fair value will approximate their book value as the majority of deposits are of short term nature and as all deposits are at market rates.

(viii) Other financial liabilities: The fair value of other financial liabilities including accrued interest payable approximate their respective book values due to their short term nature. Derivatives with negative fair values are included in other liabilities. The fair value of derivatives is based on market prices and / or valuation models as appropriate.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

38 b. FAIR VALUE HIERARCHY

The Bank measures fair values of financial instruments using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements.

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. as derived from prices). This category includes instruments valued using quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly observable from market data.

Level 3: Valuation techniques using significant unobservable inputs. This category includes instruments where the valuation technique includes inputs not based on market observable data.

The table below analyses financial assets and liabilities carried at fair value, by valuation method.

Amounts in BD 000's		**2012**				2011		
At 31 December	**Level 1**	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
Financial assets held for trading	**523**	**-**	**-**	**523**	653	-	-	653
Financial assets designated								
at fair value through profit or loss:								
Managed Funds	**-**	**912**	**-**	**912**	-	889	-	889
Capital Protected Notes	**-**	**3,692**	**-**	**3,692**	-	5,736	-	5,736
Available for sale financial assets:								
Debt securities	**432,264**	**246,809**	**-**	**679,073**	425,374	146,115	-	571,489
Equity securities	**44,218**	**-**	**13,940**	**58,158**	43,610	-	14,548	58,158
Derivative financial assets	**-**	**2,364**	**-**	**2,364**	-	5,845	-	5,845
Total	**477,005**	**253,777**	**13,940**	**744,722**	469,637	158,585	14,548	642,770
Derivative financial liabilities	**-**	**3,774**	**-**	**3,774**	-	2,087	-	2,087

The following table analyses the movement in level 3 financial assets during the year.

	Available for Sale Financial Assets	
Amounts in BD 000's	**2012**	2011
At 1 January	**14,548**	14,744
Total gains/(losses):		
in income statement	**43**	15
in other comprehensive income	**-**	(211)
Purchases	**-**	-
Settlements	**(651)**	-
Transfers into / (out) of Level 3	**-**	-
At 31 December	**13,940**	14,548
Total gain / (loss) for the year included in income statement for assets/liabilities held at 31 December	**(43)**	(15)

Sensitivity analysis of the movement in fair value of the financial instruments in the level 3 category which relates to available for sale financial assets is assessed as not significant to the other comprehensive income and total equity.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

39. AVERAGE BALANCES

The following are the average daily balances for full year:

	2012		2011	
	BD 000's	**US$ 000's**	BD 000's	US$ 000's
Total assets	**2,504,848**	**6,661,830**	2,242,745	5,964,747
Total liabilities	**2,221,053**	**5,907,056**	1,985,098	5,279,516
Equity	**283,795**	**754,774**	257,647	685,231
Contingent liabilities and undrawn loan commitments	**137,737**	**366,322**	111,745	297,194

40. CAPITAL ADEQUACY

The Bank operates as an independent banking institution with headquarters in Bahrain and branches in Bahrain, United Arab Emirates and Saudi Arabia.

The capital adequacy ratio has been calculated in accordance with Basel 2 and Central Bank of Bahrain guidelines incorporating credit risk, operational risk and market risk. The Bank uses the Standardized approach for computing credit risk. Operational risk is computed using the Basic indicator approach. Market Risk is computed using the Standardized method.

The details of the Bank's capital adequacy calculations under Basel 2 as at 31 December are shown below:

Based on year end balances	2012		2011	
	BD 000's	**US$ 000's**	BD 000's	US$ 000's
Tier 1 Capital	**272,454**	**724,612**	251,915	669,987
Tier 2 Capital	**21,648**	**57,574**	16,194	43,069
Total Capital Base	**294,102**	**782,186**	268,109	713,056
Risk Weighted Exposure:				
Credit Risk	**894,505**	**2,379,003**	900,646	2,395,335
Market Risk	**14,749**	**39,226**	33,617	89,407
Operational Risk	**146,245**	**388,949**	135,891	361,412
Total Risk Weighted Exposure	**1,055,499**	**2,807,178**	1,070,154	2,846,154
Capital Adequacy Ratio	**27.9%**		25.1%	
Tier 1 Capital Adequacy Ratio	**25.8%**		23.5%	

Based on year end balances	2012		2011	
	BD 000's	**US$ 000's**	BD 000's	US$ 000's
Tier 1 Capital	**238,234**	**633,601**	218,327	580,657
Tier 2 Capital	**41,039**	**109,146**	36,566	97,250
Total Capital Base	**279,273**	**742,747**	254,893	677,907
Risk Weighted Exposure:				
Credit Risk	**912,513**	**2,426,896**	907,109	2,412,524
Market Risk	**18,707**	**49,753**	31,876	84,777
Operational Risk	**138,480**	**368,298**	127,127	338,104
Total Risk Weighted Exposure	**1,069,700**	**2,844,947**	1,066,112	2,835,405
Capital Adequacy Ratio	**26.1%**		23.9%	
Tier 1 Capital Adequacy Ratio	**22.3%**		20.5%	

41. DEPOSIT PROTECTION SCHEME

Deposits held with the Bank's Bahrain operations are covered by the regulation protecting Deposits and Unrestricted Investment Accounts issued by the Central Bank of Bahrain in accordance with Resolution No (34) of 2010. The scheme applies to all eligible accounts held with Bahrain offices of the Bank subject to specific exclusions, maximum total amount entitled and other regulations as stipulated in the subject resolution.

42. COMPARATIVES

The corresponding figures have been regrouped where necessary to conform with the current year's presentation. The regrouping has not affected previously reported profit for the year or equity of the Bank.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

for the year ended 31 December 2012

These disclosures have been prepared in accordance with the Public Disclosure Module ("PD"), Section PD-3.1.6, CBB Rule Book, Volume I for conventional banks. These disclosures should be read in conjunction with the Notes, in particular the Significant Accounting Policies and Financial Risk Management, in the Bank's Financial Statements for the year ended 31 December 2012.

These disclosures have been reviewed by the Bank's external auditors KPMG based upon agreed upon procedures as required under Para PD-A.2.4 of the PD Module.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

EXECUTIVE SUMMARY

The Central Bank of Bahrain's (CBB) Basel 2 guidelines outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1 January 2008.

NBB has adopted the Standardised approach for Credit Risk, Standardised approach for Market Risk and the Basic Indicator approach for Operational Risk to determine the capital requirement. This report consists of the Basel Committee's Pillar 3 disclosures and other disclosure requirements as stipulated by the CBB. The report contains a description of the Bank's risk management and capital adequacy policies and practices including detailed quantitative information on capital adequacy.

As at 31 December 2012, the Bank's total risk weighted exposures amounted to BD 1,055.5 million; Tier 1 Capital and Total Regulatory Capital amounted to BD 272.5 million and BD 294.1 million respectively. Accordingly, Tier 1 Capital Adequacy Ratio and Total Capital Adequacy Ratio were 25.8% and 27.9% respectively. These ratios exceed the minimum capital requirements under the CBB's Basel 2 framework. The Bank's intention is to maintain a Tier 1 capital ratio above 8 per cent and a total capital ratio in excess of 12 per cent.

The Bank views these disclosures as an important means of increased transparency and accordingly has provided extensive disclosures in this report that is appropriate and relevant to the Bank's stakeholders and market participants.

SCOPE OF APPLICATION

The Bank operates as an independent banking institution with headquarters in Bahrain and branches in Bahrain, the United Arab Emirates and Saudi Arabia. The Bank's capital adequacy requirements are computed on a consolidated basis.

RISK AND CAPITAL MANAGEMENT

The Bank is exposed to the following types of risks:

- credit risk
- liquidity risk
- market risk
- interest rate risk
- operational risk

Risk management framework

The overall authority for risk management in the Bank is vested in the Board of Directors. The Board authorises appropriate credit, liquidity and market risk policies as well as operational guidelines based on the recommendation of Management. The Bank has established various committees that review and assess all risk issues. Approval authorities are delegated to different functionaries in the hierarchy depending on the amount, type of risk and nature of operations or risk. The Risk Group (RG) of the Bank provides the necessary support to Senior Management and the business units in all areas of risk management. This Group functions independent of the business units and reports directly to the Chief Executive Officer. The Group comprises of a Credit Review department (responsible for pre-approval analysis of credit/ investment proposals as well as risk policy and procedures management), Credit Administration department (responsible for post approval implementation and follow up), Legal department (responsible for management of legal risk) and Risk Management department (responsible for market risk and operational risk).

The Audit Committee of the Board is responsible for monitoring compliance with the Bank's policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by the Internal Audit division, which undertakes both regular and adhoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee and to Management.

Credit Risk

Credit Risk represents the potential financial loss as a consequence of a customer's inability to honour the terms and conditions of a credit facility. Such risk is measured with respect to counterparties for both on-balance sheet assets and off-balance sheet items.

The Bank acknowledges that credit risk is an inherent and substantial cost that needs to be set against income. Risk is just one aspect of the triangle for any economic capital system and must be seen in conjunction with capital requirements and returns. The Bank evaluates risk in terms of the impact on income and asset values and the evaluation reflects the Bank's assessment of the potential impact on its business on account of changes in political, economic and market conditions and in the credit worthiness of its clients. Risk management

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

RISK AND CAPITAL MANAGEMENT CONTINUED

Credit Risk continued

at the Bank has always been conservative and proactive with the objective of achieving a balanced relation between risk appetite and expected returns.

The Bank monitors and manages concentration risk by setting limits on exposures to countries, sectors, products and counterparty groups. Stringent criteria are used by Credit Review Department in setting such limits and these have ensured that the impact of any adverse developments on the Bank's income stream and capital strength is limited. Prior to launch of any new asset product, based on a comprehensive risk analysis, product specific transaction approval criteria are set. Similarly, prudent norms have been implemented to govern the Bank's investment activities, which specify to the Bank's Treasury department the acceptable levels of exposure to various products, based on its nature, tenor, rating, type, features, etc.

The Bank has well laid out procedures, not only to appraise but also regularly monitor credit risk. Credit appraisal is based on the financials of the borrower, performance projections, market position, industry outlook, external ratings (where available), track record, product type, facility tenor, account conduct, repayment sources and ability, tangible and intangible security, etc. Regular reviews are carried out for each account and risks identified are mitigated in a number of ways, which include obtaining collateral, counter-guarantees from shareholders and/or third parties. Adequate margins are maintained on the collateral to provide a cushion against adverse movement in the market price of collateral. Not only are regular appraisals conducted to judge the credit worthiness of the counterparty but day-to-day monitoring of financial developments across the globe by the Business Units and Credit Review Department ensures timely identification of any events affecting the risk profile.

The Business Units of the Bank are responsible for business generation and initial vetting of proposals to make sure that the Bank's risk acceptance criteria are met. Credit facilities in excess of BD 250,000 or falling outside pre-approved product criteria are referred to Credit Review Department, which analyses the proposal and puts forth its recommendations prior to approval by the appropriate authorities. In addition to rigorous credit analysis, the terms and conditions of all credit facilities are strictly implemented by the Credit Administration Department. An internal grading system and review process ensures prompt identification of any deterioration in credit risk and consequent implementation of corrective action.

The Bank's internal ratings are based on a 10-point scale, which takes into account the financial strength of a borrower as well as qualitative aspects to arrive at a comprehensive snapshot of the risk of default associated with the borrower. Ratings are further sub-divided into categories, which reflect estimates of the potential maximum loss in an event of default. Risk Ratings assigned to each borrower are reviewed at least on an annual basis. Regular monitoring of the portfolio enables the Bank to identify accounts, which witness deterioration in risk profile. Consumer credit facilities which are granted based on pre-defined criteria such as salary assignment, maximum repayment obligation as a percentage of salary, etc are excluded from this rating system.

The Bank also uses the ratings by established rating agencies, viz., Moody's, Standard & Poor and Fitch as part of the appraisal process while considering exposures to rated entities.

For purposes of comparison, the Bank's internal ratings are mapped to Moody's and Standard and Poor (S&P) ratings as under:

Bank's Internal Ratings Scale	Equivalent to Moody's and S&P ratings
1	AAA/Aaa
2	AA/Aa2
3	A/A2
4	BBB+/Baa1
5	BBB-/Baa3
6	BB/Ba2
7	B+/B1
8 - 10	CCC/Caa to C

However, the above mapping is not intended to reflect a direct relationship between the Bank's internal ratings and the corresponding rating of the external agencies since the basis and methodology differ.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

Liquidity risk

Liquidity Risk is the potential inability of a bank to meet its financial obligations on account of a maturity mismatch between assets and liabilities. Liquidity risk management ensures that funds are available at all times to meet the funding requirements of the Bank.

The asset/liability management policies of the Bank define the proportion of liquid assets to total assets with the aim of minimising liquidity risk. The Bank maintains adequate liquid assets such as inter-bank placements, treasury bills and other readily marketable securities, to support its business and operations. The Treasury Department monitors the maturity profile of assets and liabilities so that adequate liquidity is maintained at all times.

The Bank's ability to maintain a stable liquidity profile is primarily on account of its success in retaining and growing its customer deposit base. The marketing strategy of the Bank has ensured a balanced mix of demand and time deposits. Stability of the deposit base thus minimises the Bank's dependence on volatile short-term borrowings. Further, investment securities with contractual maturities of more than three months can also be readily liquidated. Considering the effective maturities of deposits based on retention history and in view of the ready availability of liquid investments, the Bank is able to ensure that sufficient liquidity is always available. The Asset Liability Committee (ALCO) chaired by the Chief Executive Officer reviews the Liquidity Gap Profile and the Liquidity scenario and addresses strategic issues concerning liquidity.

Market risk

Market Risk is the risk of potential losses arising from movements in market prices of interest rate related instruments and equities in the trading portfolio and foreign exchange and commodities holdings throughout the Bank. The Bank's trading activities are governed by conservative policies that are clearly documented, by adherence to comprehensive limit structures set annually and by regular reviews. Quality and rating are the main criteria in selecting a trading asset. The Bank uses the standardized method for allocating market risk capital based on the risk assessed for underlying factors of interest rate risk, equity risk, foreign exchange risk, options risk and commodity risk. Daily reports in this regard are submitted to senior management for review and decision making purposes.

Interest Rate Risk

Interest Rate Risk is measured by the extent to which changes in the market interest rates impact margins, net interest income and the economic value of the Bank's equity. Net interest income will be affected as a result of volatility in interest rates to the extent that the re-pricing structure of interest bearing assets differs from that of liabilities. The Bank's goal is to achieve stable earnings growth through active management of the assets and liabilities mix while, selectively positioning itself to benefit from near-term changes in interest rate levels. The Treasurer is primarily responsible for managing the interest rate risk. Reports on overall position and risks are submitted to senior management for review and positions are adjusted if deemed necessary. In addition, ALCO regularly reviews the interest rate sensitivity profile and its impact on earnings.

The Bank's asset and liability management process is utilised to manage interest rate risk through the structuring of on-balance sheet and off-balance sheet portfolios. The Bank uses various techniques for measuring and managing its exposure to interest rate risk. Duration analysis is used to measure the interest rate sensitivity of the fixed income portfolio. Duration of the portfolio is governed by economic forecasts, expected direction of interest rates and spreads. Modified Duration gives the percentage change in value of the portfolio following a 1% change in yield. Interest rate swaps and forward rate agreements are used to manage the interest rate risk. The Bank uses interest rate gap analysis to measure the interest rate sensitivity of its annual earnings due to re-pricing mismatches between rate sensitive assets, liabilities and derivatives positions.

Operational Risk

Operational Risk is the risk of monetary loss on account of human error, fraud, systems failures or the failure to record transactions. In order to manage and mitigate such risks, the Bank ensures that proper systems and resources (financial and personnel) are available to support the Bank's operations. Proper segregation of duties and other controls (including reconciliation, monitoring and reporting) are implemented to support the various operations, especially credit, treasury and electronic banking activities.

Detailed operational guidelines are spelt out in the Operations Manual to specify the steps to be followed in handling any transaction. These steps are designed to mitigate the risks arising from errors, omissions and oversights in dealing with customer instructions and transaction processing. The overriding principles in drawing up operational processes are that transactions must be scrutinized by a "checker" independent from the "originator" prior to booking and that there should be a clear audit trail for post facto scrutiny. The Bank's Fraud Manual and the Code of Conduct provide necessary guidance to mitigate risks and ensure that adequate controls are in place for detecting suspicious transactions. Any changes to operational procedures need to be processed through the Internal Audit Department, who ensure that satisfactory control mechanisms are in place in all procedures.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

RISK AND CAPITAL MANAGEMENT CONTINUED

Operational Risk continued

Specific limits are set up to mitigate and monitor the Bank's exposure including limits on maximum branch cash limit, maximum teller limit, maximum payment authorization limit, signature authorities, etc. Documented policies and procedures, approval and authorization process for transactions, documented authority letters, process of verification of transaction details and activities, reconciliation of key activities, dual custody of financial assets like demand drafts, cheques etc. and insurance coverage of various operational risks are the key pillars of the operational risk management process.

The Bank has an Operational Risk Management Department within the RG to independently monitor and manage all aspects of operational risk on a bank wide basis. The Bank also has a dedicated Operational Risk Management Committee to supervise, monitor and review operational risk issues and ensure that adequate mitigants are developed and implemented for all operational risk issues.

The scope of the Internal Audit department encompasses audits and reviews of all business units, support services and branches. The internal audit process focuses primarily on assessing risks and controls and ensuring compliance with established policies, procedures and delegated authorities. New products and services are reviewed by the Internal Audit department and assessed for operational risks prior to their implementation. The Internal Audit department is operationally independent and reports significant internal control deficiencies to the Audit Committee.

The Bank has a Business Continuity Plan (BCP) to ensure that the critical activities are supported in case of an emergency. The BCP is approved by the Board of Directors.

Risk Monitoring and Reporting

Systems and processes are in place to regularly monitor and report risk exposures to the Board of Directors and senior management to effectively monitor and manage the risk profile of the Bank.

The Board of Directors is provided with quarterly risk reports covering credit, market, liquidity, operational, concentration and other risks.

Senior management is provided with a daily report on market risk and monthly reports on other risks. Reports on capital adequacy and internal capital adequacy assessment are provided to senior management on a monthly basis. In addition, stress testing on capital adequacy is undertaken once a year or more frequently in times of need and communicated to Board of Directors and senior management for appropriate decisions.

Capital management

The Bank's policy is to maintain sufficient capital to sustain investor, creditor and market confidence and to support future development of the business. The impact of the level of capital on return on shareholder's equity is also considered and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank's capital management framework is intended to ensure that there is sufficient capital to support the underlying risks of the Bank's business activities and to maintain a well-capitalised status under regulatory requirements. The Bank has a comprehensive Internal Capital Adequacy Assessment Process (ICAAP) that includes Board and senior management oversight, monitoring, reporting and internal control reviews, to identify and measure the various risks that are not covered under Pillar 1 risks and to regularly assess the overall capital adequacy considering the risks and the Bank's planned business strategies. The non Pillar 1 risks covered under the ICAAP process include concentration risk, liquidity risk, interest rate risk in the banking book and other miscellaneous risks. The ICAAP also keeps in perspective the Bank's strategic plans, credit growth expectations, future sources and uses of funds, dividend policy and the impact of all these on maintaining adequate capital levels. In addition, the ICAAP process also includes stress testing on the Bank's capital adequacy to determine capital requirement and planning to ensure that the Bank is adequately capitalised in line with the overall risk profile.

The Bank ensures that the capital adequacy requirements are met on a consolidated basis and also with local regulator's requirements, if any, in countries in which the Bank has branches. The Bank has complied with regulatory capital requirements throughout the period.

Prior approval of the Central Bank of Bahrain is obtained by the Bank before submitting any proposal for distribution of profits for shareholders approval.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

CAPITAL STRUCTURE AND CAPITAL ADEQUACY

The Bank's paid up capital consists only of ordinary shares which have proportionate voting rights. The Bank does not have any other type of capital instruments.

The Bank's Tier 1 capital comprise of share capital, retained earnings and eligible reserves. Retained profits are included in Tier 1 pursuant to an external audit. Further, the following items are adjusted from Tier 1 capital as per CBB guidelines:

- Unrealised losses, on equity securities classified as available-for-sale, are deducted wholly from Tier 1.
- Fair value of investments in associates and unrated securitisation exposures are deducted equally from Tier 1 and Tier 2 i.e. 50% from Tier 1 and 50% from Tier 2.

The Bank's Tier 2 Capital comprises interim profits, collective impairment provisions and 45% of unrealised gains arising on the re-measurement to fair value of equity securities classified as available-for-sale and deduction of 50% of fair value of investments in associates and unrated securitisation exposures.

The Bank has no subsidiaries and/or investments in insurance companies exceeding 20% of the Bank's capital or the invested company's capital that is required to be deducted from capital.

Capital structure, minimum capital and capital adequacy:

BD '000s As at 31 December 2012	
Tier 1 capital	
Share Capital	85,536
Statutory Reserve	42,768
General Reserve	32,400
Other Reserves	9,145
Retained Earnings	107,019
Deductions from Tier 1 Capital	(4,414)
Total Tier 1 (A)	**272,454**
Tier 2 capital	
45% of revaluation reserves on available for sale equity investments	11,420
Collective impairment provision subject to a 1.25% risk adjusted exposure limitation	11,753
Deductions from Tier 2 Capital	(1,525)
Total Tier 2	**21,648**
Total Capital Base (Tier 1 + Tier 2) (B)	**294,102**

BD '000s As at 31 December 2012	**Risk weighted exposure**	**Capital requirement @ 12%**
Cash and collection items	51	6
Sovereigns	-	-
Banks	145,300	17,436
Corporates	290,690	34,883
Regulatory retail	243,502	29,220
Residential mortgages	13,137	1,576
Investments in equities/funds	52,829	6,339
Securitisation exposures	9	1
Others	148,987	17,878
Total Credit Risk Exposure	**894,505**	**107,339**
Market Risk	**14,749**	**1,770**
Operational Risk	**146,245**	**17,549**
Total Risk Weighted Exposure (C)	**1,055,499**	**126,658**
Capital Adequacy Ratio (B)/(C)	**27.86%**	
Tier 1 Capital Adequacy Ratio (A)/(C)	**25.81%**	

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

CREDIT RISK

The Bank has a diversified on and off balance sheet credit portfolio, which are divided into counter party exposure classes in line with the CBB's Basel 2 capital adequacy framework for the standardised approach for credit risk. A high-level description of the counter party exposure classes and the risk weights used to derive the Risk Weighted Assets are as follows:

Sovereigns Portfolio

The sovereign portfolio comprises exposures to governments and their respective central banks. The risk weights are 0% for exposures in the relevant domestic currency of the sovereign, or for any exposures to GCC governments. Foreign currency claims on other sovereigns are risk weighted based on their external credit ratings.

Certain multilateral development banks as determined by the CBB may be included in the sovereign portfolio and treated as exposures with a 0% risk weighting.

PSE Portfolio

Public sector entities (PSEs) are risk weighted according to their external ratings except for Bahrain PSEs, and domestic currency claims on other PSEs that are assigned a 0% risk weight by their respective country regulator, are consequentially allowed a 0% risk weight by CBB for computation purposes.

Banks Portfolio

Claims on banks are risk weighted based on their external credit ratings. A preferential risk weight treatment is available for qualifying short-term exposures to banks in their country of incorporation. Short-term exposures are defined as exposures with an original tenor of three months or less and denominated and funded in the respective domestic currency. The preferential risk weight for short-term claims is allowed on exposures in Bahraini Dinar/US Dollar in the case of Bahraini incorporated banks.

Corporates Portfolio

Claims on corporates are risk weighted based on their external credit ratings. A 100% risk weight is assigned to exposures to unrated corporates. A preferential risk weight treatment is available for certain corporates owned by the Government of Bahrain, as determined by the CBB, which are assigned a 0% risk weight.

Equities Portfolio

The equities portfolio comprises equity investments in the banking book, i.e. the available-for-sale securities portfolio. The credit (specific) risk for equities in the trading book is included in market risk RWAs for regulatory capital adequacy calculation purposes.

A 100% risk weight is assigned to listed equities and funds. Unlisted equities and funds are risk weighted at 150%. Investments in rated funds are risk weighted according to the external credit rating. Investments in companies engaged primarily in real estate are included in other assets and risk weighted at 200%.

In addition to the standard portfolios, other exposures are risk weighted as under:

Past due exposures

All past due loan exposures, irrespective of the categorisation of the exposure are classified separately under the past due exposures asset class. A risk weighting of either 100% or 150% is applied depending on the level of specific provision maintained against the exposure.

Other assets and holdings of securitisation tranches

Other assets are risk weighted at 100%. Securitisation tranches are risk weighted (ranging from 20% to 350%) based on their external credit ratings and resecuritisation tranches are risk weighted (ranging from 40% to 650%) based on their external credit ratings. Exposures to securitisation & resecuritisation tranches that are rated below BB- or are unrated are deducted from regulatory capital rather than subject to a risk weight. Investments in real estate and also in bonds, funds and equities of companies engaged primarily in real estate are included in other assets and risk weighted at 200%.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

External Credit Assessment Institutions (ECAI)

The Bank uses ratings issued by Standard & Poor's, Moody's and Fitch to derive the risk weightings under the CBB's Basel 2 capital adequacy framework. Where ratings vary between rating agencies, the highest rating from the lowest two ratings is used to represent the rating for regulatory capital adequacy purposes.

The following are gross credit risk exposures considered for Capital Adequacy Ratio calculations comprising of banking book exposures:

INDUSTRY OR COUNTERPARTY EXPOSURE

As at 31 December 2012 BD '000s	
Cash and balances at central banks	106,508
Treasury bills	380,114
Placements with banks and other financial institutions	486,071
Loans and advances	900,005
Investment securities	758,349
Interest receivable, other assets and property & equipment	35,267
Total assets	**2,666,314**
Non-derivative Banking commitments and contingent liabilities (notional)	**160,504**
Derivatives (notional)	**656,668**

The balances above are representative of the position during the period; hence the average balances for the period is not separately disclosed.

As at 31 December 2012 BD '000s	Govt	Mfg/ Trdg	Banks/ FIs	Const	Personal	Others	Total
Cash and balances at central banks	-	-	106,508	-	-	-	106,508
Treasury bills	380,114	-	-	-	-	-	380,114
Placements with banksand other financial institutions	-	-	486,071	-	-	-	486,071
Loans and advances	58,109	132,602	57,920	121,875	346,796	182,703	900,005
Investment securities	529,931	10,362	164,260	1,240	-	52,556	758,349
Interest receivable, other assets and property & equipment	4,093	732	2,742	3,386	616	23,698	35,267
Total assets	**972,247**	**143,696**	**817,501**	**126,501**	**347,412**	**258,957**	**2,666,314**
Non-derivative Banking commitments and contingent liabilities (notional)	**55,862**	**26,756**	**34,745**	**27,463**	**1,814**	**13,864**	**160,504**
Derivatives (notional)	**-**	**-**	**656,668**	**-**	**-**	**-**	**656,668**

The above includes certain exposures to customers / counter parties which are in excess of 15 % of the Bank's capital base. These have the approval of the Central Bank of Bahrain or are exempt exposures under the large exposures policy of the Central Bank of Bahrain. The table below gives details of these exposures:

Counterparty	Counterparty Type	Total Exposure
Counterparty A	Sovereign	827,979
Counterparty B	Sovereign	414,897
Counterparty C	Sovereign	86,549
Counterparty D	Corporate	60,114
Counterparty E	Sovereign	56,667
Counterparty F	Corporate	49,763

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

GEOGRAPHIC DISTRIBUTION OF EXPOSURE

As at 31 December 2012 BD '000s	Middle East	USA	Europe	Rest of the world	Total
Cash and balances at central banks	106,508	-	-	-	106,508
Treasury bills	380,114	-	-	-	380,114
Placements with banks/ financial institutions	443,061	4,089	38,381	540	486,071
Loans and advances	900,005	-	-	-	900,005
Investment securities	628,363	31,560	19,964	78,462	758,349
Interest receivable, other assets and property & equipment	33,513	44	1,368	342	35,267
Total assets	**2,491,564**	**35,693**	**59,713**	**79,344**	**2,666,314**
Non-derivative Banking commitments and contingent liabilities (notional)	**142,024**	**151**	**17,566**	**763**	**160,504**
Derivatives (notional)	**221,960**	**183,436**	**251,078**	**194**	**656,668**

RESIDUAL CONTRACTUAL MATURITY

As at 31 December 2012 BD '000s	Up to 3 months	3 to 6 months	6 to 12 months	1 to 3 years	3 to 5 years	5 to 10 years	10 to 20 years	Over 20 years	Total
Cash and balances at central banks	106,508	-	-	-	-	-	-	-	106,508
Treasury bills	272,423	80,437	25,254	-	-	-	-	-	380,114
Placements with banks & other financial institutions	450,696	19,731	15,644	-	-	-	-	-	486,071
Loans and advances	179,563	41,567	89,316	289,317	157,241	112,236	30,102	663	900,005
Investment securities	26,465	4,443	31,700	302,511	138,157	196,869	-	58,204	758,349
Accrued interest receivable, other assets and property & equipment	6,895	334	335	4,110	1,166	3,390	-	19,037	35,267
Total assets	**1,044,550**	**146,512**	**162,249**	**595,938**	**296,564**	**312,495**	**30,102**	**77,904**	**2,666,314**
Non-derivative Banking commitments and contingent liabilities (notional)	**65,416**	**41,997**	**24,142**	**27,056**	**1,237**	**656**	**-**	**-**	**160,504**
Derivatives (notional)	**341,238**	**52,977**	**97,817**	**-**	**-**	**164,636**	**-**	**-**	**656,668**

Past due exposures

In accordance with the Bank's policy and Central Bank of Bahrain guidelines, loans on which payment of interest or repayment of principal are 90 days past due, are defined as non-performing.

The Bank has systems and procedures in place to generate alerts in case of past dues in any account. A stringent classification process is followed for all accounts with past dues of over 90 days. The Bank applies rigorous standards for provisioning and monitoring of non-performing loans. Level of provisions required is determined based on the security position, repayment source, discounted values of cash flows, etc and adequate provisions are carried to guard against inherent risks in the portfolio.

Provision for possible loan losses, pertaining to individually significant impaired loans and advances, is determined based on the difference between the net carrying amount and the estimated recoverable amount of the loans and advances, measured at present value of estimated future cash flows from such loans and advances and discounting them based on their original effective interest rate. If a loan has a floating interest rate, the discount rate is the current effective rate determined under the contract.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

Impairment and uncollectability is also measured and recognised on a portfolio basis for a group of similar loans and advances, that are not individually identified as impaired, on the basis of estimates of incurred losses that are inherent but not yet specifically identified within the loans and advances portfolio at the balance sheet date. The estimates are based on internal risk ratings, historical default rates, rating migrations, loss severity, macroeconomic and other relevant factors with historic loss experience being adjusted to reflect the effect of prevailing economic and credit conditions.

Ageing analysis of impaired and past due loans and advances:

As at 31 December 2012 BD '000s	
Over 3 months to 1 year	60,647
1 to 3 years	4,882
Over 3 years	4,229
Total	**69,758**

Geographical location of impaired and past due loans and advances:

As at 31 December 2012 BD '000s	Loan Amount	Specific impairment provision	Collective impairment provision
Bahrain	69,381	15,716	10,094
Other GCC countries	377	300	1,635
Others	-	-	24
Total	**69,758**	**16,016**	**11,753**

Industry/sector wise breakdown of impaired and past due loans and advances:

In BD '000s	At 31 December 2012			During the year ended 31 December 2012	
	Loan Amount	Specific impairment provision	Collective impairment provision	Specific impairment Charge	Write offs
Government	-	-	890	-	-
Manufacturing/trading	5,801	646	1,687	-	16
Construction	53,050	5,994	1,391	5,382	-
Personal	10,342	9,224	4,583	299	151
Others	565	152	3,202	-	-
Total	**69,758**	**16,016**	**11,753**	**5,681**	**167**

Movement in impairment provision for loans and advances:

In BD '000s	Specific impairment provision	Collective impairment provision	Total impairment provision	Interest in suspense
At 1 January 2012	10,946	7,771	18,717	4,090
Charge & transfers for the year	5,681	9,202	14,883	2,737
Amounts written off	(167)	-	(167)	(208)
Recoveries, transfers & write backs	(444)	(5,220)	(5,664)	(185)
At 31 December 2012	**16,016**	**11,753**	**27,769**	**6,434**

Restructuring

During the year ended 31 December 2012, credit facilities amounting to BD 43.2 million were restructured. Restructuring concessions mainly related to deferral of loan installments to assist customers overcome temporary cash crunch situations or to realign the repayment with the borrowers'/projects' revised cash flow projections. Due to the minor nature of concessions, there was no significant impact on the Bank's provisions for loans and advances impairment and present and future earnings.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

CREDIT RISK MITIGATION

The reduction of the capital requirement attributable to credit risk mitigation is calculated in different ways, depending on the type of credit risk mitigation, as under:

Adjusted exposure amount: The Bank uses the comprehensive method for eligible financial collateral such as cash and equities listed on a recognized stock exchange. The exposure amount and financial collateral, where applicable, are adjusted for market volatility through the use of supervisory haircuts (for currency mis-matches, price volatility and maturity-mismatches) that are specified by the CBB.

Substitution of counterparty: The substitution method is used for eligible guarantees (only sovereigns, banks or corporate entities with ECAI ratings higher than that of the counterparty; guarantees issued by corporate entities may only be taken into account if their rating corresponds to A- or better) whereby the rating of the counterparty is substituted with the rating of the guarantor.

COLLATERAL AND VALUATION PRINCIPLES

The main collaterals taken for risk mitigation on credit exposures are deposits held by customers, pledge of quoted shares, residential/ commercial property mortgage, investment securities, counter-guarantees from other banks, etc. Other risk mitigants considered include salary and end of service benefits assignment for personal loans, personal guarantees of promoters etc. However, for purposes of capital adequacy computation, only eligible collateral recognised under Basel 2 is taken into consideration and there are no significant concentrations in such eligible collateral taken for credit risk mitigation.

The Bank's Credit Policy defines the types of acceptable collateral and the applicable haircuts or loan-to-value ratio. The Bank has a system of independent valuation of collateral. In the case of real estate, valuation is done by independent valuer at regular intervals as stipulated in the Bank's credit policy. In respect of quoted shares and other securities, the valuation is done based on the closing price on the stock exchange. The market value of the collateral is actively monitored on a regular basis and requests are made for additional collateral in accordance with the terms of the underlying agreements. In general, lending is based on the customer's repayment capacity and not the collateral value. However, collateral is considered as a secondary alternative to fall back on in the event of default.

Eligible financial collateral, guarantees and credit derivatives, presented by standard portfolio are as under:

As at 31 December 2012 BD '000s	Gross credit exposure	Of which secured by eligible Financial collateral	Guarantees and credit derivatives	Credit exposure after risk mitigants
Sovereigns	1,343,885	154	-	1,343,731
Banks	383,014	75,426	-	307,588
Corporates	350,595	30,329	-	320,266
Regulatory retail	326,298	1,629	-	324,669
Residential mortgage	17,517	-	-	17,517
Others	118,577	14,341	-	104,236

On and off-Balance Sheet netting:

The legal documents that the Bank obtains from customers include clauses that permit the Bank to offset the customer's dues to the Bank against the Bank's dues to the customer. Thus, if the same legal entity has obtained credit facilities from the Bank and also maintains credit balance with the Bank, the Bank has the legal right to set-off the credit balances against the dues. In case of certain counter party banks, the Bank has entered into specific netting agreements that provide for netting on and off-balance sheet exposures.

The amount of financial assets and financial liabilities set off under netting agreements amounted to BD 38.5 million at 31 December 2012.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

MARKET RISK

The Bank uses the standardized method for allocating market risk capital. The Bank has clearly documented policies and procedures for the management and valuation of the trading portfolio. The Treasury Operations department, which is independent of the front office, is responsible for valuation which is done on a daily basis, based on quoted market prices from stock exchanges, independent third parties or amounts derived from cash flow models as appropriate.

Amounts in BD 000's Risk Type	As at 31-12-2012	Capital Charge Maximum	 Minimum	 Average
Interest Rate Risk	1,043.3	2,578.1	683.7	1,378.4
Equities Risk	83.7	127.2	78.2	95.6
Foreign Exchange Risk	52.9	299.0	48.9	110.8
Commodities Risk	-	-	-	-
Options Risk	-	3.0	-	-
Total minimum capital required for market risk	**1,179.9**			
Multiplier	12.5			
Market Risk weighted exposure under the Standardized Method	**14,748.8**			

OPERATIONAL RISK

Whilst the Bank recognizes that operational risks cannot be eliminated in its entirety, it constantly strives to minimise operational risks (inherent in the Bank's activities, processes and systems) by ensuring that a strong control infrastructure is in place throughout the organisation and enhanced where necessary. The various procedures and processes used to manage operational risks are regularly reviewed, updated and implemented through effective staff training, close monitoring of risk limits, segregation of duties, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, and financial management and reporting. In addition, regular internal audit and reviews, business continuity planning and arrangements for insurance cover are in place to complement the processes and procedures.

The Bank presently follows the Basic Indicator Approach for assessing the capital requirement for Operational Risk. The capital requirement of BD 17.5 million is based on the gross operating income (excluding profit/loss on Investments held under Available for Sale, Held to Maturity categories and any exceptional items of income) for the last 3 years multiplied by 12.5 (the reciprocal of the 8 percent minimum capital ratio) to arrive at the operational risk-weighted exposure.

EQUITY POSITION IN BANKING BOOK

The Bank holds certain investments in equity securities as part of its strategic holdings and others are held with the objective of capital appreciation and realizing gains on sale thereof. All equity positions in the Banking book are classified as "Available for Sale". The accounting policies for "Available for Sale" instruments are described in detail in the Financial Statements under "Significant Accounting Policies".

As at 31 December 2012 BD '000s	Balance Sheet Value	Capital Requirement @ 12% of Risk Weighted Assets
Details of Equity Investments:		
Quoted Equities:	44,218	3,886
Unquoted Equities:	13,940	1,660
Total	**58,158**	**5,546**
Realised gains (recorded in Income Statement during the year)		-
Net unrealised gains recognised in Equity		22,490
Unrealised losses deducted from Tier 1 Capital		2,889
45 % of unrealised gains recognised under Tier 2 Capital		11,420

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

INTEREST RATE RISK IN BANKING BOOK

Interest Rate Risk is measured by the extent to which changes in the market interest rates impact margins, net interest income and the economic value of the Bank's equity. The Bank's asset and liability management process is utilised to manage interest rate risk through the structuring of on-balance sheet and off-balance sheet portfolios. Net interest income will be affected as a result of volatility in interest rates to the extent that the re-pricing structure of interest bearing assets differs from that of interest bearing liabilities. The Bank's goal is to achieve stable earnings growth through active management of the assets and liabilities mix while, selectively positioning it to benefit from near-term changes in interest rate levels.

Overall non-trading interest rate risk positions are managed by the Treasury division, which uses investment securities, placements with banks, deposits from banks and derivative instruments to manage the overall position arising from the Bank's non-trading activities. Reports on overall position and risks are submitted to senior management for review and positions are adjusted if deemed necessary. In addition, ALCO regularly reviews (at least on a monthly basis) the interest rate sensitivity profile and its impact on earnings. Strategic decisions are made with the objective of producing a strong and stable interest income stream over time.

Duration analysis is used to measure the interest rate sensitivity of the fixed income portfolio. Duration of the portfolio is governed by economic forecasts, expected direction of interest rates and spreads. Modified Duration gives the percentage change in value of the portfolio following a 1% change in yield. Modified Duration of the Bank's fixed income portfolio was 3.39% on 31 December 2012 implying that a 1% parallel upward shift in the yield curve could result in a drop in the value of the portfolio by BD 22.4 million.

Deposits without a fixed maturity are considered as repayable on demand and are accordingly included in the overnight maturity bucket. The Bank usually levies a pre-payment charge for any loan or deposit, which is repaid/withdrawn before the maturity date, unless it is specifically waived. This prepayment charge is to take care of any interest rate risk that the Bank faces on account of such prepayments and accordingly, no assumptions regarding such pre-payments are factored for computation of interest rate risk in the banking book.

RISK AND CAPITAL MANAGEMENT DISCLOSURES

For the year ended 31 December 2012

INTEREST RATE RISK IN BANKING BOOK CONTINUED

The Bank uses interest rate gap analysis to measure the interest rate sensitivity of its annual earnings due to re-pricing mismatches between rate sensitive assets, liabilities and derivatives' positions. The asset and liability re-pricing profile of various asset and liability categories is set out below:

As at 31 December 2012 BD '000s	Upto 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years	Rate insensitive	Total
Assets							
Cash and balances at central banks	-	-	-	-	-	106,508	106,508
Treasury bills	274,423	80,437	25,254	-	-	-	380,114
Placements with banks/ financial institutions	441,225	19,731	15,644	-	-	9,471	486,071
Trading securities	-	523	-	-	-	-	523
Loans and advances*	358,964	31,619	61,298	345,145	91,226	-	888,252
Investment securities**	61,281	3,920	19,859	414,799	195,205	62,762	757,826
Interest receivable, other assets and property & equipment	-	-	-	-	-	35,267	35,267
Total assets	**1,135,893**	**136,230**	**122,055**	**759,944**	**286,431**	**214,008**	**2,654,561**
Liabilities and equity							
Due to banks and financial institutions	136,045	2,632	-	-	-	29,852	168,529
Borrowings under repurchase agreements	75,418	-	-	-	-	-	75,148
Customers' deposits	942,658	342,236	30,156	2,743	-	760,111	2,077,904
Interest payable and other liabilities	-	-	-	-	-	13,766	13,766
Equity	-	-	-	-	-	318,944	318,944
Total liabilities and equity	**1,154,121**	**344,868**	**30,156**	**2,743**	**-**	**1,122,673**	**2,654,561**
On-Balance Sheet Interest rate sensitivity gap	**(18,228)**	**(208,638)**	**91,899**	**757,201**	**286,431**	**(908,665)**	**-**
Off-Balance Sheet interest rate gap	**145,836**	**37,600**	**(18,800)**	**-**	**(164,636)**	**-**	**-**
Cumulative interest rate sensitivity gap	**127,608**	**(43,430)**	**29,669**	**786,870**	**908,665**	**-**	**-**

* Net of collective impairment provision of BD 11,753

** Available-for-sale securities at 31 December 2012 include securities amounting to BD 75,418 sold under agreement to repurchase

The interest rate risk management process is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to an interest rate shock of 200bps increase/ decrease. An analysis of the Bank's sensitivity to an increase or decrease in market interest rates (assuming no asymmetrical movement in yield curves and a constant balance sheet position) is as follows:

As at 31 December 2012 In BD '000s	200 bp parallel increase	200 bp parallel decrease
As at period ended above	(44,823)	44,823
Average for the period	(31,993)	31,993
Minimum for the period	(26,000)	26,000
Maximum for the period	(45,744)	45,744

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Chief Executive Officer and Director

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17 214433

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BRANCHES IN BAHRAIN

AIRPORT	
Arrivals	**17 321212**
Transit	**17 321214**
A'ali	**17 643438**
Al Esteqlal Highway	**17 622611**
Al Muthanna	**17 225622**
Asry	**17 671007**
Awali	**17 756462**
Budaiya	**17 696699**
Central Market	**17 241242**
Diplomatic Area	**17 537466**
East Riffa	**17 775284**
Exhibition Avenue	**17 714900**
Hamad Town	**17 420898**
Hidd	**17 672683**
Isa Town	**17 689555**
Jidhafs	**17 552257**
Lulu Road	**17 256444**
Main Branch	
(New NBB Tower)	**17 228800**
Mina Sulman	**17 729319**
Muharraq North	**17 322522**
Muharraq Souk	**17 343717**
Palace Avenue	**17 294191**
Salmaniya	**17 250777**
Seef Mall	**17 582666**
Sitra	**17 731128**
Souk Waqef	**17 413444**

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