Annual Report 2012

THE BEST BANK
IN KUWAIT
IS NOW...
GULF BANK

بنك الخليج
GULF BANK
GROWING WITH YOU

H.H. Sheikh
Sabah Al Ahmed Al Jaber Al Sabah
(The Amir of the State of Kuwait)

H.H. Sheikh
Nawaf Al Ahmed Al Jaber Al Sabah
(The Crown Prince)

H.H. Sheikh
Jaber Al Mubarak Al Hamad Al Sabah
(The Prime Minister)

Annual Report 2012

Hory

Small wooden boat that measures between 3 to 5 meters

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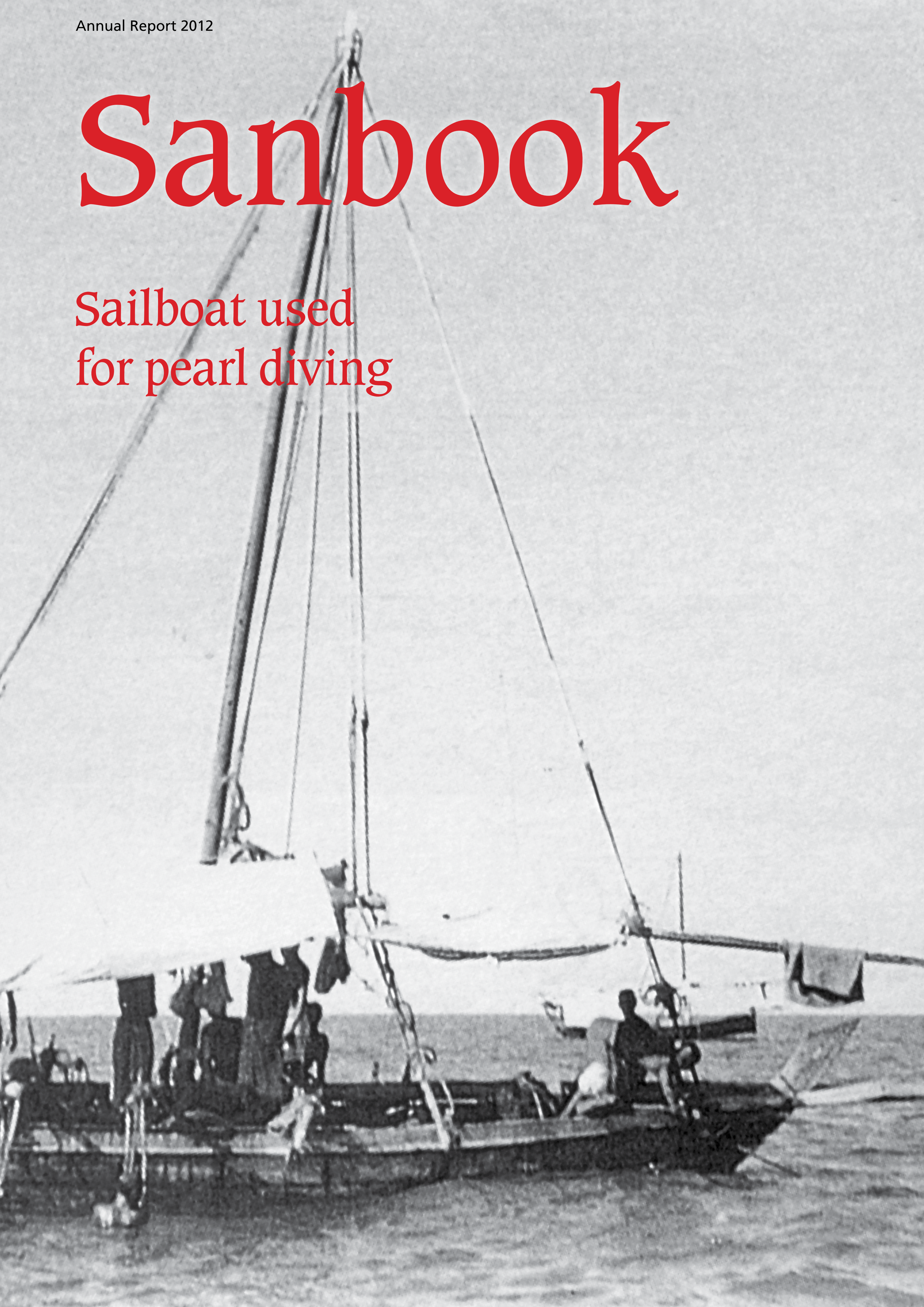
Head Office:
Mubarak Al Kabeer Street, P. O. Box 3200, Safat 13032, Kuwait, Tel: 22449501
www.e-gulfbank.com

Annual Report 2012

Sanbook

Sailboat used for pearl diving

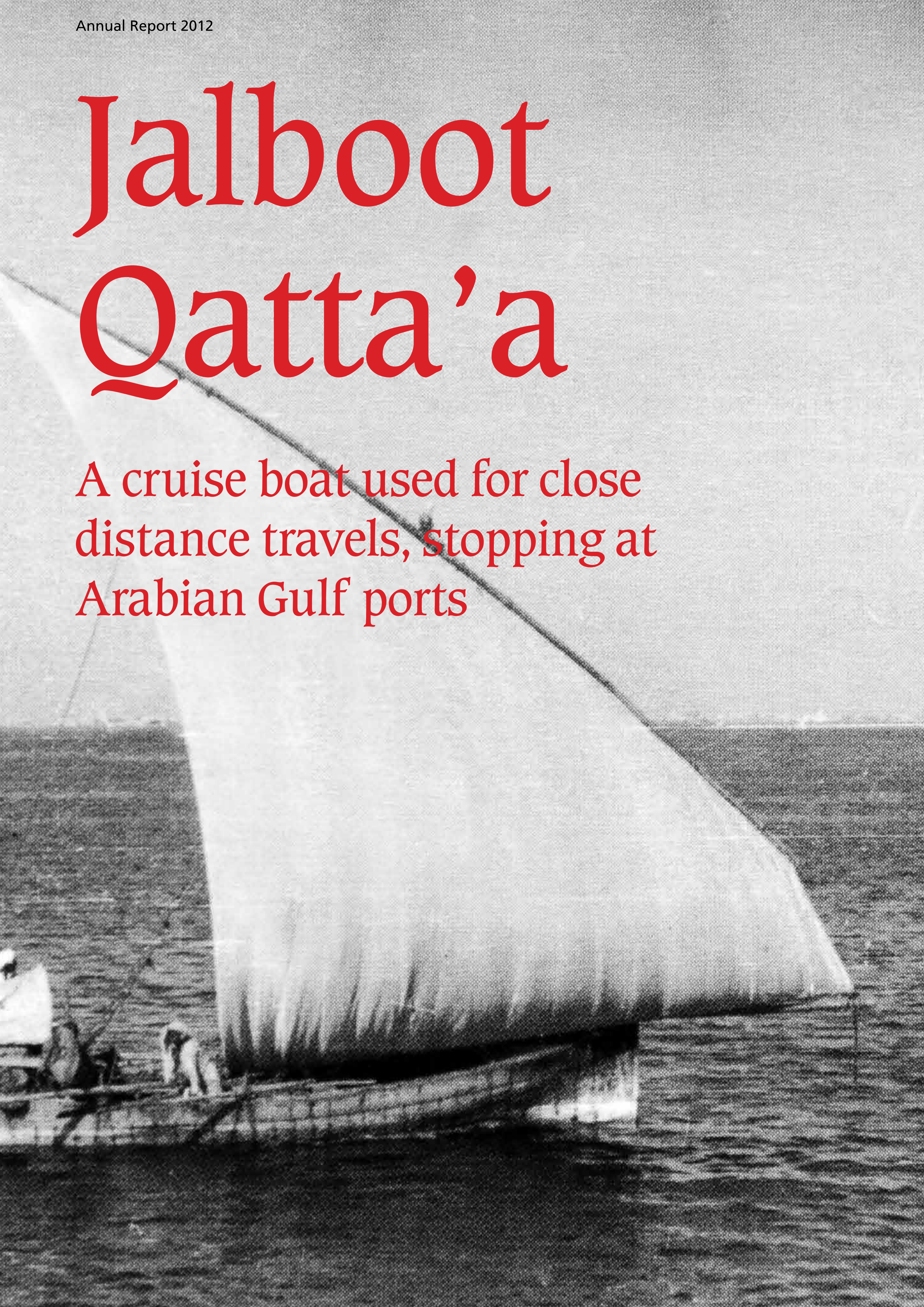


Board of Directors

Mahmoud Abdul Khaleq Al Nouri	Chairman
Omar Kutayba Yusuf Alghanim	Deputy Chairman
Ahmad Abdullatif Yousef Al Hamad	Board Member
Bader Nasser Mohammed Al Khorafi	Board Member
Jassim Mustafa Jassim Boodai	Board Member
Sayer Bader Al Sayer	Board Member
Ali Morad Yusuf Behbehani	Board Member
Omar Hamad Yusif Al Essa Al Qanai	Board Member
Farouk Ali Bastaki	Board Member

Jalboot Qatta'a

A cruise boat used for close distance travels, stopping at Arabian Gulf ports



Mahmoud Abdul Khaleq Al Nouri
Chairman

Chairman's Message

Dear Shareholders

It is my pleasure to report to you on your Bank's financial performance and the commendable progress it has made during 2012. Over this time, we have sought to ensure that the Bank continued its record of delivering on its promise to provide the best and fastest service in Kuwait – which has led to Gulf Bank winning the Best Bank Award from The Banker, a leading Financial Times publication, for the first time.

I am pleased to report that 2012 maintained the trend of success and achievement we saw in the previous year. Our two year rebuilding plan is largely behind us and we are now focused on a new, growth oriented business strategy to 2015, which is built around three pillars: solidify, accelerate, surpass. In other words, we are aiming to solidify the gains we have made to date; initiate and implement growth within our core competencies, and at the same time, also expand the boundaries and range of our current competencies.

Key Events in 2012

Gulf Bank consolidated its return to profitability during the year, with operating profit before provisions up by about KD 14 million, from KD 107.7 million in 2011 to KD 121.4 million in 2012, an increase of 13%. The Bank posted a net profit of KD 30.9 million, net of all statutory and precautionary provisions, which is around the same as the profit announced last year, underlining the strength of our core business. The Board of Directors has recommended, with the approval of the Central Bank of Kuwait, the distribution of profit in the form of bonus shares of 5%, so as to support the Bank's capital base. These results underline the continuation of a strong and solid performance by Gulf Bank. In Consumer Banking, we have continually raised the bar with our "We Promise" program, guaranteeing the best and fastest banking services in Kuwait, which, along with our strong leadership and management team, has contributed to solid growth and increased market share. We have also made inroads into Corporate Banking, where Gulf Bank was mandated as the lead manager to help finance large and complex projects in Kuwait.

During the year, our Corporate Social Responsibility programme – ' Give Life' , which focused on blood donation, delivered real benefits to the community, saving over 1,000 lives. The Bank also worked alongside a number of other organisations conducting social activities throughout the year, serving the under-privileged and the community as a whole, and demonstrating that the Bank is more than just a financial institution providing excellent banking services.

The Bank received a number of prestigious awards during 2012 for its commitment to customers and investment in service quality. We were honoured to be named The Best Bank in Kuwait by The Banker – a leading Financial Times publication. The Bank also re-affirmed its position as the leading Kuwaiti employer in the sector by winning the Localisation Award from the GCC Council of Ministers for Social Affairs and Labour for the eighth consecutive year. The award illustrates the Bank's commitment to developing the careers of Kuwaitis within the Bank, and highlights the success of its long-term efforts in maintaining one of the highest employment percentages of Kuwaiti nationals across the private sector (Kuwaitis claimed 64% of the Bank's total employees). Other major awards received by the Bank during the year included 'Bank of the Year' award from Arabian Business; 'Best Retail Bank' by Asian Banker 2012; 'Best Retail Customer Service' by Banker Middle East, 'Best Employee Development Program' award for the second consecutive year by Banker Middle East, '2011 EUR STP Excellence' award from Deutsche Bank, and last but not least, 'Banker of the Year' for our Chief Executive Officer, Michel Accad, by Banker Middle East.

Corporate Governance and Risk

Within your Bank, the Board of Directors and senior management team have worked hard to ensure that we fully comply with new banking regulatory requirements relating to risk management systems and the new rules on Corporate Governance, as announced by the Central Bank of Kuwait. We have set up a special management committee headed by the Chairman of the Board, to ensure we adhere to all deadlines set by the Central Bank. A number of the requirements have already been implemented, and your Bank's management of these areas operate in full accord with Central Bank of Kuwait and the Capital Markets Authority regulations.

Board Changes

This year has also seen a number of changes to your Board of Directors and I would like to thank my predecessor, Ali Rashaid Al Bader, for his considerable wisdom and leadership of the Bank during its turnaround strategy. I would like to extend my thanks and appreciation to colleagues Ali Faisal Al-Mutawa, Tarek Sultan Al-Essa, and Dr. Yousef Sayed Al Zalzalah, for their great efforts, which contributed to our Bank's success, and I warmly welcome to the Board, Bader Nasser Mohammed Al Khorafi, Jassim Mustafa Jassim Boodai, Sayer Bader Al Sayer, and Ahmad Abdullatif Yousef Al Hamad.

The Year Ahead

We have successfully completed the first year under our new strategy and I believe we are very well placed to continue the progress we have made into 2013. In particular, with Kuwait's development plan so central to its future prosperity, we look forward to being involved in schemes such as the 20-year Build-Operate-Transfer (BOT) project financing schemes, which will allow us to utilise our expertise in this area to assist the country's progress towards its economic goals.

In Conclusion

As an organisation, we are very proud of the progress we have made, over the past three years in general, and this year in particular, and we are now looking to the future with optimism that the economic conditions will improve at local and global levels. However, we must continually strive for improvement and excellence, if we are to build upon our position as a leader in the Kuwait banking sector.

Finally, on behalf of Gulf Bank's Board of Directors, I would like to express my sincere gratitude to His Highness, the Amir Sheikh Sabah Al Ahmed Al Jaber Al Sabah, H.H. the Crown Prince Sheikh Nawaf Al Ahmed Al Jaber Al Sabah, and H.H. the Prime Minister Sheikh Jaber Al Mubarak Al Hamad Al Sabah, for their continuing benevolent support and guidance, and to H.E. The Governor of the Central Bank of Kuwait Dr. Mohammad Al Hashel. I would also like to take this opportunity to thank you, our Shareholders, for the confidence you have shown in Gulf Bank, our customers, for their enduring trust in our products and services, and our loyal and dedicated staff, for their tireless efforts leading to Gulf Bank winning prestigious awards in the banking industry.

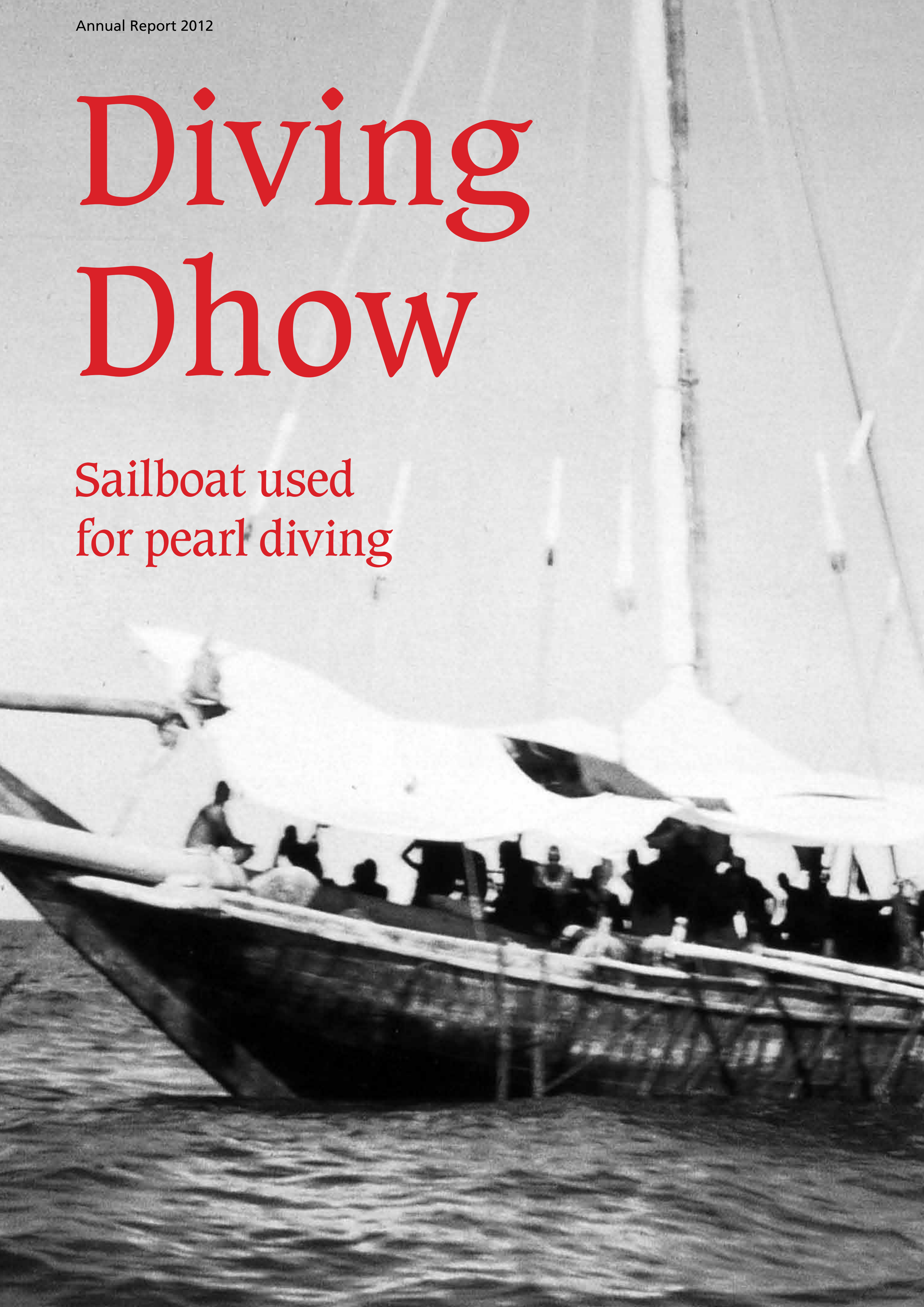
Mahmoud Abdul Khaleq Al Nouri
Chairman

The Award Winning Bank

- *'Bank of the Year' Award - The Banker, a Financial Times Publication*
- *'Bank of the Year' Award - Arabian Business*
- *'2012 Localization Award' - GCC Council of Ministers of Labour and Social Affairs*
- *'Banker of the Year' Award - Banker Middle East*
- *'HR Professional of the Year' - Naseba*
- *'J.P Morgan Quality Recognition Award 2012 for Operational Excellence' - J.P Morgan*
- *'2011 - 2012 Deutsche Bank EUR STP Excellence' Award - Deutsche Bank*
- *'Best Retail Customer Service' Award - Banker Middle East*
- *'Best Retail Bank in Kuwait' Award - Asian Banker*
- *'Best HR Strategy in Line with Business' Award - Asia's Best Employer Brand Awards ceremony*
- *'Excellence in Training' Award - Asia's Best Employer Brand Awards ceremony*
- *'Best SME Startup Scheme' Award - Banker Middle East*
- *'Best Employee Development Programme' Award - Banker Middle East*
- *'Corporate Social Responsibility Excellence' Award - The Arab Organization for Social Responsibility*
- *'Best Marketing Campaign of the Year' Award - CMO Asia*
- *'Best Integrated TV Commercial' Award - Arab Media Forum*

Diving Dhow

Sailboat used for pearl diving



Gulf Bank Management

Our Vision
To Dominate the Local Retail and Commercial Banking Space

Our Purpose
To Advance the Financial Well-Being of Our Community

Our Promise
To Provide the Best and Fastest Service

Sitting from right to left:

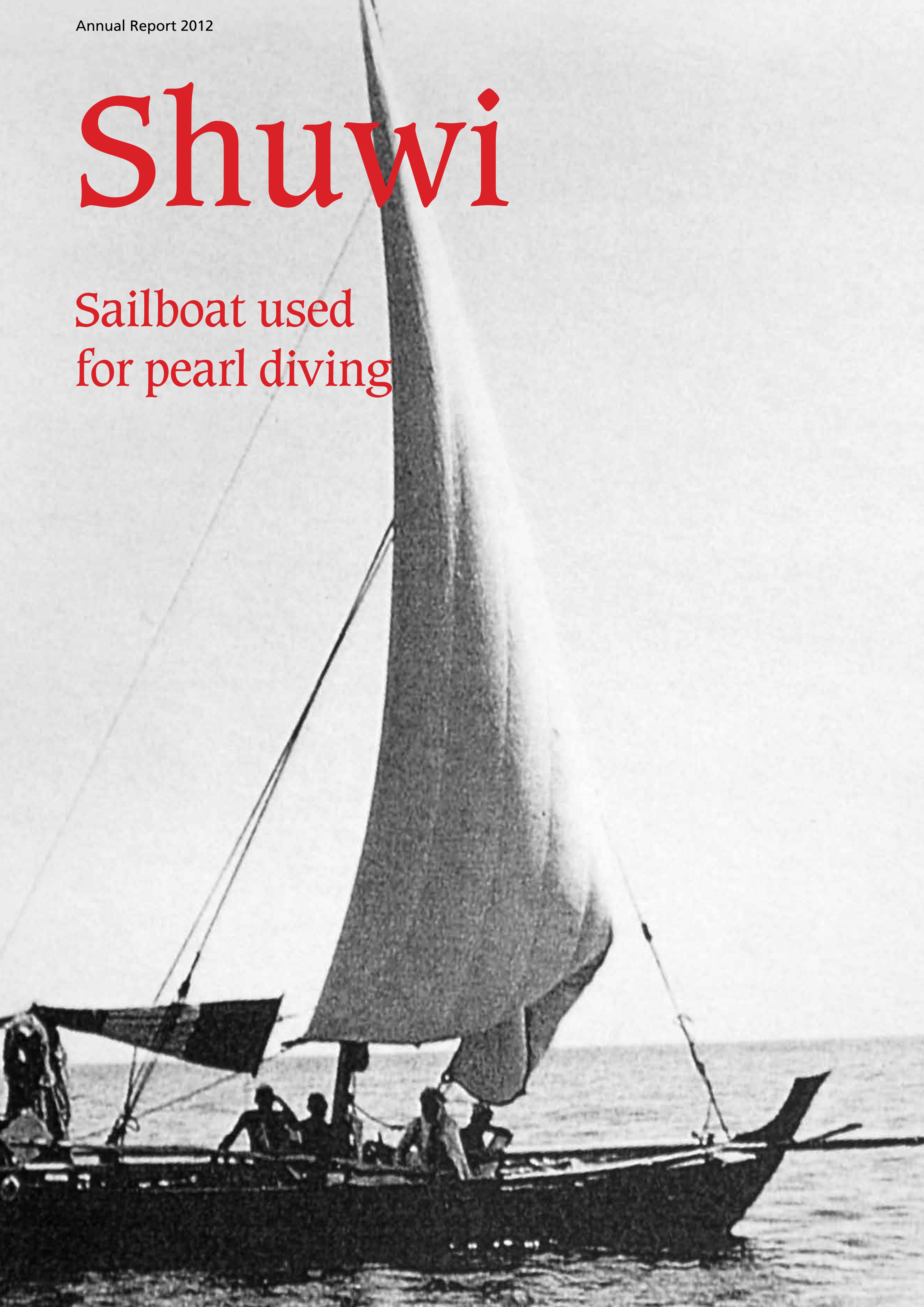
Michel Accad - Chief Executive Officer; **Mahmoud Al-Nouri** - Chairman;
Fawzy Althunayan - General Manager-Board Affairs;

Back row right to left:

Mark Magnacca - Chief Marketing Officer; **Khaled Gamal Eldin** - Chief Internal Auditor & GM-Internal Audit; **Salma Al-Hajjaj** - General Manager-Human Resources (joined Gulf Bank in February 2013); **Saleem Sheikh** - General Manager-Risk Management; **Abdullatif Al-Hamad** - General Manager-Corporate Banking; **Carlos Ribeiro** - Chief Financial Officer & General Manager-Finance & Support; **Khaled Al-Mutawa** - General Manager-International Banking & Investments; **Grant Jackson** - General Manager-Treasury; **Aly Shalaby** - General Manager-Consumer Banking Group; **Hatem Badr** - General Manager-Legal Affairs

Shuwi

Sailboat used for pearl diving



Financial Review

Income Statement Analysis

(KD Millions)	**2012**	2011
Net Interest Income	**117.7**	106.0
Other Operating Income	**61.9**	53.3
Operating Income	**179.6**	159.2
Operating Expenses	**(58.2)**	(51.5)
Operating Profit before Provisions	**121.4**	107.7
Provisions	**(88.9)**	(75.6)
Operating Profit	**32.5**	32.1
Directors' emoluments	**(0.1)**	(0.1)
KFAS/ National Labour Support Tax / Zakat	**(1.5)**	(1.3)
Net Profit	**30.9**	30.6

Net interest income was higher mainly due to improved margins.

Other Operating income includes KD 18.7 million of non-recurring items in 2012. The 2011 Operating income included KD 7.8 million of non-recurring items.

The Operating profit before provisions accordingly registered a 13% growth from KD 107.7 million in 2011 to KD 121.4 million in 2012, reflecting the improved margins and higher non-recurring items.

The specific provisions were lower by KD 5.2 million as compared to the previous year. However, the Bank continued to build up its precautionary provisions reserve in line with the strategic objective of building a fortress balance sheet, with precautionary reserves at almost twice the legal lending limit of the Bank.

Statement of Financial Position Analysis

selected balance sheet data (KD Millions)	**31-Dec 2012**	31-Dec 2011
Cash & short term funds: balances with CBK	**302.3**	115.7
Loans and advances to banks	**92.6**	34.1
Loans and advances to customers	**3,322.5**	3,334.1
Deposits with banks and OFIs	**32.7**	20.0
Investment securities	**122.4**	106.0
Total Assets	**4,846.7**	4,785.9
Due to banks	**127.4**	76.2
Subordinated loans	**84.4**	83.6
Deposits from Other Financial Institutions	**846.6**	776.8
Customer deposits	**3,247.6**	3,330.4
Total Liabilities	**4,397.4**	4,355.6
Shareholders' funds	**449.2**	430.3
Total Liabilities and Equity	**4,846.7**	4,785.9

Total assets increased by KD 26 million or 1.3% to 4.8 billion at 31st December 2012. Over 68% of the balance sheet was deployed in customer loans and advances at 31st December 2012, similar level as in 2011.

Loans and advances grew by 4.9% during the year whilst total shareholders’ equity increased to KD 449 million.

The total liabilities mainly comprise of deposits from customers (74%) and other financial institutions (‘OFIs‘) (19%).

Capital Management and Allocation

Capital Structure:

The table below details the regulatory capital for Gulf Bank ('the Bank') as at 31 December 2012 and 31 December 2011.

Capital Structure

Composition of Capital	(KD Million)		
	31-Dec-12	31-Dec-11	Variance
Tier 1 Capital			
Paid-up share capital	**276.5**	263.3	13.2
Reserves	**187.9**	179.9	8.0
Retained earnings	**17.7**	8.2	9.5
Less: Treasury Shares	**(56.3)**	(45.0)	(11.3)
Total Qualifying Tier 1 Capital	**425.8**	406.4	19.4
Tier 2 Capital			
Property Revaluation Reserve (45%)	**7.5**	7.5	-
Fair Valuation Reserve (45%)	**3.0**	3.2	(0.2)
General Provisions (1.25% of Credit RWAs)	**37.4**	36.2	1.2
Subordinated Debt	**33.8**	50.1	(16.3)
Total Qualifying Tier 2 Capital	**81.7**	97.0	(15.3)
Total Eligible Regulatory Capital (Tier 1 and Tier 2)	**507.5**	503.4	4.1

Qualifying Tier 1 capital increased by KD 19.4 million to KD 425.8 million reflecting the growth in retained earnings and reserves.

Qualifying Tier 2 capital decreased by KD 15.3 million to KD 81.7 million, due to the application of the cumulative discount factor based on the maturity profile of the subordinated debt.

Capital Management:

The Bank's capital management policy is to ensure and maintain an adequate capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of loan growth expectations for each business group, expected growth in off-balance-sheet facilities and trading (i.e. market risk) activities, future sources and uses of funds, and the Bank's future dividend policy. Capital is allocated to different business groups and stress testing is done to ensure that the Bank's internal capital targets are consistent with the approved risk appetite of the Bank.

The Bank seeks to maintain a prudent balance between the different components of its capital, particularly the relative mix of Tier 1 and Tier 2 capital.

The following table below details the risk-weighted exposures, regulatory capital requirements and regulatory capital ratios for the Bank as at 31 December 2012 and 31 December 2011.

Credit Risk Exposures	(KD Million)	
	31-Dec-12	31-Dec-11
Credit risk weighted exposures	**2,996.9**	2,898.3
Less: Excess general provisions	**(146.4)**	(87.7)
Net credit risk weighted exposures	**2,850.5**	2,810.6
Market risk weighted assets	**0.4**	1.6
Operational risk weighted exposures	**174.5**	165.8
Total risk weighted exposures	**3,025.4**	2,978.0
Regulatory Capital Requirements		
Credit Risk		
Cash items	**-**	-
Claims on sovereigns	**-**	0.7
Claims on public sector entities (PSEs)	**4.4**	4.8
Claims on banks	**18.9**	15.8
Claims on corporates	**161.3**	152.1
Regulatory retail exposures	**88.4**	76.2
Past due exposures	**20.2**	25.2
Other exposures	**66.4**	73.0
Credit risk capital requirement	**359.6**	347.8
Less: Excess general provision (12%)	**(17.5)**	(10.5)
Net credit risk capital requirement	**342.1**	337.3
Market Risk		
Interest rate position risk	**0.0**	0.1
Foreign exchange risk	**0.0**	0.1
Capital requirement for market risk	**0.0**	0.2
Capital requirement for operational risk	**20.9**	19.9
TOTAL CAPITAL REQUIREMENT	**363.0**	357.2
Capital adequacy ratios (per cent)		
Tier 1 ratio	**14.1%**	13.6%
Total capital adequacy ratio	**16.8%**	16.9%

The total risk-weighted exposure as at 31 December 2012 is KD 3,025.4 million, requiring a regulatory capital at 12.0%, of KD 363 million.

The Bank's regulatory capital as at 31 December 2012 is KD 507.5 million, translating to a capital adequacy ratio of 16.8%.

Risk Management

Organization of Governance and Risk Management:

The Risk Management Policy document, approved by the Board on 10 January 2011, provides the necessary information on risk management philosophy, objectives, management and organization structure. The risk management policies and procedures are constantly reviewed and where necessary, modified and enhanced to reflect changes in markets and products.

The Board of Directors has delegated all authority for credit decisions to the Board Credit Committee, within the Central Bank of Kuwait (CBK) guidelines.

To further strengthen the Risk management system, the Bank has completed the implementation of Enterprise Risk Management (ERM) system encompassing all areas of Risk Management.

The organisation of risk management, roles and responsibilities of the various committees are included in Note 24 of the financial statements.

Corporate Governance

Gulf Bank under the leadership of its Chairman and Board of Directors is rapidly moving towards implementation of the new rules on Corporate Governance 2012 as announced by the Central Bank of Kuwait. The Bank's vision is to implement Corporate Governance both in letter and spirit as well.

To expedite the implementation, the Chairman of the Bank has formed a Corporate Governance Implementation Committee consisting of the following:

- The Chairman of the Bank
- Chief Executive Officer/Chief General Manager
- GM – Board Affairs & Regulatory Compliance
- Chief Risk Officer

The committee has set out the overall broad objectives and milestones of the implementation plan. As such, the Bank now already has in place the following Board Committees:

- Board Corporate Governance Committee
- Board Audit Committee
- Board Risk Committee
- Board Remuneration & Nomination Committees

The By-Laws of the above committees have been completed and appropriate members appointed to these committees in line with requirements of the new rules including those of Central Bank of Kuwait and the Capital Markets Authority.

In continuation of its objective of implementing the new standards of Corporate Governance, the Bank has also achieved the following:

1. Completion & Implementation of the new Risk Appetite Document;
2. Oversight of Executive Management through a Risk Dashboard and other financial reports to the Board;
3. Approval of a new Risk Manual which among other things includes the ICAAP, Stress Testing and Capital Adequacy Requirements as well;
4. Approval and implementation of Disclosure Standards in line with CBK and CMA rules;
5. Introductory Training For Board Members

The Bank is also in the process of preparing a comprehensive Corporate Governance Manual as required by the Central Bank of Kuwait.

Credit Risk:

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract. It arises principally from lending, trade finance and treasury activities. The Bank has comprehensive policies and procedures to control and monitor all such risks. Note 24 (A) to the financial statements explains credit risk in detail and also outlines Bank's policy and framework to manage it.

Market Risk:

Market risk is the risk that movements in market rates, including foreign exchange rates, interest rates and credit spreads will reduce the Bank's income or the value of its portfolios.

The Bank is exposed to market risk through its trading activities, which are carried out both for customers and on a proprietary basis. The treasury group monitors and controls market risk for the Bank's foreign exchange and interest rate risk. The investment group monitors the equity market risk for proprietary investment portfolio. Individual dealer position and trading limits are set for each portfolio; product and risk type to ensure that the Bank's market risk is managed within the overall CBK regulatory guidelines and the market risk profile set by Asset and Liability Committee (ALCO). Interest rate, currency and liquidity mismatches are monitored constantly by the treasury group and regularly reviewed by ALCO. The degrees of mismatch permitted by ALCO are minimal.

The Bank's primary treasury business involves foreign exchange transactions on behalf of corporate customers. Customer transactions are undertaken on a back-to-back basis. The treasury group undertakes a limited amount of proprietary foreign exchange trading, mainly in the G7 currencies but also in the regional and other minor currencies. The risks are limited since the open foreign exchange positions are very small and in strict adherence with the open currency position limits set by CBK. The Bank does not trade in fixed income or equity securities.

Interest rate trading is restricted to meeting the funding requirements of the Bank's domestic and international foreign currency assets and investing any surpluses. As a matter of general policy, these positions do not contain any material element of interest rate risk. A modest amount of proprietary money market trading and foreign and local currency interbank activity is undertaken. The mismatch risks are minimal and are again governed by CBK limits.

Bank's treasury group also maintains a portfolio of Kuwait Government treasury bonds and CBK bonds to meet the CBK statutory liquidity requirements and to manage surplus domestic currency liquidity.

The Kuwaiti Dinar is the Bank's functional currency and almost all of the Bank's assets and liabilities are denominated in either KD or USD and are match funded in the same currency. As a result, there is limited structural cross currency foreign exchange exposure.

Interest Rate Risk (Banking Book):

Interest rate risk for the Bank arises from the possibility that changes in the interest rates will affect the fair value of future cash flows of the financial instruments. Note 24 (B) to the financial statements explains interest rate risk in detail and also outlines Bank's policy and framework to manage it.

Equity Risk (Banking Book):

The investments group is responsible for managing the investment securities portfolio in the banking (i.e. non-trading) book. In accordance with IAS 39, the investments are classified as 'available-for-sale', i.e. assets acquired to be held for an indefinite period of time which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. The investments are initially recognised at fair value and the subsequent unrealised gains or losses arising from changes in fair value are taken to the fair valuation reserve in equity. When an investment is disposed of, the related accumulated fair value adjustments are transferred to the income statement as gains or losses. CBK also sets a maximum limit of 50% of the Bank's capital for investment in securities.

The Bank treats available-for-sale equity instruments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgement.

Liquidity Risk:

Liquidity risk is the risk arising from the inability of the Bank to meet its obligations on time without incurring unacceptable losses. Liquidity risk arises in the general funding of a bank's activities. The Bank has maintained a balance in liquid assets over and above the CBK's minimum requirements. Note 24 (D) to the financial statements explains liquidity risk in detail and also outlines Bank's policy and framework to manage it.

Operational Risk:

Operational risk is the risk of loss arising out of policy or procedure breach or a process breakdown. It also includes fraud, unauthorised activities, error, omission, inefficiency, systems failure and external events. Note 24 (E) to the financial statements explains operational risk in detail and also outlines the Bank's policy and framework to manage it.

The Bank's Operational Risk Management framework is intended to identify, assess, monitor, mitigate and control operational risk effectively in the Bank in a consistent manner and, in the long run, to ensure that the Bank gets compensated for the risks assumed.

The Bank's Operational Risk Management framework encompasses Risk and Control Self Assessment (RCSA) and Key Risk Indicators (KRI). The framework is being implemented in each business unit of the Bank. Besides, the Bank has Incident Reporting mechanism, whereby any deviations from the standard operation are internally reported and appropriate remedial measures are implemented in a timely manner. Also, the Bank collates internal operational loss information and the data facilitates the Bank to put in place appropriate remedial measures to prevent instances of such losses in future. The Bank uses the SunGard Operational Risk solution for the purpose of monitoring operational risk.

Credit Risk Exposure

The Bank uses the Moody's Risk Rating system for risk rating its credit exposures. Note 24 to the financial statements explains Bank's internal grading process in detail.

Gross Credit Risk Exposure

The summary of the Bank's gross credit risk exposure (before credit risk mitigation) in 2012 and 2011 is shown below. The unfunded (i.e. off-balance-sheet) amounts represent the gross credit risk exposure before the credit conversion factor ('CCF') adjustments, since the gross amounts reflect the Bank's ultimate credit risk in the event of default by the counterparties.

	(KD Million)		
Gross Credit Risk Exposure	**31-Dec-12**	31-Dec-11	Growth
Funded Gross Credit Exposure	**5,022.2**	4,901.0	2%
Unfunded Gross Credit Exposure	**1,387.6**	1,530.3	-9%
Total Gross Credit Risk Exposure	**6,409.8**	6,431.3	0%

Funded gross credit risk exposure for 2012 is 78.4% (2011: 76.2%) of the total gross credit risk exposure.

Gross credit risk exposure divided between funded and unfunded on the basis of standard portfolio is detailed in the credit risk exposure section.

Average Credit Risk Exposure

Average credit risk exposure as at 31 December 2012 and 31 December 2011 is detailed below:

Funded and Unfunded credit facilities (Average) as at 31 December 2012

	2012			2011		
(KD Thousands)	**Funded**	**Unfunded**	**Total**	Funded	Unfunded	Total
Cash items	**44,339**	**-**	**44,339**	36,118	-	36,118
Claims on sovereigns	**1,052,339**	**86,227**	**1,138,566**	971,635	123,503	1,095,138
Claims on public sector entities (PSEs)	**92,017**	**123,506**	**215,523**	38,880	172,293	211,173
Claims on banks	**238,911**	**236,629**	**475,540**	275,482	252,630	528,112
Claims on corporates	**1,394,435**	**919,958**	**2,314,393**	1,411,304	865,260	2,276,564
Retail exposures	**760,470**	**41,654**	**802,124**	645,886	40,548	686,434
Past due exposures	**411,136**	**3,466**	**414,602**	446,948	2,995	449,943
Other exposures	**967,858**	**35,780**	**1,003,638**	953,448	55,158	1,008,606
Total	**4,961,505**	**1,447,220**	**6,408,725**	4,779,701	1,512,387	6,292,088

Average funded gross credit risk exposure for 2012 is 77.42% (2011: 75.96%) of the total average gross credit risk exposure. The full year average amounts are calculated using a 13-point average of the month end figures from 31 December 2011 to 31 December 2012 inclusive.

Geographical Distribution of Gross Credit Risk Exposures

The geographical distribution of the total gross credit risk exposure (after specific provisions), broken down by standard credit risk portfolio as at 31 December 2012 and 31 December 2011 is shown below. The geographical distribution is based on the primary purpose of the credit facilities.

Total gross credit risk exposures as at 31 December 2012 - Region wise

(KD Thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest of World	Total
Cash items	**45,863**	**-**	**-**	**-**	**-**	**-**	**45,863**
Claims on sovereigns	**1,037,949**	**49,320**	**-**	**-**	**-**	**-**	**1,087,269**
Claims on public sector entities (PSEs)	**61,439**	**146,292**	**-**	**-**	**-**	**-**	**207,731**
Claims on banks	**28,116**	**199,763**	**122,493**	**15,849**	**161,711**	**67**	**527,999**
Claims on corporates	**2,329,870**	**17,585**	**10,677**	**2**	**4,804**	**328**	**2,363,266**
Retail exposures	**865,441**	**106**	**107**	**2**	**10**	**-**	**865,666**
Past due exposures	**347,080**	**-**	**-**	**-**	**-**	**-**	**347,080**
Other exposures	**939,018**	**5,440**	**-**	**2,724**	**-**	**17,749**	**964,931**
Total	**5,654,776**	**418,506**	**133,277**	**18,577**	**166,525**	**18,144**	**6,409,805**
Percentage of gross credit risk exposure by geographical region	**88.2%**	**6.5%**	**2.1%**	**0.3%**	**2.6%**	**0.3%**	**100.0%**

Total gross credit risk exposures as at 31 December 2011 - Region wise

(KD Thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest of World	Total
Cash items	35,594	-	-	-	-	-	35,594
Claims on sovereigns	1,025,685	71,487	-	-	48,746	-	1,145,918
Claims on public sector entities (PSEs)	48,973	162,556	-	-	-	-	211,529
Claims on banks	14,342	181,071	109,913	27,980	141,991	36	475,333
Claims on corporates	2,259,132	44,471	20,224	2,735	3,680	17,082	2,347,324
Retail exposures	741,781	81	958	168	225	284	743,497
Past due exposures	440,864	-	-	-	-	7	440,871
Other exposures	995,845	-	-	2,252	-	33,164	1,031,261
Total	5,562,216	459,666	131,095	33,135	194,642	50,573	6,431,327
Percentage of gross credit risk exposure by geographical region	86.6%	7.1%	2.0%	0.5%	3.0%	0.8%	100.0%

The majority of the Bank's credit exposure is in Kuwait which comprises KD 5.65 billion (88.2% of total gross credit exposure) at 31 December 2012, compared with KD 5.56 billion (86.6% of total gross credit exposure) at 31 December 2011.

Credit Risk Exposure *(continued)*

Geographical Distribution of Average Credit Risk Exposures:

The average gross credit risk exposure for 2012 and 2011, broken down by geographical region and standard credit risk portfolio is shown below:

Total gross credit risk exposures as at 31 December 2012 (Average) - Region wise

(KD Thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest of World	Total
Cash items	**44,339**	**-**	**-**	**-**	**-**	**-**	**44,339**
Claims on sovereigns	**1,027,840**	**75,257**	**-**	**-**	**35,469**	**-**	**1,138,566**
Claims on public sector entities (PSEs)	**61,568**	**153,955**	**-**	**-**	**-**	**-**	**215,523**
Claims on banks	**25,157**	**149,249**	**139,317**	**21,221**	**140,534**	**62**	**475,540**
Claims on corporates	**2,236,766**	**55,344**	**15,699**	**1**	**3,864**	**2,719**	**2,314,393**
Regulatory retail exposures	**800,868**	**211**	**282**	**191**	**263**	**309**	**802,124**
Past due exposures	**414,602**	**-**	**-**	**-**	**-**	**-**	**414,602**
Other exposures	**974,814**	**308**	**-**	**2,336**	**-**	**26,180**	**1,003,638**
Total	**5,585,954**	**434,324**	**155,298**	**23,749**	**180,130**	**29,270**	**6,408,725**
Percentage of gross credit risk exposure by geographical region	**87.2%**	**6.8%**	**2.4%**	**0.4%**	**2.8%**	**0.4%**	**100%**

Total gross credit risk exposures as at 31 December 2011 (Average) - Region wise

(KD Thousands)	Kuwait	Other Middle East	Western Europe	USA & Canada	Asia Pacific	Rest of World	Total
Cash items	36,118	-	-	-	-	-	36,118
Claims on sovereigns	970,279	72,482	329	-	52,048	-	1,095,138
Claims on public sector entities (PSEs)	27,031	184,142	-	-	-	-	211,173
Claims on banks	59,864	179,055	125,886	27,508	135,704	95	528,112
Claims on corporates	2,184,230	33,047	17,699	5,064	12,018	24,506	2,276,564
Regulatory retail exposures	684,931	54	898	149	102	300	686,434
Past due exposures	443,634	6,298	-	-	-	11	449,943
Other exposures	958,289	1,044	1	1,937	-	47,335	1,008,606
Total	5,364,376	476,122	144,813	34,658	199,872	72,247	6,292,088
Percentage of gross credit risk exposure by geographical region	85.2%	7.6%	2.3%	0.6%	3.2%	1.1%	100.0%

Industry Segment Distribution of Gross Credit Risk Exposures:

The industry segment split of the gross credit risk exposure (after specific provisions), broken down by standard credit risk portfolio, as at 31 December 2012 and 31 December 2011 is shown below:

Total gross credit risk exposures as at 31 December 2012 - Industry wise

(KD Thousands)	Personal	Financial	Trade and commerce	Crude oil and gas	Cons- truction	Manu- facturing	Real estate	Other Services	Total
Cash items	-	-	-	-	-	-	-	45,863	45,863
Claims on sovereigns	-	42,869	-	-	-	-	-	1,044,400	1,087,269
Claims on public sector entities (PSEs)	-	109,574	3,471	112	-	-	-	94,574	207,731
Claims on banks	-	506,549	277	-	14,743	-	527	5,903	527,999
Claims on corporate	2,304	362,809	421,343	88,866	841,110	310,151	-	336,683	2,363,266
Regulatory retail exposures	802,090	214	23,210	882	25,235	4,640	-	9,395	865,666
Past due exposures	11,127	17,639	28,997	-	6,956	372	258,542	23,447	347,080
Other exposures	129,808	-	590	-	-	3,284	698,999	132,250	964,931
Total	945,329	1,039,654	477,888	89,860	888,044	318,447	958,068	1,692,515	6,409,805
Percentage of gross credit risk exposure by industry segment	14.7%	16.2%	7.5%	1.4%	13.9%	5.0%	14.9%	26.4%	100.0%

Total gross credit risk exposures as at 31 December 2011 - Industry wise

(KD Thousands)	Personal	Financial	Trade and commerce	Crude oil and gas	Cons- truction	Manu- facturing	Real estate	Other Services	Total
Cash items	-	-	-	-	-	-	-	35,594	35,594
Claims on sovereigns	-	61,719	-	-	-	-	-	1,084,199	1,145,918
Claims on public sector entities (PSEs)	-	-	-	112	-	-	-	211,417	211,529
Claims on banks	-	466,857	245	-	7,793	438	-	-	475,333
Claims on corporates	731	357,458	432,227	54,587	831,417	372,265	-	298,639	2,347,324
Regulatory retail exposures	687,438	274	23,762	724	23,112	4,857	-	3,330	743,497
Past due exposures	11,471	64,619	31,555	-	9,298	998	273,602	49,328	440,871
Other exposures	128,682	-	2,839	-	2,567	1,966	745,659	149,548	1,031,261
Total	828,322	950,927	490,628	55,423	874,187	380,524	1,019,261	1,832,055	6,431,327
Percentage of gross credit risk exposure by industry segment	12.9%	14.8%	7.6%	0.9%	13.6%	5.9%	15.8%	28.5%	100.0%

Credit Risk Exposure *(continued)*

Residual Maturity Distribution of Gross Credit Risk Exposures:

The residual maturity of the gross credit risk exposure (after specific provisions), broken down by standard credit risk portfolio, as at 31 December 2012 and 31 December 2011 is shown below:

Total gross credit risk exposures as at 31 December 2012 **Residual Maturity**

(KD Thousands)	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 3 years	Over 3 years	TOTAL
Cash items	**45,863**	**-**	**-**	**-**	**-**	**-**	**45,863**
Claims on sovereigns	**497,101**	**193,801**	**258,184**	**64,307**	**20,492**	**53,384**	**1,087,269**
Claims on public sector entities (PSEs)	**112**	**2**	**15**	**21,886**	**51,584**	**134,132**	**207,731**
Claims on banks	**145,678**	**82,948**	**51,693**	**61,949**	**102,593**	**83,138**	**527,999**
Claims on corporates	**193,040**	**487,106**	**304,344**	**278,464**	**519,913**	**580,399**	**2,363,266**
Regulatory retail exposures	**82,282**	**16,966**	**13,347**	**14,450**	**71,836**	**666,785**	**865,666**
Past due exposures	**266,530**	**6,053**	**2,394**	**1,205**	**42,124**	**28,774**	**347,080**
Other exposures	**89,247**	**47,047**	**281,304**	**100,941**	**62,427**	**383,965**	**964,931**
Total	**1,319,853**	**833,923**	**911,281**	**543,202**	**870,969**	**1,930,577**	**6,409,805**
Percentage of gross credit risk exposure by residual maturity	**20.6%**	**13.0%**	**14.2%**	**8.5%**	**13.6%**	**30.1%**	**100.0%**

Total gross credit risk exposures as at 31 December 2011 Residual Maturity

(KD Thousands)	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 3 years	Over 3 years	TOTAL
Cash items	35,594	-	-	-	-	-	35,594
Claims on sovereigns	482,233	199,625	161,425	244,494	20,080	38,061	1,145,918
Claims on public sector entities (PSEs)	-	-	7,471	13,956	54,643	135,459	211,529
Claims on banks	180,433	60,582	47,410	34,501	91,376	61,031	475,333
Claims on corporates	157,906	443,423	274,273	340,136	396,695	734,891	2,347,324
Regulatory retail exposures	50,863	16,571	12,298	12,916	53,915	596,934	743,497
Past due exposures	293,209	2,130	8,801	3,166	32,342	101,223	440,871
Other exposures	102,366	17,223	327,654	107,065	147,376	329,577	1,031,261
Total	1,302,604	739,554	839,332	756,234	796,427	1,997,176	6,431,327
Percentage of gross credit risk exposure by residual maturity	20.3%	11.5%	13.1%	11.7%	12.4%	31.0%	100.0%

Impaired Loans and Provisions

Impaired Loans and Provisions by Industry Segments:

The industry segments split of impaired loans (past due portion and balance outstanding) and the associated provisions (specific and general) as at 31 December 2012 and 31 December 2011 is shown below:

Impaired loans and provisions (by industry segment) as at 31 December 2012

	Impaired Loans (NPLs)		**Balance Sheet Provision Cash and non cash**			
(KD Thousands)	**Past due portion**	**Balance outstanding**	**Specific**	**General**	**Total**	**Specific Provision Cover**
Personal	**7,921**	**17,338**	**9,417**	**8,780**	**18,197**	**54.31%**
Financial	**17,554**	**17,638**	**84**	**3,184**	**3,268**	**0.48%**
Trade and commerce	**28,957**	**29,065**	**112**	**3,825**	**3,937**	**0.39%**
Crude oil and gas	**-**	**-**	**-**	**563**	**563**	**0.00%**
Construction	**6,469**	**6,640**	**2,123**	**5,367**	**7,490**	**31.97%**
Manufacturing	**364**	**1,221**	**857**	**3,043**	**3,900**	**70.19%**
Real estate	**259,889**	**280,236**	**20,975**	**7,263**	**28,238**	**7.48%**
Others	**23,620**	**23,732**	**2,000**	**151,879**	**153,879**	**8.43%**
Total	**344,774**	**375,870**	**35,568**	**183,904**	**219,472**	**9.46%**

Impaired loans and provisions (by industry segment) as at 31 December 2011

	Impaired Loans (NPLs)		Balance Sheet Provision Cash and non cash			
(KD Thousands)	Past due portion	Balance outstanding	Specific	General	Total	Specific Provision Cover
Personal	11,471	29,642	18,171	7,582	25,753	61.30%
Financial	64,619	74,739	11,559	3,242	14,801	15.47%
Trade and commerce	31,527	39,228	7,717	3,152	10,869	19.67%
Crude oil and gas	-	-	-	254	254	0.00%
Construction	7,061	12,777	8,710	5,031	13,741	68.17%
Manufacturing	990	7,401	6,411	3,035	9,446	86.62%
Real estate	269,901	288,557	18,665	7,087	25,752	6.47%
Others	51,590	62,230	10,770	94,561	105,331	17.31%
Total	437,159	514,574	82,003	123,944	205,947	15.94%

Non-performing loans (‘NPL's’) have decreased by KD 138.7 million in 2012, as compared to KD 127.3 million decrease in 2011 (for details refer Note 12 and 24 (A) of the financial statements and the following table).

Impaired Loans and Provisions *(continued)*

Provisions Charge by Industry Segments:

The industry segments split of the provision charges and write-offs are shown below:

Provision Charges and Write-offs during 2012 (by Industry Segments)

	Charge/(Release) for impairment provision		
(KD Thousands)	Specific Charge / Write-offs	General Charge	Total Charge
Personal	**(1,838)**	**1,198**	**(640)**
Financial	**(3,688)**	**(58)**	**(3,746)**
Trade and commerce	**1,905**	**673**	**2,578**
Crude oil and gas	**-**	**309**	**309**
Construction	**(988)**	**336**	**(652)**
Manufacturing	**1,670**	**8**	**1,678**
Real estate	**16,384**	**176**	**16,560**
Government	**-**	**-**	**-**
Other	**(1,569)**	**57,318**	**55,749**
Total	**11,876**	**59,960**	**71,836**

Specific charge mentioned above excludes KD 58.3 million amounts written off during the year.

Provision Charges and Write-offs during 2011 (by Industry Segments)

	Charge/(Release) for impairment provision		
(KD Thousands)	Specific Charge / Write-offs	General Charge	Total Charge
Personal	7,086	228	7,314
Financial	7,556	(38)	7,518
Trade and commerce	4,203	145	4,348
Crude oil and gas	-	38	38
Construction	(1,592)	227	(1,365)
Manufacturing	(870)	223	(647)
Real estate	16,757	819	17,576
Government	-	-	-
Other	(16,047)	59,858	43,811
Total	17,093	61,500	78,593

Specific charge mentioned above excludes KD 114.5 million amounts written off during the year.

Impaired Loans and Provisions by Geographical Segments:

The geographical split of impaired (i.e. non-performing) loans and the associated provisions cover as at 31 December 2012 and 31 December 2011 is shown below:

Impaired loans and provisions (by Geographical Region) as at 31 December 2012

	Impaired Loans (NPLs)		Balance Sheet Provisions			
(KD Thousands)	Past due portion	Balance outstanding	Specific	General	Total	Specific Provision Cover
Kuwait	**344,774**	**375,870**	**35,568**	**183,523**	**219,091**	**9.5%**
Other Middle East	**-**	**-**	**-**	**343**	**343**	**0.0%**
Western Europe	**-**	**-**	**-**	**11**	**11**	**0.0%**
USA & Canada	**-**	**-**	**-**	**-**	**-**	**0.0%**
Asia Pacific	**-**	**-**	**-**	**27**	**27**	**0.0%**
Rest of World	**-**	**-**	**-**	**-**	**-**	**0.0%**
Total	**344,774**	**375,870**	**35,568**	**183,904**	**219,472**	**9.5%**

Impaired loans and provisions (by Geographical Region) as at 31 December 2011

	Impaired Loans (NPLs)		Balance Sheet Provisions			
(KD Thousands)	Past due portion	Balance outstanding	Specific	General	Total	Specific Provision Cover
Kuwait	437,159	514,574	82,003	122,626	204,629	15.9%
Other Middle East	-	-	-	995	995	0.00%
Western Europe	-	-	-	316	316	0.00%
USA & Canada	-	-	-	2	2	0.00%
Asia Pacific	-	-	-	2	2	0.00%
Rest of World	-	-	-	3	3	0.00%
Total	437,159	514,574	82,003	123,944	205,947	15.9%

Credit Exposure:

Total Credit Exposure after applying Credit Conversion Factor but before Credit Risk Mitigation (CRM):

The total credit exposure after applying the relevant Basel II standardised approach Credit Conversion Factor ('CCF') but before CRM as at 31 December 2012 and 31 December 2011, broken down by standard credit risk portfolio, is shown below:

Gross credit risk exposure before CRM as at 31 December 2012

	Gross credit exposure			Credit exposure before CRM			
(KD Thousands)	**Funded**	**Unfunded**	**Total**	**Funded credit exposure**	**Unfunded credit after CCF**	**FX contracts after CCF**	**Total before CRM**
Cash items	**45,863**	**-**	**45,863**	**45,863**	**-**	**-**	**45,863**
Claims on sovereigns	**1,064,769**	**22,500**	**1,087,269**	**1,064,769**	**22,500**	**27**	**1,087,296**
Claims on PSEs	**96,161**	**111,570**	**207,731**	**96,161**	**111,491**	**-**	**207,652**
Claims on banks	**269,592**	**258,407**	**527,999**	**269,592**	**130,416**	**806**	**400,814**
Claims on corporates	**1,442,670**	**920,596**	**2,363,266**	**1,442,670**	**432,752**	**242**	**1,875,664**
Retail exposures	**821,956**	**43,710**	**865,666**	**821,956**	**18,993**	**-**	**840,949**
Past due exposures	**344,774**	**2,306**	**347,080**	**344,774**	**1,764**	**-**	**346,538**
Other exposures	**936,435**	**28,496**	**964,931**	**936,435**	**25,796**	**-**	**962,231**
Total	**5,022,220**	**1,387,585**	**6,409,805**	**5,022,220**	**743,711**	**1,075**	**5,767,006**

Gross credit risk exposure before CRM as at 31 December 2011

	Gross credit exposure			Credit exposure before CRM			
(KD Thousands)	Funded	Unfunded	Total	Funded credit exposure	Unfunded credit after CCF	FX contracts after CCF	Total before CRM
Cash items	35,594	-	35,594	35,594	-	-	35,594
Claims on sovereigns	1,041,462	104,456	1,145,918	1,041,462	104,456	16	1,145,934
Claims on PSEs	79,635	131,894	211,529	79,635	131,812	-	211,447
Claims on banks	213,326	262,007	475,333	213,326	153,205	135	366,666
Claims on corporates	1,399,185	948,139	2,347,324	1,399,185	429,367	415	1,828,967
Retail exposures	701,908	41,589	743,497	701,908	17,686	48	719,642
Past due exposures	437,159	3,712	440,871	437,159	2,470	-	439,629
Other exposures	992,759	38,502	1,031,261	992,759	33,929	-	1,026,688
Total	4,901,028	1,530,299	6,431,327	4,901,028	872,925	614	5,774,567

Credit Risk Mitigation:

Under the Basel II standardised approach for credit risk, CRM techniques are used to reduce the risk-weighted amount of credit risk exposures for capital adequacy purposes. Note 24 (A) to the financial statements explains credit risk in detail and also outlines Bank's policy and framework to manage it.

The Bank's credit procedures include very conservative minimum collateral coverage ratios, supported by top-up ratios. When the value of the collateral held in respect of a particular loan falls below the initial prescribed collateral coverage ratio and reaches the top up ratio threshold, the customer is requested to provide additional collateral in order to restore the prescribed collateral coverage ratio. Real estate collateral is valued once a year by independent real estate valuers (the lower of the two valuations being taken) and quoted shares are valued daily using current stock exchange prices for direct pledge and monthly if held through a portfolio manager.

In certain cases, personal/corporate guarantees from high net worth individuals or companies are also used to help secure credit facilities. The personal/corporate guarantees do not constitute eligible CRM techniques for capital adequacy purposes under the Basel II standardised approach.

Consumer loans are generally not secured, but the credit risk is minimised by the 'assignment of salary' condition that requires the customer's employer (normally a Government Ministry) to pay their salary directly to their Gulf Bank account. Collateral or security, normally in the form of a blocked customer deposit with the Bank, the assignment of an employment 'End of Service Benefit' or a personal guarantee, is taken on rare occasions when consumer loans are granted without an assignment of salary.

Credit Exposure *(continued)*

Total Credit Exposure after Credit Risk Mitigation and Resulting Credit Risk Weighted Assets:

The exposure after CRM, as at 31 December 2012 and 31 December 2011 and the resulting credit risk-weighted assets are further divided into rated and unrated exposures as given below:

Credit Risk Exposure after CRM; risk-weighted assets ('RWAs) as at 31 December 2012

	Credit exposure/CRM				Risk-weighted assets		
		CRM					
(KD Thousands)	Exposure before CRM	Eligible collateral	Eligible guarantees	Exposure after CRM	Rated	Unrated	Total
Cash items	**45,863**	**-**	**-**	**45,863**	**-**	**-**	**-**
Claims on sovereigns	**1,087,296**	**-**	**-**	**1,087,296**	**-**	**-**	**-**
Claims on PSEs	**207,652**	**14,195**	**-**	**193,457**	**36,691**	**-**	**36,691**
Claims on banks	**400,814**	**218**	**-**	**400,596**	**154,208**	**3,665**	**157,873**
Claims on corporates	**1,875,664**	**531,458**	**-**	**1,344,206**	**-**	**1,344,206**	**1,344,206**
Retail exposures	**840,949**	**98,526**	**-**	**742,423**	**-**	**736,497**	**736,497**
Past due exposures	**346,538**	**177,566**	**-**	**168,972**	**-**	**168,390**	**168,390**
Other exposures	**962,231**	**549,875**	**-**	**412,356**	**-**	**553,299**	**553,299**
Total	**5,767,007**	**1,371,838**	**-**	**4,395,169**	**190,898**	**2,806,058**	**2,996,956**

Credit Risk Exposure after CRM; risk-weighted assets ('RWAs) as at 31 December 2011

	Credit exposure/CRM				Risk-weighted assets		
		CRM					
(KD Thousands)	Exposure before CRM	Eligible collateral	Eligible guarantees	Exposure after CRM	Rated	Unrated	Total
Cash items	35,594	-	-	35,594	-	-	-
Claims on sovereigns	1,145,934	-	-	1,145,934	5,571	-	5,571
Claims on PSEs	211,447	131	-	211,316	-	40,264	40,264
Claims on banks	366,666	150	-	366,516	127,450	4,302	131,752
Claims on corporates	1,828,964	553,374	8,126	1,267,464	-	1,267,464	1,267,464
Retail exposures	719,642	78,562	-	641,080	-	635,013	635,013
Past due exposures	439,632	227,191	-	212,441	-	209,752	209,752
Other exposures	1,026,688	568,157	-	458,531	-	608,472	608,472
Total	5,774,567	1,427,565	8,126	4,338,876	133,021	2,765,267	2,898,288

Most of the CRM take the form of eligible financial collateral, mainly equities listed on the Kuwait stock exchange and cash deposits.

Trading Portfolio

Trading portfolio is limited to a modest amount of open currency position in the course of Bank's Balance Sheet management and a limited amount of money market trading is also undertaken.

The Bank uses standardised approach for determining the capital required for market risk. The Bank uses trading Value at Risk (VAR) to track and observe foreign exchange risks.

The details of the market risk capital charge for the Bank as at 31 December 2012 and 31 December 2011 is shown in the following table:

(KD Thousands)

Market Risk	31-Dec-12	31-Dec-11
Interest rate position risk	-	100
Foreign exchange risk	47	95
Total Capital requirement for market risk	47	195
Market risk-weighted assets	392	1,624

On 31 December 2012 total market risk capital charge of KD 47 thousand was equivalent to market risk-weighted assets of KD 0.392 million. Market risk-weighted assets were KD 1.23 million lower than December 2011.

Operational Risk

The Bank's business activities are mapped into the following three business lines: trading and sales, commercial banking and retail banking. The Bank's internal funds transfer pricing methodology is used to allocate interest income and interest expense between the above business lines.

The details of the operational risk capital charge for the Bank as at 31 December 2012 are shown in the following table:

Operational Risk as at 31 December 2012

(KD Thousands)	3 year average gross income	Beta factor	Operational risk capital charge
Trading and sales	**19,327**	**18%**	**3,479**
Commercial banking	**78,620**	**15%**	**11,793**
Retail banking	**47,248**	**12%**	**5,670**
Total	**145,195**		**20,942**
Total operational risk-weighted exposure			**174,516**

Operational Risk as at 31 December 2011

(KD Thousands)	3 year average gross income	Beta factor	Operational risk capital charge
Trading and sales	18,485	18%	3,327
Commercial banking	75,907	15%	11,386
Retail banking	43,280	12%	5,194
Total	137,672		19,907
Total operational risk-weighted exposure			165,825

In accordance with the Basel II guidelines, gross income includes net interest income and net non-interest income, but excludes realised profits from the sale of securities in the banking book. The 31 December 2012 total operational risk capital charge of KD 20.9 million was equivalent to operational risk-weighted exposure of KD 174.5 million.

Equity Risk in the Banking Book

Bank does not trade in equities. All of the Bank's investment securities are held in the banking (i.e. non-trading) book and are classified as 'available-for-sale' financial assets, i.e. they represent assets acquired to be held for an indefinite period of time which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. The fair values of quoted instruments are based on the quoted closing bid prices or by using the current market rate for the instrument. The fair values of unquoted instruments require significant estimation. The fair values of investments in mutual funds, unit trusts or similar investment vehicles are based on the last published bid price.

The fair value of the investment securities held at 31 December 2012 is shown below, along with the cumulative unrealised gains in the fair valuation reserve in equity and the regulatory capital implications. The income statement realisation gain from disposals made in 2012 is also shown.

Information related to the licensed Bank's equity position in the banking book as at 31 December 2012

(KD Thousands)	**Publicly traded**	**Privately traded**	**Total investment securities**
Total fair value of investment securities	**78,774**	**43,578**	**122,352**
Unrealised gains in equity	**6,277**	**427**	**6,704**
Regulatory capital details			
Unrealised gains in Tier 2 capital (45%)	**2,825**	**192**	**3,017**
Regulatory capital requirement	**9,151**	**5,243**	**14,394**
Income statement details			
Income from disposal of investment securities			**5,305**

Information related to the licensed Bank's equity position in the banking book as at 31 December 2011

(KD Thousands)	Publicly traded	Privately traded	Total investment securities
Total fair value of investment securities	39,325	66,684	106,009
Unrealised gains in equity	(257)	7,466	7,209
Regulatory capital details			
Unrealised gains in Tier 2 capital (45%)	(116)	3,360	3,244
Regulatory capital requirement	4,736	7,509	12,245
Income statement details			
Income from disposal of investment securities			7,277

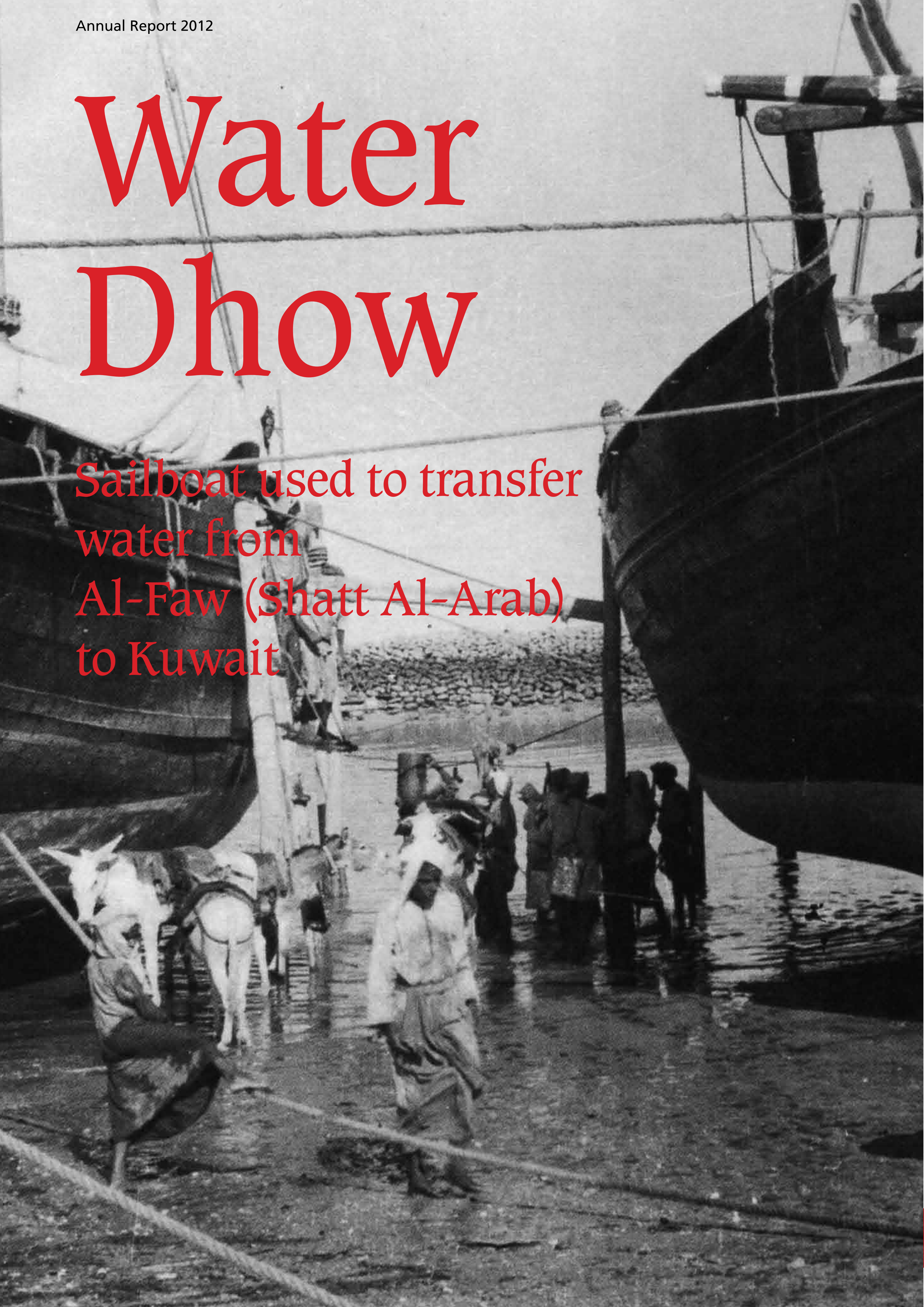
Interest Rate Risk in the Banking Book

Future net interest income is affected by movements in interest rates and a principal part of the Bank's management of market risk in the banking (i.e. non-trading) book is to manage the sensitivity of the Bank's net interest income to changes in market interest rates.

The sensitivity of net interest income to interest rate changes is provided in note 24 (B) to the financial statements.

Warjeeh

A canoe as small as the Hory made from palm tree branches and used for fishing close to shore



Water Dhow

Sailboat used to transfer water from Al-Faw (Shatt Al-Arab) to Kuwait

Financial Statements

Ernst & Young

Al Aiban, Al Osaimi & Partners

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Independent Auditors' Report to the Shareholders of Gulf Bank K.S.C.

Report on the Financial Statements

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait, and for such internal control as management 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 the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the 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 cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait.

Report on Other Legal and Regulatory Requirements

Furthermore, in our opinion proper books of account have been kept by the Bank and the financial statements, together with the contents of the report of the Bank's Board of Directors relating to these financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the financial statements incorporate all information that is required by the Capital Adequacy Regulations issued by the Central Bank of Kuwait ("CBK") as stipulated in CBK Circular No 2/BS/184/2005 dated 21 December 2005, as amended, the Commercial Companies Law No 25 of 2012, and by the Bank's Articles of Association, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of Capital Adequacy Regulations issued by the CBK as stipulated in CBK Circular No 2/BS/184/2005 dated 21 December 2005, as amended, the Commercial Companies Law No 25 of 2012, nor of the Articles of Association have occurred during the year ended 31 December 2012 that might have had a material effect on the business of the Bank or on its financial position.

We further report that, during the course of our audit, we have not become aware of any material violations of the provisions of Law No 32 of 1968, as amended, concerning currency, the CBK and the organisation of banking business, and its related regulations, during the year ended 31 December 2012.

WALEED A. AL OSAIMI
LICENCE NO. 68 A
ERNST & YOUNG
AL AIBAN, AL OSAIMI & PARTNERS

BADER A. AL WAZZAN
LICENCE NO. 62 A
DELOITTE & TOUCHE
AL-FAHAD, Al-WAZZAN & CO.

10 January 2013
Kuwait

Income Statement

Year Ended 31 December 2012

	NOTES	**2012 KD 000's**	2011 KD 000's
Interest income	3	**176,207**	172,455
Interest expense	4	**(58,510)**	(66,497)
Net interest income		**117,697**	105,958
Net fees and commissions	6	**28,535**	28,685
Net gains from dealing in foreign currencies and derivatives	7	**26,413**	16,103
Realised gains from disposal of investments available-for-sale		**5,305**	7,277
Dividend income		**664**	335
Other income		**1,025**	865
OPERATING INCOME		**179,639**	159,223
Staff expenses		**34,330**	31,941
Occupancy costs		**3,323**	3,052
Depreciation		**2,930**	2,802
Other expenses		**17,643**	13,741
OPERATING EXPENSES		**58,226**	51,536
OPERATING PROFIT BEFORE PROVISIONS/ IMPAIRMENT LOSSES		**121,413**	107,687
Charge of provisions:			
- specific	5	**11,876**	17,093
- general	12,18	**59,960**	61,500
Loans written off/(recoveries)	12	**5,168**	(10,683)
Impairment loss on investments available-for-sale		**11,936**	7,704
		88,940	75,614
OPERATING PROFIT		**32,473**	32,073
Directors' remuneration	22	**135**	135
Contribution to Kuwait Foundation for the Advancement of Sciences		**324**	246
National Labour Support Tax		**803**	804
Zakat		**324**	268
PROFIT FOR THE YEAR		**30,887**	30,620
EARNINGS PER SHARE			
Basic and diluted earnings per share (Fils)	8	**12**	12

The attached notes 1 to 29 form part of these financial statements.

Statement of Comprehensive Income

Year Ended 31 December 2012

	NOTE	2012 KD 000's	2011 KD 000's
Profit for the year		**30,887**	30,620
Other comprehensive (expense)/income			
Net unrealised loss on investments available-for-sale	13	**(8,635)**	(9,308)
Net impairment losses /realised losses (gain) on disposal of investments available-for-sale transferred to income statement	13	**8,130**	(801)
Revaluation of premises and equipment		**-**	455
Other comprehensive expense for the year		**(505)**	(9,654)
Total comprehensive income for the year		**30,382**	20,966

The attached notes 1 to 29 form part of these financial statements.

Statement of Financial Position

As at 31 December 2012

	NOTES	2012 KD 000's	2011 KD 000's
ASSETS			
Cash and short term funds	9	**483,230**	370,519
Treasury bills and bonds	10	**290,232**	418,221
Central Bank of Kuwait bonds	11	**424,375**	429,482
Deposits with banks and other financial institutions		**32,688**	20,000
Loans and advances to banks	12	**92,605**	34,140
Loans and advances to customers	12	**3,322,494**	3,334,087
Investments available-for-sale	13	**122,352**	106,009
Other assets	14	**53,079**	47,513
Premises and equipment		**25,603**	25,924
TOTAL ASSETS		**4,846,658**	4,785,895
LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks	15	**127,354**	76,179
Deposits from financial institutions	15	**846,603**	776,819
Customer deposits	16	**3,247,629**	3,330,444
Subordinated loans	17	**84,375**	83,565
Other liabilities	18	**91,456**	88,629
TOTAL LIABILITIES		**4,397,417**	4,355,636
EQUITY			
Share capital	19	**263,309**	250,770
Proposed bonus shares	22	**13,165**	12,539
Statutory reserve	20	**5,716**	2,469
Share premium	20	**153,024**	153,024
Property revaluation reserve	20	**16,698**	16,698
Treasury share reserve	21	**24,258**	24,289
Fair valuation reserve		**6,704**	7,209
Retained earnings		**22,701**	8,226
		505,575	475,224
Treasury shares	21	**(56,334)**	(44,965)
		449,241	430,259
TOTAL LIABILITIES AND EQUITY		**4,846,658**	4,785,895

Mahmoud Abdul Khaleq Al Nouri
(Chairman)

Michel Accad
(Chief Executive Officer)

The attached notes 1 to 29 form part of these financial statements.

Statement of Cash Flows

Year Ended 31 December 2012

	NOTES	2012 KD 000's	2011 KD 000's
OPERATING ACTIVITIES			
Profit for the year		**30,887**	30,620
Adjustments:			
Effective interest rate adjustment		**(1,919)**	849
Unrealised fair value gains on credit default swaps	7	**(7,429)**	(3,630)
Realised gains from disposal of investments available-for-sale		**(5,305)**	(7,277)
Dividend income		**(664)**	(335)
Depreciation		**2,930**	2,802
Loans loss provisions	5,12,18	**71,836**	78,593
Impairment loss on investments available-for-sale		**11,936**	7,704
Foreign exchange movement on subordinated loans		**810**	(615)
OPERATING PROFIT BEFORE CHANGES IN OPERATING ASSETS AND LIABILITIES		**103,082**	108,711
(Increase)/decrease in operating assets:			
Treasury bills and bonds		**127,989**	103,242
Central Bank of Kuwait bonds		**5,107**	(119,427)
Deposits with banks and other financial institutions		**(12,688)**	91,210
Loans and advances to banks		**(58,465)**	(12,360)
Loans and advances to customers		**(58,560)**	(232,085)
Other assets		**1,863**	8,144
(Decrease)/increase in operating liabilities:			
Due to banks		**51,175**	8,858
Deposits from financial institutions		**69,784**	(109,758)
Customer deposits		**(82,815)**	259,578
Other liabilities		**3,063**	12,074
NET CASH FLOWS FROM OPERATING ACTIVITIES		**149,535**	118,187
INVESTING ACTIVITIES			
Purchase of investments available-for-sale		**(41,730)**	(52,382)
Proceeds from sale of investments available-for-sale		**18,251**	28,055
Purchase of premises and equipment		**(2,609)**	(2,447)
Dividends received		**664**	335
NET CASH FLOWS USED IN INVESTING ACTIVITIES		**(25,424)**	(26,439)
FINANCING ACTIVITIES			
Purchase of treasury shares		**(11,437)**	(2,483)
Proceeds from sale of treasury shares		**37**	1,061
NET CASH FLOWS USED IN FINANCING ACTIVITIES		**(11,400)**	(1,422)
NET INCREASE IN CASH AND SHORT TERM FUNDS		**112,711**	90,326
CASH AND SHORT TERM FUNDS AT 1 JANUARY		**370,519**	280,193
CASH AND SHORT TERM FUNDS AT 31 DECEMBER	9	**483,230**	370,519
Additional cash flows information			
Interest received		**181,309**	179,634
Interest paid		**60,510**	68,841

The attached notes 1 to 29 form part of these financial statements.

Statement of Changes in Equity

Year Ended 31 December 2012

			RESERVES								
	Share capital KD 000's	Proposed bonus shares KD 000's	Statutory reserve KD 000's	Share premium KD 000's	Property revaluation reserve KD 000's	Treasury share reserve KD 000's	Fair valuation reserve KD 000's	(Accumulated losses) retained earnings KD 000's	Subtotal reserves KD 000's	Treasury shares KD 000's	Total KD 000's
At 1 January 2011	250,770	-	-	153,024	16,243	24,993	17,318	(7,386)	204,192	(44,247)	410,715
Profit for the year	-	-	-	-	-	-	-	30,620	30,620	-	30,620
Other comprehensive income / (expense) for the year	-	-	-	-	455	-	(10,109)	-	(9,654)	-	(9,654)
Total comprehensive (expense) / income for the year	-	-	-	-	455	-	(10,109)	30,620	20,966	-	20,966
Purchase of treasury shares	-	-	-	-	-	-	-	-	-	(2,483)	(2,483)
Sale of treasury shares	-	-	-	-	-	-	-	-	-	1,765	1,765
Loss on sale of treasury shares	-	-	-	-	-	(704)	-	-	(704)	-	(704)
Transfer to reserve	-	-	2,469	-	-	-	-	(2,469)	-	-	-
Proposed bonus shares (Note 22)	-	12,539	-	-	-	-	-	(12,539)	(12,539)	-	-
At 31 December 2011	250,770	12,539	2,469	153,024	16,698	24,289	7,209	8,226	211,915	(44,965)	430,259
At 1 January 2012	**250,770**	**12,539**	**2,469**	**153,024**	**16,698**	**24,289**	**7,209**	**8,226**	**211,915**	**(44,965)**	**430,259**
Profit for the year	-	-	-	-	-	-	-	30,887	30,887	-	30,887
Other comprehensive expense for the year	-	-	-	-	-	-	(505)	-	(505)	-	(505)
Total comprehensive (expense) / income for the year	-	-	-	-	-	-	(505)	30,887	30,382	-	30,382
Issue of bonus shares (Note 19)	12,539	(12,539)	-	-	-	-	-	-	-	-	-
Purchase of treasury shares	-	-	-	-	-	-	-	-	-	(11,437)	(11,437)
Sale of treasury shares	-	-	-	-	-	-	-	-	-	68	68
Loss on sale of treasury shares	-	-	-	-	-	(31)	-	-	(31)	-	(31)
Transfer to reserve	-	-	3,247	-	-	-	-	(3,247)	-	-	-
Proposed bonus shares (Note 22)	-	13,165	-	-	-	-	-	(13,165)	(13,165)	-	-
At 31 December 2012	**263,309**	**13,165**	**5,716**	**153,024**	**16,698**	**24,258**	**6,704**	**22,701**	**229,101**	**(56,334)**	**449,241**

The attached notes 1 to 29 form part of these financial statements.

Notes to the Financial Statements

31 December 2012

1. INCORPORATION AND REGISTRATION

Gulf Bank K.S.C. (the Bank) is a public shareholding company incorporated in Kuwait on 29 October 1960 and is registered as a Bank with the Central Bank of Kuwait. Its registered office is at Mubarak Al Kabir Street, P.O. Box 3200, 13032 Safat, Kuwait City.

The financial statements for the year ended 31 December 2012 were authorised for issue in accordance with a resolution of the Bank's Board of Directors on 10 January 2013. The Annual General Assembly of the shareholders has the power to amend these financial statements after issuance.

2. ACCOUNTING POLICIES

2.1 Basis of presentation

The financial statements are prepared under the historical cost basis of measurement as modified by the revaluation at fair value of financial assets classified as "available-for-sale", derivative contracts and freehold land and buildings.

The financial statements have been presented in Kuwaiti Dinars, which is the Bank's functional currency rounded off to the nearest thousand (KD 000), except when otherwise indicated.

Statement of compliance

The financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use by the State of Kuwait for financial services institutions regulated by the Central Bank of Kuwait. These regulations require adoption of all IFRS except for the IAS 39 requirement for collective provision, which has been replaced by the Central Bank of Kuwait's requirement for a minimum general provision as described under the accounting policy for impairment and uncollectibility of financial assets.

Presentation of financial statements

The Bank presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement is presented in note 24(D).

2.2 Changes in accounting policies and disclosures

The accounting policies are consistent with those used in the previous year, except as noted below.

During the year, the Bank has adopted the following amended IFRS:

IFRS 7 Financial Instruments: Disclosures — Transfer of financial assets effective 1 July 2011

The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Bank's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about the entity's continuing involvement in derecognised assets to enable the users to evaluate the nature of, and risks associated with, such involvement.

The Bank does not have any assets with these characteristics so there has been no effect on the presentation of its financial statements.

2.3 Summary of significant accounting policies

a. Financial instruments

Classification of financial instruments

The Bank classifies its financial assets as "at fair value through income statement", "loans and receivables" and "available-for-sale"; and its financial liabilities as "non-trading financial liabilities".

Financial assets classified as "at fair value through income statement" are divided into two sub categories: financial assets held for trading, and those designated at fair value through income statement at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if they are managed and their performance is evaluated and reported internally on a fair value basis in accordance with a documented investment strategy. Derivatives are also classified as "held for trading" unless they are designated as hedges and are effective hedging instruments.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Financial assets which are not classified as above are classified as "available-for-sale", and are principally those acquired to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Financial liabilities, which are not held for trading, are classified as "non-trading financial liabilities".

Management determines the classification of these financial instruments at the time of acquisition.

Recognition/de-recognition

A financial asset or a financial liability is recognised when the Bank becomes a party to the contractual provisions of the instrument.

All regular way purchases and sales of financial assets are recognised using settlement date accounting i.e. the date that the Bank receives or delivers the assets. Changes in fair value between the trade date and settlement date are recognised in the income statement, or in statement of comprehensive income in accordance with the policy applicable to the related instrument. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulations or conventions in the market place.

A financial asset (in whole or in part) is derecognised where:

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

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through agreement and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and recognition of a new liability and the difference between the carrying amount of the financial liability (or part of the financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in the income statement.

Measurement

All financial instruments are initially recognised at fair value. Transaction costs are included only for those financial instruments that are not measured at fair value through the income statement.

On subsequent re-measurement, financial assets classified as "at fair value through income statement" are carried at fair value with resultant unrealised gains or losses arising from changes in fair value included in the income statement. "Loans and receivables" are carried at amortised cost using the effective yield method less any provision for impairment. Those classified as "available-for-sale" are subsequently measured and carried at fair values. Unrealised gains and losses arising from changes in fair value of those classified as "available-for-sale" are taken to the statement of comprehensive income.

When the "available-for-sale" asset is disposed of or impaired, the related accumulated fair value adjustments previously recognised in equity are transferred to the income statement as gains or losses.

Cash and short term funds, treasury bills and bonds, Central Bank of Kuwait bonds, deposits with banks and other financial institutions, loans and advances to banks and customers and certain other assets are classified as "loans and receivables".

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted instruments are measured at cost less impairment loss, if any. "Non-trading financial liabilities" are carried at amortised cost using the effective interest method.

Impairment and uncollectibility of financial assets

An assessment is made at each statement of financial position date to determine whether there is objective evidence that a specific financial asset or a group of similar financial assets may be impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an 'incurred loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. If such evidence exists, an impairment loss is recognised in the income statement.

Impairment is determined as follows:

a. for financial assets with fixed interest rates, carried at amortised cost, impairment is the difference between the carrying value and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the original effective interest rate; and for financial assets with variable interest rates, carried at amortised cost, discounted at the current effective interest rate as determined under the contract;

b. for financial assets carried at fair value, impairment is the difference between cost and fair value, less any impairment loss previously recognised in the income statement;

For available-for-sale equity investments, impairment losses on equity investments are not reversed through the income statement; increases in their fair value after impairment are recognised directly in other comprehensive income.

For available-for-sale debt investments, the Bank assesses the instruments at an individual level to determine whether any objective evidence for impairment exists. When there is objective evidence of impairment, the amount of loss is measured as the difference between the instrument's carrying value and the present value of the future cash flows. If in a subsequent year, the fair value of a debt investment increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement.

In addition, in accordance with Central Bank of Kuwait (CBK) instructions, a minimum general provision is made on all credit facilities net of certain categories of collateral, to which CBK instructions are applicable and not subject to specific provision.

Financial assets are written off when there is no realistic prospect of recovery.

Fair values

Fair values of quoted instruments are based on quoted closing bid prices or net asset values provided by the administrators of the fund or using the current market rate of interest for that instrument. Fair values for unquoted instruments are estimated using applicable price/earnings or price/cash flow ratios refined to reflect the specific circumstances of the issuer. The fair value of investments in mutual funds, unit trusts or similar investment vehicles are based on the last published bid price.

The fair value of unquoted financial instruments is determined by reference to a significant third party transaction, or to the market value of a similar investment, or the expected discounted cash flows, brokers' quotes, or other appropriate valuation models.

The fair value of financial instruments carried at amortised cost is estimated by discounting the future cash flows at the current rates for similar financial instruments.

The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models.

'Day 1' profit or loss

When the transaction price is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognises the difference between the transaction price and fair value (a 'Day 1' profit or loss) in 'Net trading income'. In cases where fair value is determined using data which is not observable, the difference between the transaction price and model value is only recognised in the income statement when the inputs become observable, or when the instrument is derecognised.

Repurchase and resale agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date at an agreed price (repos) are not derecognised in the statement of financial position. Amounts received under these agreements are treated as interest bearing liabilities and the difference between the sale and repurchase price treated as interest expense using the effective yield method.

Assets purchased with a corresponding commitment to resell at a specified future date at an agreed price (reverse repos) are not recognised in the statement of financial position. Amounts paid under these agreements are treated as interest earning assets and the difference between the purchase and resale price is treated as interest income using the effective yield method.

Offsetting

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

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether the loan remains past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur.

b. Derivative financial instruments and hedging

In the ordinary course of business the Bank enters into various types of transactions that involve derivative financial instruments. Derivatives with positive fair values (unrealised gains) are included in 'Other assets' and derivatives with negative fair values (unrealised losses) are included in 'Other liabilities' in the statement of financial position.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with the changes in fair value recognised in the income statement.

Fair values are generally obtained by reference to quoted market prices, discounted cash flow models and pricing models as appropriate. Any changes in the fair value of derivatives that are held for trading are taken directly to the income statement and are disclosed under operating income. Derivatives held for trading also include those derivatives which do not qualify for hedge accounting described below.

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

In order to qualify for hedge accounting, the hedge is expected to be highly effective and should be reliably measurable. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk during the year for which the hedge is designated are expected to offset in a range of 80 per cent to 125 per cent. At the inception of the hedge, the risk management objective and strategy is documented, including the identification of the hedging instrument, the related hedged item, the nature of risk being hedged, and how the Bank will assess the effectiveness of the hedging relationship. Subsequently, the hedge is required to be assessed and determined to be an effective hedge on an ongoing basis.

In relation to fair value hedges, which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument to fair value is recognised immediately in 'Other assets' or 'Other liabilities' and the income statement. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the income statement.

In relation to cash flow hedges, which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in the statement of comprehensive income and the ineffective portion is recognised in the income statement. For cash flow hedges affecting future transactions that subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses which are recognised in the statement of comprehensive income are re-classified into the income statement in the same period or periods during which the financial asset or financial liability affects the income statement.

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

Hedge accounting is discontinued prospectively when the hedging instrument expires or is sold, terminated or exercised, or it no longer qualifies for hedge accounting or the forecast transaction is no longer expected to occur or the designation is revoked. At that point in time, any cumulative gain or loss on the hedging instrument recognized in equity is kept there until the forecast transaction occurs. In cases where the forecast transaction is no longer expected to occur or the designation is revoked, the net cumulative gain or loss recognised in equity is transferred to the income statement. In the case of fair value hedges of interest-bearing financial instruments, any adjustment to its carrying value relating to the discontinued hedge is amortized over the remaining term to maturity.

c. Collateral pending sale

The Bank occasionally acquires property in settlement of certain loans and advances. Such property is stated at the lower of the carrying value of the related loans and advances and the current fair value of such assets. Gains or losses on disposal, and revaluation losses, are recognised in the income statement.

d. Provisions

Provisions are recognised when, as a result of past events, it is probable that an outflow of economic resources will be required to settle a present, legal or constructive obligation and the amount can be reliably estimated. The expense relating to any provision is presented in the income statement net of any reimbursement.

e. End of service indemnity

The Bank provides end of service benefits to its expatriate employees. The entitlement to these benefits is based upon the employees' final salary and length of service subject to the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

With respect to its national employees, the Bank makes contributions to a government scheme calculated as a percentage of the employees' salaries. The Bank's obligations are limited to these contributions, which are expensed when due.

f. Treasury shares

Treasury shares consist of the Bank's own issued shares that have been reacquired by the Bank and not yet reissued or cancelled. The treasury shares are accounted for using the cost method. Under this method, the weighted average cost of the shares reacquired is charged to a contra account in equity. When the treasury shares are sold, gains are credited to a separate account in equity, (the "treasury shares reserve"), which is not distributable. Any realised losses are charged to the same account to the extent of the credit balance on that account. Any excess losses are charged to retained earnings, then to the voluntary reserve and statutory reserve. No cash dividends are paid on these shares. The issue of stock dividend shares increases the number of treasury shares proportionately and reduces the average cost per share without affecting the total cost of treasury shares.

g. Premises and equipment

Freehold land and buildings are initially recognised at cost. After initial recognition freehold land and buildings are carried at revalued amount, which is the fair value at the date of revaluation. The revaluation is carried out periodically by professional property valuers. The resultant revaluation surplus or deficit is recognised in the statement of comprehensive income to the extent the deficit does not exceed the previously recognised surplus. The portion of the revaluation deficit that exceeds a previously recognised revaluation surplus is recognised in the income statement. To the extent that a revaluation surplus reverses a revaluation loss previously recognised in the income statement, the increase is recognised in the income statement. Upon disposal the revaluation reserve relating to the freehold land and building sold is transferred directly to retained earnings.

Equipment are stated at cost, less accumulated depreciation and impairment losses if any. Land is not depreciated. Depreciation of buildings and equipment is provided on a straight-line basis over their estimated useful lives.

The estimated useful lives of the assets for the calculation of depreciation are as follows:

Buildings	5 to 10 years
Equipments	3 to 5 years

h. Impairment of non-financial assets

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's (CGU) fair value less costs to sell and its value in use. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, external valuations or other available fair value indicators.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Bank estimates the asset's or CGU's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceeds the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement.

Impairment losses relating to goodwill cannot be reversed in future periods.

i. Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured.

Interest income and expense are recognised in the income statement for all interest bearing instruments using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, all fees paid or received between parties to the contract, transaction costs and all other premiums or discounts are considered, but not future credit losses.

Other fees and commissions income are recognised as the services are provided. Dividend income is recognised when the right to receive payment is established.

j. Kuwait Foundation for the Advancement of Sciences (KFAS), National Labour Support Tax (NLST) and Zakat

KFAS, NLST and Zakat are provided for in accordance with the fiscal regulations in Kuwait.

k. Leases

Operating lease payments are recognized as an operating expense in the income statement on a straight line basis over the lease term.

l. Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Bank and accordingly are not included in the statement of financial position.

m. Foreign currencies

Foreign currency transactions are recorded at rates of exchange ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at year-end are translated into Kuwaiti Dinars at the rates of exchange ruling at the statement of financial position date. Forward exchange contracts are valued at the forward rates ruling at the statement of financial position date. Any resultant gains or losses are taken to the income statement.

In case of non-monetary assets whose change in fair values are recognised directly in other comprehensive income, foreign exchange differences are recognised directly in other comprehensive income and for non-monetary assets whose change in fair value are recognised directly in the income statement, foreign exchange differences are recognised in the income statement.

n. Cash and cash equivalents

Cash and cash equivalents consists of cash on hand and deposits with banks and other financial institutions (including Central Bank of Kuwait) having original maturities not exceeding three months.

o. Segment reporting

A segment is a distinguishable component of the Bank that engages in business activities from which it earns revenues and incurs costs. The operating segments are used by the management of the Bank to allocate resources and assess performance. Operating segments exhibiting similar economic characteristics, product and services, class of customers where appropriate are aggregated and reported as reportable segments.

p. Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognized in the financial statements at fair value, being the premium received, in ´Other liabilities´. The premium received is recognized in the income statement in 'net fees and commission' on a straight-line basis over the life of the guarantee. The guarantee liability is subsequently measured as a higher of the amount initially recognized less amortisation or the value of any financial obligation that may arise therefrom.

2.4 Significant accounting judgements, estimates and assumptions

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

Classification of financial instruments

Management has to decide on acquisition of a financial instrument, whether it should be classified as carried at fair value through income statement, available-for-sale or as loans and receivables. In making that judgement, the Bank considers the primary purpose for which it is acquired and how it intends to manage and report its performance. Such judgement determines whether it is subsequently measured at cost, amortised cost or at fair value and whether the changes in fair value of instruments are reported in the income statement or statement of comprehensive income.

Impairment losses on loans and advances

The Bank reviews loans and advances on an ongoing basis to assess whether a provision for impairment should be recorded in the income statement. In particular, considerable judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. In estimating these cash flows the Bank makes judgements about the borrower's financial conditions and the net realisable value of collaterals. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

Impairment of available-for-sale investments

The Bank reviews its debt securities classified as available for sale investments at each reporting date to assess whether they are impaired. This requires similar judgement as applied to the individual assessment of loans and advances.

The Bank records impairment charges on available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below their cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the bank evaluates, among other factors, historical share price movements and duration and extent to which the fair value of an investment is less than its cost.

Valuation of unquoted financial instruments

Valuation of unquoted financial instruments is normally based on one of the following:

- Recent arm's length market transactions;
- The expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics;
- Current fair value of another instrument that is substantially the same; or
- Valuation models.

The Bank calibrates the valuation techniques periodically and tests these for validity using either prices from observable current market transactions in the same instrument or other available observable market data.

These values are computed based on significant assumptions including foreign exchange rates, interest rates and volatilities etc. The extent of changes to these rates and volatilities are dependent on market movements, which cannot be predicted with certainty.

2.5 Standards issued but not effective

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

IAS 1 Presentation of Items of Other Comprehensive Income (amendments)

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

IAS 32 Offsetting Financial Assets and Financial Liabilities (amendments)

These amendments clarify the meaning of "currently has a legally enforceable right to set-off". The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. These amendments are not expected to impact the Bank's financial position or performance and become effective for annual periods beginning on or after 1 January 2014.

IFRS 7 Disclosures - Offsetting Financial Assets and Financial Liabilities (amendments)

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

IFRS 9 Financial Instruments: Classification and Measurement

IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but amendments to IFRS 9 Mandatory Effective Date of IFRS 9 and Transition Disclosures, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Bank's financial assets, but will not have an impact on classification and measurements of financial liabilities. The Bank will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued.

IFRS 13 Fair Value Measurement

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Bank is currently assessing the impact that this standard will have on the financial position and performance. This standard becomes effective for annual periods beginning on or after 1 January 2013.

Improvements May 2012

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

IAS 1 Presentation of Financial Statements

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

IAS 34 Interim Financial Reporting

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

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

3. INTEREST INCOME

	2012 KD 000's	2011 KD 000's
Treasury bills, bonds and Central Bank of Kuwait Bonds	**11,331**	11,495
Placements with banks	**1,345**	1,720
Loans and advances to banks and customers	**163,531**	159,240
	176,207	172,455

4. INTEREST EXPENSE

	2012 KD 000's	2011 KD 000's
Sight and savings accounts	**3,742**	3,669
Time deposits	**51,583**	60,320
Bank borrowings	**3,185**	2,508
	58,510	66,497

5. SPECIFIC PROVISIONS

	2012 KD 000's	2011 KD 000's
Loans and advances to customers		
– Cash (Note 12)	**11,992**	17,956
– Non-cash (Note 18)	**(116)**	(863)
	11,876	17,093

6. NET FEES AND COMMISSIONS

	2012 KD 000's	2011 KD 000's
Total fees and commission income	**32,243**	32,170
Total fees and commission expense	**(3,708)**	(3,485)
	28,535	28,685

7. NET GAINS FROM DEALING IN FOREIGN CURRENCIES AND DERIVATIVES

	2012 KD 000's	2011 KD 000's
Income from structured derivative transactions	**8,268**	678
Realised gain on structured derivative transactions with customers	**3,357**	3,303
Unrealised fair value gains on credit default swaps	**7,429**	3,630
Income from credit default swaps	**1,058**	1,269
Net trading income	**20,112**	8,880
Foreign exchange operations	**6,301**	7,223
	26,413	16,103

8. BASIC AND DILUTED EARNINGS PER SHARE

Basic and diluted earnings per share are based on the weighted average number of shares outstanding during the year, which are as follows:

	2012 KD 000's	2011 KD 000's
Profit for the year	**30,887**	30,620
	Shares	Shares
Weighted average number of Bank's issued and paid up shares	**2,633,087,484**	2,633,087,484
Less: Weighted average number of treasury shares	**(60,359,623)**	(48,982,125)
	2,572,727,861	2,584,105,359
	Fils	Fils
Basic and diluted earnings per share	**12**	12

Earnings per share calculation for the year ended 31 December 2011 have been adjusted to give effect to bonus shares issued in 2012.

9. CASH AND SHORT TERM FUNDS

	2012 KD 000's	2011 KD 000's
Balances with the Central Bank of Kuwait	**302,348**	115,712
Cash on hand and in current accounts with other banks	**78,360**	63,720
Deposits with banks and other financial institutions	**102,522**	191,087
	483,230	370,519

10. TREASURY BILLS AND BONDS

The Central Bank of Kuwait on behalf of the Ministry of Finance issues these financial instruments.

	2012 KD 000's	2011 KD 000's
Maturing within one year	**265,676**	398,174
Maturing after one year	**24,556**	20,047
	290,232	418,221

11. CENTRAL BANK OF KUWAIT BONDS

These financial instruments are issued by the Central Bank of Kuwait. They mature within a period not exceeding one year.

	2012 KD 000's	2011 KD 000's
Central Bank of Kuwait Bonds	**424,375**	429,482

12. LOANS AND ADVANCES TO BANKS AND CUSTOMERS

Loans and advances represent monies paid to banks and customers. The Bank's assessment of the credit risk concentration, based on the primary purpose of the loans and advances given, is provided below:

At 31 December 2012:

Loans and advances to customers

	Kuwait KD 000's	Other Middle East KD 000's	Western Europe KD 000's	Asia Pacific KD 000's	Rest of World KD 000's	Total KD 000's
Personal	**954,917**	**-**	**-**	**-**	**-**	**954,917**
Financial	**335,644**	**-**	**-**	**-**	**-**	**335,644**
Trade and commerce	**321,963**	**8,470**	**-**	**-**	**-**	**330,433**
Crude oil and gas	**23,036**	**-**	**-**	**-**	**-**	**23,036**
Construction	**283,592**	**-**	**-**	**583**	**-**	**284,175**
Manufacturing	**294,794**	**-**	**-**	**-**	**-**	**294,794**
Real estate	**949,313**	**-**	**-**	**-**	**-**	**949,313**
Others	**310,529**	**49,078**	**296**	**-**	**-**	**359,903**
	3,473,788	**57,548**	**296**	**583**	**-**	**3,532,215**
Less: Provision for impairment						**(209,721)**
						3,322,494
Loans and advances to banks	**1,621**	**22,078**	**68,906**	**-**	**-**	**92,605**

At 31 December 2011:

Loans and advances to customers

	Kuwait KD 000's	Other Middle East KD 000's	Western Europe KD 000's	Asia Pacific KD 000's	Rest of World KD 000's	Total KD 000's
Personal	846,493	-	-	-	-	846,493
Financial	405,555	-	-	-	-	405,555
Trade and commerce	315,823	1,024	-	-	-	316,847
Crude oil and gas	19,661	-	-	-	-	19,661
Construction	266,935	-	-	1,046	-	267,981
Manufacturing	360,827	-	260	-	-	361,087
Real estate	999,331	-	-	-	-	999,331
Others	239,565	56,002	-	-	17,525	313,092
	3,454,190	57,026	260	1,046	17,525	3,530,047
Less: Provision for impairment						(195,960)
						3,334,087
Loans and advances to banks	-	6,285	27,855	-	-	34,140

12. LOANS AND ADVANCES TO BANKS AND CUSTOMERS *(continued)*

Movement in provision for impairment

	2012 KD 000's			2011 KD 000's		
	Specific	**General**	**Total**	Specific	General	Total
At 1 January	**77,415**	**118,545**	**195,960**	173,983	57,975	231,958
Amounts written-off	**(58,311)**	**-**	**(58,311)**	(114,524)	-	(114,524)
Charge to the income statement (Note 5)	**11,992**	**60,080**	**72,072**	17,956	60,570	78,526
At 31 December	**31,096**	**178,625**	**209,721**	77,415	118,545	195,960

The specific and general provisions set out above are based on the requirements of the Central Bank of Kuwait and IFRS. According to the Central Bank of Kuwait instructions, minimum general provision of 1% is provided on regular cash facilities and 0.5% on regular non-cash facilities, (net of certain categories of collateral, to which CBK instructions are applicable and not subject to specific provision).

Loan recoveries represent the net difference between loans written off during the year of **KD 12,358 thousand** (2011: KD 7,640 thousand) and realizations of **KD 7,190 thousand** (2011: KD 18,323 thousand) from loans written off.

The Bank has initiated legal proceedings against a customer in connection with structured derivative transactions and is awaiting a final outcome.

	2012 KD 000's			2011 KD 000's		
Movement in provisions for impairment of loans and advances by class is as follows:	**Commercial lending**	**Consumer lending**	**Total**	Commercial lending	Consumer lending	Total
At 1 January	**177,851**	**18,109**	**195,960**	210,058	21,900	231,958
Amounts written-off	**(58,311)**	**-**	**(58,311)**	(107,381)	(7,143)	(114,524)
Charge/(write back) to the income statement (Note 5)	**72,383**	**(311)**	**72,072**	75,174	3,352	78,526
At 31 December	**191,923**	**17,798**	**209,721**	177,851	18,109	195,960
Specific provision	**21,440**	**9,656**	**31,096**	66,126	11,289	77,415
General provision	**170,483**	**8,142**	**178,625**	111,725	6,820	118,545
	191,923	**17,798**	**209,721**	177,851	18,109	195,960

As at 31 December 2012, non-performing loans and advances amounted to **KD 375,870 thousand** (2011: KD 514,574 thousand) refer Note 24A.

13. INVESTMENTS AVAILABLE-FOR-SALE

	2012 KD 000's	2011 KD 000's
Equity securities		
Quoted	**47,442**	58,311
Unquoted	**25,165**	26,987
Debt securities		
Quoted	**31,332**	18,711
Unquoted	**18,413**	2,000
	122,352	106,009

Quoted securities are traded in active markets. Fair values amounting to **KD 1,658 thousand** (2011: KD 1,901 thousand) of the unquoted securities are based on observable market data.

During the year, the Bank recognised a loss of **KD 8,635 thousand** (2011: loss of KD 9,308 thousand) in the statement of comprehensive income as net unrealised loss arising from changes in fair value of investment securities and re-cycled impairment losses net of gains arising from the disposal of "investments available-for-sale", of **KD 8,130 thousand** (2011: gain of KD 801 thousand) to the income statement.

The determination of the cash flows and discount factors for unquoted equity and debt securities requires significant estimation. There are certain investments where this estimation cannot be reliably determined, and as a result investments with a carrying amount of **KD 41,920 thousand** (2011: KD 27,086 thousand) are carried at cost net of impairment.

14. OTHER ASSETS

	2012 KD 000's	2011 KD 000's
Accrued interest receivable	**23,820**	29,112
Sundry debtors and others	**26,759**	18,401
Repossessed collateral	**2500**	-
	53,079	47,513

During the year, the Bank obtained possession of a real estate property valued at KD 2,500 thousand held as collateral in settlement of a debt due from a customer. This repossessed colleteral will be disposed of within the stipulated time limit prescribed by the CBK.

Sundry debtors and others include **KD Nil** (2011: KD 8,916 thousand) (including foreign exchange translation differences) being fair value of open structured derivative transactions with a customer which are not yet due against which the Bank has made an equivalent credit risk provision.

15. DUE TO BANKS AND DEPOSITS FROM FINANCIAL INSTITUTIONS

	2012 KD 000's	2011 KD 000's
Due to banks		
Current accounts and demand deposits	**32,604**	24,789
Time deposits	**94,750**	51,390
	127,354	76,179
Deposits from financial institutions		
Current accounts and demand deposits	**60,731**	49,220
Time deposits	**785,872**	727,599
	846,603	776,819

16. CUSTOMER DEPOSITS

	2012 KD 000's	2011 KD 000's
Current accounts	**835,542**	706,496
Savings accounts	**289,443**	258,236
Time deposits	**2,122,644**	2,365,712
	3,247,629	3,330,444

17. SUBORDINATED LOANS

As at 31 December 2012, the Bank has subordinated loans of USD 300 million equivalent to **KD 84,375 thousand** (2011: KD 83,565 thousand). This comprise of three 10 year subordinated loans: USD 50 million due in June 2014, USD 100 million due in December 2014, and USD 150 million due in October 2016. The loans were obtained from financial institutions outside of Kuwait and qualify as Tier 2 subordinated loan capital. The loans are repayable at maturity, with an option for early pre-payment with the prior approval of Central Bank of Kuwait, and interest is variable and related to interbank offer rates.

18. OTHER LIABILITIES

	2012 **KD 000's**	2011 KD 000's
Interest payable	**13,506**	15,506
Deferred income	**6,882**	4,550
Provisions for non-cash facilities (refer movement below)	**9,751**	9,987
Fair value loss provision on credit default swaps (Note 28)	**3,415**	10,844
Staff related provisions	**9,185**	9,213
Others	**48,717**	38,529
	91,456	88,629

	2012 KD 000's			2011 KD 000's		
	Specific	**General**	**Total**	Specific	General	Total
At 1 January	**4,588**	**5,399**	**9,987**	5,451	4,469	9,920
(write-back) /Charge to the income statement (Note 5)	**(116)**	**(120)**	**(236)**	(863)	930	67
At 31 December	**4,472**	**5,279**	**9,751**	4,588	5,399	9,987

19. SHARE CAPITAL

	2012 **KD 000's**	2011 KD 000's
Authorised, issued and fully paid shares	**263,309**	250,770

The number of authorised, issued and fully paid shares of KD 0.100 each as at 31 December 2012 is 2,633,087,484 (2011: 2,507,702,366). Bonus of 5% on the outstanding shares proposed as at 31 December 2011 was approved at the 2011 Annual General Meeting and was issued in 2012 following that approval (Note 22).

20. RESERVES

a) Statutory Reserve

In accordance with the Law of Commercial Companies and the Bank's Articles of Association, 10 percent of the profit for the year before directors' fees, contribution to KFAS, NLST and Zakat (2011: after recovering the previously incurred losses) has been transferred to statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve totals 50 percent of paid up share capital.

Distribution of this reserve is limited to the amount required to enable the payment of a dividend of 5 percent of share capital in years when accumulated profits are not sufficient for the payment of a dividend of that amount.

b) Share premium

The balance in the share premium account is not available for distribution but can be utilised for capital restructuring to offset the accumulated losses.

20. RESERVES *(continued)*

c) Property revaluation reserve

The property revaluation reserve represents the surplus of market value over carrying value of the premises and equipment owned by the Bank. The balance in this reserve is taken directly to retained earnings when the underlying assets are disposed off.

21. TREASURY SHARES AND TREASURY SHARE RESERVE

	2012 **KD 000's**	2011 KD 000's
Number of treasury shares	**79,665,829**	49,958,737
Percentage of treasury shares	**3.03%**	1.99%
Cost of treasury shares (KD 000's)	**56,334**	44,965
Market value of treasury shares as at 31 December (KD 000's)	**33,460**	25,479

Movement in treasury shares was as follows:

	No. of shares	
	2012	2011
Balance as at 1 January	**49,958,737**	46,878,737
Purchases	**29,787,092**	4,950,000
Sales	**(80,000)**	(1,870,000)
Balance as at 31 December	**79,665,829**	49,958,737

The balance in the treasury share reserve of **KD 24,258 thousand** (2011: KD 24,289 thousand) is not available for distribution.

22. PROPOSED BONUS SHARES AND DIRECTORS' REMUNERATION

The Board of Directors have recommended distribution of bonus shares of 5% (2011: 5%) on the outstanding issued share capital as at 31 December 2012 amounting to **KD 13,165 thousand** (2011: KD 12,539 thousand) which is subject to approval of shareholders at the Annual General Meeting (AGM). Proposed bonus shares, if approved shall be distributed to shareholders registered in Bank's records as at the date of the AGM.

During the year, the shareholders at Annual General Meeting (AGM) held on 17 March 2012 approved the distribution of bonus shares of 5% on the outstanding issued share capital as at 31 December 2011 amounting to KD 12,539 thousand representing 125,385,118 shares of 100 fils each.

Directors' remuneration of **KD 135 thousand** (2011: KD 135 thousand) is in accordance with local regulations and is subject to approval of the shareholders at the Annual General Meeting.

23. RELATED PARTY TRANSACTIONS

Certain related parties (Board members and officers of the Bank, their families and companies of which they are the principal owners) were customers of the Bank in the ordinary course of business. The terms of these transactions are approved as per the Bank's policies.

The transaction and balances included in the statement of financial position are as follows:

	Number of Board members or executive management members		Number of related parties			
Board members	**2012**	2011	**2012**	2011	**2012 KD 000's**	2011 KD 000's
Loans and advances	**-**	2	**3**	6	**52,450**	110,674
Provision for losses on receivable from a related party	**-**	-	**-**	1	**-**	2,162
Investment available-for-sale	**-**	-	**-**	-	**770**	780
Deposits	**7**	8	**16**	16	**217,583**	321,622
Guarantees issued	**-**	-	**3**	6	**4,907**	35,917
Executive management						
Loans	**1**	1	**-**	-	**541**	561
Deposits	**13**	13	**-**	-	**1,218**	1,382
Guarantees issued	**2**	2	**-**	-	**1**	1

The loans issued to directors and key management personnel are repayable within 3 years and have interest rates of **2% to 5.75%** p.a. (2011: 3% to 6.75% p.a.). Some of the loans advanced to Board members and their related parties are collateralised. The fair value of these collaterals as of 31 December 2012 was **KD 51,334 thousand** (2011: KD 92,598 thousand).

The transactions included in the income statement are as follows:

	2012 KD 000's	2011 KD 000's
Board members and key management personnel:		
Interest income earned	**2,064**	3,098
Interest expense on deposits	**2,863**	5,067
Key management compensation:		
Salaries and other short-term benefits	**2,979**	2,777
End of service/termination benefits	**95**	83

24. FINANCIAL INSTRUMENTS

Strategy in using financial instruments

As a commercial bank, the Bank's activities are principally related to the use of financial instruments including derivatives. It accepts deposits from customers at both fixed and floating rates for various periods and seeks to earn above average interest margins by investing these funds in high quality assets. It also seeks to increase these margins by consolidating short term funds and lending for longer periods at higher rates while maintaining sufficient liquidity to meet all claims that may fall due.

With the exception of specific hedging arrangements, foreign exchange and interest rate exposures associated with these derivatives are normally offset by entering into counterbalancing positions, thereby controlling the variability in the net cash amounts required to liquidate market positions.

Risk management

The use of financial instruments also brings with it the associated inherent risks. The Bank recognises the relationship between returns and risks associated with the use of financial instruments and the management of risk forms an integral part of the Bank's strategic objectives.

The strategy of the Bank is to maintain a strong risk management culture and manage the risk/reward relationship within and across each of the Bank's major risk-based lines of business. The Bank continuously reviews its risk management policies and practices to ensure that the Bank is not subject to large asset valuation volatility and earnings volatility.

The following sections describe the several risks inherent in the banking process, their nature and how they are managed.

A. CREDIT RISK

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. It arises principally from lending, trade finance and treasury activities.

Concentrations of credit risk arise when a number of counter parties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

Concentrations of credit risk indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographic location.

A brief description of the risk management framework is given below:

The Bank has comprehensive policies and procedures to control and monitor all such risks. Credit risk is minimised by monitoring credit exposures, limiting transactions with individual counterparties and continually assessing collateral coverage/quality and the creditworthiness of counterparties.

Individual customer, industry segment and cross-border limits are used to diversify lending and avoid undue concentrations. Credit exposure relating to trading activities is controlled by the use of strict counterparty limits, master netting agreements and collateral arrangements (where appropriate), and by limiting the duration of exposures.

An independent credit control unit, reporting to Chief Risk Officer, is responsible for providing high-level centralised management of credit risk. The responsibilities of this team include: monitoring adherence to credit policies and procedures; establishing and maintaining large credit exposure policies covering the maximum exposure to individual customers, customer groups and other risk concentrations; undertaking independent and objective credit review to assess the credit risk for both new facilities and renewals; controlling exposures to banks and other financial institutions; controlling cross-border exposures; controlling exposures to specific industry groups; maintaining and developing the Bank's facility rating process in order to categorise exposures into meaningful segments; and preparing regular reports to senior management on areas such as customer/industry risk concentrations, country limits and cross-border exposures and non-performing accounts and provisions.

The Bank has detailed credit approval guidelines for each of its individual retail loan products. The eligibility criteria vary according to the specific loan product, but include items such as minimum length of employment. Applicants must also provide a credit reference from their employer, specifying salary and length of service, and a commitment from the employer to pay their salary directly to their savings account with the Bank. In accordance with CBK regulations, the applicant's total monthly debt repayment to income ratio must not exceed the limits stipulated.

The Bank has seven credit committees: the Board Credit Committee ('BCC'), the Executive Credit Committee ('ECC'), the Management Credit Committee ('MCC'), Business Banking Credit Committee ('BBCC'), the Retail Credit Committee ('RCC'), Remedial Credit Committee and the Classification and Provisions Committee ('CPC').

The Board of Directors has delegated all authority for credit decisions to the BCC within the Central Bank of Kuwait guidelines. The responsibilities of the BCC are to review and approve any amendments to the Bank's credit policies and risk strategies for submission to the Board of Directors for final approval and to review, approve, reject, modify or conditionally approve credit proposals in excess of the delegated authority of the ECC and in compliance with the credit policies of the Bank.

The ECC and MCC has the authority to approve, reject or modify credit applications submitted to it within its delegated authority levels. Applications that fall outside the delegated authority limits of the ECC are referred to the BCC and applications that fall outside the purview of the MCC are referred to the ECC.

Business Banking Credit Committee ('BBCC') has the responsibility for facilitating asset creation and monitoring exposure management upto the approved limit in Small and Medium Enterprise ('SME') segment. BBCC has the sole authority to approve, reject or modify business banking credit applications submitted to it upto the limit of its delegated authority. There is a well defined organisational structure and risk management mechanism for business banking which offers specific products to the SME segment based on turnover and its priority for the Bank.

The RCC meets regularly and has the authority to approve, reject or modify credit applications from retail customers submitted to it within its delegated authority levels. An independent, centralised quality assurance function ensures the completeness and accuracy of the loan application documentation, undertakes credit and "black list" checks and monitors standing order commitments and other loan repayment obligations. In addition, all consumer credit applications are subject to a credit check by the industry-owned Credit Information Network ('Ci-Net') credit reference agency to assess the creditworthiness and indebtedness of the applicant.

Remedial Credit Committee has been delegated powers to review, settle, restructure, reschedule, abandon recovery efforts and write-off debts upto the approved limits pertaining to customers under its supervision. Applications that fall outside the delegated authority limits of the Remedial Credit Committee are referred to the ECC.

Depending on the amount and risk profile of the client credit applications for corporate and international lending are reviewed by the BCC, ECC, MCC, BBCC and Remedial Credit Committee and typically include the following information: executive summary, customer profile and summary of limits and amounts outstanding; risk rating and credit memorandum prepared by the Bank's independent credit review unit; customer profitability analysis; financial and cash flow analysis; details of purpose of loan, collateral, repayment source and details of guarantors, if applicable; and audited financial statements and/or personal net worth statements, as appropriate.

The Bank has legal lending limits, country limits and industry sector limits that must be adhered to when lending approval is being considered in respect of relevant applications or participations.

The Bank has a detailed credit policy defining its policy on acceptable country credit risk exposure, and evaluating and controlling cross border risk. The individual country limits are approved and reviewed by the ECC. This approval is based on the country analysis and assessment of business requirements undertaken by the Bank's international banking division and recommended by the MCC.

The International Banking division regularly reviews the Bank's overall cross border limits and exposure risk ratings. The review focuses on the overall spread of cross border risk and recommendations to alter individual country risk limits are made where necessary.

Maximum exposure to credit risk

The table below shows the maximum exposure to credit risk net of provision for the components of the statement of financial position, including positive fair value of derivatives without taking into account any collateral and other credit enhancements. Maximum concentration of credit risk to a single or group of related counterparties is limited to 15 per cent of the Bank's comprehensive capital as determined by the regulatory guidelines.

BY CLASS OF FINANCIAL ASSETS	**Maximum exposure 2012 KD 000's**	Maximum exposure 2011 KD 000's
Cash and short term funds (excluding cash on hand)	**437,367**	334,925
Treasury bills and bonds	**290,232**	418,221
Central Bank of Kuwait bonds	**424,375**	429,482
Deposits with banks and other financial institutions	**32,688**	20,000
Loans and advances to banks	**92,605**	34,140
Loans and advances to customers:		
Corporate lending	**2,508,002**	2,641,300
Consumer lending	**814,492**	692,787
Investments available-for-sale (Note 13)	**49,745**	20,711
Other assets	**53,079**	47,513
Total	**4,702,585**	4,639,079
Contingent liabilities	**1,238,489**	1,240,181
Credit default swaps	**153,568**	294,706
Foreign exchange contracts	**68,687**	79,937
Structured products	**-**	11,142
Total	**1,460,744**	1,625,966
Total credit risk exposure	**6,163,329**	6,265,045

Credit risk can also arise due to a significant concentration of Bank's assets to any single counterparty, this risk is managed by diversification of the portfolio. The 20 largest gross loan exposures outstanding as a percentage of total credit risk exposures as at 31 December 2012 is **19%** (2011: 19%).

Collateral and other credit enhancements

The Bank employs a range of policies and practices to reduce credit risk. The Bank seeks collateral coverage, assignment of contract proceeds and other forms of protection to secure lending and minimise credit risks wherever possible. The Bank's borrowing agreements also include legally enforceable netting arrangements for loans and deposits enabling the Bank to consolidate the customer's various accounts with the Bank and either transfer credit balances to cover any outstanding borrowings or freeze the credit balances until the customer settles their outstanding obligations to the Bank.

The Bank's credit facilities are largely secured by collateral, consisting primarily of: equities listed on the Kuwait Stock Exchange; unquoted equities, real estate (land and buildings); fixed term deposits and cash balances with the Bank that are blocked and legally pledged in its favour; and direct, explicit, irrevocable and unconditional bank guarantees.

The Bank has procedures to ensure that there is no excessive concentration of any particular asset class within the collaterals.

Internal credit quality rating

The Bank's policy is to cover the credit risk in Commercial banking through a risk rating process. The process is based on international best practices, and provides transparency and consistency to enable comparison between obligors.

The Bank uses Moody's Risk Rating tool for rating its corporate borrowers. Under the Moody's Risk rating framework all the borrowers are rated based on financial and business assessments. Financial assessment takes into account operations, liquidity, capital structure and debt coverage while business assessment is based on industry risk, management quality and company standing.

The Risk Rating Process derives the Obligor Risk Ratings (ORRs) and Facility Risk Ratings (FRRs). The rating methodology focuses on factors such as: operating performance, liquidity, debt service and capital structure. The ratio analysis includes assessment of each ratio's trend across multiple periods, both in terms of rate change and the volatility of the trend. It also compares the value of the ratio for the most recent period with the values of the comparable peer group. Qualitative assessment of the operations, liquidity and capital structure are also included in the assessment.

For new ventures or project finance transactions, Obligor Risk Ratings are generated through the use of projections covering the period of the loan.

Obligor Risk Rating (ORR) reflects the probability of default for an obligor (irrespective of facility type or collateral) over the next 12 months for a senior unsecured facility.

The Obligor Risk Ratings of performing assets are broadly classified into 3 categories, viz, 'High', 'Standard' and 'Acceptable'. Credit exposures classified as 'High' quality are those where the ultimate risk of financial loss from the obligor's failure to discharge its obligation is assessed to be low. Credit exposures classified as 'Standard' quality comprise facilities whose financial condition, and risk indicators and repayment capacity are satisfactory. Credit exposures classified as 'Acceptable' quality are performing accounts, and payment performance is fully compliant with contractual conditions. The ultimate risk of financial loss on 'Acceptable' quality is assessed to be higher than that for the exposures classified within 'High' and 'Standard' quality range.

Facility Risk Rating

The Bank also has an approved framework for Facility Risk Ratings (FRR). While Obligor Risk Rating does not take into consideration factors like availability of collateral and support, FRR is a measure of the quality of the credit exposure based on the expected loss in the event of default after considering collateral and support. The availability of eligible collateral or support substantially reduces the extent of the loss in the event of default and such risk mitigating factors are reflected in FRR.

North American Industry Classification System (NAICS) Code:

The Bank classifies the Bank's exposure as per NAICS Code. Such classifications are in addition to the classification based on purpose codes as defined by Central Bank of Kuwait. This allows the Bank to classify its portfolio into various sub-segments so as to facilitate analysis and improve management of concentrations, if any.

Portfolio Risk Rating

The Bank has also introduced a Portfolio Risk Rating process through which the overall portfolio quality is being assessed at regular intervals and deliberated upon in Risk Management Committee.

RAROC Model

The Bank also introduced a RAROC (Risk Adjusted Return on Capital) model as a pricing tool for credit facilities granted to corporate clients. It is based on the premise that pricing is to be aligned with risk embedded in the proposal. After having satisfied that all the prerequisites (such as good and consistent Obligor Risk Ratings, system of Facility Risk Ratings based on collateral mitigation, estimation of Probability of Defaults, Calculation of Loss Norms by each facility rating and

24. FINANCIAL INSTRUMENTS *(continued)*
A. CREDIT RISK *(continued)*

Reasonable Validation & Calibration) are in place, RAROC Model has been introduced in the Bank and this will help to make the right decisions, create shareholder value and allow proper pricing to customers.

2012	**Neither past due nor impaired**				
	High KD 000's	**Standard KD 000's**	**Acceptable KD 000's**	**Past due but not impaired KD 000's**	**Total KD 000's**
Cash and short term funds (excluding cash on hand)	**437,367**	**-**	**-**	**-**	**437,367**
Treasury bills and bonds	**290,232**	**-**	**-**	**-**	**290,232**
Central Bank of Kuwait bonds	**424,375**	**-**	**-**	**-**	**424,375**
Deposits with banks and other financial institutions	**32,688**	**-**	**-**	**-**	**32,688**
Loans and advances to banks	**92,605**	**-**	**-**	**-**	**92,605**
Loans and advances to customers:					**-**
- Corporate lending	**440,928**	**1,525,507**	**291,646**	**82,592**	**2,340,673**
- Consumer lending	**782,266**	**-**	**-**	**38,493**	**820,759**
Effective interest rate adjustment	**(3,363)**	**-**	**(1,724)**	**-**	**(5,087)**
Debt investment available-for-sale (Note 13)	**49,745**	**-**	**-**	**-**	**49,745**
Other assets	**53,079**	**-**	**-**	**-**	**53,079**
	2,599,922	**1,525,507**	**289,922**	**121,085**	**4,536,436**

2011	Neither past due nor impaired				
	High KD 000's	Standard KD 000's	Acceptable KD 000's	Past due but not impaired KD 000's	Total KD 000's
Cash and short term funds (excluding cash on hand)	334,925	-	-	-	334,925
Treasury bills and bonds	418,221	-	-	-	418,221
Central Bank of Kuwait bonds	429,482	-	-	-	429,482
Deposits with banks and other financial institutions	20,000	-	-	-	20,000
Loans and advances to banks	27,873	-	-	6,267	34,140
Loans and advances to customers:					-
- Corporate lending	705,873	1,316,517	156,793	144,197	2,323,380
- Consumer lending	641,698	-	-	57,401	699,099
Effective interest rate adjustment	(4,506)	-	(2,500)	-	(7,006)
Debt investment available-for-sale (Note 13)	20,711	-	-	-	20,711
Other assets	47,513	-	-	-	47,513
	2,641,790	1,316,517	154,293	207,865	4,320,465

97% (2011: 98%) of the past due but not impaired category is below 60 days and **3%** (2011: 2%) is between 60-90 days.

Financial assets by class individually impaired

2012	**Gross exposure KD 000's**	**Impairment provision KD 000's**	**Fair value of collateral KD 000's**
Loans and advances to customers:			
- Corporate lending	**360,976**	**21,440**	**337,210**
- Consumer lending	**14,894**	**9,656**	**-**
	375,870	**31,096**	**337,210**

2011	Gross exposure KD 000's	Impairment provision KD 000's	Fair value of collateral KD 000's
Loans and advances to customers:			
- Corporate lending	498,271	66,126	371,372
- Consumer lending	16,303	11,289	-
	514,574	77,415	371,372

	2012		2011	
	Assets KD 000's	**Off balance sheet items KD 000's**	Assets KD 000's	Off balance sheet items KD 000's
Geographic region:				
Domestic (Kuwait)	**4,370,712**	**1,018,028**	4,335,580	1,061,321
Other Middle East	**252,244**	**161,051**	198,261	274,736
Europe	**69,202**	**109,647**	65,563	88,229
USA and Canada	**8,438**	**7,413**	17,887	11,268
Asia Pacific	**1,989**	**164,536**	4,270	190,371
Rest of world	**-**	**69**	17,518	41
	4,702,585	**1,460,744**	4,639,079	1,625,966
Industry sector:				
Personal	**936,549**	**-**	820,740	-
Financial	**615,789**	**420,926**	664,107	363,514
Trade and Commerce	**323,791**	**151,034**	305,979	181,498
Crude Oil and Gas	**22,793**	**66,823**	19,407	35,762
Construction	**281,841**	**603,744**	254,241	614,915
Government	**1,137,147**	**-**	963,415	158,978
Manufacturing	**291,006**	**24,510**	351,641	25,848
Real Estate	**921,829**	**29,102**	973,579	38,595
Others	**171,840**	**164,605**	285,970	206,856
	4,702,585	**1,460,744**	4,639,079	1,625,966

24. FINANCIAL INSTRUMENTS *(continued)*
A. CREDIT RISK *(continued)*

Contingent liabilities and commitments are financial instruments with contractual amounts representing credit risk

The primary purpose of these instruments is to ensure that funds are available to a customer as required. However, the total contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded. These instruments are disclosed in Note 26.

Derivative financial instruments with contractual or notional amounts that are subject to credit risk

These derivative financial instruments, comprising foreign exchange and interest rate contracts, allow the Bank and its customers to transfer, modify or reduce their foreign exchange and interest rate risks.

This amount is subject to credit risk and is limited to the current replacement value of instruments that are favourable to the Bank, which is only a fraction of the contractual or notional amounts used to express the volumes outstanding. This credit risk exposure is managed as part of the overall borrowing limits granted to customers. These instruments are disclosed in Note 28.

B. INTEREST RATE RISK

Interest rate risk arises from the possibility that changes in interest rates will affect the fair value or cash flows of the financial instruments. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance-sheet instruments that mature or reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through risk management strategies.

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held last year, including the effect of hedging instruments. The sensitivity of the statement of comprehensive income is from the impact on fair value of investments available-for-sale for the effects of assumed changes in interest rates.

The following table reflect the effects of 25 basis points change in interest rates on the income statement, with all other variables held constant:

Currency	Movement in Basis points	**2012** **KD 000's**	2011 KD 000's
KWD	25	**3,481**	3,324
USD	25	**(182)**	(109)

A majority of the Bank's assets and liabilities reprice within one year. Accordingly there is a limited exposure to interest rate risk. The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is the historical rate for a fixed rate instrument carried at amortised cost and a current market rate for a floating rate instrument or an instrument carried at fair value.

C. CURRENCY RISK

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank views itself as a Kuwaiti entity with Kuwaiti Dinars as its functional currency. The Board of Directors has set limits on positions by currency. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

Based on the Bank's financial assets and liabilities held at the statement of financial position date, in case of a change in currency movements with all other variables held constant, the effect on the Bank's profit and other comprehensive income is as follows:

	2012			2011		
Currency	**Change in currency rate in %**	**Impact on income statement KD 000's**	**Impact on other comprehensive income KD 000's**	Change in currency rate in %	Impact on income statement KD 000's	Impact on other comprehensive income KD 000's
USD	**+5**	**(1,486)**	**1,532**	+5	(2,402)	2,364

Bank's investments are held in well diversified portfolio of equity and hedge funds which invest in a variety of securities and products which are denominated in different currencies whose performance cannot necessarily be measured with relation to movement in any particular currency rate. Only the impact on the carrying amount of these securities has been considered in the sensitivity analysis.

D. LIQUIDITY RISK

Liquidity risk is the risk that the Bank will encounter difficulties in meeting obligations associated with financial liabilities. Liquidity risk can be caused by market disruptions or credit downgrades which may cause certain sources of funding to dry up immediately. To guard against this risk, management has diversified funding sources and assets are managed with liquidity in mind, maintaining a sufficient balance of cash, cash equivalents and readily marketable securities.

Liquidity risk arises in the general funding of a Bank's activities. Under the guidance of the Asset Liability Committee (ALCO), the Treasury group manages the liquidity and funding of the Bank to ensure that sufficient funds are available to meet the Bank's known cash funding requirements and any unanticipated needs that may arise. At all times, the Bank holds what it considers to be adequate levels of liquidity to meet deposit withdrawals, repay borrowings and fund new loans, even under stressed conditions.

The liquidity and funding management process includes: projecting cash flows by major currency; monitoring financial position, liquidity ratios against internal and regulatory requirements; maintaining a diverse range of funding sources with adequate back-up facilities; monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and managing debt financing needs. The Bank maintains a diversified and stable funding base of core retail and corporate deposits, and the treasury group maintains liquidity and funding contingency plans to cope with potential difficulties that may arise from local or regional markets or geopolitical events.

Liquidity risk is further minimised by adherence to the strict CBK liquidity requirements, namely: maturity ladder mismatch limits for specific time periods: 10% for 7 days or less; 20% for 1 month or less; 30% for 3 months or less; 40% for 6 months or less; and the requirement to hold 18% of KD customer deposits in Kuwait Government treasury bills and bonds, current account/ deposit balances with CBK and/or any other financial instruments issued by CBK.

24. FINANCIAL INSTRUMENTS *(continued)*
D. LIQUIDITY RISK *(continued)*

The table below summarises the maturity profile of the assets and liabilities at the year end based on residual contractual repayment arrangements (assets and liabilities without a contractual maturity are based on management expectation):

At 31 December 2012

Assets	Up to 1 month KD 000's	1 to 3 months KD 000's	3 to 6 months KD 000's	6 to 12 months KD 000's	1 to 3 years KD 000's	Over 3 years KD 000's	Total KD 000's
Cash and short term funds	483,230	-	-	-	-	-	483,230
Treasury bills and bonds	29,384	63,801	108,184	64,307	14,794	9,762	290,232
Central Bank of Kuwait bonds	144,786	129,810	149,779	-	-	-	424,375
Deposits with banks and other financial institutions	-	32,688	-	-	-	-	32,688
Loans and advances to banks	14,659	14,986	31,039	12,656	19,265	-	92,605
Loans and advances to customers	213,306	377,387	231,612	504,827	667,957	1,327,405	3,322,494
Investments available-for-sale	-	-	-	-	40,882	81,470	122,352
Other assets	53,079	-	-	-	-	-	53,079
Premises and equipment	-	-	-	-	-	25,603	25,603
Total assets	938,444	618,672	520,614	581,790	742,898	1,444,240	4,846,658
Liabilities							
Due to banks	80,947	28,125	18,282	-	-	-	127,354
Deposits from financial institutions	174,950	174,046	99,962	367,644	30,001	-	846,603
Customer deposits	1,775,566	692,665	368,577	295,226	115,595	-	3,247,629
Subordinated loans	-	-	-	-	42,188	42,187	84,375
Other liabilities	43,147	19,006	10,340	14,079	3,988	896	91,456
Total liabilities	2,074,610	913,842	497,161	676,949	191,772	43,083	4,397,417

At 31 December 2011

Assets	Up to 1 month KD 000's	1 to 3 months KD 000's	3 to 6 months KD 000's	6 to 12 months KD 000's	1 to 3 years KD 000's	Over 3 years KD 000's	Total KD 000's
Cash and short term funds	370,519	-	-	-	-	-	370,519
Treasury bills and bonds	39,802	80,625	115,425	162,322	20,047	-	418,221
Central Bank of Kuwait bonds	264,682	118,857	45,943	-	-	-	429,482
Deposits with banks and other financial institutions	-	20,000	-	-	-	-	20,000
Loans and advances to banks	4,196	13,928	13,928	-	2,088	-	34,140
Loans and advances to customers	457,646	355,379	302,572	465,189	1,034,652	718,649	3,334,087
Investments available-for-sale	-	-	-	-	-	106,009	106,009
Other assets	47,513	-	-	-	-	-	47,513
Premises and equipment	-	-	-	-	-	25,924	25,924
Total assets	1,184,358	588,789	477,868	627,511	1,056,787	850,582	4,785,895
Liabilities							
Due to banks	35,789	25,070	15,320	-	-	-	76,179
Deposits from financial institutions	153,602	127,230	111,447	341,899	42,641	-	776,819
Customer deposits	1,698,836	877,598	398,355	355,174	481	-	3,330,444
Subordinated loans	-	-	-	-	41,783	41,782	83,565
Other liabilities	79,984	3,743	1,908	2,533	309	152	88,629
Total liabilities	1,968,211	1,033,641	527,030	699,606	85,214	41,934	4,355,636

24. FINANCIAL INSTRUMENTS *(continued)*
D. LIQUIDITY RISK *(continued)*

The tables below summarise the maturity profile of the Bank's financial liabilities and contingent liabilities, commitments and non-derivative financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately.

At 31 December 2012

	Less than 1 month KD 000's	**1 to 3 months KD 000's**	**3 to 12 months KD 000's**	**1 to 5 years KD 000's**	**Over 5 years KD 000's**	**Total KD 000's**
Due to banks	**80,989**	**28,222**	**18,372**	**-**	**-**	**127,583**
Deposits from financial institutions	**175,810**	**176,635**	**473,415**	**31,254**	**-**	**857,114**
Customer deposits	**1,778,971**	**696,754**	**673,571**	**121,671**	**-**	**3,270,967**
Subordinated loans	**431**	**-**	**1,682**	**88,240**	**-**	**90,353**
Other liabilities	**42,849**	**18,973**	**24,559**	**5,075**	**-**	**91,456**
Total undiscounted liabilities	**2,079,050**	**920,584**	**1,191,599**	**246,240**	**-**	**4,437,473**

At 31 December 2011

	Less than 1 month KD 000's	1 to 3 months KD 000's	3 to 12 months KD 000's	1 to 5 years KD 000's	Over 5 years KD 000's	Total KD 000's
Due to banks	35,794	25,256	15,436	-	-	76,486
Deposits from financial institutions	154,321	127,880	459,843	43,440	-	785,484
Customer deposits	1,699,700	879,103	757,641	481	-	3,336,925
Subordinated loans	-	323	1,313	88,099	-	89,735
Other liabilities	79,956	3,733	4,463	477	-	88,629
Total undiscounted liabilities	1,969,771	1,036,295	1,238,696	132,497	-	4,377,259

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities:

At 31 December 2012

	Less than 1 month KD 000's	**1 to 3 months KD 000's**	**3 to 12 months KD 000's**	**1 to 5 years KD 000's**	**Over 5 years KD 000's**	**Total KD 000's**
Contingent liabilities	**155,012**	**250,055**	**431,891**	**350,368**	**51,163**	**1,238,489**
	155,012	**250,055**	**431,891**	**350,368**	**51,163**	**1,238,489**

At 31 December 2011

	Less than 1 month KD 000's	1 to 3 months KD 000's	3 to 12 months KD 000's	1 to 5 years KD 000's	Over 5 years KD 000's	Total KD 000's
Contingent liabilities	42,626	429	30,932	1,154,932	11,262	1,240,181
	42,626	429	30,932	1,154,932	11,262	1,240,181

The table below shows the contractual expiry by maturity of the Bank's gross settled derivatives positions:

Derivatives	**Less than 1 month KD 000's**	**1 to 3 months KD 000's**	**3 to 12 months KD 000's**	**1 to 5 years KD 000's**	**Total KD 000's**
At 31 December 2012:					
Gross settled derivatives	**4,918**	**35,355**	**25,664**	**-**	**65,937**
At 31 December 2011:					
Gross settled derivatives	17,236	53,759	5,462	-	76,457

E. OPERATIONAL RISK

Operational risk arises from a failure to control properly all aspects of documentation, processing, settlement of, accounting for, transactions, and more widely, all the hazards to which a bank is exposed as a result of being in business and doing business. The Bank has a set of policies and procedures, which are approved by the Board of Directors and are applied to identify, assess and supervise operational risk in addition to other types of risks relating to the banking and financial activities of the Bank.

The operational risks are managed through the Risk Management Department in line with the Central Bank of Kuwait instructions dated 14 November 1996, concerning the general guidelines for internal controls and the instructions dated 13 October 2003, regarding the sound practices for managing and supervising operational risks in banks. The department ensures compliance with policies and procedures to identify, assess, supervise and monitor operational risk as part of overall risk management.

F. EQUITY PRICE RISK

This is a risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market. The Bank manages this risk through diversification of investments.

Majority of the Bank's investments are held in well diversified portfolio of hedge funds which invest in a variety of securities whose performance cannot necessarily be measured in relation to movement in any specific equity index.

The effect on equity (as a result of change in the fair value of equity instruments held as available for sale) at the year end due to an assumed 5% change in the market indices, with all other variable held constant, is as follows:

Market indices	**% Change in equity price**	**2012 Effect on Equity KD 000's**	2011 Effect on Equity KD 000's
Kuwait stock exchange	+5%	1,074	830
New York stock exchange	+5%	215	198

G. PREPAYMENT RISK

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate loans when interest rates fall.

Most of the Bank's interests bearing financial assets are at floating rates. In addition, majority of the interest bearing financial liabilities excluding subordinated loans where the repayment option is with the Bank, have a maturity of less than one year and accordingly, the Bank is not exposed to significant prepayment risk.

25. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Fair values of all financial instruments are not materially different from their carrying values. For financial assets and financial liabilities that are liquid or having a short-term maturity (less than three months), the carrying amount approximates their fair value and this applies to demand deposits, savings accounts without a specific maturity and variable rate financial instruments.

The methodologies and assumptions used to determine fair values of financial instruments is described in fair value section of Note 2: Significant Accounting Policies.

26. CONTINGENT LIABILITIES AND COMMITMENTS

To meet the financial needs of customers, the Bank enters into various contingent liabilities and irrevocable commitments. Even though these obligations may not be recognised on the statement of financial position, they do contain credit risk and therefore form part of the overall risk of the Bank.

The total outstanding contingent liabilities and commitments are as follows:

	2012 KD 000's	2011 KD 000's
Guarantees	**1,032,466**	973,591
Letters of credit	**206,023**	266,590
	1,238,489	1,240,181

As at the reporting date the Bank had undrawn commitments to extend overdraft facilities to customers amounting to **KD 105,201 thousand** (2011: KD 115,499 thousand). The contractual terms entitle the Bank to withdraw these facilities at any time.

27. SEGMENTAL ANALYSIS

a. By Business Unit

Commercial Banking	Acceptance of deposits from individuals, corporate and institutional customers and providing consumer loans, overdrafts, credit card facilities and funds transfer facilities to individuals; and other credit facilities of corporate and institutional customers.
Treasury & Investments	Providing money market, trading and treasury services, as well as the management of the Bank's funding operations by use of treasury bills, government securities, placements and acceptances with other banks. The proprietary investments of the Bank are managed by the investments unit.

Segmental information for the year ended 31 December

	Commercial Banking		**Treasury & Investments**		**Total**	
	2012 KD 000's	2011 KD 000's	**2012 KD 000's**	2011 KD 000's	**2012 KD 000's**	2011 KD 000's
Operating income	**136,934**	125,315	**16,994**	18,952	**153,928**	144,267
Segment result	**71,588**	74,416	**11,384**	9,567	**82,972**	83,983
Unallocated income					**25,711**	14,956
Unallocated expense					**(77,796)**	(68,319)
Profit for the year					**30,887**	30,620
Segment assets	**3,460,963**	3,382,537	**1,307,013**	1,329,921	**4,767,976**	4,712,458
Unallocated assets					**78,682**	73,437
Total Assets					**4,846,658**	4,785,895
Segment liabilities	**2,890,900**	2,775,530	**1,370,040**	1,449,653	**4,260,940**	4,225,183
Unallocated liabilities and equity					**585,718**	560,712
Total Liabilities and Equity					**4,846,658**	4,785,895

b. Geographic segment information relating to location of assets, liabilities and off balance sheet are given in Note 24A.

Revenue from transactions with a single external customer or counter party did not result in 10% or more of the Bank's total revenue in 2012 or 2011.

28. DERIVATIVES

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

The table below shows the positive and negative fair values of derivative financial instruments, together with the notional amounts analysed by the term to maturity. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured.

The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of either market or credit risk. All derivative contracts are fair valued based on observable market data.

At 31 December 2012:

				Notional amounts by term to maturity		
Derivatives instruments held as:	**Positive fair value KD 000's**	**Negative fair value KD 000's**	**Notional amount total KD 000's**	**Within 3 months KD 000's**	**3-12 months KD 000's**	**Over 1 year KD 000's**
Trading (and non qualifying hedges)						
Forward foreign exchange contracts	**388**	**(370)**	**65,937**	**25,663**	**40,274**	**-**
Credit default swaps (Note 18)	**47**	**(3,462)**	**153,568**	**-**	**21,854**	**131,714**
Structured products (Note 14)	**-**	**-**	**-**	**-**	**-**	**-**
	435	**(3,832)**	**219,505**	**25,663**	**62,128**	**131,714**

At 31 December 2011:

				Notional amounts by term to maturity		
Derivatives instruments held as:	Positive fair value KD 000's	Negative fair value KD 000's	Notional amount total KD 000's	Within 3 months KD 000's	3-12 months KD 000's	Over 1 year KD 000's
Trading (and non qualifying hedges)						
Forward foreign exchange contracts	567	(749)	76,457	70,995	5,462	-
Credit default swaps (Note 18)	-	(10,844)	294,706	12,535	130,023	152,148
Structured products (Note 14)	8,916	-	11,142	-	11,142	-
	9,483	(11,593)	382,305	83,530	146,627	152,148

Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and interest rate futures are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount or to transfer third party credit risk based on an agreed principal and related outstanding interest. For interest rate swaps, counter parties generally exchange fixed and floating rate interest payments based on a notional value in a single currency. For currency swaps, fixed or floating interest payments as well as notional amounts are exchanged in different currencies. For credit default swaps, fee is earned based on the amount of credit risk swapped.

Derivatives held or issued for trading purposes

Most of the Bank's derivative trading activities relate to sales, positioning and arbitrage. Sales activities involve offering products to customers in order to enable them to transfer, modify or reduce current and expected risks. Positioning involves managing positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying and profiting from price differentials between markets or products. Also included under this heading are any derivatives which do not meet IAS 39 hedging requirements.

29. CAPITAL ADEQUACY & CAPITAL MANAGEMENT

The disclosures relating to the Capital Adequacy Regulations issued by CBK as stipulated in its Circular number 2/BS/184/2005 dated 21 December 2005, and the disclosures required by the amendments of IAS 1 – Capital disclosures, are included under the 'Capital Management and Allocation' section of the annual report.