# Annual Report 2011

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)**

# We Promise

The Best and
Fastest Service

**Guaranteed.**

# Table of Contents

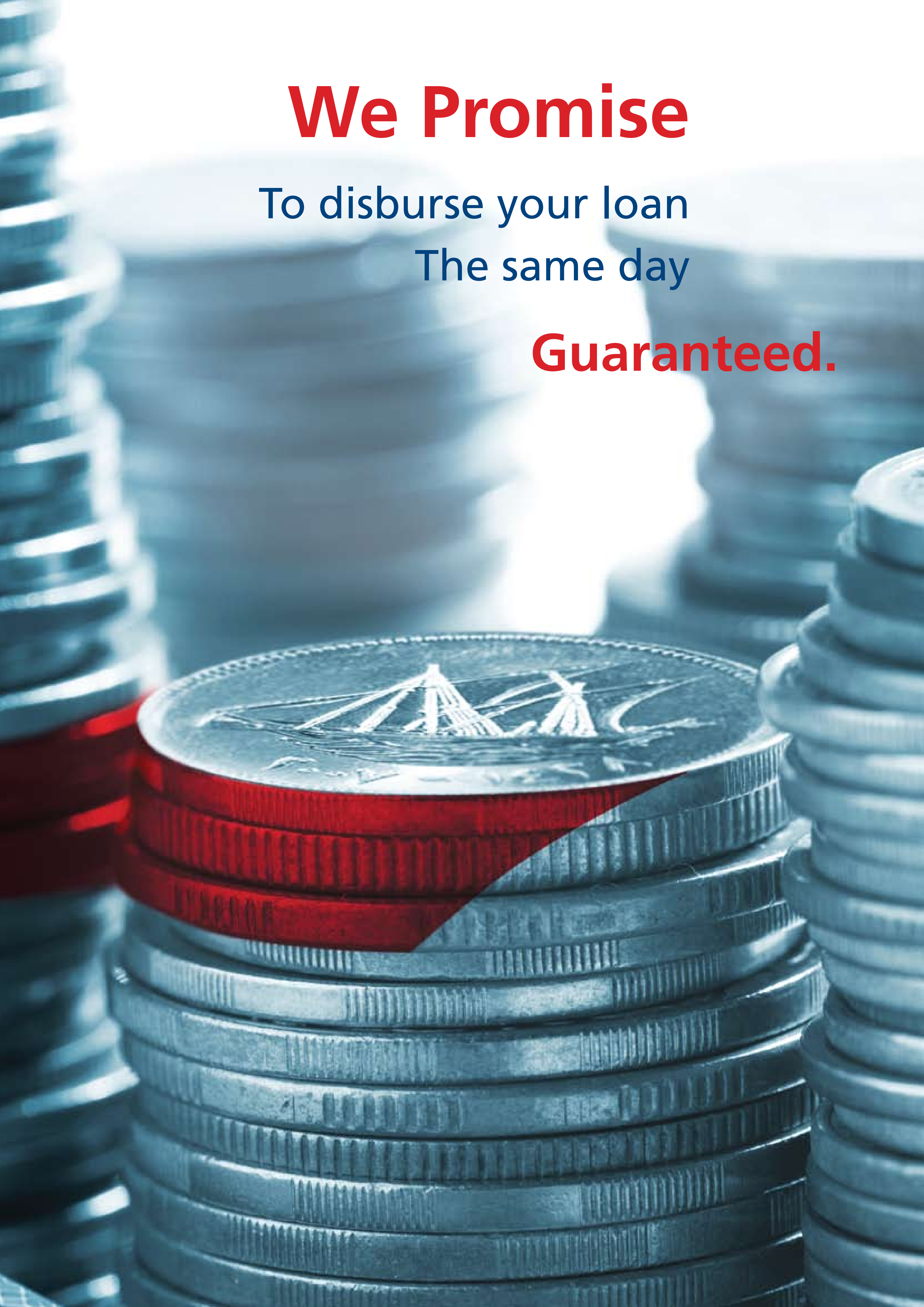


**Head Office:**
Mubarak Al Kabeer Street, P. O. Box 3200, Safat 13032, Kuwait, Tel: 22449501
www.e-gulfbank.com


We Promise
To deliver your Gulf Bank cards
The same day
Guaranteed.

# Board of Directors

| | |
|---|---|
| • Ali Abdul Rahman Al Rashaid Al Bader | Chairman |
| • Mahmoud Abdul Khaleq Al Nouri | Deputy Chairman |
| • Tarek Abdul Aziz Sultan Al-Essa | Board Member |
| • Ali Faisal Ali Al-Mutawa | Board Member |
| • Ali Morad Yusuf Behbehani | Board Member |
| • Omar Hamad Yusuf Al-Essa | Board Member |
| • Omar Kutayba Yusuf Alghanim | Board Member |
| • Farouk Ali Akbar Abdulla Bastaki | Board Member |
| • Dr. Yousef Sayed Hasan Ali Al Zalzalah | Board Member |


We Promise
To disburse your loan
The same day
Guaranteed.

**Ali Abdul Rahman Al Rashaid Al Bader**
Chairman

# Chairman's Message

### Introduction

I have the pleasure to welcome you to the 51st Annual General Meeting of Gulf Bank and thank you for attending. I would like to brief you on the Bank's performance and achievements for 2011.

Over the past year, we have made sure that our Bank provides best services and outstanding banking products. I am pleased to report that 2011 was a year of success and achievement for your Bank.

By the end of the year, the Bank had completed its 2010-2011 strategic plan, the main features of which included building a fortress balance sheet, overcoming the challenges we faced, re-focusing on our core banking competences, providing our customers with excellent services, and preparing for the impending growth strategy.

### Review of 2011

2011 has been a prolific year for Gulf Bank and I would like to highlight some of the major milestones that Gulf Bank has achieved throughout the year, enabling the Bank to look forward to the future with confidence.

### Key Events in 2011

During the year, Gulf Bank successfully restored profitability, posting a net profit of KD 30.6 million, net of all statutory and precautionary provisions. The Board of Directors recommends distribution of profit in the form of bonus shares of 5%, so as to support the Bank's capital base.

This year's results show a continuation of a strong and solid performance by Gulf Bank, recording substantial operating revenue, fees and commission income, in addition to growing our customer deposit base. We have strengthened our balance sheet significantly, made good progress to resolve a tangible portion of non-performing loans, delivered good results by focusing on our core banking areas of Consumer and Corporate Banking, and seen our customer service levels greatly enhanced.

Gulf Bank has launched its 'We Promise' program that gives an explicit guarantee to deliver high calibre individual services with exceptional speed and efficiency. The program successfully contributed to increasing the Bank's business and resources.

The Bank also inaugurated its new IT Data Center Facility that is located in Hawally. The new facility is a vital part of Gulf Bank's information technology infrastructure which will provide a secure, bank-wide, and world-class infrastructure for customers' transactions and data, and it will ensure business continuity at all times.

In December, Gulf Bank was the only Bank in the region to get an improved credit rating and raised outlook by Standard & Poor's. Gulf Bank's long-term credit rating was upgraded from BBB- to BBB, and its outlook raised from stable to positive. The upgrade by Standard & Poor's highlights the Bank's great improvement through the strength of our financial performance, the improved quality of our assets, and the effectiveness of our business strategy.

In addition, the Bank successfully installed its new Enterprise Risk Management System, thus enabling Gulf Bank to have the full suite of solutions that will help provide a more centralized view of risk and liquidity across many of the Bank's key functions.

Thanks to our successful and varied activities throughout the year, our continuingly effective strategy that aims to tackle a number of Kuwaiti community related issues has been served. Gulf Bank is not just a financial institution that provides excellent banking services.

In addition to these efforts, Gulf Bank has achieved numerous prestigious awards and gained significant recognition over the year. These include: 'Best Bank in the retail sector' award from the Arabian Business Magazine, '2012 Best Foreign Exchange Bank Provider' in Kuwait by Global Finance Magazine, 'Thought Leadership Excellence' award at the MENA CIO's

Summit 2011, the 'International Excellence in Retail Financial Services' award from The Asian Banker, the 'Best Retail Customer Service', the 'Best Phone Banking Service', the 'Best Corporate Governance' and 'Best Employee Training' awards from the Banker Middle East, the 'Quality Recognition Award' from Citibank, and Deutsche Bank's Award for International Payment Performance. In addition, Gulf Bank was awarded the 'GCC Localization Award' for seven consecutive years from the GCC Council of Ministers of Labour and Social Affairs, an unprecedented feat by any of the local banks.

The management is in the process of finalizing the Bank's strategy for the coming four years (2012 – 2015), which will be presented to the Board of Directors for review and approval. The new strategy features expansion and growth, and aims at increasing the Bank's market share, both by growing sources of funds from new and existing accounts, and increasing the areas of financing, lending and investment.

**Moving Forward**

We are optimistic for the Bank in 2012, and it is our ambition to increase the level of our profits despite the conditions prevailing in the market. We also aspire for state development efforts towards developing and diversifying the economic resources, increasing citizens' project ownership and management, as well as empowering the private sector to perform its anticipated role in implementing the development projects, and boosting the economy at large.

**In Conclusion**

We are looking to the future with confidence and to opening a new chapter in the growth and progress of Gulf Bank, as we embrace a number of imaginative and innovative initiatives that will transform the nature and status of our operations and fiscal returns, while strengthening Gulf Bank's foothold as a leader in the Kuwaiti market.

On behalf of the Board of Directors, I would like to pay tribute 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 benevolent support and guidance, and to H.E. The Governor of the Central Bank of Kuwait, Sheikh Salem Abdul Aziz Al Sabah, and all Members of the Government.

I would like to take this opportunity to thank you, our Shareholders for your confidence in Gulf Bank, our customers for your enduring trust in our products and services, and lastly, Gulf Bank's entire staff for your tireless commitment towards our targeted goals.

**Ali Abdul Rahman Al Rashaid Al Bader**
Chairman

# The Award Winning Bank

- 'International Excellence in Retail Financial Services' Award
- 'Best Retail Customer Service' Award - Banker Middle East
- 'Best Phone Banking Service' Award - Banker Middle East
- International Payment Performance Award - Deutsche Bank
- Quality Recognition Award - Citibank
- 'Thought Leader Excellence' Award - MENA CIO's Summit
- 'Best Employee Development' Award - Banker Middle East
- 'Best Corporate Governance' Award - Banker Middle East
- Excellence in Finance Award - NASEBA
- GCC Localization Award
- Stevie Award Distinguished Honoree
- Best FX Bank Provider - Global Finance
- 'Best Bank in the Retail Sector' Award - Arabian Business


We Promise
To finance your dream car
The same day
Guaranteed.

# 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 left to right:**

**Fawzy Althunayan** - General Manager Board Affairs; **Ali Al-Rashaid Al-Bader** - Chairman; and **Michel Accad** - Chief General Manager & Chief Executive Officer.

**Back row left to right:**

**Mark Magnacca** - Chief Marketing Officer; **Aly Shalaby** - General Manager, Consumer Banking Group; **Abdullatif Al-Hamad** - General Manager, Corporate Banking; **Grant Jackson** - General Manager, Treasury; **Khaled Al-Mutawa** - General Manager, International Banking & Investments; **Carlos Ribeiro** - Chief Financial Officer and General Manager-Finance and Support; **Surour Alsamerai** - General Manager, Human Resources; **Hatem Badr** - General Manager, Legal Affairs; **Saleem Sheikh** - Chief Risk Officer and General Manager-Risk Management.

# We Promise

To deposit your salary
Early morning

**Guaranteed.**

# Financial Review

# Income Statement Analysis

| (KD Millions) | **2011** | 2010 |
|---|---|---|
| Net Interest Income | **106.0** | 103.4 |
| Other Operating Income | **45.6** | 77.3 |
| Operating Income | **151.5** | 180.7 |
| Operating Expenses | **(51.5)** | (46.9) |
| Operating Profit before Provisions | **100.0** | 133.8 |
| Provisions | **(67.9)** | (113.8) |
| Operating Profit | **32.1** | 20.0 |
| Directors' emoluments | **(0.1)** | (0.2) |
| KFAS/ National Labour Support Tax / Zakat | **(1.3)** | (0.7) |
| Net Profit | **30.6** | 19.1 |

Gulf Bank reported an operating profit of KD 100 million for 2011 compared to KD 133.8 million achieved in 2010. The 2010 operating profits included non recurring items amounting to KD 40 million.

Net interest income was higher mainly due to improved margins.

Operating income was KD 151.5 million compared to KD 180.7 million (mainly due to non-recurring items included in 2010). Fee income grew by 5% over 2010.

The specific provisions were significantly lower by KD 76.3 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.

The Net profit for the year was KD 30.6 million as compared to KD 19.1 million for 2010 reflecting a growth of 60%.

# Statement of Financial Position Analysis

| *selected balance sheet data* (KD Millions) | **31-Dec 2011** | 31-Dec 2010 |
|---|---|---|
| Cash & short term funds: balances with CBK | **115.7** | 74.3 |
| Loans and advances to banks | **34.1** | 21.8 |
| Loans and advances to customers | **3,334.1** | 3,181.4 |
| Deposits with banks and OFIs | **20.0** | 111.2 |
| Investment securities | **106.0** | 92.2 |
| **Total assets** | **4,785.9** | 4,599.8 |
| | | |
| Due to banks | **76.2** | 67.3 |
| Subordinated loans | **83.6** | 84.2 |
| Deposits from Other Financial Institutions | **776.8** | 886.6 |
| Customer deposits | **3,330.4** | 3,070.9 |
| Total Liabilities | **4,355.6** | 4,189.1 |
| Shareholders' funds | **430.3** | 410.7 |
| **Total Liabilities and Equity** | **4,785.9** | 4,599.8 |

Total assets increased by KD 186 million or 4% to 4.8 billion at 31st December 2011. 70% of the balance sheet was deployed in customer loans and advances at 31st December 2011, similar level as in 2010.

Loans and advances grew by more than 7% during the year.

Customer deposits increased by KD 260 million (8%) from KD 3.1 billion to KD 3.3 billion in 2011. Shareholders' funds increased by 5% in 2011.

The total liabilities mainly comprise of deposits from customers (76%) and other financial institutions('OFIs') (18%).

# Capital Management and Allocation

**Capital Structure:**

The table below details the regulatory capital for Gulf Bank ('the Bank') as at 31 December 2011 and 31 December 2010.

**Capital Structure**

| **Composition of Capital** | (KD Million) | | |
|---|---|---|---|
| | **31-Dec-11** | 31-Dec-10 | Variance |
| **Tier 1 Capital** | | | |
| Paid-up share capital | **263.3** | 250.8 | 12.5 |
| Reserves | **179.9** | 178.0 | 1.9 |
| Retained earnings | **8.2** | (7.4) | 15.6 |
| Less: Treasury Shares | **(45.0)** | (44.2) | (0.8) |
| **Total Qualifying Tier 1 Capital** | **406.4** | 377.2 | 29.2 |
| | | | |
| **Tier 2 Capital** | | | |
| Property Revaluation Reserve (45 %) | **7.5** | 7.3 | 0.2 |
| Fair Valuation Reserve (45%) | **3.2** | 7.8 | (4.6) |
| General Provisions (1.25% of Credit RWAs) | **36.2** | 32.2 | 4.0 |
| Subordinated Debt | **50.1** | 67.3 | (17.2) |
| **Total Qualifying Tier 2 Capital** | **97.0** | 114.6 | (17.6) |
| **Total Eligible Regulatory Capital (Tier 1 and Tier 2)** | **503.4** | 491.8 | 11.6 |

Qualifying Tier 1 capital increased by KD 29.2 million to KD 406.4 million reflecting the growth in retained earnings and reserves.

Qualifying Tier 2 capital decreased to KD 97 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 adequacy 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 2011 and 31 December 2010.

| **Credit Risk Exposures** | (KD Million) | |
|---|---|---|
| | **31-Dec-11** | 31-Dec-10 |
| Credit risk weighted exposures | **2,898.3** | 2,578.2 |
| Less: Excess general provisions | **(87.7)** | (30.2) |
| **Net credit risk weighted exposures** | **2,810.6** | 2,548.0 |
| Market risk weighted assets | **1.6** | 85.5 |
| Operational risk weighted exposures | **165.8** | 169.9 |
| **Total risk weighted exposures** | **2,978.0** | 2,803.4 |
| **Regulatory Capital Requirements** | | |
| **Credit Risk** | | |
| Cash items | **0.0** | 0.0 |
| Claims on sovereigns | **0.7** | 0.7 |
| Claims on public sector entities (PSEs) | **4.8** | 4.1 |
| Claims on banks | **15.8** | 18.6 |
| Claims on corporates | **152.1** | 135.3 |
| Regulatory retail exposures | **76.2** | 68.8 |
| Past due exposures | **25.2** | 26.9 |
| Other assets | **73.0** | 55.0 |
| Credit risk capital requirement | **347.8** | 309.4 |
| Less: Excess general provision (12%) | **(10.5)** | (3.6) |
| **Net credit risk capital requirement** | **337.3** | 305.8 |
| **Market Risk** | | |
| Interest rate position risk | **0.1** | 0.2 |
| Foreign exchange risk | **0.1** | 10.1 |
| **Capital requirement for market risk** | **0.2** | 10.3 |
| **Capital requirement for operational risk** | **19.9** | 20.4 |
| **TOTAL CAPITAL REQUIREMENT** | **357.2** | 336.5 |
| **Capital adequacy ratios (per cent)** | | |
| Tier 1 ratio | **13.6%** | 13.5% |
| **Total capital adequacy ratio** | **16.9%** | 17.5% |

The total risk-weighted exposure as at 31 December 2011 is KD 2,978 million, requiring a regulatory capital at 12.0%, of KD 357.2 million.

The Bank's regulatory capital as at 31 December 2011 is KD 503.4 million, translating to a capital adequacy ratio of 16.9%.

# 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 recently 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.

**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 the 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.

The 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 the 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 the Bank's policy and framework to manage it.

**Operational Risk:**

Operational risk is the risk of loss arising through 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.

# Credit Risk Exposures

The Bank uses the Moody's Risk Rating system for risk rating its credit exposures. Note 24 to the financial statements explains the 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 2011 and 2010 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-11** | 31-Dec-10 | **Growth** |
| Funded Gross Credit Exposure | **4,901.0** | 4,648.7 | 5.4% |
| Unfunded Gross Credit Exposure | **1,530.3** | 1,570.9 | (2.6)% |
| Total Gross Credit Risk Exposure | **6,431.3** | 6,219.6 | 3.4% |

Funded gross credit risk exposure for 2011 is 76.2% (2010: 74.7%) 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 2011 and 31 December 2010 is detailed below:

**Funded and Unfunded credit facilities (Average) as at 31 December 2011**

| | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| *(KD Thousands)* | **Funded** | **Unfunded** | **Total** | Funded | Unfunded | Total |
| Cash items | **36,118** | **-** | **36,118** | 27,468 | - | 27,468 |
| Claims on sovereigns | **971,635** | **123,503** | **1,095,138** | 901,523 | 193,137 | 1,094,660 |
| Claims on public sector entities (PSEs) | **38,880** | **172,293** | **211,173** | 12,476 | 170,497 | 182,973 |
| Claims on Banks | **275,482** | **252,630** | **528,112** | 306,593 | 289,051 | 595,644 |
| Claims on corporates | **1,411,304** | **865,260** | **2,276,564** | 1,307,436 | 792,223 | 2,099,659 |
| Retail exposures | **645,886** | **40,548** | **686,434** | 618,935 | 39,169 | 658,104 |
| Past due exposures | **446,948** | **2,995** | **449,943** | 525,759 | 3,778 | 529,537 |
| Other assets | **953,448** | **55,158** | **1,008,606** | 916,565 | 118,467 | 1,035,032 |
| Total | **4,779,701** | **1,512,387** | **6,292,088** | 4,616,755 | 1,606,322 | 6,223,077 |

Average funded gross credit risk exposure for 2011 is 75.96% (2010: 74.2%) 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 2010 to 31 December 2011 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 2011 and 31 December 2010 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 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** |
| **Regulatory retail exposures** | **741,781** | **81** | **958** | **168** | **225** | **284** | **743,497** |
| **Past due exposures** | **440,864** | **-** | **-** | **-** | **-** | **7** | **440,871** |
| **Other assets** | **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%** |

Total gross credit risk exposures as at 31 December 2010 - Region wise

| *(KD Thousands)* | Kuwait | Other Middle East | Western Europe | USA & Canada | Asia Pacific | Rest of World | Total |
|---|---|---|---|---|---|---|---|
| Cash items | 30,966 | - | - | - | - | - | 30,966 |
| Claims on sovereigns | 906,297 | 84,180 | - | - | 58,926 | - | 1,049,403 |
| Claims on public sector entities (PSEs) | - | 171,872 | - | - | - | - | 171,872 |
| Claims on Banks | 102,318 | 199,557 | 90,590 | 36,103 | 159,798 | 264 | 588,630 |
| Claims on corporate | 2,103,384 | 30,229 | 27,494 | 8,699 | 20,619 | 34,006 | 2,224,431 |
| Regulatory retail exposures | 657,158 | 28 | 905 | - | - | 292 | 658,383 |
| Past due exposures | 439,800 | 30,773 | - | - | - | - | 470,573 |
| Other assets | 961,113 | 6,304 | 6 | 1,840 | - | 56,113 | 1,025,376 |
| Total | 5,201,036 | 522,943 | 118,995 | 46,642 | 239,343 | 90,675 | 6,219,634 |
| Percentage of gross credit risk exposure by geographical region | 83.6% | 8.4% | 1.9% | 0.7% | 3.9% | 1.5% | 100.0% |

The majority of the Bank's credit exposure is in Kuwait which comprises KD 5.56 billion (86.6% of total gross credit exposure) at 31 December 2011, compared with KD 5.20 billion (83.6% of total gross credit exposure) at 31 December 2010.

Credit Risk Exposures *(continued)*

**Geographical Distribution of Average Credit Risk Exposures:**

The average gross credit risk exposure for 2011 and 2010, broken down by geographical region and standard credit risk portfolio is shown below:

**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 assets | 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 average credit risk exposure by geographical region | 85.2% | 7.6% | 2.3% | 0.6% | 3.2% | 1.1% | 100% |

Total gross credit risk exposures as at 31 December 2010 (Average) - Region wise

| *(KD Thousands)* | Kuwait | Other Middle East | Western Europe | USA & Canada | Asia Pacific | Rest of World | Total |
|---|---|---|---|---|---|---|---|
| Cash items | 27,468 | - | - | - | - | - | 27,468 |
| Claims on sovereigns | 901,523 | 123,029 | - | - | 70,108 | - | 1,094,660 |
| Claims on public sector entities (PSEs) | 6,678 | 176,294 | - | - | - | - | 182,972 |
| Claims on Banks | 76,019 | 220,200 | 116,105 | 44,664 | 138,417 | 239 | 595,644 |
| Claims on corporates | 1,965,524 | 48,852 | 19,763 | 2,011 | 24,998 | 38,511 | 2,099,659 |
| Regulatory retail exposures | 656,766 | 117 | 871 | - | 49 | 301 | 658,104 |
| Past due exposures | 521,524 | 8,013 | - | - | - | - | 529,537 |
| Other assets | 947,823 | 8,969 | 39 | 2,581 | - | 75,621 | 1,035,033 |
| Total | 5,103,325 | 585,474 | 136,778 | 49,256 | 233,572 | 114,672 | 6,223,077 |
| Percentage of gross average credit risk exposure by geographical region | 82.0% | 9.4% | 2.2% | 0.8% | 3.8% | 1.8% | 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 2011 and 31 December 2010 is shown below:

**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 corporate | 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 assets | 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% |

Total gross credit risk exposures as at 31 December 2010 - Industry wise

| *(KD Thousands)* | Personal | Financial | Trade and commerce | Crude oil and gas | Cons-truction | Manu-facturing | Real estate | Other Services | Total |
|---|---|---|---|---|---|---|---|---|---|
| Cash items | - | - | - | - | - | - | - | 30,966 | 30,966 |
| Claims on sovereigns | - | - | - | - | - | - | - | 1,049,403 | 1,049,403 |
| Claims on public sector entities (PSEs) | - | - | - | - | - | - | - | 171,872 | 171,872 |
| Claims on Banks | - | 588,630 | - | - | - | - | - | - | 588,630 |
| Claims on corporates | 5,278 | 385,831 | 357,035 | 34,897 | 724,076 | 351,118 | - | 366,196 | 2,224,431 |
| Regulatory retail exposures | 602,010 | 442 | 19,848 | - | 21,454 | 2,594 | 4,147 | 7,888 | 658,383 |
| Past due exposures | 21,475 | 48,651 | 26,092 | - | 15,626 | 1,661 | 317,175 | 39,893 | 470,573 |
| Other assets | 131,878 | 11,858 | 11,598 | - | 10,225 | 2,812 | 674,342 | 182,663 | 1,025,376 |
| Total | 760,641 | 1,035,412 | 414,573 | 34,897 | 771,381 | 358,185 | 995,664 | 1,848,881 | 6,219,634 |
| Percentage of gross credit risk exposure by industry segment | 12.2% | 16.6% | 6.7% | 0.6% | 12.4% | 5.8% | 16.0% | 29.7% | 100.0% |

Credit Risk Exposures *(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 2011 and 31 December 2010 is shown below:

**Total gross credit risk exposure 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 assets | 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% |

Total gross credit risk exposure as at 31 December 2010 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 | 30,966 | - | - | - | - | - | 30,966 |
| Claims on sovereigns | 372,412 | 187,760 | 159,725 | 190,043 | 117,015 | 22,448 | 1,049,403 |
| Claims on public sector entities (PSEs) | - | - | - | 39,284 | 43,358 | 89,230 | 171,872 |
| Claims on Banks | 224,594 | 136,402 | 12,281 | 54,456 | 85,434 | 75,463 | 588,630 |
| Claims on corporates | 154,849 | 489,465 | 157,858 | 331,789 | 299,327 | 791,143 | 2,224,431 |
| Regulatory retail exposures | 41,613 | 15,851 | 9,446 | 17,252 | 40,850 | 533,371 | 658,383 |
| Past due exposures | 308,655 | 946 | 2,783 | 74,341 | 21,259 | 62,589 | 470,573 |
| Other assets | 79,514 | 133,542 | 49,185 | 329,175 | 155,248 | 278,712 | 1,025,376 |
| Total | 1,212,603 | 963,966 | 391,278 | 1,036,340 | 762,491 | 1,852,956 | 6,219,634 |
| Percentage of gross credit risk exposure by residual maturity | 19.5% | 15.5% | 6.3% | 16.7% | 12.3% | 29.7% | 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 2011 and 31 December 2010 is shown below:

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

| | Impaired Loans (NPLs) | | Balance Sheet Provisions Cash and non cash | | | |
|---|---|---|---|---|---|---|
| *(KD Thousands)* | Past due portion | Balance outstanding | Specific | General | Total | Specific Provisions Cover |
| **Personal** | **11,471** | **29,642** | **18,171** | **7,582** | **25,753** | **61.3%** |
| **Financial** | **64,619** | **74,739** | **11,559** | **3,242** | **14,801** | **15.5%** |
| **Trade and commerce** | **31,527** | **39,228** | **7,717** | **3,152** | **10,869** | **19.7%** |
| **Crude oil and gas** | **-** | **-** | **-** | **254** | **254** | **-** |
| **Construction** | **7,061** | **12,777** | **8,710** | **5,031** | **13,741** | **68.2%** |
| **Manufacturing** | **990** | **7,401** | **6,411** | **3,035** | **9,446** | **86.6%** |
| **Real estate** | **269,901** | **288,557** | **18,665** | **7,087** | **25,752** | **6.5%** |
| **Government** | **-** | **-** | **-** | **-** | **-** | **-** |
| **Others** | **51,590** | **62,230** | **10,770** | **94,561** | **105,331** | **17.3%** |
| **Total** | **437,159** | **514,574** | **82,003** | **123,944** | **205,947** | **15.9%** |

Impaired loans and provisions (by industry segment) as at 31 December 2010

| | Impaired Loans (NPLs) | | Balance Sheet Provisions Cash and non cash | | | |
|---|---|---|---|---|---|---|
| *(KD Thousands)* | Past due portion | Balance outstanding | Specific | General | Total | Specific Provisions Cover |
| Personal | 21,475 | 39,704 | 18,229 | 7,354 | 25,583 | 45.9% |
| Financial | 48,651 | 134,520 | 85,884 | 3,280 | 89,164 | 63.8% |
| Trade and commerce | 26,022 | 33,570 | 7,768 | 3,007 | 10,775 | 23.1% |
| Crude oil and gas | - | - | - | 216 | 216 | - |
| Construction | 14,781 | 21,800 | 10,301 | 4,804 | 15,105 | 47.3% |
| Manufacturing | 1,608 | 8,883 | 7,281 | 2,812 | 10,093 | 82.0% |
| Real estate | 315,437 | 337,362 | 21,931 | 6,268 | 28,199 | 6.5% |
| Government | - | - | - | - | - | - |
| Others | 39,893 | 66,011 | 28,040 | 34,703 | 62,743 | 42.5% |
| Total | 467,867 | 641,850 | 179,434 | 62,444 | 241,878 | 28.0% |

Non-performing loans ('NPL's') have decreased by KD 127.3 million in 2011, as compared to KD 506.8 million decrease in 2010 (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 is shown below:

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

| | Charge/(Release) for impairment provisions | | |
|---|---|---|---|
| *(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.

Provision Charges and Write-offs during 2010 (by Industry Segments)

| | Charge/(Release) for impairment provisions | | |
|---|---|---|---|
| *(KD Thousands)* | Specific Charge / Write-offs | General Charge | Total Charge |
| Personal | 811 | (330) | 481 |
| Financial | 33,402 | 334 | 33,736 |
| Trade and commerce | (5,104) | 351 | (4,753) |
| Crude oil and gas | (4) | (87) | (91) |
| Construction | 45,739 | 141 | 45,880 |
| Manufacturing | (5,829) | 432 | (5,397) |
| Real estate | 1,928 | 516 | 2,444 |
| Government | 75 | - | 75 |
| Other | 22,415 | 19,050 | 41,465 |
| Total | 93,433 | 20,407 | 113,840 |

**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 2011 and 31 December 2010 is shown below:

**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 Provisions Cover |
| **Kuwait** | **437,159** | **514,574** | **82,003** | **122,626** | **204,629** | **15.9%** |
| **Other Middle East** | **-** | **-** | **-** | **995** | **995** | **0.0%** |
| **Western Europe** | **-** | **-** | **-** | **316** | **316** | **0.0%** |
| **USA & Canada** | **-** | **-** | **-** | **2** | **2** | **0.0%** |
| **Asia Pacific** | **-** | **-** | **-** | **2** | **2** | **0.0%** |
| **Rest of World** | **-** | **-** | **-** | **3** | **3** | **0.0%** |
| **Total** | **437,159** | **514,574** | **82,003** | **123,944** | **205,947** | **15.9%** |

Impaired loans and provisions (by Geographical Region) as at 31 December 2010

| | Impaired Loans (NPLs) | | Balance Sheet Provisions | | | |
|---|---|---|---|---|---|---|
| *(KD Thousands)* | Past due portion | Balance outstanding | Specific | General | Total | Specific Provisions Cover |
| Kuwait | 437,094 | 605,521 | 173,878 | 61,902 | 235,780 | 28.7% |
| Other Middle East | 30,773 | 36,329 | 5,556 | 95 | 5,651 | 15.3% |
| Western Europe | - | - | - | 3 | 3 | 0.0% |
| USA & Canada | - | - | - | 70 | 70 | 0.0% |
| Asia Pacific | - | - | - | 37 | 37 | 0.0% |
| Rest of World | - | - | - | 337 | 337 | 0.0% |
| Total | 467,867 | 641,850 | 179,434 | 62,444 | 241,878 | 28.0% |

# 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 2011 and 31 December 2010, broken down by standard credit risk portfolio, is shown below:

**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 assets** | **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** |

Gross credit risk exposure before CRM as at 31 December 2010

| | 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 | 30,966 | - | 30,966 | 30,966 | - | - | 30,966 |
| Claims on sovereigns | 906,297 | 143,106 | 1,049,403 | 906,297 | 143,106 | 25 | 1,049,428 |
| Claims on PSEs | - | 171,872 | 171,872 | - | 171,872 | - | 171,872 |
| Claims on Banks | 307,942 | 280,688 | 588,630 | 307,942 | 165,828 | 175 | 473,945 |
| Claims on corporates | 1,384,645 | 839,786 | 2,224,431 | 1,384,645 | 427,625 | - | 1,812,270 |
| Retail exposures | 618,240 | 40,143 | 658,383 | 618,240 | 17,137 | - | 635,377 |
| Past due exposures | 467,867 | 2,706 | 470,573 | 467,867 | 2,002 | - | 469,869 |
| Other assets | 932,774 | 92,602 | 1,025,376 | 932,774 | 84,035 | - | 1,016,809 |
| Total | 4,648,731 | 1,570,903 | 6,219,634 | 4,648,731 | 1,011,605 | 200 | 5,660,536 |

**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 the 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 2011 and 31 December 2010 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 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 assets** | **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** |

Credit Risk Exposure after CRM; risk-weighted assets (RWAs) as at 31 December 2010

| | Credit exposure/CRM | | | | Risk-weighted assets | | |
|---|---|---|---|---|---|---|---|
| | | CRM | | | | | |
| *(KD Thousands)* | Exposure before CRM | Eligible collateral | Eligible guarantees | Exposure after CRM | Rated | Unrated | Total |
| Cash Items | 30,966 | - | - | 30,966 | - | - | - |
| Claims on sovereigns | 1,049,428 | - | - | 1,049,428 | 6,173 | - | 6,173 |
| Claims on PSEs | 171,872 | - | - | 171,872 | - | 34,374 | 34,374 |
| Claims on Banks | 473,945 | 609 | - | 473,336 | 144,529 | 10,418 | 154,947 |
| Claims on corporates | 1,812,270 | 674,705 | 10,342 | 1,127,223 | - | 1,127,223 | 1,127,223 |
| Retail exposures | 635,377 | 58,674 | 70 | 576,633 | - | 572,946 | 572,946 |
| Past due exposures | 469,869 | 245,280 | 190 | 224,399 | - | 223,856 | 223,856 |
| Other assets | 1,016,809 | 651,540 | - | 365,269 | - | 458,660 | 458,660 |
| Total | 5,660,536 | 1,630,808 | 10,602 | 4,019,126 | 150,702 | 2,427,477 | 2,578,179 |

Most of the CRM takes 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 the 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 2011 and 31 December 2010 is shown in the following table:

| | *(KD Thousands)* | |
|---|---|---|
| **Market Risk** | **31-Dec-11** | 31-Dec-10 |
| Interest rate position risk | **100** | 163 |
| Foreign exchange risk | **95** | 10,097 |
| **Total Capital requirement for market risk** | **195** | 10,260 |
| **Market risk-weighted assets** | **1,624** | 85,466 |

On 31 December 2011 total market risk capital charge of KD 195 thousand was equivalent to market risk-weighted assets of KD 1.6 million. Market risk-weighted assets were KD 83.8 million lower than December 2010.

# 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 2011 are shown in the following table:

### 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** | **18.0%** | **3,327** |
| **Commercial banking** | **75,907** | **15.0%** | **11,386** |
| **Retail banking** | **43,280** | **12.0%** | **5,194** |
| **Total** | **137,672** | | **19,907** |
| **Total operational risk weighted exposure** | | | **165,825** |

### Operational Risk as at 31 December 2010

| *(KD Thousands)* | 3 year average gross income | Beta factor | Operational risk capital charge |
|---|---|---|---|
| Trading and sales | 27,042 | 18.0% | 4,868 |
| Commercial banking | 69,147 | 15.0% | 10,372 |
| Retail banking | 42,994 | 12.0% | 5,159 |
| Total | 139,183 | | 20,399 |
| Total operational risk weighted exposure | | | 169,924 |

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 2011 total operational risk capital charge of KD 19.9 million was equivalent to operational risk-weighted exposure of KD 165.8 million.

# Equity Risk in the Banking Book

The 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 2011 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 2011 is also shown.

**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** |

Information related to the licensed bank's equity position in the banking book as at 31 December 2010

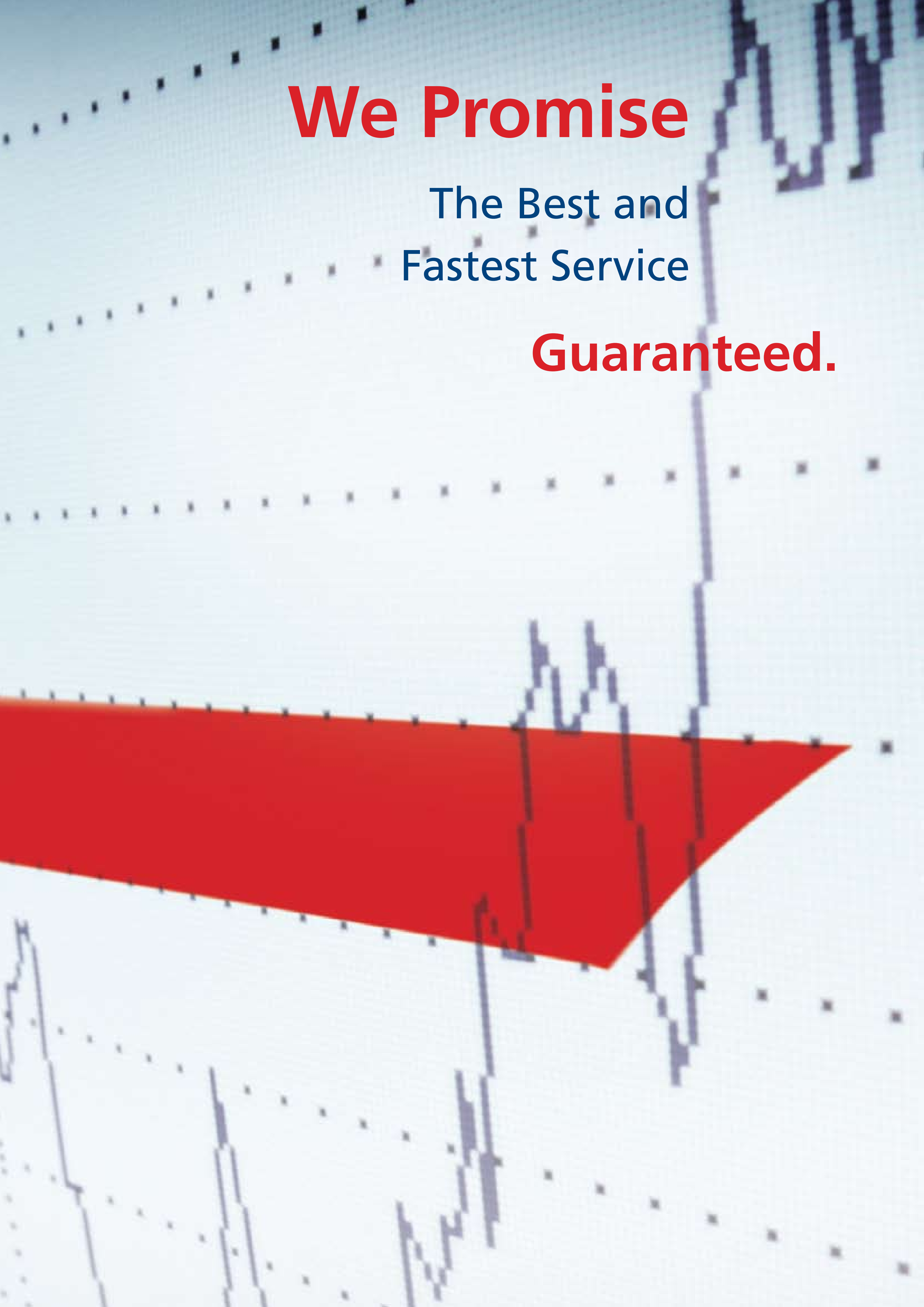
| *(KD Thousands)* | Publicly traded | Privately traded | Total investment securities |
|---|---|---|---|
| **Total fair value of investment securities** | 6,653 | 85,565 | 92,218 |
| Unrealised gains in equity | 3,585 | 13,733 | 17,318 |
| **Regulatory capital details** | | | |
| Unrealised gains in Tier 2 capital (45%) | 1,613 | 6,180 | 7,793 |
| Regulatory capital requirement | 562 | 9,361 | 9,923 |
| **Income statement details** | | | |
| Income from disposal of investment securities | | | 21,639 |

# 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.


We Promise
To keep your queuing time
Below 10 minutes
Guaranteed.
صراف الحسابات الشخصية
(وقت الانتظار لا يتعدى 10 دقائق)
Personal Cash Teller
(Queuing time below 10 minutes)
صراف حسابات الشركات
Corporate Cash Teller
مسؤول خدمة العملاء
Relationship Officer
استلام البطاقات
Card Collection
بنك الخليج
GULF BANK
معكم نستمر


We Promise
The Best and
Fastest Service
Guaranteed.

# Financial Statements

# 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 2011, 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 mi statement, 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 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 2011, 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 number 2/BSI184/2005 dated 21 December 2005, as amended, Commercial Companies Law of 1960, as amended, 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 Central Bank of Kuwait as stipulated in CBK Circular number 2/BSI184/2005 dated 21 December 2005, as amended, Commercial Companies Law of 1960, as amended, nor of the Articles of Association have occurred during the year ended 31 December 2011 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 Central Bank of Kuwait and the organisation of banking business, and its related regulations, during the year ended 31 December 2011.

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

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

**10 January 2012**
**Kuwait**

# Income Statement

**Year Ended 31 December 2011**

| | NOTES | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|---|
| Interest income | 3 | **172,455** | 180,764 |
| Interest expense | 4 | **(66,497)** | (77,382) |
| **Net interest income** | | **105,958** | 103,382 |
| Net fees and commissions | 6 | **28,685** | 27,458 |
| Net gains from dealing in foreign currencies and derivatives | 7 | **16,103** | 32,210 |
| Realised gains from disposal of investments available-for-sale | | **7,277** | 21,639 |
| Dividend income | | **335** | 237 |
| Impairment loss on investments available-for-sale | 13 | **(7,704)** | (4,800) |
| Other income | | **865** | 534 |
| **OPERATING INCOME** | | **151,519** | 180,660 |
| Staff expenses | | **31,211** | 28,198 |
| Occupancy costs | | **3,052** | 2,811 |
| Depreciation | | **2,802** | 2,551 |
| Other expenses | | **14,471** | 13,292 |
| **Operating expenses** | | **51,536** | 46,852 |
| **OPERATING PROFIT BEFORE PROVISIONS** | | **99,983** | 133,808 |
| Charge of provisions: | | | |
| - specific | 5 | **17,093** | 93,433 |
| - general | 12,18 | **61,500** | 20,407 |
| Loans recoveries | 12 | **(10,683)** | - |
| | | **67,910** | 113,840 |
| **OPERATING PROFIT** | | **32,073** | 19,968 |
| Directors' remuneration | 22 | **135** | 180 |
| Contribution to Kuwait Foundation for the Advancement of Sciences | | **246** | - |
| National Labour Support Tax | | **804** | 522 |
| Zakat | | **268** | 207 |
| **PROFIT FOR THE YEAR** | | **30,620** | 19,059 |
| **EARNING PER SHARE** | | | |
| Basic and diluted earning per share (Fils) | 8 | **12** | 8 |

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

# Statement of Comprehensive Income

**Year Ended 31 December 2011**

| | NOTE | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|---|
| Profit for the year | | **30,620** | 19,059 |
| **Other comprehensive (expense)/income** | | | |
| Net unrealised (loss)/gains on investments available-for-sale | 13 | **(9,308)** | 1,336 |
| Net realised gain transferred to the income statement on disposal of / impairment losses on investments available-for-sale | 13 | **(801)** | (19,535) |
| Revaluation of premises and equipment | | **455** | (396) |
| **Other comprehensive expense for the year** | | **(9,654)** | (18,595) |
| **Total comprehensive income for the year** | | **20,966** | 464 |

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

# Statement of Financial Position

**As at 31 December 2011**

| | NOTES | 2011 KD 000's | 2010 KD 000's |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and short term funds | 9 | **370,519** | 280,193 |
| Treasury bills and bonds | 10 | **418,221** | 521,463 |
| Central Bank of Kuwait bonds | 11 | **429,482** | 310,055 |
| Deposits with banks and other financial institutions | | **20,000** | 111,210 |
| Loans and advances to banks | 12 | **34,140** | 21,780 |
| Loans and advances to customers | 12 | **3,334,087** | 3,181,377 |
| Investments available-for-sale | 13 | **106,009** | 92,218 |
| Other assets | 14 | **47,513** | 55,657 |
| Premises and equipment | | **25,924** | 25,824 |
| **TOTAL ASSETS** | | **4,785,895** | 4,599,777 |
| **LIABILITIES AND EQUITY** | | | |
| **LIABILITIES** | | | |
| Due to banks | 15 | **76,179** | 67,321 |
| Deposits from financial institutions | 15 | **776,819** | 886,577 |
| Customer deposits | 16 | **3,330,444** | 3,070,866 |
| Subordinated loans | 17 | **83,565** | 84,180 |
| Other liabilities | 18 | **88,629** | 80,118 |
| **TOTAL LIABILITIES** | | **4,355,636** | 4,189,062 |
| **EQUITY** | | | |
| Share capital | 19 | **250,770** | 250,770 |
| Proposed bonus shares | 22 | **12,539** | - |
| Statutory reserve | 20 | **2,469** | - |
| Share premium | 20 | **153,024** | 153,024 |
| Property revaluation reserve | 20 | **16,698** | 16,243 |
| Treasury share reserve | 21 | **24,289** | 24,993 |
| Fair valuation reserve | | **7,209** | 17,318 |
| Retained earnings (accumulated losses) | | **8,226** | (7,386) |
| | | **475,224** | 454,962 |
| Treasury shares | 21 | **(44,965)** | (44,247) |
| | | **430,259** | 410,715 |
| **TOTAL LIABILITIES AND EQUITY** | | **4,785,895** | 4,599,777 |

**Ali Al-Rashaid Al-Bader**
(Chairman)

**Michel Accad**
(Chief General Manager & Chief Executive Officer)

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

# Statement of Cash Flows

**Year Ended 31 December 2011**

| | NOTES | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Profit for the year | | **30,620** | 19,059 |
| Adjustments: | | | |
| Effective interest rate adjustment | | **849** | 597 |
| Unrealised fair value gains on credit default swaps | 7 | **(3,630)** | (14,525) |
| Realised gains from disposal of investments available-for-sale | | **(7,277)** | (21,639) |
| Dividend income | | **(335)** | (237) |
| Impairment loss on investments available-for-sale | 13 | **7,704** | 4,800 |
| Depreciation | | **2,802** | 2,551 |
| Loans loss provisions | 5,12,18 | **78,593** | 113,840 |
| Foreign exchange movement on subordinated loans | | **(615)** | (1,860) |
| OPERATING PROFIT BEFORE CHANGES IN OPERATING ASSETS AND LIABILITIES | | **108,711** | 102,586 |
| **(Increase)/decrease in operating assets:** | | | |
| Treasury bills and bonds | | **103,242** | (35,257) |
| Central Bank of Kuwait bonds | | **(119,427)** | (37,568) |
| Deposits with banks and other financial institutions | | **91,210** | (40,943) |
| Loans and advances to banks | | **(12,360)** | (12,522) |
| Loans and advances to customers | | **(232,085)** | (31,945) |
| Other assets | | **8,144** | (4,600) |
| **(Decrease)/increase in operating liabilities:** | | | |
| Due to banks | | **8,858** | (22,553) |
| Deposits from financial institutions | | **(109,758)** | (32,385) |
| Customer deposits | | **259,578** | (78,574) |
| Other liabilities | | **12,074** | 4,785 |
| **NET CASH FROM/(USED IN) OPERATING ACTIVITIES** | | **118,187** | (188,976) |
| **INVESTING ACTIVITIES** | | | |
| Purchase of investments available-for-sale | | **(52,382)** | (461) |
| Proceeds from sale of investments available-for-sale | | **28,055** | 49,529 |
| Purchase of premises and equipment | | **(2,447)** | (3,884) |
| Dividends received | | **335** | 237 |
| **NET CASH (USED IN)/FROM INVESTING ACTIVITIES** | | **(26,439)** | 45,421 |
| **FINANCING ACTIVITIES** | | | |
| Purchase of treasury shares | | **(2,483)** | (99) |
| Proceeds from sale of treasury shares | | **1,061** | 2,497 |
| **NET CASH (USED IN)/FROM FINANCING ACTIVITIES** | | **(1,422)** | 2,398 |
| **NET INCREASE/(DECREASE) IN CASH AND SHORT TERM FUNDS** | | **90,326** | (141,157) |
| **CASH AND SHORT TERM FUNDS AT 1 JANUARY** | | **280,193** | 421,350 |
| **CASH AND SHORT TERM FUNDS AT 31 DECEMBER** | 9 | **370,519** | 280,193 |
| **Additional cash flow information** | | | |
| Interest received | | **179,634** | 180,225 |
| Interest paid | | **68,841** | 78,063 |

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

# Statement of Changes in Equity

**Year Ended 31 December 2011**

| | | | 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 | Retained earnings (accumulated losses) KD 000's | Subtotal Reserves KD 000's | Treasury Shares KD 000's | Total KD 000's |
| At 1 January 2010 | 250,770 | - | - | 153,024 | 16,639 | 27,979 | 35,517 | (26,445) | 206,714 | (49,631) | 407,853 |
| Profit for the year | - | - | - | - | - | - | - | 19,059 | 19,059 | - | 19,059 |
| Other comprehensive expense for the year | - | - | - | - | (396) | - | (18,199) | - | (18,595) | - | (18,595) |
| Total comprehensive (expense)/income for the year | - | - | - | - | (396) | - | (18,199) | 19,059 | 464 | - | 464 |
| Purchase of treasury shares | - | - | - | - | - | - | - | - | - | (99) | (99) |
| Sale of treasury shares | - | - | - | - | - | - | - | - | - | 5,483 | 5,483 |
| Loss on sale of treasury shares | - | - | - | - | - | (2,986) | - | - | (2,986) | - | (2,986) |
| At 31 December 2010 | 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 | - | 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** |

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

# Notes to the Financial Statements

**31 December 2011**

## 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 2011 were authorised for issue in accordance with a resolution of the Bank's Board of Directors on 10 January 2012. The Annual General Assembly of the shareholders has the power to amend these financial statements after issuance.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### a. 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 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.

### Changes in accounting policies

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 new and amended IFRS, IAS and improvements:

*IAS 24 Related Party Transactions (Amendment) effective 1 January 2011*

The IASB issued an amendment to IAS 24 that clarifies the definitions of a related party. The new definitions emphasise a symmetrical view of related party relationships and clarify the circumstances in which persons and key management personnel affect related party relationships of the Bank. In addition, the amendment introduces an exemption from the general related party disclosure requirements for transactions with government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity. The adoption of the amendment did not have any impact on the financial position or performance of the Bank.

*IAS 32 Financial Instruments: Presentation (Amendment) effective 1 February 2010*

The IASB issued an amendment that alters the definition of a financial liability in IAS 32 to enable the banks to classify rights issues and certain options or warrants as equity instruments. The amendment is applicable if the rights are given pro rata to all of the existing owners of the same class of the bank's non-derivative equity instruments, to acquire a fixed number of the Bank's own equity instruments for a fixed amount in any currency. The amendment has had no effect on the financial position or performance of the Bank because the Bank does not have these types of instruments.

### Improvements to IFRSs

In May 2010, the IASB issued its third omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The adoption of the following amendments resulted in changes to accounting policies, but no impact on the financial position or performance of the Bank.

- IAS 1 Presentation of Financial Statements: The amendment clarifies that the Bank may present an analysis of each component of other comprehensive income either in the statement of changes in equity or in the notes to the financial statements.

Other amendments resulting from Improvements to IFRSs did not have any impact on the accounting policies, financial position or performance of the Bank.

The following IASB Standards have been issued but are not yet effective and have not been early adopted by the Bank:

*IAS 1 Financial Statement Presentation – Presentation of Items of Other Comprehensive Income (OCI)*

The amendments to IAS 1 change the grouping of items presented in OCI. Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. The amendment affects presentation only and has therefore no impact on the Bank's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

*IFRS 7 Financial Instruments: Disclosures — Enhanced Derecognition Disclosure Requirements*

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 continuing involvement in derecognised assets to enable the user to evaluate the nature of, and risks associated with, the Bank's continuing involvement in those derecognised assets. The amendment becomes effective for annual periods beginning on or after 1 July 2011. The amendment affects disclosure only and has no impact on the Bank's financial position or performance.

*IFRS 9 Financial Instruments: Classification and Measurement*

IFRS 9 as issued reflects the first phase of the IASBs 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 is effective for annual periods beginning on or after 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 potentially have no impact on classification and measurements of financial liabilities. The Bank will quantify the effect in conjunction with the other phases, when issued, to present a comprehensive picture. The application of IFRS 9 is under local regulatory review for adoption in the State of Kuwait.

*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.

## b. 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.

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 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.

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.

**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. 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 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;

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.

**Offseting**

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 loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur.

**c. 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.

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 should be expected to be highly effective, i.e. the changes in fair value or cash flows of the hedging instrument should effectively offset corresponding changes in the hedged item, and should be reliably measurable. 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 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 their carrying value relating to the discontinued hedge is amortized over the remaining term to maturity.

### d. 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.

### e. 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.

### f. 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.

### g. 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.

### h. 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 decrease 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 is 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 |

### i. 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.

### j. 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 commission income are recognised as the services are provided. Dividend income is recognised when the right to receive payment is established.

### k. 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.

### l. Leases

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

### m. 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.

### n. 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 is 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 is recognised directly in the income statement, foreign exchange differences are recognised in the income statement.

### o. Cash and cash equivalents

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

### p. Significant accounting judgements, estimates and assumptions

In the process of applying the Bank's accounting policies, management uses judgements, and makes estimates in determining the amounts recognised in the financial statements. The most significant use of judgements and estimates is 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.

#### Evidence of impairment in investments

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.

#### Impairment losses on loans and advances and investment in debt instruments

The Bank reviews problem loans and advances and investment in debt instruments 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 situations and the net realisable value of collaterals. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgement and uncertainty, and actual results may differ resulting in future changes to such provisions.

#### 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.

### q. 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.

### r. 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.

## 3. INTEREST INCOME

| | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|
| Treasury bills and bonds, Central Bank of Kuwait Bonds | **11,495** | 12,159 |
| Placements with banks | **1,720** | 2,443 |
| Loans and advances to banks and customers | **159,240** | 166,162 |
| | **172,455** | 180,764 |

## 4. INTEREST EXPENSE

| | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|
| Sight and savings accounts | **3,669** | 3,931 |
| Time deposits | **60,320** | 70,487 |
| Bank borrowings | **2,508** | 2,964 |
| | **66,497** | 77,382 |

## 5. SPECIFIC PROVISIONS

| | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|
| Loans and advances to customers | | |
| – Cash (Note 12) | **17,956** | 94,533 |
| – Non-cash (Note 18) | **(863)** | (2,018) |
| Loans written-off | **-** | 918 |
| | **17,093** | 93,433 |

## 6. NET FEES AND COMMISSIONS

| | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|
| Total fees and commission income | **32,170** | 31,007 |
| Total fees and commission expense | **(3,485)** | (3,549) |
| | **28,685** | 27,458 |

Total fees and commission income includes **KD 174 thousand** (2010: KD 203 thousand) from fiduciary activities.

## 7. NET GAINS FROM DEALING IN FOREIGN CURRENCIES AND DERIVATIVES

| | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|
| Income from structured derivative transactions | **678** | 5,223 |
| Realised gain on structured derivative transactions with customers | **3,303** | 3,227 |
| Unrealised fair value gains on credit default swaps | **3,630** | 14,525 |
| Income from credit default swaps | **1,269** | 1,722 |
| Net trading income | **8,880** | 24,697 |
| Foreign exchange operations | **7,223** | 7,513 |
| | **16,103** | 32,210 |

## 8. BASIC AND DILUTED EARNING PER SHARE

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

| | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|
| Profit for the year | **30,620** | 19,059 |
| | **Shares** | Shares |
| Weighted average number of Bank's issued and paid up shares | **2,507,702,366** | 2,507,702,366 |
| Less: Weighted average number of treasury shares | **(46,431,189)** | (49,123,696) |
| | **2,461,271,177** | 2,458,578,670 |
| | **Fils** | Fils |
| Basic and diluted earning per share | **12** | 8 |

## 9. CASH AND SHORT TERM FUNDS

| | 2011<br>KD 000's | 2010<br>KD 000's |
|---|---|---|
| Balances with the Central Bank of Kuwait | **115,712** | 74,275 |
| Cash on hand and in current accounts with other banks | **63,720** | 76,121 |
| Deposits with banks and other financial institutions | **191,087** | 129,797 |
| | **370,519** | 280,193 |

## 10. TREASURY BILLS AND BONDS

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

| | 2011<br>KD 000's | 2010<br>KD 000's |
|---|---|---|
| Maturing within one year | **398,174** | 494,240 |
| Maturing after one year | **20,047** | 27,223 |
| | **418,221** | 521,463 |

## 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.

| | 2011<br>KD 000's | 2010<br>KD 000's |
|---|---|---|
| Central Bank of Kuwait Bonds | **429,482** | 310,055 |

## 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 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** |

At 31 December 2010

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 | 779,000 | 81 | - | - | - | 779,081 |
| Financial | 484,505 | - | - | - | - | 484,505 |
| Trade and commerce | 269,597 | - | - | - | - | 269,597 |
| Crude oil and gas | 20,445 | - | - | - | - | 20,445 |
| Construction | 247,732 | 8,548 | - | 2,654 | - | 258,934 |
| Manufacturing | 336,564 | - | 260 | - | - | 336,824 |
| Real estate | 932,145 | - | - | - | - | 932,145 |
| Others | 245,866 | 52,133 | - | 506 | 33,299 | 331,804 |
| | 3,315,854 | 60,762 | 260 | 3,160 | 33,299 | 3,413,335 |
| Less: Provision for impairment | | | | | | (231,958) |
| | | | | | | 3,181,377 |
| Loans and advances to banks | 3,367 | 2,265 | 14,030 | 2,118 | - | 21,780 |

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

**Movement in provision for impairment**

| | 2011 KD 000's | | | 2010 KD 000's | | |
|---|---|---|---|---|---|---|
| | **Specific** | **General** | **Total** | Specific | General | Total |
| At 1 January | **173,983** | **57,975** | **231,958** | 483,874 | 37,702 | 521,576 |
| Exchange adjustments | **-** | **-** | **-** | 3,166 | - | 3,166 |
| Recoveries | **-** | **-** | **-** | 1,159 | - | 1,159 |
| Amounts written-off | **(114,524)** | **-** | **(114,524)** | (408,749) | - | (408,749) |
| Charge to the income statement (Note 5) | **17,956** | **60,570** | **78,526** | 94,533 | 20,273 | 114,806 |
| At 31 December | **77,415** | **118,545** | **195,960** | 173,983 | 57,975 | 231,958 |

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 7,640 thousand (2010: KD Nil) and realizations of KD 18,323 thousand (2010: KD Nil) 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.

| | 2011 KD 000's | | | 2010 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 | **210,058** | **21,900** | **231,958** | 481,784 | 39,792 | 521,576 |
| Exchange adjustments | **-** | **-** | **-** | 3,166 | - | 3,166 |
| Recoveries | **-** | **-** | **-** | - | 1,159 | 1,159 |
| Amounts written-off | **(107,381)** | **(7,143)** | **(114,524)** | (387,902) | (20,847) | (408,749) |
| Charge/(write back) to the income statement (Note 5) | **75,174** | **3,352** | **78,526** | 113,010 | 1,796 | 114,806 |
| At 31 December | **177,851** | **18,109** | **195,960** | 210,058 | 21,900 | 231,958 |
| Specific provision | **66,126** | **11,289** | **77,415** | 158,084 | 15,899 | 173,983 |
| General provision | **111,725** | **6,820** | **118,545** | 51,974 | 6,001 | 57,975 |
| | **177,851** | **18,109** | **195,960** | 210,058 | 21,900 | 231,958 |

As at 31 December 2011, non-performing loans and advances amounted to **KD 514,574 thousand** (2010: KD 641,850 thousand) split between facilities granted pre-invasion and post-liberation as follows:

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | **Loans & Advances KD 000's** | **Specific Provision KD 000's** | Loans & Advances KD 000's | Specific Provision KD 000's |
| Pre-invasion | - | - | - | - |
| Post-liberation | **514,574** | **77,415** | 641,850 | 173,983 |
| Total | **514,574** | **77,415** | 641,850 | 173,983 |

In accordance with the Central Bank of Kuwait instruction no. 2/105/11480 dated 22 September 2010 the pre-invasion loans and the related provision have been written-off.

## 13. INVESTMENTS AVAILABLE-FOR-SALE

| | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|
| **Equity securities** | | |
| Quoted | **58,311** | 70,483 |
| Unquoted | **26,987** | 21,735 |
| **Debt securities** | | |
| Quoted | **18,711** | - |
| Unquoted | **2,000** | - |
| | **106,009** | 92,218 |

Quoted securities are traded in active markets. Fair values amounting to **KD 1,901 thousand** (2010: KD 7,260 thousand) of the unquoted securities are based on market observable data.

During the year, the Bank recognised a loss of **KD 9,308 thousand** (2010: gain of KD 1,336 thousand) in the statement of comprehensive income as net unrealised loss arising from changes in fair value of investment securities and re-cycled a gain of **KD 801 thousand** (2010: gain of KD 19,535 thousand) to the income statement arising from the disposal of 'investments available-for-sale'. The Bank also recognized an impairment loss of **KD 7,704 thousand** (2010: KD 4,800 thousand) in the income statement.

The determination of the cash flows and discount factors for unquoted equity and debt investments 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 27,086 thousand** (2010: KD 14,475 thousand) are carried at cost net of impairment.

## 14. OTHER ASSETS

| | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|
| Accrued interest receivable | **29,112** | 34,881 |
| Sundry debtors and others | **18,401** | 20,776 |
| | **47,513** | 55,657 |

Sundry debtors and others include **KD 8,916 thousand** (2010: KD 10,688 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

| | 2011<br>KD 000's | 2010<br>KD 000's |
|---|---|---|
| **Due to banks** | | |
| Current accounts and demand deposits | **51,390** | 11,046 |
| Time deposits | **24,789** | 56,275 |
| | **76,179** | 67,321 |
| **Deposits from financial institutions** | | |
| Current accounts and demand deposits | **49,220** | 61,575 |
| Time deposits | **727,599** | 825,002 |
| | **776,819** | 886,577 |

## 16. CUSTOMER DEPOSITS

| | 2011<br>KD 000's | 2010<br>KD 000's |
|---|---|---|
| Current accounts | **706,496** | 546,747 |
| Savings accounts | **258,236** | 230,795 |
| Time deposits | **2,365,712** | 2,293,324 |
| | **3,330,444** | 3,070,866 |

## 17. SUBORDINATED LOANS

As at 31 December 2011, the Bank has subordinated loans of USD 300 million equivalent to **KD 83,565 thousand** (2010: KD 84,180 thousand). This comprises 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

| | **2011** **KD 000's** | 2010 KD 000's |
|---|---|---|
| Interest payable | **15,506** | 17,850 |
| Deferred income | **4,550** | 3,485 |
| Provisions for non-cash facilities (refer movement below) | **9,987** | 9,920 |
| Fair value loss provision on credit default swaps (Note 28) | **10,844** | 14,473 |
| Staff related provisions | **9,213** | 7,675 |
| Others | **38,529** | 26,715 |
| | **88,629** | 80,118 |

| | **2011 KD 000's** | | | 2010 KD 000's | | |
|---|---|---|---|---|---|---|
| | **Specific** | **General** | **Total** | Specific | General | Total |
| At 1 January | **5,451** | **4,469** | **9,920** | 7,469 | 4,335 | 11,804 |
| Charge/(write-back) to the income statement (Note 5) | **(863)** | **930** | **67** | (2,018) | 134 | (1,884) |
| At 31 December | **4,588** | **5,399** | **9,987** | 5,451 | 4,469 | 9,920 |

## 19. SHARE CAPITAL

| | **2011** **KD 000's** | 2010 KD 000's |
|---|---|---|
| **Authorised, issued and fully paid:** | | |
| 2,507,702,366 (2010: 2,507,702,366) shares of KD 0.100 each | **250,770** | 250,770 |

## 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 has been transferred to statutory reserve after recovering the previously incurred losses. 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.

### 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

| | **2011** **KD 000's** | 2010 KD 000's |
|---|---|---|
| Number of treasury shares | **49,958,737** | 46,878,737 |
| Percentage of treasury shares | **1.99%** | 1.87% |
| Cost of treasury shares (KD 000's) | **44,965** | 44,247 |
| Market value of treasury shares as at 31 December (KD 000's) | **25,479** | 26,721 |

Movement in treasury shares was as follows:

| | *No. of shares* | |
|---|---|---|
| | **2011** | 2010 |
| Balance as at 1 January | **46,878,737** | 52,453,737 |
| Purchases | **4,950,000** | 225,000 |
| Sales | **(1,870,000)** | (5,800,000) |
| Balance as at 31 December | **49,958,737** | 46,878,737 |

The balance in the treasury share reserve of **KD 24,289 thousand** (2010: KD 24,993 thousand) is not available for distribution.

## 22. PROPOSED BONUS SHARES AND DIRECTORS' REMUNERATION

The Board of Directors has recommended distribution of bonus shares of 5% on the outstanding issued share capital as at 31 December 2011 amounting to **KD 12,539 thousand** (2010: KD Nil) 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.

Directors' remuneration of **KD 135 thousand** (2010: KD 180 thousand) is in accordance with local regulations and is subject to approval of the shareholders at the Annual General Meeting. During the year, the proposed directors' remuneration for 2010 of KD 180 thousand was cancelled.

## 23. RELATED PARTY TRANSACTIONS

Certain related parties (directors 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. Such transactions were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with unrelated parties, and did not involve more than a normal amount of risk.

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** | **2011** | 2010 | **2011** | 2010 | **2011 KD 000's** | 2010 KD 000's |
| Loans and advances | **2** | 1 | **6** | 7 | **110,674** | 160,448 |
| Provision for impairment on receivable from a related party | **-** | - | **1** | - | **2,162** | - |
| Deposits | **8** | 7 | **16** | 18 | **321,622** | 488,133 |
| Guarantees issued | **-** | - | **6** | 3 | **35,917** | 10,157 |
| **Executive management** | | | | | | |
| Loans | **1** | 4 | **-** | - | **561** | 1,026 |
| Deposits | **13** | 13 | **-** | - | **1,382** | 977 |
| 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 **3% to 6.75% p.a.** (2010: 2.5% to 6.5% p.a.). Some of the loans advanced to directors and their related parties during the year are collateralised. The fair value of these collaterals as of 31 December 2011 was **KD 92,598 thousand** (2010: KD 193,457 thousand).

The transactions included in the income statement are as follows:

| | **2011 KD 000's** | 2010 KD 000's |
|---|---|---|
| **Directors and key management personnel:** | | |
| Interest income | **3,098** | 7,542 |
| Interest expense | **5,067** | 10,033 |
| **Key management compensation:** | | |
| Salaries and other short-term benefits | **2,777** | 2,595 |
| End of service/termination benefits | **99** | 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 counterparties 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 tenor of exposures.

An independent credit control unit, reporting to the 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 have the authority to approve, reject or modify credit applications submitted to them within their 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 the 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.

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

Geographical and industry sector concentrations of assets, liabilities and off-balance sheet items are as follows:

| | **2011** | | | 2010 | | |
|---|---|---|---|---|---|---|
| | **Assets KD 000's** | **Liabilities KD 000's** | **Off balance sheet items KD 000's** | Assets KD 000's | Liabilities KD 000's | Off balance sheet items KD 000's |
| *Geographic region:* | | | | | | |
| Domestic (Kuwait) | **4,335,580** | **4,199,302** | **1,061,321** | 4,145,242 | 4,022,125 | 942,766 |
| Other Middle East | **198,261** | **90,500** | **274,736** | 173,239 | 116,623 | 346,605 |
| Europe | **65,563** | **4,496** | **88,229** | 50,565 | 4,028 | 83,044 |
| USA and Canada | **17,887** | **599** | **11,268** | 30,955 | 9,500 | 15,961 |
| Asia Pacific | **4,270** | **1,132** | **190,371** | 16,362 | 15,982 | 222,981 |
| Rest of world | **17,518** | **59,607** | **41** | 34,406 | 20,804 | 155 |
| | **4,639,079** | **4,355,636** | **1,625,966** | 4,450,769 | 4,189,062 | 1,611,512 |
| *Industry sector:* | | | | | | |
| Personal | **820,740** | **1,884,642** | **-** | 760,641 | 2,399,270 | - |
| Financial | **664,107** | **996,608** | **363,514** | 614,361 | 249,904 | 330,419 |
| Trade and Commerce | **305,979** | **29,786** | **181,498** | 262,049 | 24,685 | 152,744 |
| Crude Oil and Gas | **19,407** | **2,538** | **35,762** | 20,445 | 5,238 | 14,452 |
| Construction | **254,241** | **36,113** | **614,915** | 251,916 | 31,637 | 524,019 |
| Government | **963,415** | **1,206,078** | **158,978** | 905,793 | 1,035,592 | 143,406 |
| Manufacturing | **351,641** | **8,178** | **25,848** | 329,549 | 14,159 | 28,643 |
| Real Estate | **973,579** | **6,248** | **38,595** | 910,686 | 5,801 | 84,984 |
| Others | **285,970** | **185,445** | **206,856** | 395,329 | 422,776 | 332,845 |
| | **4,639,079** | **4,355,636** | **1,625,966** | 4,450,769 | 4,189,062 | 1,611,512 |

**Maximum exposure to credit risk**

The table below shows the maximum exposure to credit risk net of provisions for the components of the statement of financial position, including positive fair value of derivatives without taking account of any collateral and other credit enhancements.

| BY CLASS OF FINANCIAL ASSETS | **Maximum exposure 2011 KD 000's** | Maximum exposure 2010 KD 000's |
|---|---|---|
| Cash and short term funds (excluding cash on hand) | **334,925** | 249,227 |
| Treasury bills and bonds | **418,221** | 521,463 |
| Central Bank of Kuwait bonds | **429,482** | 310,055 |
| Deposits with banks and other financial institutions | **20,000** | 111,210 |
| Loans and advances to banks | **34,140** | 21,780 |
| Loans and advances to customers: | | |
| Corporate lending | **2,641,300** | 2,571,221 |
| Consumer lending | **692,787** | 610,156 |
| Debt Investments available-for-sale (Note 13) | **20,711** | - |
| Other assets | **47,513** | 55,657 |
| Total | **4,639,079** | 4,450,769 |
| Contingent liabilities | **1,240,181** | 1,180,704 |
| Credit default swaps | **294,706** | 380,650 |
| Foreign exchange contracts | **79,937** | 22,363 |
| Structured products | **11,142** | 11,224 |
| Capital commitment | **-** | 1,571 |
| Commitments | **-** | 15,000 |
| Total | **1,625,966** | 1,611,512 |
| Total credit risk exposure | **6,265,045** | 6,062,281 |

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 2011 is **19%** (2010: 18%).

**Collateral and other credit enhancements**

The Bank employs a range of policies and practices to reduce credit risk. The Bank seeks collateral coverage, the 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; 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 software for rating its borrowers. Under the Moody's Risk rating framework, all borrowers are rated on a descending order of credit quality. The Moody's Risk rating system analyses the financial data of the borrowers and assigns an appropriate risk rating.

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

During the year, the Bank introduced the concept of Facility Risk Rating (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 has also introduced NAICS Code for classification of Bank's exposure 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.

| **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** |

| 2010 | 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) | 249,227 | - | - | - | 249,227 |
| Treasury bills and bonds | 521,463 | - | - | - | 521,463 |
| Central Bank of Kuwait bonds | 310,055 | - | - | - | 310,055 |
| Deposits with banks and other financial institutions | 111,210 | - | - | - | 111,210 |
| Loans and advances to banks | 21,780 | - | - | - | 21,780 |
| Loans and advances to customers: | | | | | |
| - Corporate lending | 613,406 | 1,080,877 | 277,089 | 190,345 | 2,161,717 |
| - Consumer lending | 569,491 | - | - | 46,417 | 615,908 |
| Effective interest rate adjustment | (5,630) | - | - | (510) | (6,140) |
| Debt investment available-for-sale (Note 13) | - | - | - | - | - |
| Other assets | 55,657 | - | - | - | 55,657 |
| | 2,446,659 | 1,080,877 | 277,089 | 236,252 | 4,040,877 |

**98%** (2010: 98%) of the past due but not impaired category is below 60 days and **2%** (2010: 2%) is between 60-90 days.

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

**Financial assets by class individually impaired**

| **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** | **-** |
| **Effective interest rate adjustment** | **-** | **-** | **-** |
| | **514,574** | **77,415** | **371,372** |

| 2010 | Gross exposure KD 000's | Impairment provision KD 000's | Fair value of collateral KD 000's |
|---|---|---|---|
| Loans and advances to customers: | | | |
| - Corporate lending | 619,562 | 158,084 | 388,367 |
| - Consumer lending | 22,305 | 15,899 | - |
| Effective interest rate adjustment | (17) | - | - |
| | 641,850 | 173,983 | 388,367 |

**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 reflects the effect of 25 basis points change in interest rates on the income statement, with all other variables held constant:

| Currency | Movement in Basis points | **2011** **KD 000's** | 2010 KD 000's |
|---|---|---|---|
| **KWD** | 25 | **3,324** | 3,097 |
| **USD** | 25 | **(109)** | (330) |

Majority of the Bank's investments are held in well diversified portfolio of equity and hedge funds which invest in a variety of securities and products whose performance cannot necessarily be measured in relation to movement in any interest rates quoted around the world.

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:

| | **2011** | | | 2010 | | |
|---|---|---|---|---|---|---|
| **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** | **(2,402)** | **2,364** | +5 | (9,662) | 3,353 |
| **EURO** | **+5** | **(16)** | **15** | +5 | (254) | 262 |

Majority of the 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

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

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.

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 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 and equity | | | | | | | |
| 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 |
| Equity | - | - | - | - | - | 430,259 | 430,259 |
| Total liabilities | 1,968,211 | 1,033,641 | 527,030 | 699,606 | 85,214 | 472,193 | 4,785,895 |

**At 31 December 2010**

| 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 | 280,193 | - | - | - | - | - | 280,193 |
| Treasury bills and bonds | 129,208 | 82,648 | 106,371 | 176,013 | 27,223 | - | 521,463 |
| Central Bank of Kuwait bonds | 165,762 | 99,357 | 44,936 | - | - | - | 310,055 |
| Deposits with banks and other financial institutions | - | 111,210 | - | - | - | - | 111,210 |
| Loans and advances to banks | 3,908 | 1,753 | 274 | 15,845 | - | - | 21,780 |
| Loans and advances to customers | 400,918 | 479,547 | 132,169 | 547,466 | 523,203 | 1,098,074 | 3,181,377 |
| Investments available-for-sale | - | - | - | - | - | 92,218 | 92,218 |
| Other assets | 55,657 | - | - | - | - | - | 55,657 |
| Premises and equipment | - | - | - | - | - | 25,824 | 25,824 |
| Total assets | 1,035,646 | 774,515 | 283,750 | 739,324 | 550,426 | 1,216,116 | 4,599,777 |
| Liabilities and equity | | | | | | | |
| Due to banks | 47,679 | 19,642 | - | - | - | - | 67,321 |
| Deposits from financial institutions | 238,468 | 165,461 | 107,038 | 375,610 | - | - | 886,577 |
| Customer deposits | 1,427,232 | 1,031,137 | 463,326 | 146,132 | 3,039 | - | 3,070,866 |
| Subordinated loans | - | - | - | - | - | 84,180 | 84,180 |
| Other liabilities | 67,261 | 6,544 | 2,912 | 3,079 | 322 | - | 80,118 |
| Equity | - | - | - | - | - | 410,715 | 410,715 |
| Total liabilities | 1,780,640 | 1,222,784 | 573,276 | 524,821 | 3,361 | 494,895 | 4,599,777 |

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.

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

**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** |

At 31 December 2010

| | 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 | 47,693 | 19,674 | - | - | - | 67,367 |
| Deposits from financial institutions | 238,576 | 166,041 | 488,968 | - | - | 893,585 |
| Customer deposits | 1,427,797 | 1,034,686 | 615,668 | 3,114 | - | 3,081,265 |
| Subordinated loans | - | 393 | 1,575 | 48,793 | 42,827 | 93,588 |
| Other liabilities | 67,261 | 6,544 | 5,991 | 322 | - | 80,118 |
| Total undiscounted liabilities | 1,781,327 | 1,227,338 | 1,112,202 | 52,229 | 42,827 | 4,215,923 |

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

**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** |
| **Capital commitment** | **-** | **-** | **-** | **-** | **-** | **-** |
| **Commitments** | **-** | **-** | **-** | **-** | **-** | **-** |
| | **42,626** | **429** | **30,932** | **1,154,932** | **11,262** | **1,240,181** |

At 31 December 2010

| | 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 | 146,769 | 245,867 | 401,047 | 359,534 | 27,487 | 1,180,704 |
| Capital commitment | - | - | - | 1,571 | - | 1,571 |
| Commitments | - | - | - | 15,000 | - | 15,000 |
| | 146,769 | 245,867 | 401,047 | 376,105 | 27,487 | 1,197,275 |

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 2011:** | | | | | |
| **Gross settled derivatives** | **17,236** | **53,759** | **5,462** | **-** | **76,457** |
| At 31 December 2010: | | | | | |
| Gross settled derivatives | 13,979 | - | - | - | 13,979 |

24. FINANCIAL INSTRUMENTS *(continued)*

## 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 equity and hedge funds which invest in a variety of securities whose performance cannot necessarily be measured in relation to movement in any specific equity index.

## 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 interest 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 are 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:

| | **2011 KD 000’s** | 2010 KD 000’s |
|---|---|---|
| Guarantees | **973,591** | 969,495 |
| Letters of credit | **266,590** | 211,209 |
| Capital commitments | **-** | 1,571 |
| Irrevocable commitments to extend credit: | | |
| Original term to maturity of more than one year | **-** | 15,000 |
| | **1,240,181** | 1,197,275 |

As at the reporting date the Bank had undrawn commitments to extend overdraft facilities to customers amounting to **KD 115,499 thousand** (2010: KD 82,376 thousand). The contractual terms entitle the Bank to withdraw these facilities at any time.

## 27. SEGMENTAL ANALYSIS

### By Business Unit

| | |
|---|---|
| Commercial Banking | Acceptance of deposits from individuals, corporates' 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 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. |

### a. By Business Unit

**Segmental information for the year ended 31 December**

| | Commercial Banking | | Treasury & Investments | | Total | |
|---|---|---|---|---|---|---|
| | **2011 KD 000's** | 2010 KD 000's | **2011 KD 000's** | 2010 KD 000's | **2011 KD 000's** | 2010 KD 000's |
| Operating income | **124,146** | 116,601 | **12,416** | 38,420 | **136,562** | 155,021 |
| Segment result | **74,416** | (20,793) | **9,567** | 35,652 | **83,983** | 14,859 |
| Unallocated income | | | | | **14,957** | 25,639 |
| Unallocated expense | | | | | **(68,320)** | (21,439) |
| **Profit for the year** | | | | | **30,620** | 19,059 |
| Segment assets | **3,382,537** | 3,239,596 | **1,329,921** | 1,291,935 | **4,712,458** | 4,531,531 |
| Unallocated assets | | | | | **73,437** | 68,246 |
| **Total Assets** | | | | | **4,785,895** | 4,599,777 |
| Segment liabilities | **2,775,530** | 2,641,579 | **1,464,671** | 1,434,178 | **4,240,201** | 4,075,757 |
| Unallocated liabilities | | | | | **545,694** | 524,020 |
| **Total Liabilities and Equity** | | | | | **4,785,895** | 4,599,777 |

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

No revenue from transactions with a single external customer or counter party resulted to 10% or more of the Bank's total revenue in 2011 or 2010.

## 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 following table 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 update.

28. DERIVATIVES *(continued)*

**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** | **-** | **(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** |

At 31 December 2010: 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 | - | - | 13,979 | 13,979 | - | - |
| Credit default swaps | - | (14,473) | 380,650 | 8,418 | 65,941 | 306,291 |
| Structured products (Note 14) | 10,688 | - | 11,224 | - | - | 11,224 |
| | 10,688 | (14,473) | 405,853 | 22,397 | 65,941 | 317,515 |

### 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, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency. For currency swaps, fixed or floating interest payments 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.