Investment Bank

Bahrain Middle East Bank (B.S.C)

TRANSCENDING BOUNDARIES ...

ANNUAL REPORT 2012

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Who are we?

Established in 1982

A Conventional Wholesale Bank Licensee. Regulated by the Central Bank of Bahrain

As permitted by its license, sphere of service offer:

Portfolio and Asset Management

Treasury and capital markets

Trade finance

Private equity fund investments

Financial advisory and structured products

A new five year plan was implemented in 2009 as a result of which the Bank enters 2012 well placed to further develop its business activities.

Our operations are backed by a sound network of relationships amongst Top Tier Financial Institutions, Investment Banks and Private Equity Fund Managers - globally

Mission

"To create added and sustainable value for all"

Vision

"Value added partnership"

Chairman's Report

27 February 2013

On behalf of the Board of Directors, it gives me great pleasure to place before you the Board of Director's Report on the Bank's performance for the financial year ending 31 December 2012, and provide an overview of highlights during the period.

The year 2012 can be characterized as a year that witnessed a high level of market volatility caused by uncertainties in respect to US economic conditions and an alarming EU debt crisis. Despite these challenges, and several other constraints distinct to BMB, 2012 proved to be yet another year of 'delivery as promised' for your institution having scaled its business activities based on the same framework of initiatives that has proven its success and viability since initiated as part of the Bank's new strategy.

The achievement was reflective of, and the end result of, relentless pursuit par excellence on part of its Management and, provided further evidences to the depth, diversity and relative resilience of its new model which clearly has demonstrated its inherent strength to deliver an extra-ordinary performance even amidst the most difficult and unfavorable market conditions.

The profound and continuing shift in the quality of earnings is noteworthy with core business activities having accounted for over three quarters of total operational income with its 'previous' sole contributor private equity now marginalized.

In a nutshell, 2012 will be best remembered as a year in which several key milestones were achieved of preserving, protecting and creating sustainable value for all stakeholders:

A year that marked the 'third successive year' of net positive financial contribution post restructuring despite the many challenges and constraints unique to the Bank.

A year that witnessed the Bank's Credit Rating Outlook be revised to 'Positive' thus putting it at its "highest ever" in its operating history. The Outlook revision was reflective of, and encompassed, the success of all post restructuring initiatives undertaken pursuant to the new management take-over in 2009, which included, the fundamental shift in the quality of earnings, the depth, diversity and scope of its new model with increasing contribution from more stable and recurring sources of income, substantial reduction in operating costs and recurring savings accruing thereon and other qualitative improvements effected across all aspects of business operations. Here, it is worthy to note, that the Outlook revision of your institution comes in a time where Ratings across Sovereign and other Institutions - be financial or otherwise - globally are increasingly under pressure reflecting the unfavorable economic environment that continues to prevail with any Positive Rating actions a rare occurrence.

A year that saw cumulative net distributions to co-investors across various financial instrument holdings reach a staggering US$ 20.7 million since restructuring. Despite a difficult market environment, amount distributed to co-investors for 2012 amounted to US$ 5.4 million.

A year that witnessed creditors obligations originating from the pre-2008 period honored and repaid reach an aggregate US$ 41.0 million. Repayments made in 2012 alone amounted to US$ 15.0 million. It is worthy to note that these repayments have all been honored without resorting to any external channels of funding. The repayments in effect brings total outstanding financial obligations of your institution, including commitments, to a very comfortable and 'all time low' US$ 17.5 million as at 31 December 2012 from having had US$ 126.7 million at the time of restructuring.

Moving on to the qualitative front, the year also witnessed the Bank set a new bar in terms of excellence and performance with tangible improvements effected across further strengthening internal controls, cost efficiencies and overall risk management reflecting its continued drive for perfection and setting exemplary standards of best practices.

Looking at 2013 and beyond, with prior period debt now substantially repaid and drawing to a close, subject to necessary resources permitting, the Bank remains well geared for focused business development and to increase the scale of core business activities within the already proven framework. This brings about a great degree of confidence of the opportunities that lies ahead to create serious and sustainable value for shareholders.

On behalf of the Board, I take this opportunity to congratulate the Management for this remarkable achievement and all round accomplishment during the most challenging and unfavorable operating environment. With the first phase of the Bank's five year strategic plan now successfully concluded, we look to the future with an increasing level of confidence and optimism"

Wilson Benjamin
Chairman of the Board of Directors

Board of Directors and Committees

Board of Directors

Mr. Wilson S. Benjamin	Chairman
Sheikh Abdullah Ali K. Al Sabah	Vice Chairman
Mr. Ebrahim A.S. Bu Hendi	Director
Dr. Awadh Kh. Al-Enezi	Director
Mr. Karunaker Nampalli	Director
Mr. Akbar A. Habib	Director

Executive Committee ("The EXCO")

Sheikh Abdullah Ali K. Al Sabah	Chairman
Mr. Wilson S. Benjamin	Vice Chairman
Mr. Akbar A. Habib	Member

Audit Committee & Corporate Governance Committee

Mr. Ebrahim A. S. Bu Hendi	Chairman
Dr. Awadh Kh. Al-Enezi	Vice-Chairman
Mr. Karunaker Nampalli	Member

Nomination & Remuneration Committee

Dr. Awadh Kh. Al-Enezi	Chairman
Mr. Ebrahim A. S. Bu Hendi	Vice-Chairman
Sheikh Abdulla Ali K. Al Sabah	Member

Profile

Mr. Wilson S. Benjamin

Chairman, Board of Directors – Executive Member
Vice Chairman, Executive Committee

Prior to his election as Chairman of the Board of BMB in March 2006, Mr. Benjamin was the Vice Chairman of the Bank. Since 1992, he has been the President and Chief Executive Officer of Al-Fawares Holding Company, where he is responsible for AlFawares investments and participation in the management of certain of its portfolio companies. Mr. Benjamin is also the Chairman of the Board of Directors and Chief Executive Officer of ATO Ram 2 Ltd., where he is responsible for managing ATO's operations and its investments in public and private companies in the United States, Europe and the Gulf Cooperation Council. Mr. Benjamin received a B.Sc. in Business Administration from Al-Hikma University in Baghdad, Iraq.

Sheikh Abdullah Ali K. Al Sabah

Vice Chairman, Board of Directors – Executive Member
Chairman, Executive Committee
Member, Nomination & Remuneration Committee

Prior to his election as Vice Chairman in March 2006, Sheikh Abdullah was a member of the Board of Directors. Sheikh Abdullah is the Chairman & Managing Director of Al Fawares Holding for Financial Investments, a subsidiary of Al Fawares Holding Company, where he is responsible for Al Fawares investments in Egypt and Africa; Executive Vice President, Al Fawares Holding Company; General Manager of Universal Media in Kuwait. He also serves on the Boards of many other companies in Kuwait, Egypt and the U.S. He has a Master's in Finance from George Washington University

Mr. Ebrahim A. S. Bu Hendi

Director, Board of Directors – Independent Member
Chairman, Audit Committee & Corporate Governance Committee
Vice Chairman, Nomination & Remuneration Committee

Over thirty years of banking/treasury experience gained through working with Citibank, Chase Manhattan, Paribas and National Commercial Bank, Saudi Arabia. The last ten years were at Bank of Bahrain & Kuwait as AGM – Treasury, Investment and overseas branches. He is a Board Member and Chairman of the Audit Committee of Bahrain Commercial Facilities Company since March 2007. Mr. Bu Hendi has an MBA from Sheffield Hallam University, U.K.

Dr. Awadh Kh. Al-Enezi

Director, Board of Directors – Independent Member
Vice Chairman, Audit Committee & Corporate Governance Committee
Chairman, Nomination & Remuneration Committee

A PhD graduate of Bath University, U.K. in 1991 and the University of New York in 1993. Dr. Al-Enezi is a lecturer at the University of Kuwait and is Cultural Attaché at the Embassy of the State of Kuwait in Cairo. A recipient of numerous awards, he has published several papers dealing with the socio-economic culture in Kuwait. He is an active board member of several institutions.

Mr. Karunaker Nampalli

Director, Board of Directors – Executive Member
Member of the Audit Committee & Corporate Governance Committee

Thirty-three years of banking experience in India and the GCC, in operations, trade finance, project finance, corporate banking, credit and client relationship management, including most recent positions at Burgan Bank and Kuwait International Bank in Kuwait. During his career he has been active in staff training, both in terms of preparing manuals and reference materials for training, as well as conducting seminars. Mr. Nampalli is a graduate of Osmania University and holds a Post Graduate Diploma of Export-Import Management from Bharatiya Vidya Bhavan, Delhi. He is also a Certified Associate of the Indian Institute of Bankers. Mr. Nampalli serves at Al Fawares Holding Company as Finance Controller since April 2006.

Mr. Akbar A. Habib

Chief Executive Officer – Executive Member
Director, Board of Directors
Member, Executive Committee

Mr. Habib joined BMB in 2009. He has over decades of experience in managing and leading business interest across banking and financial services with a proven track record in turnaround situations and building value. He was previously the Group Chief Executive Officer of Oman National Investment Corporation (ONIC) Holding where he is credited with the highly successful restructuring and repositioning of the group. Mr. Habib has also previously worked with the Central Bank of Oman, the Civil Services Pension Fund, Oman International Bank and has served as board member across numerous institutions in the GCC.

Management Team Profile

Muzzamal Zulfiqar Malik

Head of Business Development

- BA in Economics from Fordham University and an MBA from Columbia University
- Joined BMB in March 2010.
- A highly qualified finance and banking professional with an exceptional record of engineering major financial projects, key business expansion drives and strategizing turnkey global financial solutions in Retail, Commercial and Investment Banking fields.
- Throughout his career so far, he has gained extensive experience in core credit analysis, setting up bank branch operations, devising and implementing strategic plans, structuring trade finance transactions and client relationship management.

Mohammed Al Shaikh

Head of Human Resources

Joined BMB in 1983

- Over 35 years' experience in human resources, administration training and development of staff
- Extensive training in HR and Banking through courses in the UK and Bahrain
- Prior to BMB, served at ALBA in the HR Department

Philip Morley

Head of Information Technology

Microsoft Certified Professional (MCP), IT Infrastructure Library (ITIL-V3), Diploma in Computer Applications (DCA), Certified Financial Technician (CFTe), B.Sc - Physics

- Joined BMB in 1998
- Over 15 years of experience in the IT Industry with in-depth knowledge of application systems, software development, project management and IT Infrastructure expertise.
- Prior to BMB, served as a consultant handling projects for various multi-national organizations in India

Thaer Ali Rabea

Head of Compliance & MLRO

Holding Master Degree (MBA) from Glamorgan University, United Kingdom, Certified Compliance Officer from American Academy of Financial Management USA and BA Advance Accounting Auditing from Ponna University, India.

- Joined BMB in August 2008
- Over twenty two years banking experience in the areas of internal audit, operations, back office, accounting and credit.
- Prior to BMB, was Head of Compliance at CrediMax. Also served at Shamil Bank and HSBC Bahrain

Management Team Profile

Raza Shah Kakakhail

Head of Operations

Holder of Masters Degree in Public Administration (Major Finance)

Joined BMB in June 2010

- Over 14 years' experience across Commercial and Investment Banking.
- Capabilities across Banking Operations, Treasury Back Office, Trade Finance, Corporate Finance & Client Relationship Management
- Prior to BMB, was Country Head Bank Al-Falah Afghanistan and in MCB Pakistan in various management capacities

Abbas Falah

Senior Manager, Finance

- Holding Master Degree (MBA), Certified Islamic Public Accountant (CIPA), Certified Sharia Advisor and Auditor (CSAA), B.Sc in A ccounting.
- Joined BMB in October 2009.
- Ten years of experience in conventional banking and Islamic banking
- Currently serves in Financial Control Department and is a member of the Executive Management Committee.
- Prior to BMB, served at Seera Bank, TAIB Bank, Central Bank of Bahrain, and ABC Bank Experience in setting-up several banks in Bahrain

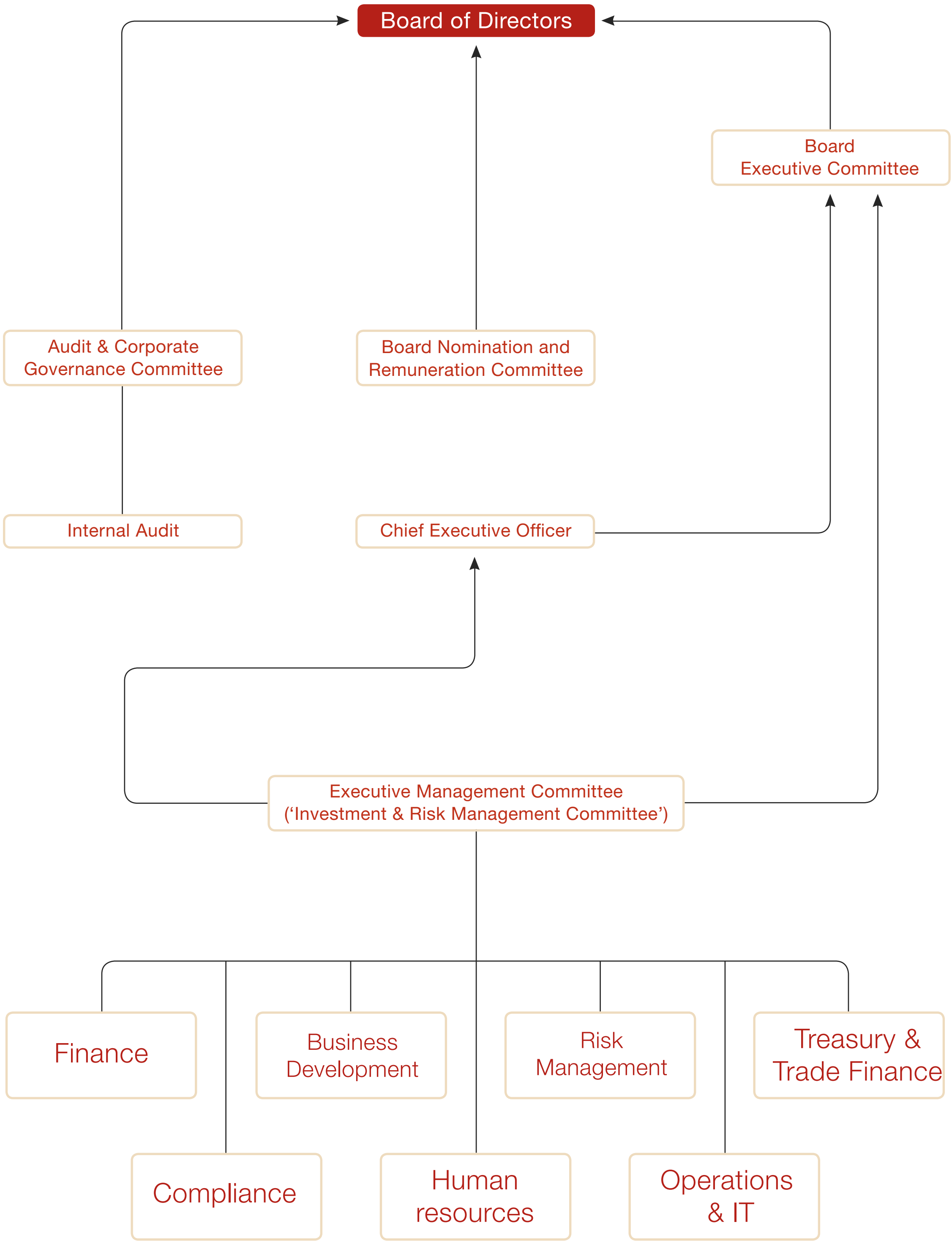
Khalil Hassan

Senior Manager Treasury and Trade Finance

Studied in Anniesland College Glasgow, UK, Qualified in Capital Markets & Portfolio Management from Bahrain Institute of Banking and Finance

- Joined BMB in March 2010
- A seasoned Banking professional with over 23 years' experience across Treasury and Trade Finance.
- Prior to BMB, served at several major International Banks such as Chemical Bank, Manufacturers Hanover Trust, Chase Manhattan Bank, Future Bank, Bahrain Saudi Bank, Habib Bank and Nomura Investment Bank

Organizational Structure



Corporate Governance Report

The Bank's Corporate Governance Framework

Introduction

BMB operates under a written corporate governance framework drawn from the Corporate Governance Code of the land. This framework explicitly states the goals, roles and responsibilities for its Board of Directors, management and staff, and includes well defined reporting lines and structures. At the department level, the Bank employs detailed policies and procedures, segregation of duties and dual controls to be in agreement with the Code.

The Framework

Includes:

1. A disclosure Policy;
2. Code of Conduct policy for Directors;
3. Code of Ethics for Management and employees;
4. Insider Trading policy;
5. The New Corporate Governance Code.

The Board of Directors

• Responsibilities:

The Board is ultimately responsible for the governance and performance of the Bank. The Board discharges that responsibility by;

- setting the strategic direction of the Bank including the identification, acceptance, monitoring and management of risks,
- establishing a robust corporate governance system, which includes risk limits, internal controls, policies and procedures and a system to foster compliance with applicable laws and as well as professional standards and ethics by itself and Bank staff and monitoring the same for implementation,
- reviewing its own and the Bank management's performance and
- preparation and reporting of the Bank's financial results in a fair and transparent manner In order to carry-out its duties on a day to day basis, the Board has delegated credit authority to the Chief Executive Officer based on a risk rating matrix. When considering transactions, any exposure to an entity that exceeds the CEO's limit will require the approval of the Board of Directors.

• Structure and composition

In accordance with the Bank's Articles of Association, the Board is elected by the Bank's Shareholders. The current composition of the Board is six Directors, one-third of them are Independent Directors. The CEO serves on the Board as an Executive Director. Collectively, the Board possesses knowledge, experience and skills appropriate for the Bank.

The Board considers that there is an appropriate balance of Executive and Independent Directors on the Board and that the current Board composition is appropriate.

The roles and responsibilities of the Chairman and the CEO are separate from one another and are each held by an experienced Director.

The Chairman's main responsibilities include:

- To lead the Board and ensure the effective engagement and contribution of all Directors, so that the Board may fully discharge its legal and regulatory responsibilities;
- To ensure effective communication with shareholders and ensure that the Board members understand the views of the major shareholders;
- To oversee the annual performance evaluation of the Board and individual Directors;
- To develop a constructive relationship with the CEO and to manage his performance.

The day-to-day management of the Bank has been delegated by the Board to the CEO. The CEO is responsible to control and monitor the Bank's business on a day-to-day basis, recommending strategy to the Board, leading senior management and implementing the Board's strategic and operational decisions.

Directors take the time to meet independently, members of the Management at the Bank. Independent Directors have the flexibility to meet prior or post the Board Meetings, to review issues without the presence of the other Board Members.

• Induction and professional development

Induction programs are tailored for all newly appointed Directors. The program comprises a comprehensive Directors' Handbook, meetings with other Directors and senior management, as well as comprehensive guidance on the duties and responsibilities of Directors, the Bank's policies and procedures and relevant legal and Regulatory requirements

Meetings

The Board of Directors met as per the constitution of each Committee and in line with the Articles of the Bank and the Corporate Governance Code. They also received information between meetings in respect of activities of the management committee and developments in the Bank's business.

Below given table details the attendance of Directors at meetings of the Board and its Committees in 2012.

Directors attendance - 2012

Board Member	BOD	EXCO	A & CG	N & RC
Mr. Wilson Benjamin	3	3	-	-
Sh. Abdullah A. Al Sabah	4	4	-	2
Mr. Ebrahim A Bu Hendi	4	-	4	2
Dr. Awadh Kh. Al-Enezi	4	-	4	2
Mr. Karunaker Nampalli	4	-	4	-
Mr. Akbar A. Habib	4	4	-	-

The performance evaluation of the Board, its Committees and Directors was undertaken at year-end. The conclusions were declared at the Shareholder meeting held on 28th March, 2013.

Management and staff performance appraisals

The appraisal of the management and staff is also undertaken annually through a Balanced Scorecard approach, whereby every staff member is assessed for both their quantitative and qualitative contributions to the organization. The balanced scorecard provides a list of measures that balance the organizations internal and process measures with results, achievements and financial measures.

Appointment & Re-election

Our current Board of Directors were re-elected/elected at the Shareholders Assembly on 30th March, 2011 for a three year period. Their candidature was reviewed and approved by the Board of Directors for recommendation to Shareholders. Pursuant to Shareholder approval, their appointments were endorsed by Central Bank of Bahrain

The Board Committees:

The Board has established four committees to ensure that it carries out its functions and provides effective supervision and leadership:

1.Executive Committee
2. Audit Committee
3. Corporate Governance Committee
4. The Nomination & Remuneration Committee

The functions of Audit and Corporate Governance Committee have been combined pursuant to the Central Bank of Bahrain approval.

The roles and delegated authorities of these Committees are set out in their charters, copies of which are available at www.bmb.com.bh

Executive Committee ("EXCO")

Members:

Sh. Abdullah A Al Sabah (Chairman)
Mr. Wilson Benjamin (Vice Chairman)
Mr. Akbar A. Habib

The primary responsibilities and functions of EXCO are:

- Act on behalf of the board when practicality and expediency dictates.
- Act in limited circumstances, on emergency matters that require immediate approval or other actions of the board.
- Ensure continuity in the management of the business and affairs of the bank.
- Discuss at greater lengths various macro management aspects of bank, including investments, credit, risk and capital adequacy aspects of the bank.
- Provide an avenue where specific issues may be explored in greater depth than may be possible during the board meetings.
- Act as an advisor to the board on various matters.

Audit Committee

Members:

Mr. Ebrahim A. Bu Hendi (Chairman)
Dr. Awad Kh. Al Enezi (Vice Chairman)
Mr. Karunakar Nampalli (Member)

The primary responsibilities and functions of the Audit Committee are to provide assistance to the Board to fulfill its duties to ensure and oversee:

- The integrity of the Bank's financial statements;
- The suitability, independence and performance of the Bank's auditors (internal and external), as well as remuneration of the Bank's external auditors;
- Internal controls, including controls over financial reporting and disclosure;
- Compliance with legal and regulatory requirements.

Generally, the role of the Audit Committee is advisory in nature, with recommendations reported to the Board for final approval. However, in certain limited circumstances decisions may be taken by the Audit Committee, which are binding on the Board; for example, approving the terms of engagement of the external auditor. The Audit Committee holds a minimum of four meetings per year and provides regular reports to the Board

Corporate Governance Committee

Members:

Mr. Ebrahim A. Bu Hendi (Chairman)
Dr. Awad Kh. Al Enezi (Vice Chairman)
Mr. Karunakar Nampalli (Member)

The primary responsibilities and functions of the Corporate Governance Committee are:

- To ensure the compliance with regulatory requirements relating to corporate governance;
- Report on corporate governance matters to the Bank's constituents; in particular reference to the Regulator and shareholders;

The role of this Committee is advisory in nature. Recommendations are made to the Board, if any, for final approval.

Nomination & Remuneration Committee

Members:

Dr. Awadh Kh. Al-Enezi (Chairman)
Mr. Ebrahim A. S. Bu Hendi (Vice Chairman)
Sheikh Abdullah Ali Al Sabah (Member)

The Nomination, Remuneration Committee responsibilities are:

- Identify persons qualified to become members of the board or senior managers of the bank (with the exception of the appointment of the internal auditor which is the responsibility of the Audit Committee), and make recommendations accordingly;
- Review the bank's remuneration policies for approved persons consistent with corporate values and strategy of the bank.
- Make recommendations regarding remuneration policies and amounts for approved persons to the board, taking account of total remuneration including salaries, fees, expenses and employee benefits;
- Recommend board member remuneration based on their attendance and performance;
- Oversee directors' corporate governance educational activities.

In determining the composition of the Board, the Nomination, & Remuneration Committee considers the knowledge, skills,and experience which are anticipated to be required by the Board. No Director participates in any decisions regarding his own appointment or remuneration. The Nomination & Remuneration Committee is authorized to take certain appointment and remuneration deci

sions which may bind the Board. In all other cases, recommendations are made to the Board for their final approval.

The Auditors

BMB Board in its meeting in 2010 approved the Internal Audit Outsourcing Policy. The Policy governs the Bank's approach when managing internal audit outsourcing risks. This policy is designed to comply with Central Bank of Bahrain regulatory requirements on outsourcing as well as Basel Committee on Bank Supervision (BCBS) recommendations on outsourcing.

In line with Central Bank of Bahrain regulations on information confidentiality, internal audit service providers shall maintain strict confidentiality of the Bank's information and records.

The Audit Committee shall on an annual basis evaluate the performance of the internal audit service provider against agreed performance benchmarks.

Auditors:	Internal Auditor	BDO
	External Auditor	KPMG

Audit Fees - 2012
Details available at corporate office

Audit arrangements
The external auditor is appointed annually with the consensus of the Shareholders of the Bank. The Board's Audit Committee and Articles of Association include measures to ensure the ongoing independence of the Bank's external auditor.

In compliance with the regulatory - Central Bank of Bahrain - guideline, which requires that the audit partner responsible for their audit does not undertake that function more than five years in succession unless otherwise exempted by the CBB, the BMB shareholders in its general meeting held in March 2012 voted for the re-appointment of KPMG as External auditor for another term of one year.

Related-party transactions
Details of all transactions where a Director and/or other related parties might have potential interests are provided to the Board for its review and approval, and the interested Directors neither participate in the discussions, nor do they vote on such matters. For details of the Bank's related party transactions, please see (Note 25) of the audited financial statements.

Conflict of interest

The Board maintains awareness of the other commitments of its Directors and senior management. BMB implemented a Directors' Conflict of Interest Policy which is part of the Code of Conduct - which can be found on the Bank's website at www.bmb.com.bh. As at 31 December 2012, the Board was satisfied that other commitments of the Directors and senior management do not conflict with their duties.

Internal Control
The Board is committed to managing risk and ensuring that effective measures are in place to safeguard the Bank's assets, ensure proper accounting records and reliable financial information by procedures designed to avoid or reduce risks and ensure compliance with applicable laws and regulations. The Bank is subject to three main sources of regulation and supervision:

1. The Central Bank of Bahrain
2. Bahrain Company Laws, including the Federal Law No.8 of 1984 Concerning Commercial Companies.
3. As a listed company, the Bank is subject to the rules and regulations enforced by the Bahrain Bourse

Several parties play important roles in corporate governance and controls at BMB: the Bank's Compliance Officer, Money Laundering Reporting Officer, its internal auditors, external auditors and the Risk Management Department.

While the Audit Committee oversees and reviews the Bank's compliance policies and their implementation, the Bank's compliance officer, acts as the focal point and is responsible for implementing, monitoring and ensuring compliance with regulatory and statutory requirements. Compliance with anti-money laundering procedures and internal training in such procedures is also monitored and implemented by the Bank's compliance officer.

The Bank's Compliance Officer also serves as its Money Laundering Reporting Officer ("MLRO") for financial crimes regulatory purposes. Additionally, the Compliance Officer also serves as the Disclosure Compliance Officer for the Central Bank of Bahrain and the Bahrain Bourse disclosure requirements.

The Bank's internal controls over financial reporting comprise processes designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles

The Bank's external auditors, KPMG, have unhindered access to the Audit Committee, Executive Committee, and the Board of Directors, with or without members of management being present to discuss their audit findings and any other matter which should be brought to the attention of the Board. The Bank's outsourced internal audit function periodically reviews policies and procedures for adequacy as well as compliance with applicable regulations and laws and assesses the implementation thereof using a risk based approach. The Internal auditor reports directly to the Audit Committee of the Board of Directors, who approves the yearly internal audit plan, and all other review reports independent of the Bank's management.

Communication with shareholders

In addition to the Bank's extensive disclosure through its annual report and website, the Chairman and the Bank's strategic relations department are in regular dialogue with the majority shareholders and ensure that the Board understands their views.

Dividend policy

In determining the Bank's dividend payout for a particular year, the Board of Directors considers a variety of factors including the Bank's outlook for earnings growth, liquidity requirements, cash flow from operations, debt covenants, acquisition and business expansion strategy, debt position, and capital adequacy rules.

Performance linked incentive structure

In 2012, the Bank did not have a stock-option plan for Staff Members nor any out of the ordinary performance linked incentive.

Aggregate Remuneration to Board of Directors and senior management and Board

The aggregate remuneration to the Board of Directors and senior management can be found in Note 25 to the Audited Financial Statements for the financial year ending 31 December 2012. Further details available at the corporate office.

Investor relations

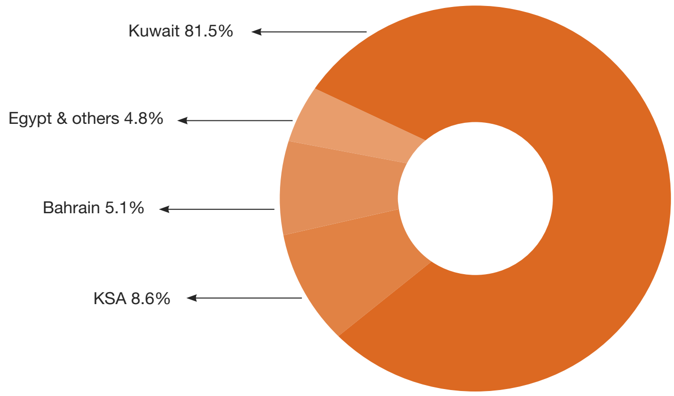
The Bank's Investor Relations Department undertakes:

- Maintenance of relationships with all investors
- Material disclosures to investors and key Bank stakeholders

The Bank's 'top five' major share-holders 31 December 2012

Name	Number of shares	%
Al Fawares Holding Co. (Kuwait)	161,906,308	66.9
Massaleh Investment Co. (Kuwait)	19,600,005	8.1
Mohammed Al Ohali (Saudi Arabia)	19,425 ,691	8.0
Commercial International Bank (Egypt)	11,760,000	4.9
Security Group Company (Kuwait)	11,760,000	4.9

Distribution of 'total shares' by nationality



Neither the Government of the Kingdom of Bahrain nor the management of the Bank hold any shares of the Bank. Two Directors on record hold direct shareholding in the Bank - Sh. Adullah Al Sabah and Dr. Awadh Kh. Al Enezi

Insider Trading

No trading of the Bank's shares was undertaken by its Directors' or Senior management during the financial year 2012.

The Corporate Governance Code and “Status of Compliance”

Background

In accordance with the regulatory requirements of High Level Controls Module issued in October 2010 and to the Public Disclosure Module, which contains the Corporate Governance requirements as issued by the Ministry of Industry and Commerce in 2010, the Bank’s Board and its Management have endeavored to undertake compliance to each of the components of this Code. The Auditors of the Bank – KPMG – have also reviewed the adherence of the Bank to the Code. The Bank is in compliance to requirements of the Code as at 31st December, 2012 with the following exceptions, which are duly explained hitherto.

Rule-book Reference	Stipulation	Status and Explanation
The Board		
HC-1.4.6 **(Guideline only)**	The chairman of the board should be an independent director, so that there will be an appropriate balance of power and greater capacity of the board for independent decision making	Being a ‘controlled company’, Chairman is a representative of Parent
HC-1.4.8 **(Guideline only)**	The Chairman must not be an Executive Director	Being a ‘controlled company’, Chairman is a representative of Parent
Membership of Committees of Board		
HC-5.3.2 **&**	The remuneration committee should include only independent directors or, alternatively, only non-executive directors of whom majority are independent directors and the chairman is an independent director.	The Remuneration & Nomination Committee of the Board are combined.
HC-4.2.2	The nomination committee must include only independent directors or, alternatively, only non-executive directors of whom majority must be independent directors and the chairman must be an independent director.	The Nomination & Remuneration committee is composed of three members of whom ‘two’ are independent. The Chairman is an independent member. Due to the fact that the bank currently only has two independent board members, an executive director has been appointed to this Committee.
HC-1.8.2	The Corporate Governance Committee should comprise of at least three independent members.	The Corporate Governance Committee is composed of three members of who “two” are independent. The Chairman is an independent member. This Committee is merged with the Audit Committee of the Board.

The Bank has adopted the Corporate Governance Guidelines, has a full-fledged Corporate Governance Committee of the Board, as also all requisite Committees, their Charters and constitution, updated the various Policies, and all aspects as set out in the said Code. Details of the Compliance in accordance to the Corporate Governance Guidelines are available on the Bank’s website.

The Board of Directors’ Report on the summarized Evaluation of Performance of the Board, each of its Committees, the performance of each of its Directors and the Board of Directors’ Report on the Conflict of Interest for Financial Year 2012 was placed before the Shareholders at its Annual Assembly on March 28, 2013.

CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2012

Bahrain Middle East Bank (B.S.C)

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS

Bahrain Middle East Bank BSC

Kingdom of Bahrain

Report on the consolidated financial statements

27 February 2013

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

Responsibility of the board of directors for the consolidated financial statements

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

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated 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 consolidated 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 consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2012, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on other regulatory requirements

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 1), we report that the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; the financial information contained in the chairman's report is consistent with the consolidated financial statements; we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1, applicable provisions of Volume 6 and CBB directives), the CBB Capital Markets Regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association having occurred during the year that might have had a material adverse effect on the business of the Bank or on its financial position; and satisfactory explanations and information have been provided to us by the management in response to all our requests.

KPMG

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2012

(United States Dollars thousands)

Assets	**Note**	**2012**	2011
Cash and cash equivalents	6	2,318	8,697
Placement with financial institutions	7	4,000	5,200
Trading securities	8	437	2,035
Available-for-sale investments	9	21,544	27,813
Held-to-maturity investments	10	4,624	4,613
Loans and advances	11	20,956	20,513
Other assets	12	1,386	2,287
Total assets		**55,265**	71,158
Liabilities			
Deposit from financial institutions	13	6,000	6,000
Deposits from customers	14	5,089	8,752
Securities sold under repurchase agreements		-	3,325
Borrowings	15	11,389	19,389
Other liabilities	16	2,342	4,684
Total liabilities		**24,820**	42,150
Equity			
Share capital	17	60,501	60,501
Legal reserve		17,545	17,326
Accumulated losses		(49,045)	(51,014)
Fair value reserve		1,444	2,195
Total equity		**30,445**	29,008
Total liabilities and equity		**55,265**	71,158

These consolidated financial statements were approved by the Board of Directors on 27 February 2013 and signed on its behalf by:

Wilson S. Benjamin	**Sheikh Abdullah A.K Al Sabah**	**Akbar A. Habib**
Chairman	Vice Chairman	Chief Executive Officer and Member of the Board

Notes 1 to 32 form an integral part of these consolidated financial statements

CONSOLIDATED STATEMENT OF INCOME
FOR THE YEAR ENDED 31 DECEMBER 2012

(United States Dollars thousands)

	Note	2012	2011
Investment banking income	18	7,218	6,234
Foreign exchange translation gain		927	461
Interest income	19	1,624	1,402
Other income	20	390	3,974
Total income		**10,159**	12,071
General and administration expenses	21	(6,411)	(6,330)
Interest expense	22	(1,011)	(1,728)
Impairment loss on other assets		-	(292)
Total expenses		**(7,422)**	(8,350)
Profit before provisions		**2,737**	3,721
Provisions	23	(549)	-
Profit for the year		**2,188**	3,721
Basic and diluted earnings per share - US$ cents	17	**0.90**	1.54

These consolidated financial statements were approved by the Board of Directors on 27 February 2013 and signed on its behalf by:

Wilson S. Benjamin	**Sheikh Abdullah A.K Al Sabah**	**Akbar A. Habib**
Chairman	Vice Chairman	Chief Executive Officer and Member of the Board

Notes 1 to 32 form an integral part of these consolidated financial statements

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2012

(United States Dollars thousands)		
	2012	2011
Profit for the year	**2,188**	3,721
Other comprehensive income:		
Fair value reserve (available-for-sale investments):		
Net amount transferred to statement of income	(882)	(1,375)
Net change in fair value	131	(4,001)
Other comprehensive income for the year	**(751)**	(5,376)
Total comprehensive income for the year	**1,437**	(1,655)

Notes 1 to 32 form an integral part of these consolidated financial statements

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2012

(United States Dollars thousands)

2012	**Share capital**	**Legal reserve**	**Accumulated losses**	**Fair value reserve**	**Total equity**
Balance at 1 January	**60,501**	**17,326**	**(51,014)**	**2,195**	**29,008**
Total comprehensive income for the year:					
Profit for the year	-	-	2,188	-	2,188
Other comprehensive income:					
Fair value reserve (available-for-sale investments):	-	-	-	-	-
Net amount transferred to statement of income	-	-	-	(882)	(882)
Net change in fair value	-	-	-	131	131
Total other comprehensive income	-	-	-	(751)	(751)
Total comprehensive income for the year	-	-	2,188	(751)	1,437
Transfer to legal reserve	-	219	(219)	-	-
Balance as at 31 December	**60,501**	**17,545**	**(49,045)**	**1,444**	**30,445**

(United States Dollars thousands)

2011	**Share capital**	**Legal reserve**	**General reserve**	**Accumulated losses**	**Fair value reserve**	**Total equity**
Balance at 1 January	**54,955**	**16,954**	**7,521**	**(61,884)**	**7,571**	**25,117**
Total comprehensive income for the year:						
Profit for the year	-	-	-	3,721	-	3,721
Other comprehensive income:						
Fair value reserve (available-for-sale investments):	-	-	-	-	-	-
Net amount transferred to statement of income	-	-	-	-	(1,375)	(1,375)
Net change in fair value	-	-	-	-	(4,001)	(4,001)
Total other comprehensive income	-	-	-	-	(5,376)	(5,376)
Total comprehensive income for the year	-	-	-	3,721	(5,376)	(1,655)
Additional share capital introduced	5,546	-	-	-	-	5,546
Transfer to legal reserve	-	372	-	(372)	-	-
Transfer from general reserve	-	-	(7,521)	7,521	-	-
Balance as at 31 December	**60,501**	**17,326**	**-**	**(51,014)**	**2,195**	**29,008**

Notes 1 to 32 form an integral part of these consolidated financial statements

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2012

(United States Dollars thousands)	**2012**	2011
Cash flows from operating activities		
Profit for the year	2,188	3,721
Adjustments for:		
Foreign exchange movement	(11)	1
Excess provisions written back	-	(3,471)
Interest expense	1,011	1,728
Provisions	549	-
Depreciation	132	196
Impairment loss on other assets	-	292
Changes in operating assets and liabilities:		
Placement with financial institutions	1,200	5,106
Trading securities	1,598	3,759
Available-for-sale investments	5,181	(2,738)
Loans and advances	(655)	(8,380)
Other assets	813	(807)
Deposit from financial institutions	-	3,000
Deposits from customers	(3,663)	(8,497)
Securities sold under repurchase agreements	(3,325)	3,325
Other liabilities	(48)	(101)
Net cash from / (used in) operating activities	**4,970**	(2,866)
Cash flows from investing activities		
Purchase of equipment	(44)	(29)
Net cash used in investing activities	**(44)**	(29)
Cash flows from financing activities		
Repayment of borrowings	(8,000)	(1,000)
Interest paid	(3,305)	(1,838)
Proceeds from issue of share capital	-	5,546
Prior years' dividends claimed and paid	-	(39)
Net cash (used in)/ from financing activities	**(11,305)**	2,669
Net decrease in cash and cash equivalents	**(6,379)**	(226)
Cash and cash equivalents at the beginning of the period	8,697	8,923
Cash and cash equivalents as 31 December	**2,318**	8,697

Notes 1 to 32 form an integral part of these consolidated financial statements

1 REPORTNG ENTITY

a. Incorporation and principal activity

Bahrain Middle East Bank (B.S.C.) (the “Bank”, “BMB” or “BMB Investment Bank”) is a Bahraini Shareholding Company with limited liability and is incorporated in the Kingdom of Bahrain. The registered office of the Bank is: BMB Centre, Building 135, Road 1702, Block 317, Diplomatic Area, Manama, Kingdom of Bahrain.

On 9 April 2007 the Central Bank of Bahrain issued a Conventional Wholesale Banking license to BMB. The Bank is listed on the Bahrain Stock Exchange under BMEB.BH.

The Group comprises the Bank and its subsidiaries (Note 26).

The principal activities of the Group are asset management, private equity investments, equities and fixed income, corporate advisory and trade finance.

b. Regulation and supervision

BMB is regulated by the Central Bank of Bahrain (“CBB”).

The approval of and notification to CBB is required for major changes to strategy and /or corporate plan, changes to senior management, the establishment of new subsidiaries and branches and the appointment /election of members of the Board of Directors.

2 BASIS OF PREPARATION

a. Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) and the requirements of the Bahrain Commercial Companies Law 2001.

b. Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following items in the statements of financial position:

• available-for-sale financial assets measured at fair value

• trading securities measured at fair value

c. Functional and presentation currency

The consolidated financial statements are presented in US Dollars (“US$” or “USD”), which is the Banks functional currency. Except as others indicated, financial information presented in USD has been rounded to the nearest thousand.

d. New standards, amendments and interpretations that are effective on or after 1 January 2012

The following standard which became effective as of 1 January 2012 is relevant to the Group:

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

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

The adoption of this amendment had no significant impact on the consolidated financial statements.

2. Basis of preparation (continued)

e. New standards, amendments and interpretations issued but not yet effective

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning on or after 1 January 2013, and have not been applied in preparing these consolidated financial statements. Those which are relevant to the Group are set out below. The Group does not plan to early adopt these standards.

- IAS 1, 'Financial statement presentation'

The amendments to IAS 1 require that an entity present separately the items of other comprehensive income that would be reclassified to profit or loss in the future if certain conditions are met from those that would never be reclassified to profit or loss. The amendment is effective for annual periods beginning after 1 July 2012 with an option of early application.

The Group is not expecting a significant impact from the adoption of this amendment.

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

Disclosures - Offsetting Financial Assets and Financial Liabilities (amendments to IFRS 7) introduces disclosures about the impact of netting arrangements on an entity's financial position. The amendments are effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. Based on the new disclosure requirements the Group will have to provide information about what amounts have been offset in the statement of financial position and the nature and extent of rights of set off under master netting arrangements or similar arrangements.

- Offsetting Financial Assets and Financial Liabilities (amendments to IAS 32) clarify the offsetting criteria IAS 32 by explaining when an entity currently has a legally enforceable right to set off and when gross settlement is equivalent to net settlement. The amendments are effective for annual periods beginning on or after 1 January 2014 and interim periods within those annual periods. Earlier application is permitted.

The Group is not expecting a significant impact from the adoption of these amendments.

- IFRS 9 - Financial Instruments

IFRS 9 (2009) introduces new requirements for the classification and measurement of financial assets. IFRS 9 (2010) introduces additions to the standard relating to financial liabilities. The IASB currently has an active project to make limited amendments to the classification and measurement requirements of IFRS 9 and add new requirements to address the impairment of financial assets and hedge accounting.

The IFRS 9 (2009) requirements represent a significant change from the existing requirements in IAS 39 in respect of financial assets. The standard contains two primary measurement categories for financial assets: amortised cost and fair value. A financial asset would be measured at amortised cost if it is held within a business model whose objective is to hold assets in order to collect contractual cash flows, and the asset's contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. All other financial assets would be measured at fair value. The standard eliminates the existing IAS 39 categories of held to maturity, available-for-sale and loans and receivables.

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

The standard requires that derivatives embedded in contracts with a host that is a financial asset within the scope of the standard are not separated; instead the hybrid financial instrument is assessed in its entirety as to whether it should be measured at amortised cost or fair value.

2. Basis of preparation (continued)

e. New standards, amendments and interpretations issued but not yet effective (continued)

IFRS 9 (2010) introduces a new requirement in respect of financial liabilities designated under the fair value option to generally present fair value changes that are attributable to the liability's credit risk in other comprehensive income rather than in profit or loss. Apart from this change, IFRS 9 (2010) largely carries forward without substantive amendment the guidance on classification and measurement of financial liabilities from IAS 39.

IFRS 9 is effective for annual periods beginning on or after 1 January 2015 with early adoption permitted. The IASB decided to consider making limited amendments to IFRS 9 to address practice and other issues. The Group has commenced the process of evaluating the potential effect of this standard but is awaiting finalisation of the limited amendments before the evaluation can be completed.

Given the nature of the Group's operations, this standard is not expected to have a significant impact on the Group's financial statements.

- IFRS 10 - Consolidated financial statements and IAS 27 Separate Financial Statements (2011)

IFRS 10 introduces a single control model to determine whether an investee should be consolidated. As a result, the Group may need to change its consolidation conclusion in respect of its investees, which may lead to changes in the current accounting for these investees (see note 4(a)). The standard is effective for annual periods beginning on or after 1 January 2013.

The IASB published Investment Entities (Amendments to IFRS 10 and IFRS 12), which grants certain relief from consolidation to investment entities. It requires qualifying investment entities to account for investment in controlled investees on a fair value basis. The effective date is annual periods beginning on or after 1 January 2014, but early adoption is permitted to enable alignment with the adoption of IFRS 10.

- IFRS 12 - Disclosures of interests in other entities

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

The standard is effective for annual periods beginning on or after 1 January 2013. The Group is currently assessing the disclosure requirements for interests in subsidiaries and unconsolidated unstructured entities in comparison with existing disclosures.

- IFRS 13 - Fair value measurement

IFRS 13 provides a single source of guidance on how fair value is measured, and replaces the fair value measurement guidance that is currently dispersed throughout IFRS. Subject to limited exceptions, IFRS 13 is applied when fair value measurements or disclosures are required or permitted by other IFRSs. Although many of the IFRS 13 disclosure requirements regarding financial assets and financial liabilities are already required, the adoption of IFRS 13 will require the Group to provide additional disclosures. These include fair value hierarchy disclosures for non-financial assets/liabilities and disclosures on fair value measurements that are categorised in Level 3.

IFRS 13 is effective for annual periods beginning on or after 1 January 2013. The Group is currently reviewing its methodologies for determining fair values.

- Improvements to IFRSs (2011)

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

f. Early adoption of standards

The Group did not early adopt new or amended standards in 2012.

3 USE OF ESTIMATES AND JUDGEMENTS

The preparation of the consolidated financial statements in conformity with IFRS required management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which estimates are revised and in any future affected.

Management believes that the underlying assumptions are appropriate and that the Group's consolidated financial statements therefore fairly present the financial position and result as at 31 December 2012. Other than the basis of preparation as set out in note 2 above, the areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are set out below.

a. Valuation of unquoted equity fund investments held as available-for-sale investments

Unquoted equity fund investments held as available-for-sale investment are stated at their fair values, based upon the asset values of individual investments within the funds, as well as overall fund performance as set out in the fund managers' latest available reports, expected repayment of management fees, where applicable, and the future prospects for the underlying investments. Until receipt of the fund manager's next report, the Group makes adjustments to the fair value of unquoted equity fund investments based on fund manager's communication and historical experience, as well as distributions and capital calls occurring in the interim period.

b. Impairment of available-for-sale investments

The Group applies the principles and guidance provided by IAS 39 in making a determination if an available-for-sale investment is impaired. In addition to the general impairment tests provided by IAS 39, this standard includes two other general objective tests for impairment of equity instruments carried at fair value. The first are significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates and which indicate the cost of the investment in the equity instrument may not be recovered. The second is a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost. Such determinations require the application of significant judgement. In making the determination about a possible impairment, the Group evaluates many factors, including, where appropriate, the normal volatility in share price.

c. Classification of held-to-maturity investments

The Group follows the IAS 39 guidance on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. A key element in classifying such instruments as held-to-maturity is both the Group's intent and ability to hold such instruments to maturity. Making such a determination requires significant judgement about the Group's future financial condition and position. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to hold these investments to maturity other than for the specific circumstances – for example, selling an insignificant amount close to maturity - it will be required to reclassify the entire category as available-for-sale. In such a case, the investments would, therefore, be measured at fair value not amortised cost.

4 SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

a. Basis of consolidation

Subsidiaries are those enterprises (including special purpose entities) controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are consolidated from the date that control commences until the date that control ceases.

4 Significant accounting policies (continued)

a.Basis of consolidation (continued)

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective such as for the purposes of a specific investment transaction(s). An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the SPE's risks and rewards, the Group concludes that it controls the SPE. The assessment of whether the Group has control over an SPE is carried out at inception and normally no further reassessment of control is carried out in the absence of changes in the structure or terms of the SPE, or additional transactions between the Group and the SPE.

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions with subsidiaries are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

b. Foreign currencies

The assets and liabilities of foreign subsidiaries are translated into USD at the rates of exchange prevailing at the reporting date. The income and expenses of foreign subsidiaries are translated into USD at the rates of exchange prevailing on the dates of the transactions or at the average rate of exchange for the year.

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Income and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of income.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into the functional currency at the spot exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date that the fair value was determined. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on translation are recognised in the statement of income.

c. Financial Instruments

IAS 39 requires classification of financial assets into the following four categories:

- Held for trading;
- Loans and receivables;
- Held-to-maturity; and
- Available-for-sale.

The accounting policies for each category are as follows:

(i) Held for trading

The Group classifies a financial asset in this category if it was acquired principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin or is part of a portfolio for which there is evidence of a recent actual pattern of short-term profit or position taking. These financial assets are initially recognised at fair value and subsequently re-measured at fair value. All related realised and unrealised gains and losses are included in net gain from trading securities in the period in which they arise.

(ii) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell immediately or in the near term.

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

4 Significant accounting policies (continued)

c. Financial Instruments (continued)

(iii) Held-to-maturity

Fixed maturity investments having fixed or determinable payments and where the Group has both the positive intent and the ability to hold such investments to maturity are classified as held-to-maturity. Such investments are carried at amortised cost less provision for impairment in value - if any. Amortised cost is calculated using the effective interest rate method. Were the Group to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available-for-sale.

(iv) Available-for-sale

Available-for-sale investments are non-derivative investments that were designated as available-for-sale or are not classified as another category of financial assets. These mainly comprise unquoted funds and quoted equity securities. Available-for-sale investments are carried at fair value. They are subsequently measured at fair value with fair value changes recognised in other comprehensive income until the investment is sold or impaired, whereupon the cumulative gains and losses previously recognised in other comprehensive income are reclassified to statement of income as a reclassification adjustment.

Unquoted equity securities whose fair value cannot reliably be measured were carried at cost, less impairment.

Unquoted equity fund investments held as available-for-sale are stated at their fair values, based upon the asset values of individual investments within the funds, as well as overall fund performance provided by the fund manager's latest available report, expected repayment of management fees, where applicable, and the future prospects for the underlying investments.

Until receipt of the fund manager's next report, the Bank makes adjustments to the fair value of unquoted equity fund investments based on fund manager's communication and historical experience, as well as distributions and capital calls during the interim period.

The fair value for quoted equity investments is the market bid price.

Income is recognised in the statement of income when contract for sale has been executed.

Recognition and de-recognition

Regular way purchases and sales of financial assets and liabilities are recognised on trade-date; the date on which the Group commits to purchase or sell the financial asset or liability. Regular way purchases or sales are purchases or sales of financial assets that require delivery within the time frame generally established by regulation or connection in the market place.

Financial assets are derecognised and removed from the consolidated statement of financial position when the right to receive cash flows from the assets has expired; the Group has transferred its contractual right to receive the cash flows from the assets, and substantially all the risks and rewards of ownership; or where control is not retained. Financial liabilities are derecognised and removed from the consolidated statement of financial position when the obligation is discharged, cancelled, or expires.

Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRSs, or for gains and losses arising from a group of similar transactions such as in the Group's trading activity.

4 Significant accounting policies (continued)

c. Financial Instruments (continued)

Amortized cost measurement

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, less principal repayments, add or less the cumulative amortization using the effective interest method of any difference between the initial amounts recognized and the maturity amount, less any reduction for impairment.

Impairment

At each reporting date the Group assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets (including equity securities) are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

Impairment loss on assets carried at amortised cost are measured as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the asset's original effective interest rate. Financial assets that are not specifically impaired are collectively assessed for any impairment that has been incurred but not yet identified. Collective impairment is assessed by grouping together assets with similar risk characteristics. Impairment losses are recognised in statement of income and reflected in an allowance account against loans and advances.

Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in other comprehensive income to statement of income as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to statement of income is the difference between the acquisition costs, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in statement of income. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in statement of income, then the impairment loss is reversed, with the amount of the reversal recognised in statement of income. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

d. Impairment of non-financial assets

The carrying amounts of the non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment then the assets recoverable amount is estimated. If any such indication exists impairment losses are recognised in the statement of income.

e. Provision

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

f. Dividends

Dividends are recognised as a liability in the period in which they are approved by the shareholders.

4 Significant accounting policies (continued)

g. Treasury shares

Own shares reacquired by the Bank and held at the reporting date are designated as treasury shares. These shares are shown as a deduction from the Bank's shareholders' equity. The gain and loss on the sale of treasury shares is recognised in shareholders' equity.

h. Fees and commission

Fees and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including investment management fees, performance fees and placement fees, are recognised as the related services are performed.

Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

i. Interest income and expense

Interest income and expense for all interest-bearing financial instruments is accrued and recognised within 'interest income' and 'interest expense' in the statement of income.

Interest income from loans and advances is accrued based on contractual interest rates, using the effective interest rate method.

Interest income on Government and Government Agency bonds and other bonds are recognised on an accrual basis using the effective interest rate method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates future cash flows considering all contracted terms of the financial instruments, but not future credit losses. The calculation of effective interest rate includes all transaction costs and all other premiums or discounts.

j. Dividend income

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

k. Employee benefits

Pensions and other social benefits for Bahraini employees are covered by the General Organisation for Social Insurance scheme, which is a defined contribution scheme under IAS 19 - Employee Benefits, to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis. The charge for the year is recognised in the statement of income.

Expatriate employees are entitled to leaving indemnities payable under the Bahrain Labour Law 2012, based on length of service and final salary and other allowances paid. Provision for this unfunded commitment, which represents a defined benefit scheme under IAS 19 - Employee Benefits, has been made by calculating the notional liability had all employees left at the reporting date. The charge for the year is recognised in the statement of income.

4 Significant accounting policies (continued)

l. Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, whose operating results are reviewed regularly by the Group Executive Committee of the Board (being the chief operating decision maker) to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

m. Cash and cash equivalents

Cash and cash equivalents comprise cash and short-term funds and deposits with banks, with original maturities of less than 90 days.

n. Deposits, borrowings and securities sold under repurchase agreements

Deposits, borrowings and securities sold under repurchase agreements are the Group's sources of debt funding.

When the Group sells a financial asset and simultaneously enters into an agreement to repurchase the asset (or a similar asset) at a fixed price on a future date (repo or stock lending), the arrangement is accounted for as a deposit, and the underlying asset continues to be recognised in the Group's consolidated financial statements.

Subsequent to initial recognition Deposits, borrowings and securities sold under repurchase agreements are measured at their amortised cost using the effective interest method, except where the Group designates liabilities at fair value through profit or loss.

o. Earnings per share

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

p. Fiduciary activities

The Group administers and manages assets owned by clients which are not reflected in the consolidated financial statements. Fees are recognised as the services are provided and are included in the fee and commission in the statement of income.

q. Legal reserve

Legal reserve comprises amounts set aside in accordance with the Bahrain Commercial Companies Law 2001, which requires that the Bank should make an annual transfer of a minimum of 10% of profit for the year to a non-distributable, except in circumstance stipulated in the law, legal reserve until such reserve equals 50% of its paid up share capital.

5 CLASSIFICATION OF FINANCIAL INSTRUMENTS

(United States Dollars thousands)

2012	**Held-for-trading**	**Loans and receivables**	**Held-to-maturity**	**Available-for-sale**	**Others at amortised cost**	**Total**
Cash and cash equivalents	-	2,318	-	-	-	2,318
Placements with financial institutions	-	4,000	-	-	-	4,000
Trading securities	437	-	-	-	-	437
Available-for-sale investments	-	-	-	21,544	-	21,544
Held-to-maturity investments	-	-	4,624	-	-	4,624
Loans and advances	-	20,956	-	-	-	20,956
Other assets	-	858	-	-	-	858
Total financial assets	**437**	**28,132**	**4,624**	**21,544**	**-**	**54,737**
Deposit from financial institutions	-	-	-	-	6,000	6,000
Deposits from customers	-	-	-	-	5,089	5,089
Borrowings	-	-	-	-	11,389	11,389
Other liabilities	-	-	-	-	1,839	1,839
Total financial liabilities	**-**	**-**	**-**	**-**	**24,317**	**24,317**

2011	Held-for-trading	Loans and receivables	Held-to-maturity	Available-for-sale	Others at amortised cost	Total
Cash and cash equivalents	-	8,697	-	-	-	8,697
Placements with financial institutions	-	5,200	-	-	-	5,200
Trading securities	2,035	-	-	-	-	2,035
Available-for-sale investments	-	-	-	27,813	-	27,813
Held-to-maturity investments	-	-	4,613	-	-	4,613
Loans and advances	-	20,513	-	-	-	20,513
Other assets	-	1,808	-	-	-	1,808
Total financial assets	2,035	36,218	4,613	27,813	-	70,679
Deposit from financial institutions	-	-	-	-	6,000	6,000
Deposits from customers	-	-	-	-	8,752	8,752
Securities sold under repurchase agreements	-	-	-	-	3,325	3,325
Borrowings	-	-	-	-	19,389	19,389
Other liabilities	-	-	-	-	4,360	4,360
Total financial liabilities	-	-	-	-	41,826	41,826

(United States Dollars thousands)

6 CASH AND CASH EQUIVALENTS

	2012	2011
Money at call with banks	2,318	8,697
	2,318	8,697

7 PLACEMENTS WITH FINANCIAL INSTITUTIONS

Placements with Financial Institutions include US$ 3,374 thousands (2011: US$ 4,421 thousands) placed with a third party retail bank in the Kingdom of Bahrain; representing amounts held on account of sub-participants in Private Equity Funds and for the purposes of honouring their capital calls to fund managers.

8 TRADING SECURITIES

	2012	2011
Equity securities	434	1,211
Debt securities	3	824
	437	2,035

Trading securities primarily consist of equity securities investments in GCC.

9 AVAILABLE-FOR-SALE INVESTMENTS

	2012	2011
Unquoted equity fund investments - at fair value	21,500	25,100
Unquoted equity investments - at cost less impairment	38	483
Quoted equity investments - at fair value	6	2,230
	21,544	27,813

As stated in Note 3, the determination of fair value for unquoted equity funds investment and unquoted equity investments held as available-for-sale involves significant estimates and judgment on the part of the Bank's management and such determinations made are estimates, not absolute or certain values. The effect of a 5% variation in fair values determined as at 31 December 2012 would have the following impact on the Bank's results for the year ended 31 December 2012 and/or the Bank's equity as of that date:

A shift of ±5% in management's fair value estimates for "available-for-sale investments" and not impaired as at 31 December 2012 would impact "available for sale investments" as well as fair value reserve within equity by ±US$ 1,075 thousands as at that date (2011: US$ 1,366 thousands).

At 31 December 2012, the Bank had undrawn investment commitments to private equity funds of US$ 6.3 million (31 December 2011: US$ 9.5 million, Note 29). Of these, the Group's proprietary commitments amounted to US$ 3.2 million (31 December 2011: US$ 5.4 million) and the rest were on account of sub-participants for which the Bank has segregated Funds and placed with a third party retail Bank for the purposes of honouring as and when they fall due. Under the term of the agreements with these equity fund managers, the Group is irrevocably committed to invest funds upon notice from investment managers, except for certain excused investments. Excused investments include those prohibited by local law and, in certain cases, investments contrary to Shari'ah principles where the Bank is a co-investor with its clients who apply Shari'ah principles to their investment activity. Certain of the Bank's available-for-sale investments are pledged against a borrowing facility.

For unquoted equity investments, the exit strategy is via a trade sale or IPO.

Net realised gain on account of available for sale investments during the year amounted to US$ 2,629 thousand (2011; US$ 2,911 thousand).

(United States Dollars thousands)

10 HELD-TO-MATURITY INVESTMENTS

	2012	2011
Sovereign bond	4,388	4,388
Other bonds	236	225
	4,624	4,613

The sovereign bond is pledged against a deposit from a financial institution and carries a floating rate of interest (deposit from financial institution - refer Note 13).

11 LOANS AND ADVANCES

	2012	2011
Trade finance	13,292	8,380
Instalment sale receivable	7,876	11,261
Other	-	872
	21,168	20,513
Less: Collective provision	(212)	-
	20,956	20,513

Instalment sale receivable

The transaction dates back to 1995 where the Bank entered into an agreement to sell its investment in a land in the State of Kuwait on an instalment sale basis. The sale was to a corporate domiciled in the State of Kuwait and was for a total aggregate consideration of US$ 43,200 thousand. As per existing repayment plan, US$ 2,457 thousand - including interest - is paid by the purchaser in June of every year - with a final instalment due in 2017. The loan is secured by a corporate guarantee.

Trade finance loans - relate to insurance backed trade finance transactions as undertaken by the Bank.

The collective provision is recognized on loans and advances in line with the banking industry norms.

12 OTHER ASSETS

	2012	2011
Prepayments	341	203
Accrued interest receivable	289	852
Equipment	187	276
Management fees receivable	-	291
Others	569	665
	1,386	2,287

13 DEPOSITS FROM FINANCIAL INSTITUTIONS

The Bank has pledged a government bond classified as held to maturity against a deposit (refer Note10).

14 DEPOSITS FROM CUSTOMERS

	Current		Non-current		Total	
	2012	2011	2012	2011	2012	2011
Customer participation in funds	-	308	3,374	4,113	3,374	4,421
Quasigovernment entities, corporate and individuals	857	3,582	-	-	857	3,582
Others	858	749	-	-	858	749
	1,715	4,639	**3,374**	4,113	**5,089**	8,752

(United States Dollars thousands)

14 Deposits from customers (continued)

Customer participation in funds represents amounts received from customers to be invested in private equity funds marketed by BMB. These funds, although treated as part of customer deposits, are retained by the Bank until draw-downs are made by private equity fund managers. Customer deposits carry floating rates of interest until drawdown. Customer participation in funds includes US$ 622 thousand (31 December 2011: US$ 1,268 thousand) in deposits held on behalf of BMB Technology and Telecommunications Fund (Note 29).

As at 31 December 2011, deposits from Government institutions, corporate and individuals included a term deposit from a quasi-government depositor - as originally obtained by the Bank during 2004. These over-due amounts outstanding as at 31 December 2008 amounted to US$ 13.1 million – which was later rescheduled by the Bank in December 2009. As at 31 December 2012, these amounts were fully repaid.

Others consist of small deposit amount of non-Bahraini based corporate and individuals.

15 BORROWINGS

	2012	2011
Secured		
Loan from Government lender	1,389	9,389
Loan from Quasi - government lender	10,000	10,000
	11,389	19,389

Loan from Government lender

Facility granted in 2003 / 2004 of US$ 13.6 million. As per existing repayment plan, repayments are on a quarterly basis with a final instalment due in March 2013. Since 2008, the Bank has repaid an aggregate US$ 11.0 million in accordance with rescheduled terms and conditions. The facility carries a fixed rate of interest.

Collateral is provided in the form of select securities as held within available for sale investments. At 31 December 2012, the fair value of the investments securities that had been pledged as collateral was US$ 6.0 million (2011: US$ 9.3 million).

Loan from Quasi - government lender

Initially granted in June 2001, the facility is payable on 29 December 2016. The interest rate is floating based on 1 year Libor and is payable annually.

Collateral is provided in the form of selected securities as held within available for sale investments. At 31 December 2012, the fair value of the investments securities that had been pledged as collateral was US$ 6.5 million (2011: US$ 10.2 million).

16 OTHER LIABILITIES

	2012	2011
Accrued interest payable	1,168	3,462
Employee leaving indemnity (Note 24)	428	264
Accrued expenses	75	60
Others	671	898
	2,342	4,684

17 SHARE CAPITAL

	2012		2011	
	Number ‘000	**Amount USD’000**	Number ‘000	Amount USD’000
Authorized				
Ordinary shares of US$0.25 each	**2,000,000**	**500,000**	2,000,000	500,000
Issued and fully paid				
Ordinary shares of US$0.25 each	**242,003**	**60,501**	242,003	60,501

A distribution of each class of equity security, setting out the number of holders and percentage in the following categories at 31 December:

	2012			2011		
Ordinary shares	**No. of Shares**	**No. of Shareholders**	**% of Total Outstanding Shares**	No. of Shares	No. of Shareholders	% of Total Outstanding Shares
Less than 1%	9,357,440	13,130	3.87%	9,357,440	13,130	3.87%
1% up to less than 5%	31,713,882	3	13.10%	31,713,882	3	13.10%
5% up to less than 10%**	39,025,696	2	16.13%	39,025,696	2	16.13%
10% up to less than 20%	-	-	-	-	-	-
20% up to less than 50%	-	-	-	-	-	-
50% and above*	161,906,308	1	66.90%	161,906,308	1	66.90%
	242, 003,326	**13,136**	**100%**	242, 003,326	13,136	100%

Over 5% equity ownership:

* Reflects ownership of Al Fawares Holding Co KSCC (Kuwait)

** Reflects ownership of Massaleh Investment KSC (Kuwait) and Mr. Mohamed Humood Sulaiman Al Ohali (Kingdom of Saudi Arabia).

Rights issue

During the year 2011, forming a part of Phase I of the Bank›s capital raising programme, a total 40,000,000 new shares were offered each at an offer price of US$ 0.25 per share for an aggregate amount of US$ 10 million. The results of the offering which closed on 12 December 2011 were as follows:

	2012		2011	
	Number ‘000	**USD ‘000**	Number ‘000	USD ‘000
Offered shares	-	-	40,000	10,000
Subscribed shares	-	-	22,184	5,546

Treasury shares

At 31 December 2012, the Bank owned 1 of its own shares (31 December 2011: 1 share). This share is treated as a deduction from the shareholders’ equity.

Earnings per share (basic and diluted)

	Basic		Diluted	
	2012 ‘000	2011 ‘000	**2012 ‘000**	2011 ‘000
Profit for the year	2,188	3,721	2,188	3,721
Weighted average number of ordinary shares	242,003	242,003	242,003	242,003
Earnings per share – US$ cents	**0.90**	1.54	**0.90**	1.54

(United States Dollars thousands)

18 INVESTMENT BANKING INCOME

	2012	2011
Net(loss) /gain from trading equities	(80)	873
Net gain from available -for-sale investments	2,629	2,911
Fees and commission	4,669	2,450
	7,218	6,234

19 INTEREST INCOME

	2012	2011
Loans and advances	1,277	840
Government bonds and other bonds	322	375
Placements with financial institutions	25	187
	1,624	1,402

20 OTHER INCOME

	2012	2011
Income from property management services	390	503
Unclaimed dividends written-back	-	2,736
Provisions for expenses written back	-	735
	390	3,974

21 GENERAL AND ADMINISTRATION EXPENSES

	2012	2011
Staff expenses	3,946	3,855
Premises expenses	591	786
Other operating expenses	1,874	1,689
	6,411	6,330

22 INTEREST EXPENSE

	2012	2011
Borrowings	772	1,535
Deposits from financial institutions	231	91
Deposits from customers	3	66
Others	5	36
	1,011	1,728

23 PROVISIONS

	2012	2011
Impairment provisions on investments	337	-
Collective provision on loans and advances	212	-
	549	-

(United States Dollars thousands)

24 EMPLOYEE BENEFITS

The costs associated with contributions made by the Bank towards the pension scheme for Bahraini nationals administered by the Government of the Kingdom of Bahrain amounted to US$ 87 thousands (31 December 2011: US$ 70 thousands). The Kingdom of Bahrain pension scheme is a defined contribution plan, and accordingly, the Bank has a legal and constructive obligation to pay the contributions as they fall due and no obligation exists to pay the future benefits. The Bank has 30 employees (2011: 32 employees) as at the reporting date. The expatriate employees of the Group based in Bahrain are paid leaving indemnity in accordance with the Kingdom of Bahrain labour laws. The movement in leaving indemnity liability is summarised below:

	2012	2011
At 1 January	264	214
Accruals for the year	180	97
Paid during the year	(16)	(47)
At 31 December (Note 16)	**428**	264

25 RELATED-PARTY TRANSACTIONS AND BALANCES

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include entities over which the Bank exercises significant influence, major shareholders, directors and executive management of the Bank.

(a) Key management personnel of the Group are those persons having authority and responsibility for planning, directing and controlling the activities of the Group. Key management personnel comprise the Board of Directors, Chief Executive Officer, Head of Business Development and Chief Financial Officer. Transactions entered during the year and balances at the year-end are set out below.

	Key management personnel	
	2012	**2011**
Loans		
At 1 January	53	-
Advanced during the year	-	61
Repayments during the year	(19)	(8)
At 31 December	34	53

No loans were advanced to any director of the Bank during the year 2012 (2011: Nil).

No provisions have been recognised in respect of loans given to related parties (2011: Nil).

The above loans are included as part of other assets.

The loans made to key management personnel are repayable monthly up to a maximum period of three years. All loans bear administration charges of 1% per annum (31 December 2011: 1% per annum).

Deposits from Directors and related Parties were as follows:

	2012	2011
Deposits		
At 1 January	88	94
Received during the year	80	33
Repaid during the year	(51)	(39)
At 31 December	117	88

(United States Dollars thousands)

25 Related party transactions and balances (continued)

Key management compensation

Compensation to key management personnel, including directors, was as follows:

	2012	2011
Salaries and other short-term employee benefits	1,694	1,628
Post-employment benefits	75	38
	1,769	**1,666**
Directors' remuneration	85	62

The Bank considers Al Fawares Holding Co. (the "Parent Company") and entities controlled or significantly influenced by Al Fawares Holding Co. as being related parties.

Guarantee

The Bank has received a corporate payment guarantee from Al Fawares Holding Co. with regard to the instalment sale receivable (Note 11).

26 INVESTMENT IN SUBSIDIARIES

Listing of subsidiaries

The principal subsidiaries of the Bank at 31 December were as follows:

	Ownership interest		**Country of incorporation**	**Nature of Business**
Subsidiaries	**2012**	2011		
BMB Investment Company (Jersey) Limited	100%	100%	Jersey	Investment holding
Adhari Limited	100%	100%	Cayman Islands	Investment holding
BMB Property Services	100%	100%	Bahrain	Building Management
BMB Trade Finance	100%	100%	Cayman Islands	Investment holding
Universal Merchant Holdings NV	100%	100%	Netherlands Antilles	Investment holding
BMB Netherlands Antilles NV	100%	100%	Netherlands Antilles	Investment holding
BMB Curacao Netherlands NV	100%	100%	Netherlands Antilles	Investment holding
Universal Finance Holding NV	100%	100%	Netherlands	Investment holding
European Universal Finance NV	100%	100%	Netherlands	Investment holding
Qassari Limited – LDC	100%	100%	Cayman Islands	Investment holding
Umm Shoum Limited – LDC	100%	100%	Cayman Islands	Investment holding
Bu Zaidan Limited – LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures - I LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – II LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – III LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – IV LDC	100%	100%	Cayman Islands	Investment holding
BMB New Era Ventures – V LDC	100%	100%	Cayman Islands	Investment holding
Beverages Limited*	-	100%	Channel Islands	Investment holding

- At 31 December all subsidiary companies were consolidated in the financial statements.

- *Beverages Limited was liquidated during the year 2012.

- Except for BMB Property Services, the Bank's all other subsidiaries are used for the exclusive purposes of holding investments, and trade finance activities.

27 FINANCIAL RISK MANAGEMENT

In the normal course of its business, the Bank is exposed to various risks, related to the nature of the activities in which it engages. The principal sources of risk are credit risk, market risk, interest rate risk, currency risk, liquidity risk, equity risk, operating risk and legal risk.

At BMB, the management of financial and other risks is based on the establishment of an appropriate risk governance structure, comprising:

- clearly defined exposure and risk limits by geography, sector and counter party
- internally, a collectively decisioning structure composed of independent departments and other departmental heads
- specialised task force for day to day monitoring and management of liquidity risk
- investment evaluation criteria based on quantitative and qualitative approaches
- robust operating policies and procedures, including those for specific allocation of risk limits to individual obligors and/or transactions
- on-going review of exposures, excesses and risks by an independent department
- assessment of regulatory compliance by an independent department
- periodic internal audits of the control environment

Risk limits are at the heart of this process. BMB begins by setting maximum exposure limits as a percentage of capital for major lines of business. Within these macro limits, sub limits are set by geography, obligor type/credit grade, instrument, tenor, etc. For trading activities additional limits such as VaR, duration, maximum intraday and inter-day exposures, “stop losses”, etc. are applied as well. Individual transactions then take place within these sub-limits.

In addition to the existence of various risk limits, overall risk discipline is maintained by the requirement that the Bank (a) maintains a Basel II Capital Adequacy Ratio in excess of the regulatory required minimum and (b) considers the impact on the Bank’s liquidity position of any major transaction(s) or new business initiative.

Risk management at BMB begins at the Board of Directors level. The Board of Directors exercise oversight and final approval of the risk management process at BMB. It operates through two Board Committees, the Executive Committee and the Audit Committee. With input provided by the Bank’s Executive Management Committee - that also acts as the Risk Management Committee - the Executive Board Committee proposes the overall risk management strategy of the Bank. Based on the recommendations of the Executive Board Committee, the Board of Directors approves the aggregate levels of risk the Bank can assume as well as reviewing and approving the Bank’s risk management policies, risk limits and risk control framework. Among its duties, the Audit Committee is charged with reviewing and approving the Bank’s policies and procedures as well as overseeing both the internal and external audits of the Bank, including matters related to anti money laundering and terrorism finance.

The Board delegates certain authority to the Executive Board Committee to implement the risk control decisions of the Board. To carry out these responsibilities, the Executive Board Committee operates through an Executive Management Committee (the “EMC”).

The EMC is chaired by the Chief Executive Officer and comprises members of the senior management. It serves as the Bank’s credit committee, asset/liability management committee and investment approval committee. In addition it prepares and submits to the Board detailed risk control policies and procedures as well as country, asset class and individual counterparty limits for Board approval. On an on-going basis, the EMC monitors the environment in which the Bank operates and the risks to which it is exposed and adjusts the Bank’s operations as appropriate.

The Risk Management Department (“RMD”) plays a key role in this process. The RMD is independent of the Bank’s trading and business areas and reports directly to the Chief Executive Officer. It is responsible for identifying and quantifying risk exposures, recommending appropriate limits and monitoring usage of them. As part of its duties, the RMD prepares a variety of daily risk reports, including stress tests, for senior manage ment and the EMC. In addition, the RMD manages problem and past-due assets.

Internal Audit, which is independent of both operations and the Bank’s business units, also assists in the risk management process. In particular, Internal Audit is charged with a periodic review of the effectiveness of BMB’s policies and internal controls – a review which is independent of the Bank’s executive management.

27 Financial risk management (continued)

As a further step in mitigating risks, the Bank follows a policy of diversification in its activities and seeks to minimize the risk exposure to particular geographical regions, counterparties, instruments and types of business. In identifying and monitoring risk exposures, BMB uses a variety of quantitative tools as well as qualitative approaches to measure risks at the "macro" level. The Bank seeks to judiciously balance the use of these two approaches rather than rely on a single approach.

The following sections review the principal risks to which the Bank is exposed in the normal course of its business and how it manages those risks.

Credit risk

Credit risk is the risk of loss arising as a result of the inability or unwillingness of a counterparty to meet its obligations to the Bank. The Risk Management Department, under the oversight of EMC, has the responsibility for establishing credit risk standards and implementing the Bank's credit risk management process. BMB uses the Standardised Approach under the Basel II Framework for measuring and managing its credit risk.

Where ratings by an External Credit Assessment Institution - as recognised by the Central Bank are available - the Bank estimates the probability of default through a risk grading system which employs a ten-grade scale, with "1" denoting a risk which has the least probability of default (equivalent to AAA rating) and "10" denoting a defaulted obligation (equivalent to rating of CCC or below) –. Risk grading as embedded in credit ratings take into account (a) quantitative factors (historical and prospective, such as cash flow, profitability, asset quality and tenor of risk), (b) qualitative factors (such as management quality, market share and competitive position) and other factors, including country risk, the type of transaction, tenor and credit mitigation.

All obligors and countries are risk graded. All lines of credit, counterparty, country and trading limits are subject to annual reaffirmation by the Board of Directors. The limits are also reviewed more frequently, as necessary to ensure consistency with the Bank's trading and investment strategies or to take into account latest market developments.

Given the nature of the Bank's business, the Bank uses nominal balance sheet amounts, including accrued interest and other receivables, as its measure of exposure. Credit risks for a given economic entity (including its subsidiaries and affiliates) are aggregated as the measure of exposure and are managed at that level. Credit standards are defined in the Bank's Credit Policies and Procedures Manual and include a sound process for evaluating obligor, transaction and product risks, as well as concentration risk, etc.

In order to ensure a common approach to risk control, the Bank uses the same credit procedure when entering into trading activities, including FX and derivatives, as it does for traditional lending products. Master netting agreements and collateral arrangements, as well as limits and the tenors of transactions, are employed to further control risks.

Overall, the Bank management considers that its policies and procedures constitute a reasonable approach to managing the credit risk in the activities it is engaged in.

With respect to specific assets, the following summarises key credit risk issues:

• Cash and deposits are placed with primarily investment grade institutions

• Government bonds carry the underlying sovereign risk

• The instalment sales receivable is supported by a corporate guarantee

• Other loans are backed by credit insurance

BMB is not engaged in retail business and, therefore, does not use credit "scoring" models. Nor has the Bank securitized any of its assets and, therefore, has no recourse obligations under such transactions. BMB does not have any exposure to "highly leveraged institutions" as defined by the Financial Stability Task Force.

(United States Dollars thousands)

27 Financial risk management (continued)

Credit risk (continued)

Concentration of credit risk arises when a number of obligors or 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. Accordingly, such concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or region.

The following tables summarize the Group's geographical and industry sector exposures and any potential risk concentrations arising there from. Maximum credit risk exposures are detailed without considering the effects, if any, of collateral or other credit mitigation techniques on the Group's assets, liabilities and credit related contingent items.

(a) Geographical sector

	North America		Europe		Rest of the world		Total	
	2012	2011	**2012**	2011	**2012**	2011	**2012**	2011
Assets								
Cash and cash equivalents	729	2,942	763	5,186	826	569	2,318	8,697
Placement with financial institutions	-	-	-	-	4,000	5,200	4,000	5,200
Trading securities	-	-	-	-	3	824	3	824
Held-to-maturity investments	-	-	236	225	4,388	4,388	4,624	4,613
Loans and Advances	-	872	13,159	8,380	7,797	11,261	20,956	20,513
Other assets	-	146	169	166	689	1,496	858	1,808
Total assets subject to risk	**729**	3,960	**14,327**	13,957	**17,703**	23,738	**32,729**	41,655
Credit related contingent items	**2,642**	4,282	**2,433**	3,332	**5,416**	6,014	**10,491**	13,628

(b) Industry sector

2012	Banking/ Finance	Government	Technology/ Telecoms	Diversified	Others	Total
Assets						
Cash and cash equivalents	2,318	-	-	-	-	2,318
Placement with financial institutions	4,000	-	-	-	-	4,000
Trading securities	3	-	-	-	-	3
Held-to-maturity Investments	-	4,388	-	-	236	4,624
Loans and advances	13,159	-	-	-	7,797	20,956
Other assets	149	118	-	-	591	858
Total assets subject to credit risk	**19,629**	**4,506**	**-**	**-**	**8,624**	**32,759**
Credit related contingent items	**1,453**	**-**	**4,817**	**1,485**	**2,736**	**10,491**

(United States Dollars thousands)

27 Financial risk management (continued)

Credit risk (continued)

2011	Banking/ Finance	Government	Technology/ Telecoms	Diversified	Others	Total
Assets						
Cash and cash equivalents	8,697	-	-	-	-	8,697
Placement with financial institutions	5,200	-	-	-	-	5,200
Trading securities	824	-	-	-	-	824
Held-to-maturity Investments	-	4,388	-	-	225	4,613
Loans and advances	8,380	-	872	-	11,261	20,513
Other assets	-	118	391	-	1,299	1,808
Total assets subject to credit risk	23,101	4,506	1,263	-	12,785	41,655
Credit related contingent items	1,423	-	6,366	3,103	2,736	13,628

Market risk

Market risk is defined as potential adverse changes in the fair value or future cash flows of a trading position or portfolio of financial instruments resulting from the movement of market variables, such as interest rates, currency rates, equity and commodity prices, market indices as well as volatilities and correlations between markets. As its primary tool, the Bank measures its market risk exposure using the Standardised Approach prescribed by the Basel Committee and the Central Bank of Bahrain.

As noted above, market risk arises from changes in various market variables, including interest rate and foreign exchange risk. The tables on the following pages provide information on the Bank's interest rate and foreign currency risk exposures.

Interest rate risk

Interest rate risk is the risk that changes in market interest rates will affect (a) the fair value of financial instruments ("fair value interest rate risk") and/or (b) the future cash flows associated with financial instruments subject to periodic re-pricing ("cash flow interest rate risk"). The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and credit related contingent items that mature or re-price in a given period. The Bank manages this risk by matching the re-pricing of assets and liabilities through a variety of means, such as the daily risk analysis reports from the market risk system which assists the management in measuring and monitoring the Bank's exposure to interest rate risk.

The Bank's interest rate sensitivity position, based on the contractual re-pricing or maturity dates, whichever dates are earlier, is as follows:

(United States Dollars thousands)

27 Financial risk management (continued)

Interest rate risk (continued)

2012	Up to 1 month	2 – 3 months	4 – 6 months	7 – 12 months	2 – 5 years	Over 5 years	Non-interest bearing	Total
Cash and cash equivalents	2,318	-	-	-	-	-	-	2,318
Placement with financial institutions	4,000	-	-	-	-	-	-	4,000
Trading securities	-	-	-	-	-	-	437	437
Available-for-sale investments	-	-	-	-	-	-	21,544	21,544
Held-to-maturity investments	-	-	-	-	-	4,624	-	4,624
Loans and advances	3,083	5,690	4,386	-	7,797	-	-	20,956
Other assets	-	-	-	-	-	-	858	858
Total assets	**9,401**	**5,690**	**4,386**	**-**	**7,797**	**4,624**	**22,839**	**54,737**
Deposits from financial institutions	3,000	3,000	-	-	-	-	-	6,000
Deposits from customers	3,288	-	-	-	-	-	1,801	5,089
Securities sold under repurchase agreements	-	-	-	-	-	-	-	-
Borrowings	-	1,389	-	-	10,000	-	-	11,389
Other liabilities	-	-	-	-	-	-	1,839	1,839
Equity	-	-	-	-	-	-	30,445	30,445
Total liabilities and equity	**6,288**	**4,389**	**-**	**-**	**10,000**	**-**	**34,085**	**54,762**
Total interest rate sensitivity gap	**3,113**	**1,301**	**4,386**	**-**	**(2,203)**	**4,624**	**-**	**-**

(United States Dollars thousands)

27 Financial risk management (continued)

Interest rate risk (continued)

2011	Up to 1 month	2 – 3 months	4 – 6 months	7 – 12 months	2 – 5 years	Over 5 years	Non-interest bearing	Total
Cash and cash equivalents	8,697	-	-	-	-	-	-	8,697
Placement with financial institutions	-	-	5,200	-	-	-	-	5,200
Trading securities	-	-	-	-	-	-	2,035	2,035
Available-for-sale investments	-	-	-	-	-	-	27,813	27,813
Held-to-maturity investments	-	-	-	-	-	4,613	-	4,613
Loans and advances	3,267	328	7,806	-	9,112	-	-	20,513
Other assets	-	-	-	-	-	-	1,808	1,808
Total assets	11,964	328	13,006	-	9,112	4,613	31,656	70,679
Deposits from financial institutions	-	6,000	-	-	-	-	-	6,000
Deposits from customers	7,668	-	-	-	-	-	1,084	8,752
Securities sold under repurchase agreements	3,325	-	-	-	-	-	-	3,325
Borrowings	-	2,000	-	6,000	11,389	-	-	19,389
Other liabilities	-	-	-	-	-	-	4,360	4,360
Equity	-	-	-	-	-	-	29,008	29,008
Total liabilities and equity	10,993	8,000	-	6,000	11,389	-	34,452	70,834
Total interest rate sensitivity gap	971	(7,672)	13,006	(6,000)	(2,277)	4,613	-	-

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 an historical rate for a fixed rate instrument carried at fair value. The effective interest rate by major currencies for each of the monetary financial instruments which bear interest is as follows:

2012			
	Effective interest rate %		
	US$	GBP	EUR
Assets			
Government bonds	5.8	-	-
Other bonds	-	1.4	-
Loans and advances	6.1	-	-
Liabilities			
Customer deposits	0.6	0.5	0.6
Borrowings	5.0	-	-

(United States Dollars thousands)

27 Financial risk management (continued)

Interest rate risk (continued)

2011			
	Effective interest rate %		
	US$	GBP	EUR
Assets			
Government bonds	5.8	-	-
Other bonds	4.8	1.5	-
Loans and advances	5.1	-	-
Liabilities			
Customer deposits	0.6	0.5	0.6
Borrowings	7.8	-	-

- The effective interest rates are computed based upon a weighted average of the effective interest rates applicable to several individual instruments held at 31 December.
- The effective interest rate for customer deposits has been computed excluding non-interest bearing accounts of US$ 1,801 thousand (31 December 2011: US$ 1,084 thousand).
- Statutory deposit held at the CBB is not included in the above.

Key to currencies:

US$ - United States Dollar
GBP - Great Britain Pound
EUR - Euro

Currency risk

The Group is exposed to effects of fluctuations in the prevailing foreign currency exchange rates on its financial positions and cash flows. The table below summarises the Group's exposure to foreign currency exchange rate risk US$ equivalent.

At 31 December 2012					
	US$	**EUR**	**GBP**	**Others**	**Total**
Assets:					
Cash and cash equivalents	1,050	489	214	565	2,318
Placement with financial institutions	4,000	-	-	-	4,000
Trading securities	-	-	-	437	437
Available-for-sale Investments	14,291	6,160	258	835	21,544
Held-to-maturity Investments	4,388	-	236	-	4,624
Loans and advances	20,301	655	-	-	20,956
Other assets	623	113	-	650	1,386
Total financial assets	**44,653**	**7,417**	**708**	**2,487**	**55,265**
Liabilities:					
Deposit from financial institutions	6,000	-	-	-	6,000
Deposits from customers	3,208	1,843	4	34	5,089
Securities sold under repurchase agreements	-	-	-	-	-
Borrowings	11,389	-	-	-	11,389
Other liabilities	2,151	-	-	191	2,342
Total financial liabilities	**22,748**	**1,843**	**4**	**225**	**24,820**
Net financial position	**21,905**	**5,574**	**704**	**2,262**	**30,445**
Credit related contingent items	**7,301**	**3,190**	**-**	**-**	**10,491**

(United States Dollars thousands)

27 Financial risk management (continued)

Currency risk (continued)

At 31 December 2011	US$	EUR	GBP	Others	Total
Assets:					
Cash and cash equivalents	4,676	2,803	602	616	8,697
Placement with financial institutions	5,200	-	-	-	5,200
Trading securities	783	53	42	1,157	2,035
Available-for-sale Investments	12,892	13,038	764	1,119	27,813
Held-to-maturity Investments	4,388	-	225	-	4,613
Loans and advances	20,073	440	-	-	20,513
Other assets	1,912	-	-	375	2,287
Total financial assets	49,924	16,334	1,633	3,267	71,158
Liabilities:					
Deposit from financial institutions	6,000	-	-	-	6,000
Deposits from customers	6,695	2,034	16	7	8,752
Securities sold under repurchase agreements	3,325	-	-	-	3,325
Borrowings	19,389	-	-	-	19,389
Other liabilities	4,563	-	-	121	4,684
Total financial liabilities	39,972	2,034	16	128	42,150
Net financial position	9,952	14,300	1,617	3,139	29,008
Credit related contingent items	10,299	2,811	518	-	13,628

Pricing risk

The Group is exposed to equity securities pricing risk as its investments are classified as held for trading. The Group's trading portfolio comprises of equity instruments quoted on stock exchanges. If market prices increased/decreased by 5%, with all other variables held constant, the loss for the year and equity would have been US$ 22 thousand higher/lower than that reported (2011: US$ 102 thousand).

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. ("liability liquidity risk"). It also represents the risk that the Bank will be unable to realize its assets in a timely fashion for prices close to their carrying values ("asset liquidity risk").

In its investing activities, BMB seeks to diversify its assets across instruments and markets and to avoid obligor concentrations which could constitute asset liquidity risk. This is particularly the case of our investments in unlisted private equity funds where BMB has consciously implemented a strategy of reducing the Bank's average individual investment size.

Liquidity is managed on a daily basis and senior management closely monitors significant daily changes to the liquidity position. In evaluating the liquidity position, the Bank also takes into account the possible call of un-drawn commitments in its investment portfolio.

The table below presents the financial assets and liabilities of the Group based on remaining contractual maturities at the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows where the Group manages the inherent liquidity risk based on expected undiscounted cash flows.

(United States Dollars thousands)

27 Financial risk management (continued)

Liquidity risk (continued)

2012	Within 1month	2–3 months	4–6 months	7–12 Months	2–5 years	6–10 Years	11–20 years	Total
Assets								
Cash and cash equivalents	2,318	-	-	-	-	-	-	**2,318**
Placement with financial institutions	4,000	-	-	-	-	-	-	**4,000**
Trading securities	437	-	-	-	-	-	-	**437**
Available-for-sale investments*	-	-	-	5,859	12,306	3,379	-	**21,544**
Held-to-maturity investments	-	-	127	-	-	-	4,624	**4,751**
Loans and advances	3,083	5,690	4,386	-	8,933	-	-	**22,092**
Other assets	175	285	-	67	331	-	-	**858**
Total assets	**10,013**	**5,975**	**4,513**	**5,926**	**21,570**	**3,379**	**4,624**	**56,000**
Liabilities								
Deposits from financial institutions	3,000	3,000	-	-	-	-	-	**6,000**
Deposits from customers	1,715	-	-	-	3,374	-	-	**5,089**
Borrowings	-	1,397	-	506	11,516	-	-	**13,419**
Other liabilities	1,155	646	-	38	-	-	-	**1,839**
Total liabilities	**5,870**	**5,043**	**-**	**544**	**14,890**	**-**	**-**	**26,347**
Net liquidity gap	**4,143**	**932**	**4,513**	**5,382**	**6,680**	**3,379**	**4,624**	**29,653**

2011	Within 1 month	2–3 months	4–6 months	7–12 Months	2–5 years	6–10 Years	11–20 years	Total
Assets								
Cash and cash equivalents	8,697	-	-	-	-	-	-	8,697
Placement with financial institutions	-	-	5,229	-	-	-	-	5,229
Trading securities	2,035	-	-	-	-	-	-	2,035
Available-for-sale investments*	-	-	-	5,624	19,082	3,107	-	27,813
Held-to-maturity investments	-	-	127	-	-	-	4,613	4,740
Loans and advances	3,267	328	8,297	-	10,300	-	-	22,192
Other assets	141	303	634	-	730	-	-	1,808
Total assets	14,140	631	14,287	5,624	30,112	3,107	4,613	72,514
Liabilities								
Deposits from financial institutions	-	6,044	-	-	-	-	-	6,044
Deposits from customers	2,886	-	1,000	164	4,719	-	-	8,769
Securities sold under repurchase agreements	3,325	-	-	-	-	-	-	3,325
Borrowings	2,062	-	-	6,605	13,418	-	-	22,085
Other liabilities	23	904	-	2,000	1,433	-	-	4,360
Total liabilities	8,296	6,948	1,000	8,769	19,570	-	-	44,583
Net liquidity gap	5,844	(6,317)	13,287	(3,145)	10,542	3,107	4,613	27,931

27 Financial risk management (continued)

Liquidity risk (continued)

*Is based on management expectation and, in their view likelihood of distributions by the Fund Manager.

Private equity risk

BMB invests in private equity with the intent of later sale of these investments at a profit to third parties, either through a sale to another business ("trade sale") or an initial public offering ("IPO"). Private equity risk is the risk that the Bank will not be able to sell its investments at a profit within the intended time period. This risk arises from three factors. The first relates to the specific investment itself: that it does not develop a sustainable business or its line of business is not attractive to other investors. The second factor relates to macro trends in markets for IPO's and mergers and acquisition activity. The state of these markets affects both the price and timing of any "exit" from an investment. Third, as these investments typically are realised over the medium term and are not traded on organised exchanges, they have limited liquidity.

BMB uses the Standardised Approach under the Basel Framework for measuring and managing its private equity risk, which is considered a part of its "Banking Book".

The Bank manages risks at the specific investment level in the following ways. Firstly, it invests primarily in independently managed third party funds whose managers have a demonstrated successful track record. Based on its own experience and analysis of the private equity industry, BMB believes that the quality of the fund manager is a key risk mitigant. Secondly, the Bank seeks to diversify its investments across fund managers, different stages in the investment cycle (various stages of venture capital, buy-out, etc.), geographical locations and industries. The goal is to reduce exposure to any one investment. At 31 December 2012, the Bank has effectively invested in over 266 companies.

Trends in macroeconomic events and their effects on the IPO and trade sale market are largely out of the control of the Bank. BMB seeks to mitigate its exposure to these risks by selecting managers who have demonstrated a solid track record over the entire economic cycle and by diversification of investments. Diversification is also the key tool for dealing with the inherent limited liquidity of this asset class. In addition, from time to time, the Bank approaches leading investment banks to determine realistic market opportunities for the securitisation of private equity assets.

As a result of a recent review, the Bank has decided to focus on private equity fund investment and minimize direct private equity investments. Refer to also Note 9.

Operating and legal risk

Operating risk is the risk of loss arising from errors that can be made in instructing payments or settling transactions, breakdown in technology and internal control systems.

Since 2008, BMB started to use the Basic Indicator Approach under the Basel II Framework for measuring and managing its operating risk.

Currently, the Bank conducts its business from a single location. BMB is an investment bank and does not operate a retail or commercial banking franchise. Accordingly, the number of client relationships and volume of transactions at BMB are lower than at such institutions. The nature of transactions differ as well, given the Bank's focus on investment in unlisted private equities for its own and its clients' account. These factors mitigate to some extent the operational risks to which the Bank is exposed, both in terms of volumes of transactions and the liquidity of the assets underlying these transactions (e.g. the Bank does not offer cash deposit/withdrawal services, ATMs, credit cards, etc.).

BMB operations are conducted according to well-defined procedures. These procedures include a comprehensive system of internal controls, including segregation of duties and other internal checks, which are designed to prevent either inadvertent staff errors or malfeasance prior to the release of a transaction.

The Bank also engages in subsequent monitoring of accounting records, periodic reconciliation of cash and securities accounts and other checks to enable it detect any erroneous or improper transactions which may have occurred.

27 Financial risk management (continued)

Operating and legal risk (continued)

Legal risk includes the risk of non-compliance with applicable laws or regulations, the illegality or unenforceability of counterparty obligations under contracts and additional unintended exposure or liability resulting from the failure to structure transactions or contracts properly. Legal risks are mitigated through legal counsel review of transactions and documentation, as appropriate. Where possible, the Bank uses standard formats for transaction documentation.

To protect BMB from involvement in money laundering or terrorist finance activities, the Bank has designed and implemented a comprehensive set of policies and procedures. Adherence to the Bank's policies and procedures is reinforced through periodic staff training and internal and external reviews, as well as internal and external review by auditors.

To further mitigate operational and legal risks, the Bank purchases a variety of insurance.

28 CAPITAL MANAGEMENT

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

To manage its capital, BMB employs a risk adjusted measure of capital adequacy (a Capital Adequacy Ratio or "CAR") based on the local regulatory implementation of the Basel Committee on Banking Supervision's capital adequacy guidelines. During 2012 & 2011, the Bank used the standards in the Basel II Framework and for the year 2010 and before, the Basel 1988 Accord and 1996 Amendment for Market Risks.

The BMB Group manages its capital:

- to comply at all times with the Capital Adequacy Ratio set by the Group's regulator, the Central Bank of Bahrain
- to ensure that the Bank has sufficient capital to enable it to absorb diminutions in the value of its assets or unexpected losses while continuing to function as a "going concern"
- to maintain a sound capital base that allows the Bank to take advantage of opportunities to develop and grow its business.

The Group's executive management monitors the Bank's capital adequacy on a daily basis using the CAR. Reports on the Bank's capital adequacy are filed quarterly with the Central Bank of Bahrain.

In determining its Capital Adequacy Ratio, the Bank calculates risk adjusted assets which are then divided by regulatory capital rather than the equity capital appearing in the Bank's statement of financial position.

Regulatory equity capital is composed of three elements:

Tier 1 Capital is the paid up share capital, audited retained earnings and accumulated reserves arising from the appropriation of current and past years' income and/or retained earnings less any treasury stock, minority interests or negative fair value reserves - Local regulations require that certain investments or exposures be deducted from Tier 1 capital. As at 31 December 2012, the Bank made deductions of US$ 360 thousand on account of such exposures (2011: US$ 1,059 thousands).

Tier 2 Capital consists of the qualifying portion of subordinated loan, current year profit and unrealised gains arising on fair valuation. Under Central Bank of Bahrain regulations, the aggregate amount of Tier 2 capital eligible for inclusion in the CAR is limited to no more than 100% of Tier 1 Capital.

Effective 1 January 2008 the Bank implemented Basel II Framework as per the CBB regulation. Using the Basel II Standardised Approaches for credit and market risk and the Basic Indicator Approach for operational risk, BMB's Basel II Capital Adequacy Ratio as at 31 December 2012 increased to 34.0% as compared to 24.7% as at 31 December 2011.

(United States Dollars thousands)

28 Capital management (continued)

Capital base and risk weighted assets

	2012	2011
Tier 1 capital		
Share capital	60,501	60,501
Legal reserves	17,545	16,954
Accumulated losses	(49,045)	(51,014)
Unrealised gross loses arising from fair valuing equity securities	(3,122)	(3,151)
Excess amount over maximum permitted large exposure limit	(360)	(1,059)
Total qualifying Tier 1 capital	**25,519**	22,231
Tier 2 capital		
Revaluation reserves – available-for-sale investments	2,055	2,407
Subordinated loan	-	-
Total qualifying Tier 2 capital	**2,055**	2,407
Total regulatory capital	**27,574**	24,638
Risk weighted assets		
On-balance sheet	78,494	87,397
Off-balance sheet	2,671	12,131
Total risk weighted assets	81,165	99,528
Capital Adequacy Ratio	**34.0%**	24.7%

29 CREDIT RELATED CONTINGENT ITEMS AND COMMITMENTS

Credit-related contingent items include commitments to extend credit and to participate in investments, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Bank's customers.

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed dates or other termination clauses and require the payment of a fee. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

Standby letters of credit, guarantees and acceptances commit the Bank to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

Undrawn investment commitments comprise contractual commitments to investments made in other equities and funds. These amounts are called by fund managers, generally for a period of between four and six years. Undrawn investment commitments also include commitments to quoted equities where the settlement date is after the reporting date.

The outstanding credit related contingent items and commitments items at 31 December were as follows:

	2012	2011
Undrawn investment commitments in other equities and funds (Note 9)	6,302	9,469
Letters of credit and guarantee	1,453	1,423
Other commitments	2,736	2,736
Funds under management	76,495	80,283

Other commitments represent unclaimed dividend amounts written back by the Bank in 2011. However, as per regulatory requirement, these amounts have been carried as a contingent item (refer Note 20).

(United States Dollars thousands)

29 Credit related contingent items (continued)

Funds under management include BMB Technology and Telecommunications Investment Company, a US Focused venture capital fund of funds, customer sub-participations in private equity funds - as managed by the Bank and other Client funds managed on a discretionary basis.

30 FAIR VALUE OF FINANCIAL INSTRUMENTS

The table below compares the estimated fair values of financial assets and liabilities in the statement of financial position and credit related contingent items with their respective book amounts as of 31 December 2012 and 2011. As set out in Note 4 to the financial statements, certain of the Bank's financial instruments are accounted for under the historical cost convention except for the measurement at fair value of certain available-for-sale investments and trading securities which may differ from the fair value for which the asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Consequently differences can arise between the book amounts and the fair value estimates.

2012	**Carrying value**	**Fair value**	**Under carrying value**
Assets			
Held-to-maturity investments	4,624	4,197	(427)
Loans and advances	21,168	21,168	-
Net shortfall of fair value over carrying value			**(427)**

2011	Carrying value	Fair value	Under carrying value
Assets			
Held-to-maturity investments	4,613	3,638	(975)
Loans and advances	20,513	20,513	-
Net shortfall of fair value over carrying value			(975)

The total shortfall in fair value of US$ 427 thousand (2011: US$ 975 thousand) is not relevant except in a forced sale situation since the Bank has the intention to hold these Held-to-maturity investment securities until maturity when it would recover full nominal amounts. However, in the event these held to maturity investment securities are sold, the impact on the consolidated income statement and equity would be US$ 427 thousand.

The total fair value of Held-to-maturity investment security is based on quoted market prices at the reporting date. The fair value of loans and advances is based on amounts estimated to be received upon maturity.

The fair value of the instalment sale receivable is shown at amortised cost, which approximates the value calculated using the discounted cash flow method.

No fair value adjustment is appropriate for off-balance sheet financial instruments with contractual amounts representing credit risk as specific provisions are made in respect of individual transactions where a potential loss, if any, has been identified.

The estimated fair value of the following assets and liabilities is not significantly different from the corresponding book amounts as the items are short term in nature:

• Cash and cash equivalents

• Deposits from financial institutions

• Other assets

• Deposits from customers

•Other liabilities

(United States Dollars thousands)

Fair value of financial instruments (continued)

The estimate fair values of the borrowings are not significantly different from book amounts as these liabilities are primarily re-priced on a quarterly/annual basis.

Fair value hierarchy

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Group's market assumptions. These two types of inputs have created the following fair value hierarchy:

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

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

Level 3 - Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation.

This hierarchy requires the use of observable market data when available. The Group considers relevant and observable market prices in its valuations where possible.

The table below analyses financial instruments measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised

31 December 2012	**Level 1**	**Level 2**	**Level 3**	**Total**
Trading securities	437	-	-	437
Available-for-sale investments				
- Quoted equity	6	-	-	6
- Unquoted equity fund investments	-	-	21,500	21,500
Total	**443**	**-**	**21,500**	**21,943**
31 December 2011	Level 1	Level 2	Level 3	Total
Trading securities	2,035	-	-	2,035
Available-for-sale investments				
- Quoted equity	2,230	-	-	2,230
- Unquoted equity fund investments	-	-	25,100	25,100
Total	4,265	-	25,100	29,365

Movements in level 3 of investments classified at fair value:

	2012	2011
At 1 January	25,100	29,956
Net fair value movement on available-for-sale investments	(241)	(3,146)
Additions	1,060	1,445
Exits (at cost)	(3,189)	(1,780)
Fair value transferred to statement of income on disposals	(1,230)	(1,375)
At 31 December	**21,500**	25,100

Level 3 available-for-sale investments represent private equity funds where the underlying fund managers exercise judgements in valuation of investments. There have been no transfers in/out of level 3.

(United States Dollars thousands)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

SEGMENT INFORMATION

The Group's business segments are broken down by key business activities and those with clearly identifiable revenue streams and expenses. These include "Trading", "Investing" and "Other operating segments". The segmentation is in line with that internally reported to the Chief Operating decision maker.

Business Segments

The Group's main business activities can be broadly broken down into trading, investing which is mainly made up of its investments in Private Equity Funds, and other operating segments.

Segment	**Activity**
Trading	Investments in listed bonds and equities
Investing	Investments Private Equity Funds
Other operating segments	Investor marketing and building rental income etc

2012	**Trading activity**	**Investing activity**	**Other operating segments**	**Total**
Investment banking income	(80)	2,629	4,669	7,218
Foreign exchange translation gain	-	927	-	927
Interest income	23	1,123	478	1,624
Interest expense	-	(862)	(149)	(1,011)
Results from operations before impairment	(57)	3,817	4,998	8,758
Unallocated other income	-	-	-	390
Unallocated corporate expenses	-	-	-	(6,411)
Impairment provision				(549)
Net income for the year				**2,188**

	Trading Activity	Investing activity	Other operating segments	Total
Reportable segment assets	437	26,168	28,660	**55,265**
Reportable segment liabilities	-	5,089	19,731	24,820
Equity				30,445
Total liabilities and total equity				**55,265**

2011	Trading Activity	Investing activity	Other operating segments	Total
Investment banking income	873	2,911	2,450	6,234
Foreign exchange translation gain	-	461	-	461
Interest income	123	735	544	1,402
Interest expense	-	(1,413)	(315)	(1,728)
Results from operations before impairment	996	2,694	2,679	6,369
Unallocated other income	-	-	-	3,974
Unallocated corporate expenses	-	-	-	(6,622)
Net income for the year				3,721

(United States Dollars thousands)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

31 Segment information (continued)

2011	Trading Activity	Investing activity	Other operating segments	Total
Reportable segment assets	2,035	32,426	36,697	71,158
Reportable segment liabilities	-	8,752	33,398	42,150
Equity				29,008
Total liabilities and total equity				71,158

Geographical Segments

	North America		Europe		Rest of the world		Total	
	2012	2011	**2012**	2011	**2012**	2011	**2012**	2011
Income								
Total income	**2,706**	3,848	**873**	969	**6,580**	7,254	**10,159**	12,071
Assets								
Total assets	**13,332**	14,901	**20,083**	30,283	**21,850**	25,974	**55,265**	71,158

Although the Group's two main business segments are managed on a worldwide basis, they operate in two main geographical areas. The Group's exposure to credit risk is concentrated in these areas:

North America - United States of America and Canada

Europe - Primarily Western Europe

32 COMPARATIVES

During the current year the Group has regrouped certain items in the consolidated financial statements to improve presentation. Such regrouping did not have any impact on net equity or profit or loss of the Group previously reported.

This Annual Report contains certain "forward-looking" statements, and such information is based on the beliefs Bahrain Middle East Bank (B.S.C) (hereinafter referred to as "BMB"), as well as assumptions made by, and information currently available to, BMB. When used in this Annual Report, the words "anticipate", "believe", "estimate", "expect", "plan", "intend", and words or phrases of similar import, are intended to identify forward-looking statements. Such forward-looking statements may include, without limitation, statements relating to the following: BMB's plans, strategy, objectives or goals; BMB's future economic performance or prospects, specific country, region and worldwide business environment; potential effect on future performance of certain contingencies; and assumptions underlying any such statements. These statements are inherently subject to significant business, economic, competitive, regulatory, and operational uncertainties, contingencies and risks, both specific and general in nature, many of which are beyond the control of BMB. Any forward-looking statements are speculative in nature, and it can be expected that one or more than of the assumptions underlying such statements will prove not to be accurate, and unanticipated events and circumstances may occur. Actual results and events will likely vary from the plans, objectives, expectations, estimates, and intentions expressed in such forward-looking statements, and such variations may be material.

Consequently, this Annual Report shall not be regarded as a representation by BMB that the plans, objectives, expectations, estimates, and intentions expressed in such forward-looking statements will be achieved and shall not be relied on whatsoever. BMB does not intend to update these forward-looking statements.