HSBC Bank Oman S.A.O.G.
(Formerly Oman International Bank S.A.O.G.)

Annual Report 2012

HSBC

His Majesty Sultan Qaboos bin Said

Contents

Board of Directors' Report

Dear Shareholders,

It is a great pleasure and privilege to present the first full year report for 'HSBC Bank Oman S.A.O.G.' ("HBON"), seven months on since the operations of Oman International Bank S.A.O.G. ("OIB") and HSBC Bank Middle East Limited's Oman branch ('HSBC Oman') combined. This period has therefore been one of integration, and of building the foundation for future sustainable success for the Bank and all our stakeholders. Under challenging conditions, significant progress was achieved, thanks to the commitment, patience and support of our loyal customers and the hard work and dedication of all of our employees.

Economic Overview

The Oman economy experienced healthy economic performance in 2012, with an actual GDP growth of 8.3% and continued strong government expenditure. Inflation remained moderate at approximately 3% while growth of non-oil GDP was estimated at 10.6%. In 2013, Oman is expected to benefit from further investment commitments, with a projected public expenditure of RO12.9bn, a 29% increase over 2012 to fund new infrastructure projects. The government forecasts a 7% growth in Oman's overall economy in 2013 and significantly, the allocation to social expenditure will increase by 16% and for housing by 45%.

History

The combination in June 2012 of the Oman International Bank and HSBC Oman to form HSBC Bank Oman S.A.O.G. has brought together two organisations with a rich history in the country. The result is a stronger and larger financial institution in the Sultanate, with a considerably expanded domestic network and a truly international presence. At the date of the merger, the combined entity became the third largest bank by total assets, and had the second largest branch network in the Sultanate. For both entities, the merger increased scale and international connectivity and for OIB customers, provides immediate access to HSBC's global product suite.

Established in 1947, HSBC Bank Middle East was the first bank in the Sultanate, and remains the oldest and largest foreign bank in the country. OIB was founded in 1979 and has enjoyed a long and illustrious history. As well as building one of the most extensive branch networks across the country, OIB established a track record of innovation and was the first bank in Oman to introduce the Omani Rial Credit Card, mobile banking, and phone banking.

The merger to form our Bank represented HSBC's first merger in the Middle East and North Africa region for many years and provided the HSBC Group with a rare opportunity to increase scale and commitment to Oman. It also means the Bank is now fully connected to one of the world's largest financial services organisations, with an international network covering more than 80 countries globally.

Merger and Integration

Under International Financial Reporting Standard 3 ('IFRS 3'): 'Business Combinations', the operations of HSBC Oman and OIB merged on 3 June 2012 through a transaction accounted for as a "reverse acquisition". HSBC Holdings Plc acquired 51% of the combined entity through its indirect wholly owned subsidiary HSBC Bank Middle East Limited, following the issuance by OIB of 1,020,159,523 shares in favour of HSBC Bank Middle East Limited. As a result, the financial statements of HBON are shown as a continuation of those of HSBC Oman, adjusted to reflect the legal capital and statutory reserves of OIB.

Board of Directors' Report

Performance Summary

Overall, HBON has posted a set of results which reflects management's focus on the integration of two banks and the investment in its future as a combined enlarged entity.

As per IFRS 3 net interest income for the year was RO40.1m, up by 81.5% compared to RO22.1m for the year ended 31 December 2011. Total other operating income improved by 60.2% to reach RO20.4m. However, margin pressure and associated revenue challenges did impact performance during the year. In addition, the amount provided for loan impairment charges net of recoveries was RO4.6m. Non-performing loans as a percentage of total loans increased from 1.2% in 2011 to 7.1% in 2012 with a coverage ratio of 89.4%.

Costs have been tightly managed and the ongoing operating expenses of the combined entity fell. This establishes a strong platform for our continued growth in 2013 and beyond. While total operating expenses rose to RO48.7m, the increase is primarily due to integration expenses of RO13.9m. Through close management, the integration was achieved below budget and delivers long term recurrent savings on the costs required to operate the combined Bank. The principal costs of integration were incurred in information technology, refurbishment of the branch network, enhancing the ATM proposition and branding of the newly merged entity.

During the year, the Bank recorded a 62.7% decrease in net profit to RO5.8m compared with RO15.5m for 2011. Earnings per share were RO0.004 for the year ended 31st December 2012 compared to RO0.016 in the previous year.

Loans and advances, net of provisions and reserved interest, rose to RO1,194m as at 31 December 2012 compared to RO454m as at 31 December 2011. Of the increase RO685m, or 92.6%, was due to merger, while the balance was due to growth in advances by the Bank.

Customer deposits stood at RO1,851m as at 31 December 2012, up 147.8% on the RO748m as at 31 December 2011. RO1,014m of the increase was as a result of the business combination, while the remaining RO89m was due to growth in deposits by the Bank. The loan to deposit ratio reached 64.5% in 2012 compared to 60.7% in 2011.

The Capital Adequacy Ratio stood at 16.03% compared to 17.25% in the previous year, consistent with our policy of ensuring a robust capital adequacy ratio, to support the continued growth of the Bank into the future.

Reflecting the Bank's intention to invest for the future, the Board of Directors proposes a total cash dividend of RO2.0m, with a dividend payout ratio of 34.5%.

Serving Our Customers

In the months following the merger, the overriding priority of the management team has been the operational, strategic and cultural integration of the two entities to ensure that customer expectations are met. This work is ongoing, but to date, we have met the initial deadlines in integrating the two separate operational platforms with immediate customer benefits.

Systems integration was completed in November, providing all HBON branches with access to an international standard banking and management system, supporting effective and consistent procedures across every branch. Our customers can now access the full service proposition at all branches of the bank across the Sultanate and our customers are already benefitting from a more competitive lending proposition offered across the network. Overall, the service experience has been dramatically enhanced through a unified banking environment and we will continue to work with our customers to improve the offering further.

HBON joined the OmanNet National Switch following the merger, providing our customers with immediate access to well over 1,000 ATMs across the Sultanate. The ATM network has also been updated extensively, with 107 units replaced and upgraded. As a result, customers now have direct access to their accounts through a dedicated network of more than 130 ATM units, offering deposit and withdrawal facilities around the country.

In addition, the management team has conducted a full review of our business, aimed at improving organisational efficiency and the sustainability of our operating model. After initial review, the branch network has been segmented into three categories - Flagship, Mid-Market and Community – to match the needs of each segment of our customer base. To date, 21 branches have been refurbished, with 60 scheduled for completion in 2013, improving the experience for our customers and our staff.

In accordance with the merger agreements, the disposal

Board of Directors' Report (continued)

or closure of our branches in India and Pakistan is on-going, together with the restructuring of any non-strategic businesses.

Investing in Our People and Brand

HBON aims to build long-term customer relationships through the provision of a consistent and high-quality service and customer experience. In support of this, an extensive programme comprising 12,892 days of in-depth staff training began immediately following the merger. We are committed to the development of our talented Omani workforce and are providing the full range of international training and development opportunities offered by the HSBC Group.

Customer Migration

Since June we have migrated more than 400,000 retail customers and 10,000 corporate customers onto the new single systems platform. New HSBC cards and account collateral have been distributed to customers through our branches. Furthermore, to ensure full compliance with Central Bank of Oman regulations, we have implemented an extensive Know Your Customer campaign across our network. This up-to-date customer information will also allow us to provide our customers with a more personalised banking experience.

Corporate Sustainability – Our Commitment to Oman

At HBON, we strongly believe in the importance of playing a positive role in the economy and society. In Oman, our Corporate Sustainability programme involves a number of initiatives, with at least 75% of our community investment activity supporting educational and environmental causes. During 2012, the Bank was involved in several initiatives. We collaborated with the Oman Chamber of Commerce and Industry (OCCI) to support the education of Omani high school graduates from underprivileged families through the 'Al Najah Programme'; we launched the second year of the 'Kids Read' education programme in conjunction with the Ministry of Education and the British Council; we continued our 4-year partnership with the Environment Society of Oman to support research on sustainable frankincense farming in Dhofar; and we drove a national Earth Hour pledge campaign to raise climate impact awareness in communities and encourage support for change.

Looking Ahead

HBON's immediate strategy is dedicated to the completion of the integration and transition processes. This will drive the investment in our branches, people and systems, in order to support our customers' needs and deliver on our strategic priorities. Looking further into 2013, we will shift our focus to the growth plan for the business, developing existing relationships, connecting our customers to more opportunities and delivering an increasingly consistent and superior customer experience.

Our ambitions to expand and grow the business require the maintenance of sufficient capital resources to support our diverse activities. Our performance in 2012 ensured that HBON is sufficiently capitalised to support our growth aspirations, with an aim to deliver sustainable shareholder return in the coming years.

Conclusion

A significant set of milestones for the Bank have been achieved in a short timeframe. We will continue to focus our efforts on meeting and exceeding the needs of our customers. Importantly, we would like to thank all our stakeholders for their patience and support as we transition into a new and exciting chapter for the Bank.

In closing, and on behalf of the Board of Directors, I would like to extend my gratitude and appreciation to all our valued customers, staff and management for their uncompromised dedication and steadfast commitment, as well as to the Central Bank of Oman and the Capital Market Authority for their continued support and guidance. I also wish especially to thank His Excellency Dr Omar bin Abdulmuniem Al Zawawi.

On behalf of the Board I express our deepest gratitude to His Majesty Sultan Qaboos bin Said for his visionary leadership and the peace, stability and growth which his reign has brought us.

Simon N Cooper
Chairman

KPMG
4th Floor, HSBC Bank Building
MBD
P.O. Box 641
P.C. 112
Sultanate of Oman

Tel 968 24709181
Fax 968 24700839

Report to the Shareholders of HSBC Bank Oman SAOG ("the Bank") of Factual Findings in connection with the Corporate Governance Report of the Bank and application of the Corporate Governance practices in accordance with Capital Market Authority Code of Corporate Governance

We have performed the procedures prescribed in the Capital Market Authority ("CMA") Circular No. 16/2003 dated 29 December 2003, as amended, with respect to the Corporate Governance Report of the Bank ("the Report") and its application of the Corporate Governance practices in accordance with the CMA Code of Corporate Governance ("the Code") issued under Circular No. 11/2002 dated 3 June 2002, and the CMA Rules and Guidelines on disclosure, issued under CMA Administrative Decision 5/2007, dated 27 June 2007, as amended. The Report is set out on pages 6 to 19.

Our engagement was undertaken in accordance with the International Standards on Auditing applicable to agreed-upon procedures engagements. The procedures were performed solely to assist you in evaluating the Report.

We found the Report reflects, in all material respects, the Bank's application of the provisions of the Code and is free from any material misrepresentation.

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing, we do not express any assurance on the Bank's Corporate Governance Report. Had we performed additional procedures or had we performed an audit or review of this Report in accordance with International Standards on Auditing, other matters might have come to our attention that would have been reported to you.

This report is solely for the purpose set forth in the second paragraph above, and for inclusion, with the Report, in the Bank's annual report, and is not to be used for any other purpose; and we accept no responsibility to any third party. This report relates only to the Report included in the Bank's annual report for the year ended 31 December 2012 and does not extend to the financial statements or any other reports of HSBC Bank Oman SAOG, taken as a whole.

KPMG

5 March 2013

Michael G. W. Armstrong

Corporate Governance Report
For the Annual Report 2012

1. Governance philosophy of HBON to include values and business principles

1.1 HSBC Bank Oman S.A.O.G. ('HBON') emerged as a result of a merger on 3 June 2012 between the former HSBC Bank Middle East Limited Oman branch ('HBME Oman') and Oman International Bank S.A.O.G. ('OIB'), with HSBC Bank Middle East Limited ('HBME') having a 51% shareholding in HBON following the merger.

1.2 The HBON Board of Directors ('Board') believes that good governance is central to protecting the interests of all stakeholders, and to achieving HBON's business strategies.

1.3 HBON has implemented a corporate governance framework ('Framework'), which ensures that the governance of HBON meets all local Oman regulations; and also international best practice based on the HSBC Group global standards.

1.4 The Framework clearly sets out the matters reserved to the shareholders, to the Board and to the executive management team ('Management'). The governance philosophy of HBON is based on the following principles:

- An effective and accountable Board of Directors;
- A clear and strategic direction for business development;
- Prudent accounting principles and information;
- Sound decision-making mechanisms;
- Strategy-linked performance evaluation;
- Human resource development.

1.5 The Board has implemented two Board committees as required under the local laws, namely the HBON Audit Committee and the HBON Risk Committee. The Board also has oversight for the HBON management committees, which include an Asset & Liability Management Committee, a Risk Management Committee, an Operational Risk & Internal Control Committee and an Executive Management Committee.

1.6 Each of these Board and management committees is governed by formal terms of reference which set out their membership, scope, responsibilities and accountability.

1.7 HBON has adopted the following values and business principles. These govern the culture and behaviour expected within HBON:

Values

To be dependable and do the right thing

- Stand firm for what is right, deliver on commitments, be resilient and trustworthy;
- Take personal accountability, be decisive, use judgment and common sense, empower others.

To be open to different ideas and cultures

- Communicate openly, honestly and transparently, value challenge, learn from mistakes;
- Listen, treat people fairly, be inclusive, value different perspectives.

To be connected to customers, communities, regulators and each other

- Build connections, be aware of external issues, collaborate across boundaries;
- Care about individuals and their progress, show respect, be supportive and responsive.

Principles

- Financial Strength - maintain capital strength and liquidity;
- Risk-Management - be enterprising and commercial, understand and be accountable for the impact of our actions, take prudent decisions;

- Speed - be fast and responsive, make principles-led decisions;
- Performance-focus - drive leading, competitive levels of performance, act with urgency and intensity, prioritise, simplify;
- Efficiency - focus on cost discipline and process efficiency;
- Quality - pursue excellence;
- Customer-focus - provide outstanding customer experience;
- Integrated - align HBON with the standards of the rest of the HSBC Group and break down silos;
- Sustainability - take a long-term outlook, understand impact of actions on stakeholders, brand and reputation.

1.8 HBON has also adopted the following purpose statement:

'To be where the growth is, connecting customers to opportunities; to enable businesses to thrive and economies to prosper; to help people fulfil their hopes and dreams and realise their ambitions.'

1.9 The HBON values are carefully balanced with its commitments to each of its following stakeholders:

- Customers;
- Employees;
- Shareholders;
- Regulators and governments;
- Suppliers, bondholders, other creditors;
- Communities and societies.

1.10 HBON seeks to comply in all respects with the letter and spirit of the Oman Code of Corporate Governance for Public Listed Companies as updated from time to time ('Code'). This paragraph summarises HBON's compliance approach towards the Code:

Article 3 – composition of the Board of Directors

- The Board comprises a majority of non-executive directors, a minimum of a third of whom are considered to be independent. Note that the CMA have recently amended the definition of 'independent' under the Code but have confirmed via their website that this amendment is only to apply from the date of the next board election;
- The roles of the Chairman of the Board and the CEO are separate (held by two separate individuals) and are clearly defined.

Article 4 – number of Board meetings

During 2012, the Board met eighteen times, complying with the requirement to meet at least four times in a year, with a maximum time gap of four months between any two consecutive meetings.

A comprehensive agenda and Board papers (covering the matters set out in Annexure 2 of the Code) are tabled for information and (where applicable) approval at each Board meeting.

Article 5 – functions of the Board members

The duties of the Board members are clearly defined in the Framework, and include the matters set out in Article 5 of the Code.

Article 6 – Board meeting and role of the secretary

The Board has appointed a legally qualified company secretary of HBON. The company secretary carries out the duties set out in Article 6 of the Code, and in addition, advises on best international governance practice, and local governance requirements.

Corporate Governance Report (continued)

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Article 7 – Audit Committee

The Board has set up an Audit Committee in compliance with the terms of Article 7 of the Code. Formal terms of reference have been adopted, covering membership, scope, responsibilities and accountability. Private sessions are held regularly between the Audit Committee on the one part and (separately) the Chief Financial Officer, Head of Internal Audit, External Auditors, Head of Compliance and the statutory legal adviser.

Article 8 – role of the Audit Committee

The Audit Committee terms of reference cover the matters set out in Annexure 3 to the Code.

Article 9 – audit and internal control

External auditors have been appointed in compliance with Article 9 of the Code. The external auditors do not provide any non-audit services to HBON.

Article 10 – systems of internal control

The Board keeps the systems of internal control of HBON under continual review.

Article 11 – executive management

Management has been appointed under formal contracts of employment.

Article 12 – promoting competence of the executive management team

The Board keeps the training and development of Management, together with skills required and succession planning, under continual review.

Article 13 – accountability of the executive management team

Management is accountable to the Board through the CEO. The Framework sets out matters which are reserved to the Board. Day to day business matters are conducted through the executive management committee.

Article 14 – organisational manual

Clear delegations of authority and matters reserved to the Board are set out in the Framework.

Article 15 – implementation of Board policies by the executive management team

The Board ensures that the decisions and policies which it approves under the 'reserved matters' set out in the Framework are implemented by Management. The CEO attends the Board meetings, and is accountable for ensuring that Board decisions and policies are implemented effectively, and on time.

Article 16 – management discussion and analysis

Reference is made to the separate Management Discussion and Analysis report.

Article 17 – management disclosure of interests

Management is bound by a conflict of interest policy, and also a share dealing policy.

Article 18 – financial information on the website

HBON financial information is uploaded onto the Muscat Securities Market ('MSM') all in accordance with the local regulatory requirements. It is also uploaded into the HBON website (www.hsbc.co.om).

Article 19 – rules for related party transactions

A register of directors' interests is maintained in order to identify any contracts or other interests held by any of the HBON directors.

Article 20 – details of related party transactions

Disclosable related party transactions are kept under continual review. Details of any such transactions identified are included in the notice of annual general meeting.

Article 21 – works and procurement policy

HBON has implemented and follows a formal works and procurement policy.

Article 22 – auditor disclosure on related party transactions

The external auditors report on the proper discharge of the responsibilities of any related party under any contract not falling with the normal course of the business.

Articles 23 and 24 – other related party rules

HBON complies with all other international standards relating to the disclosure of related party transactions.

2. Board of Directors of HBON

2.1 Board membership is governed by the Commercial Companies Law and other applicable laws of Oman. The current Board comprises seven members, elected for a term of three years. The next Board election will be in 2015, unless required earlier under the provisions of the law and HBON's articles of association ('Articles').

2.2 The functions of the Board are governed by all relevant laws, regulations and the Articles, to include the Banking Law, Central Bank of Oman ('CBO') regulations, the Commercial Companies Law, and Article 5 of the Code.

2.3 HBON is committed to ensuring that each of the seven directors on the Board possesses the following characteristics:

- High ethical standards and integrity in their personal and professional dealings;
- High intelligence and wisdom, which is applied to make sound decisions;
- Capacity to read and understand financial statements;
- Potential to contribute towards the effective stewardship of HBON;
- The ability to perform to a high standard during periods of short and long term pressure;
- Capacity to approach others assertively, responsibly and cooperatively;
- Capacity to activate and consult employees of HBON to reach high standards of management.

2.4 The Board as a whole strives to achieve the following core competency, with each candidate contributing at least in one domain:

- Skills to motivate high performing talent;
- Strategic insight and ability to direct by encouraging innovation and continuously challenging the organisation to sharpen its vision;
- Expertise in financial and corporate finance;
- The ability to understand management trends in general; and also to understand the banking industry locally and globally;
- To acquire and maintain appropriate and relevant industry specific knowledge;
- To acquire and maintain business expertise in international markets

Corporate Governance Report (continued)
For the Annual Report 2012

- 2.5 The following table sets out the qualifications and biography of the Board. It includes details of the directors of the former OIB who resigned with effect from 31 May 2012:

Name	**Biography**	**HBON* Appointment date *(Director of OIB from 31 May – 3 June 2012)**	**HBON* Resignation date *(OIB)**
Directors in office			
Mr. Simon Cooper *Chairman* *Qualifications: Graduate of the University of Cambridge and holds an MA in Law; Alumni of Columbia Business School*	Deputy Chairman and Chief Executive Officer of HSBC MENA since May 2009; appointed a Group General Manager of HSBC in May 2008; former President & CEO, HSBC Korea; From 2004 – 2006 Managing Director and Head of Corporate & Investment Banking of HSBC in Singapore; previously the Deputy Chief Executive and Head of Corporate & Investment Banking in HSBC Thailand from 2001 to 2003. Prior to his role in Thailand, Mr Cooper had 12 years of experience as a Director in corporate finance with the HSBC Group in London, Hong Kong and Singapore.	*31 May 2012	
Mr. Waleed Omar Al Zawawi *Deputy Chairman* *Qualifications: Masters from Kings College, UK*	Director of Oman International Bank S.A.O.G. since 1996 with over 28 years of corporate experience.	*31 May 2012	
Dr. Juma Ali Juma Al Juma *Senior Independent Director* *Qualifications: PhD in Political Science*	Worked with the Royal Office from 1982 to 1996; General Secretary of the Tender Council from 1996 to 2001; Minister of Manpower from 2001 to 2008. Currently Chairman of Oman Airports Management Company S.A.O.C.	*31 May 2012	
Mr. Aimen Ahmed Sultan Al Hosni *Qualifications: Masters in Public Administration*	Working with the Ministry of Civil Services since 1999; currently Director General of Information and Statistics and Superintendent of Oracle HRMS Project; Director of Oman Telecommunications Company S.A.O.G.; Chairman of Oman National Engineering and Investment Company S.A.O.G.	*31 May 2012	
Mr. David Kotheimer *Qualifications: Master of Business Administration degree from Thunderbird School of Global Management in Glendale, Arizona; Bachelor of Arts degree in political science from the University of Pittsburgh in Pittsburgh, Pennsylvania*	Regional Head of Strategy & Planning and Head of International for the HSBC Group's Middle East and North Africa (MENA) Region; formerly Deputy CEO for HSBC Brazil located in São Paulo from July 2009 to January 2012, responsible for several businesses and functions within the Brazilian operations including Legal, Human Resources, Compliance, Marketing, Planning, Transformation, Private Banking and Asset Management.	*31 May 2012	

Corporate Governance Report
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Name	Biography	HBON* Appointment date *(Director of OIB from 31 May – 3 June 2012)	HBON* Resignation date *(OIB)
Directors in office			
Ms. Francesca McDonagh *Qualifications: Bachelor of Administration (Honours) from the University of Oxford in Philosophy, Politics and Economics*	Head of Retail Banking and Wealth Management (RBWM) for HSBC in MENA since July 2011; formerly Head of Personal Financial Services in Hong Kong, responsible for consumer assets, direct channels, retail branches, customer experience and strategic development of the retail business.	*31 May 2012	
Mr. Abdulfattah Sharaf *Qualifications: Graduate of the University of Denver, USA with a Bachelor of Arts, majoring in political science and a minor in special education*	CEO, UAE, HBME; formerly CEO Personal Financial Services, MENA, responsible for all of HSBC's Retail Banking business in MENA; former CEO of NBD Securities, a subsidiary of Emirates NBD, in terms of assets the largest financial conglomerate in the Middle East.	*31 May 2012	
Resigned from office			
Mr. Bipin Dharamsey Nensey Former Deputy Chairman of OIB	Director with Dharamsey Nensey Company, Muscat since 1977; Deputy Chairman of the OIB Board since 2002; Deputy Chairman of the Board of Muscat National Holding Company S.A.O.G.		*31 May 2012
Mr. Salem Nasser Sultan Al Bortmany *Qualifications: Bachelors in Chemical Engineering, UK, Masters in Business Administration and Management, UK and Senior Executive Program, USA*	Currently the Deputy General Manager of Areej Vegetable Oil & Derivatives Company S.A.O.G.; Director on the Boards of Reem Batteries & Power Appliances Company S.A.O.C. and Oman Textile Holding Company S.A.O.G.		*31 May 2012
Mr. Rajiv Dhar *Qualifications: Chartered Accountant (India) and alumnus of the Wharton School*	Currently Executive Director Finance at Omar Zawawi Establishment LLC; Director on the Boards of National Detergent Company S.A.O.G., Oman Textile Holding Company S.A.O.G. and Oman Fiber Optic Company S.A.O.G.		*31 May 2012
Mr. Safaa El Din Sadek *Qualifications: Certified Accountant (Egypt), Fellow of The Arab Society of Certified Accountants and Fellow of the Arab Society of Certified Accountants of Jordan*	Auditor at the Central Accounting Organization of Egypt from 1964 to 1970; Country Senior Partner of PwC Oman from 1971 to 2002.		*31 May 2012

Corporate Governance Report (continued)

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2.6 The following table sets out the profile of the CEO, HBON

Name	**Biography**
Mr. Ewan Stirling *Qualifications: Bachelor of Law (LLB Hons) from the University College of Wales*	Appointed CEO of HSBC in Oman in 2007. Joined HSBC in 1986; first served in the Middle East with The British Bank of the Middle East in Bahrain as a Manager Customer Accounts; Credit Manager, Corporate Banking in HSBC Hong Kong from 1991-1993, after which he joined The HSBC Group's head office in Asia Pacific as Manager Strategic Planning; also served in the UK for HSBC Investment Bank as Associate Director of Amanah Finance between 1999-2001. Later appointed as Senior Manager Strategic Alliance at the Group's Head Office in the UK with a specific responsibility for Merrill Lynch HSBC from 2001-2002. He then joined the Bank in Hong Kong as Senior Manager Strategy Implementation between 2002-2004 and then as Head of Customer Propositions.

2.7 The following table provides details of each HBON Director, term of office, capacity of representation/name of representative (in case of a Juristic Director), membership of Board Committees and membership in Boards of other S.A.O.G. companies.

Name	**Term (Yrs) From 31 May 2012**	**Designation**	**Capacity (as indicated in the director candidate application forms)**	**Committee Member?**	**Director of any other S.A.O.G. Company?**
Mr. Simon Cooper	3	Chairman	Independent Non-executive	No	No
Mr Waleed Omar Al Zawawi	3	Deputy Chairman	Independent Non-executive	Audit	Yes
Dr. Juma Ali Juma Al Juma	3	Senior Independent Director	Independent Non-executive	No	Yes
Mr Aimen Ahmed Al Hosni	3	Director	Independent Non-executive	Risk	Yes
Mr David Kotheimer	3	Director	Independent Non-executive	Risk and Audit (Chairman)	No
Ms. Francesca McDonagh	3	Director	Independent Non-executive	Risk and Audit	No
Mr. Abdulfattah Sharaf	3	Director	Independent Non-executive	Risk	No

2.8 The following table sets out the attendance of each Board member during 2012 at the Board meetings, and also at the Annual General meeting:

Note: The following coding applies to this table:

Ja=January
Ma=March
A=April
My=May
Ju=July
O=October
D=December
Y=Yes
N=No
Py=Proxy

Director	02 Ja	29 Ja	30 Ja	4 Ma	13 Ma	14 Ma	31 Ma	17 A	30 A	9 My	28 My	30 My	31My	3 Ju	29 Ju	16 O	23 O	9 D	31 My AGM	31 My OGM
Mr. Simon Cooper	-	-	-	-	-	-	-	-	-	-	-	-	Y	Y	Y	Y	Py	Y	-	Y
Mr. Waleed Omar Al Zawawi	-	Py	Py	Y	Y	Y	Y	Y	Y	Y	Py	Y	Y	Y	Y	Y	Y	Y	Y	Y
Dr. Juma Ali Juma	Y	Y	Y	Y	Y	Py	Y	Y	Y	Y	Y	Y	Y	-	Y	Y	Y	Y	Y	Y
Mr. Aimen Ahmed Al Hosni	Y	Y	Y	Y	Y	Py	Y	Y	Y	Y	Y	Y	Y	Y	Y	-	-	Y	Y	Y
Mr. David Kotheimer	-	-	-	-	-	-	-	-	-	-	-	-	Y	Y	Y	Y	Y	-	-	Y
Ms. Francesca McDonagh	-	-	-	-	-	-	-	-	-	-	-	-	Y	Y	Y	Y	Y	Y	-	Y
Mr. Abdulfattah Sharaf	-	-	-	-	-	-	-	-	-	-	-	-	Y	Y	Y	Y	Y	Y	-	Y
Mr. Bipin Dharamsey*	Y	Py	Py	Y	Y	Y	Y	Y	Y	Y	Y	Y	-	-	-	-	-	-	Y	Y
Mr. Safaa El din Sadek*	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	-	-	-	-	-	-	Y	Y
Mr. Rajeev Dhar*	-	Py	Py	Y	Y	Py	Y	Y	Y	Y	Y	Y	-	-	-	-	-	-	Y	Y
Mr. Salem Bortmany*	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	-	-	-	-	-	-	Y	Y

*The term of these directors ended on 31 May 2012. They did not offer themselves for re-election.

Corporate Governance Report (continued)
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2.9 The composition of the Board and its skill base is kept under continual review.

2.10 All Board members receive comprehensive and timely information to enable them to perform their duties.

2.11 Board induction and training is provided on a regular basis, to include training on relevant legal, regulatory and financial affairs.

2.12 The Framework sets out the matters reserved to the Board, and to the shareholders.

2.13 HBON is ready, where practicable, to enter into dialogue with institutional investors, based on a mutual understanding of objectives.

2.14 All annual and interim financial statements, price sensitive public reports and the reports to the regulators prepared by the Board contain a balanced and understandable assessment.

2.15 The Board is aware of its responsibilities for preparing the accounts.

2.16 The Board ensures effective internal control in all areas of HBON's operations, including financial, operations-related, compliance and risk management.

2.17 The Board has adopted a transparent policy in the matter of relationship with the external auditors, particularly in relation to any award of non-audit-related work. The overriding principle is that the external auditors are (and are seen to be) independent in exercising their duties.

2.18 HBON follows internal policies to ensure fair disclosure of all public information released in relation to HBON, and in particular, to ensure that any such information is timely, honest, correct, straightforward, not misleading, and complete.

2.19 Day to day business matters are delegated to, and are conducted by, HBON through the executive management committee.

Corporate Governance Report
For the Annual Report 2012

3. Board Committees of HBON

The following table sets out a brief overview of the primary objective of the Audit Committee and the Risk Committee, and attendance during 2012:

Board Committee	Times met	Membership (meetings attended)	Duties and Responsibilities
Audit Committee	OIB 4 times 1 January 2012 to 31 May 2012 HBON 5 times 31 May 2012 to 31 December 2012	Safaa Sadek Chairman till 31 May 2012 (4) Waleed Omar Zawawi (2) Salem Bortmany (4) Member till 31 May 2012 David Kotheimer Chairman since 31 May 2012 (5) Waleed Omar Zawawi (5) Francesca McDonagh (5)	The primary objective of the Audit Committee is to be accountable to the Board and to provide non-executive responsibility for oversight of, and advice to the Board on, matters relating to financial reporting; together also with all other matters set out in Annexure 3 of the Code.
Risk Committee	OIB 5 times 1 January 2012 to 31 May 2012 HBON 3 times 31 May 2012 to 31 December 2012	Dr. Juma Ali Juma Chairman till 31 May 2012 (3) Bipin Dharamsey Nensey (3) Safaa Sadek (5) Rajiv Dhar (4) Salem Bortamany (5) David Kotheimer Chairman since 31 May 2012 (3) Francesca McDonagh (3) Aimen Al Hosni (2) Abdulfattah Sharaf (3)	The primary objective of the Risk Committee is to be accountable to the Board and to provide non-executive responsibility for oversight of, and advice to the Board on, high level risk-related matters and risk governance.

Corporate Governance Report (continued)
For the Annual Report 2012

4. Process of Nominating the Directors

4.1 The present Board was elected on 31 May 2012 for a period of three years.

4.2 The Board appointed Simon Cooper as Chairman of the Board and Waleed Omar Al Zawawi as Deputy Chairman.

4.3 The Board election is held every three years. The next Board election will be held in 2015, subject to any requirement for an earlier election pursuant to the law or the Articles. Any vacancy arising due to resignation of any director may be filled temporarily by the Board, subject to re-election at the next Annual General Meeting.

4.4 Anyone wishing to be nominated for the position of Director must:

- Meet all legal requirements, to include those set out in the Commercial Companies Law and the Articles; and
- Submit an application form (in the pro-forma template issued by the Capital Market Authority) at least two days before the general meeting at which the election of Directors will take place.

4.5 The HBON Legal Advisor shall review eligibility and correctness of the applications and compliance with laws and regulations. As required by Ministerial Decision No. E/53/2008, HBON shall file the elected Directors forms together with the Minutes of the Annual General Meeting with Capital Market Authority ('CMA') within the period specified by law.

5. Remuneration

5.1 Members of the Board do not receive a salary, but are entitled to receive Board and Committee sitting fees in the following amounts, namely:

- RO500 as a sitting fee payable for every Board meeting attended; and
- RO500 as a sitting fee for every Committee meeting attended;

subject always to (i) an individual director cap of RO10,000 per annum and (ii) a maximum annual fees/expenses cap in aggregate (for the Board as a whole) of RO200,000.

5.2 During 2012, Simon Cooper, David Kotheimer, Francesca McDonagh and Abdulfattah Sharaf each waived their entitlement to be paid the whole or any part of their Board/Committee sitting fees.

5.3 The total Board/Committee sitting fees and expenses paid during 2012 amounted to RO80,975 in accordance with the following table:

Name of the Director	**Sitting fees (RO)**
Mr. Simon Cooper	-
Mr. Waleed Omar Al Zawawi	9,790
Dr. Juma Ali Juma	8,870
Mr. Aimen Ahmed Al Hosni	9,225
Mr. David Kotheimer	-
Ms. Francesca McDonagh	-
Mr. Abdulfattah Sharaf	-
Mr. Bipin Dharamsey Nensey	5,870
Mr. Safaa El Din Sadek	7,740
Mr. Rajeev Dhar	5,015
Mr. Salem Bortmany	7,305
Total sitting fees	**53,815**
Total hotel, travel and other Board expenses	**27,160**
GRAND TOTAL	**80,975**

5.4 The total remuneration paid in aggregate during 2012 to the senior members of the executive management team including salary, benefits, bonuses, stock options, gratuity and pensions amounted to RO1.107 million.

6. Details of non-compliance by HBON

6.1 There are no instances of non-compliance by HBON on matters related to Capital Markets, regulated by Muscat Securities Market ('MSM') and the CMA during the last three years. There are no aspects of non-compliance with the Code.

7. Means of Communication with Shareholders and Investors

7.1 HBON had 3,597 shareholders as at 31 December 2012.

7.2 The main source of information for the shareholders is the annual report which includes, amongst other things, the Board of Directors' statement and the audited financial statements.

7.3 In addition however (i) the quarterly un-audited Balance Sheet and Profit and Loss Account along with a report from the Board of Directors are published in the local press; (ii) the full set of financial statements and the report from the Board of Directors is filed with the CMA and the MSM; and (iii) these reports are posted on HBON's website at www.hsbc.co.om. The website displays official news announcements and presentations made to institutional investors and analysts.

7.4 Reference is made to the separate Management Discussion and Analysis report.

Corporate Governance Report (continued)
For the Annual Report 2012

8. Market Price and distribution of holdings

8.1 The following table sets out the HBON market price data during 2012:

Market Price Data – High and Low

Month	RO High	RO Low	Average Index (MSM-Financial)
Jan-12	0.294	0.280	6,422.05
Feb-12	0.281	0.270	6,333.55
Mar-12	0.289	0.271	6,751.11
Apr-12	0.290	0.250	7,036.04
May-12	0.240	0.224	6,687.82
Jun-12	0.251	0.236	6,497.20
Jul-12	0.242	0.225	6,063.75
Aug-12	0.234	0.223	6,197.96
Sep-12	0.225	0.215	6,283.10
Oct-12	0.220	0.214	6,279.66
Nov-12	0.217	0.207	6,246.34
Dec-12	0.215	0.206	6,426.46

(Based on the daily closing prices on the MSM)

8.2 The following table sets out the distribution of HBON share ownership during 2012:

% Shareholding	No. of shareholders
Less than 5%	3,596
Between 5 – 10%	0
More than 10%	1
Total	3,597

9. Professional profile of the statutory auditor

9.1 KPMG are the statutory auditors of HBON.

The shareholders of HBON approved the appointment of KPMG as the auditors of HBON for the year 2012.

KPMG is one of the leading accounting firms in Oman. The Oman practice of KPMG, which forms part of KPMG Lower Gulf, was established in 1974 and employs more than 130 people, to include four Partners, five Directors and twenty Managers, including Omani nationals.

KPMG Lower Gulf (UAE and Oman), is a member of the KPMG network of independent firms affiliated with KPMG International Co-operative. KPMG is a global network of professional firms providing Audit, Tax and Advisory services and has more than 152,000 outstanding professionals working together in 156 countries worldwide to deliver value along with robust audit opinions.

KPMG in Oman is accredited by the Capital Market Authority (CMA) to audit joint stock companies (S.A.O.G.'s). During the year 2012, professional fees in the amount of RO142,000 were rendered by the external auditors in respect of the services provided by them to the organisation (RO56,000 for audit, RO12,000 for tax and 74,000 for other Audit/related services).

10. Audit Fees

10.1 During 2012, the total fee charged by the external auditors for services rendered to HBON amounted to RO142,000 in aggregate.

11. Acknowledgment by the Board of Directors:

11.1 The Board confirms that to the best of its knowledge and belief:

- The preparation of the financial statements have been made in accordance with the applicable standards and rules;
- The efficiency and adequacy of the internal control systems of HBON have been reviewed and are in compliance with internal rules and regulations;
- There are no material things that affect the continuation of HBON and its ability to continue its operations during the next financial year.

For and on behalf of the Board of Directors,

Simon N Cooper
Chairman

Management Discussion and Analysis

Overview

Financial Highlights

Earnings per share in RO

0.004 - *down 75%*

2011: 0.016

Dividends per share in RO

0.001

Net assets per share in RO

0.147 - *up 25%*

2011: 0.118

For the year

Profit after taxation in RO'000

5,796 - *down 63%*

2011: 15,528

Total operating income in RO'000

60,529 - *up 74%*

2011: 34,851

Total operating expenses in RO'000

48,734 *up 159%*

2011: 18,816

At the year-end

Loans and advances to customers in RO'000

1,194,443 - *up 163%*

2011: 454,280

Deposits from Customers in RO'000

1,851,567 - *up 148%*

2011: 747,750

Ratio of customer advances to customer deposits

64.5% - *up 4%*

2011: 60.8%

Total equity in RO'000

294,137 - *up 158%*

2011: 114,134

Risk-weighted assets in RO'000

1,796,589 - *up 161%*

2011: 688,133

Capital ratios

Tier 1 ratio

15.1% - *down 1.5%*

2011: 16.6%

Total capital ratio

16.0% - *down 1.2%*

2011: 17.3%

Management Discussion and Analysis
Overview

Performance ratios

Credit coverage ratios		Return ratios
Non-performing loans to total loans	**Coverage Ratio**	**Return on average share capital**
7.1% - *up 6%*	89.4% - *down 3%*	3.7%
2011: 1.2%	2011: 92.7%	

Efficiency and revenue mix ratios

Cost efficiency ratio	Net interest income to total operating income	Net fee income to total operating income	Net trading income to total operating income
80.5% - *up 27%*	66.2% - *up 3%*	16.5% - *down 5%*	14.9% - *down 0.0%*
2011: 54.0%	2011: 63.4%	2011: 21.3%	2011: 14.9%

Share information at the year-end

RO0.100 ordinary shares in issue	Market capitalisation in RO'000	Closing market price (Muscat Securities Market)
2,000,312,790	414,065 - *up 53%*	0.207 - *down 7%*
2011: 968,052,610	2011: 271,055	2011: 0.280

Management Discussion and Analysis (continued)

Oman's Economy

During 2012, indicators suggest that growth in Oman remained strong. Momentum was bolstered by a continuing expansionary fiscal and monetary policy underpinned by a strong public sector balance sheet. Oman's estimated GDP growth for the year was 8.3%, with moderate inflation at approximately 3%, and non-oil GDP growth at an estimated 10.6%. Increased oil production and higher oil revenues boosted government spending to RO11.4bn in 2012, helping fund new infrastructure projects.

The government continued to demonstrate its commitment to improving living standards and creating job opportunities within the country. Initiatives included encouraging its foreign and private sector investments in large government projects, supporting the establishment of small and medium sized businesses and building new industrial zones.

Oman's economic performance has contributed to its ranking as the world's 32nd most competitive country out of 142 countries in the 2012/2013 World Economic Forum's Global Competitiveness Index (GCI), ahead of Bahrain and Kuwait in the GCC, as well as emerging economies like Brazil and India. The World Economic Forum positions Oman in the 'transition' stage between efficiency-driven and innovation-driven economic development.

Oman's Banking Environment

Oman's banking sector also recorded a healthy performance in 2012, on the back of the strong economy and high oil prices. Total assets of commercial banks as cash and deposits with the Central Bank of Oman increased by 13.8% to RO20,962.7m by December 2012 from RO18,407.6m in December 2011. Total credit increased by 14.4% to RO14,313.9m at the end of December 2012 from RO12,514.9m in the previous year. While credit granted to government entities declined by 4.9%, credit to the private sector and public institutions increased by 14.9% and 16.4% respectively.

Total revenue of commercial banks in Oman increased 12.1% on a year on year basis by the end of 2012, to an estimated total of approximately RO656.4m.

Meanwhile total deposits increased by 12.7% (to RO14,171.7m at the end of December 2012 compared to RO12,573.3m for the same period in 2011), with higher deposits for the private sector and government entities and a decline for public enterprises.

HSBC Bank Oman at a Glance

The merger of Oman International Bank S.A.O.G. with HSBC Bank Middle East Limited's Oman operations represents the banking sector's largest merger to date in the Sultanate. HSBC Bank Oman S.A.O.G. is now the second largest in terms of network with our 1,000 employees, 87 branches across the Sultanate and global reach. HSBC Bank Oman offers diversified financial solutions to a customer base of more than 400,000 retail and 10,000 corporate clients. Globally, HSBC is one of the largest banking and financial services organisations in the world, with over 6,600 offices in 81 countries and territories in six geographical regions.

Our products and services are delivered to clients through three businesses in Oman: Retail Banking and Wealth Management ("RBWM"), Commercial Banking ("CMB"), and Global Banking and Markets ("GB&M").

Financial Performance Analysis

HSBC Bank Oman S.A.O.G. ("HBON") financial statements for 2012 are reported as per IFRS 3 using reverse acquisition accounting. As per IFRS 3 requirements, the P&L of HBON contains 12 months of HSBC Bank Middle East Limited Oman branch ("HSBC Oman") and seven months (June-December 2012) of Oman International Bank S.A.O.G. ("OIB") results, the latter being discontinued from an accounting perspective. The five months of OIB results forms part of the reserves on the balance sheet of HBON.

Net Interest Income ('NII'): NII for the year reached to RO40.1m, up by 81.5% compared with RO22.1m for the year ended 2011. The increase includes seven months net interest income of RO17m from the OIB book and RO1m increase in the HSBC Oman book. Net interest income came under pressure from an increasingly competitive environment and interest rate caps on the retail loan book.

Total other operating income: Other operating income increased by RO7.6m to RO20.4m for the year ended 2012, primarily from higher documentary credit business, and improved spreads on large value government account transactions as well as in the HSBC Securities Services ('HSS') business. The increase included RO5.8m from seven months of OIB results and a RO1.8m contribution by HSBC Oman.

Management Discussion and Analysis

Operating expenses: Total operating expenses increased to RO48.7m compared to RO18.8m for the year ended 2011, mainly due to integration expenses of RO13.9m and RO18.4m from seven months of OIB's costs. The integration costs comprised of upgrades in information technology platforms, rebranding and refurbishment of the branch network and enhancing ATM facilities and services for customers.

Loan impairment charges net of recoveries: Loan impairment charges net of recoveries were RO4.6m, compared to RO1m net of recovery in 2011. The increase included a general provision of RO0.7m from the growth in advances and RO11.2m from specific provisions of the combined entity, mainly for corporate customers. The latter was partly offset by fair value adjustment of RO5.7m and increased recovery of RO0.5m. While non-performing loans as a percentage of total loans increased from 1.2% in 2011 to 7.1% in 2012; the Bank maintained a strong coverage ratio of 89.4%.

Profit for the year: HBON recorded a 62.7% decrease in net profit to RO5.8m compared with RO15.5m for 2011. The reduction was mainly due to one-off integration costs of RO13.9m and increased net loan impairment charges of RO5.6m during 2012.

As illustrated in Note 3 of the financial statements, had the merger occurred on 1 January 2012, and taking into account the results of OIB for the 12 month period, net profit for the year ended 31 December 2012 of the combined entity would have been RO2.6m. The reduction was due to a combination of lower operating income and higher operating expenses in the OIB book and higher loan impairment charges in both the OIB and HSBC Oman books.

Total assets: HBON continued to witness growth in key areas in 2012, with an increase in total assets from RO970.1m to RO2,412.8m. This total includes RO1,316.8m in assets from the OIB book, at the time of the merger, with the balance of RO126m from the increase of assets in HBON post-merger. The major composition of growth in assets post-merger comprised of RO55m in loans and advances, financial investments of RO202m, which were offset by reductions of RO29m in Cash and Central Bank balances, and RO92m in Due from Banks.

Loans and advances: Customer lending increased by 162.9% from RO454m in 2011 to RO1,194m as at 31 December 2012. The significant growth in Loans and Advances of RO685m was mainly due to business combination and RO55m as a result of growth in advances of HBON post merger.

Customer deposits: Deposits from customers grew by 147.8% from RO748m in 2011 to RO1,851m by 31 December 2012. The increase of RO1,014m in customer deposits was driven by the business combination with RO89m due to growth in HBON deposits. With a robust deposit base, HBON's strategy is to maintain and further develop a diversified business across the corporate, institutional banking and retail businesses, internationally connected through HSBC's global network.

Capital Adequacy Ratio: HBON has maintained a high capital adequacy ratio at 16.03%, which is in line with HBON's policy of preserving capital strength to support future growth. In the near future, under Basel III guidelines, banks will be required to keep an additional capital conversion buffer of 2.5% above the minimum capital requirement, which HBON is well positioned to meet.

Our financial performance in 2012 has kept HBON appropriately capitalised to support our growth aspirations, and positioned to deliver sustainable shareholder returns over the coming years. Accordingly, HBON's dividend payout has been set in line with capital and growth targets to support these returns.

Retail Banking and Wealth Management

The Retail Banking and Wealth Management business underwent significant changes in 2012, with an emphasis on providing a superior customer proposition.

In order to bring together the two entities' retail businesses, a nationwide campaign was launched to issue new debit and credit cards for all retail customers. This significant logistical exercise was completed in the 4th quarter alone, with some minimal inconvenience and disruption to customers. The Bank also undertook a project to ensure all customer records were up to date and in accordance with international 'Know Your Customer' (KYC) standards.

Some notable upgrades were made for our customers in the second half of 2012. Roll-out of a new fleet of ATMs designed to give HBON customers the most modern ATM network in the Sultanate, began in November. In addition, former OIB customers were also connected into the OmanNet switch for the first time in June; broadening access to all 1,100 ATMs across the network.

Management Discussion and Analysis (continued)

Following systems integration in November 2012, all former OIB customers now have access to Internet Banking for the first time, which will be further strengthened through a significant upgrade in 2013. This is an area where HSBC will bring its global expertise to benefit customers locally in Oman, in addition to mobile banking technology.

Finally, HBON has made several lending policy changes to benefit our customers, one notable example being eliminating the requirement former OIB customers had to provide a guarantor on application. This now places HBON very competitively as a lender within the market.

We commenced a branch refurbishment programme in the second half of 2012, and now plan further investments in our network, both to upgrade the look and feel of our branches, and improve the customer experience, alongside further investment in the training and career development of our staff.

Overall, 2012 has been a year of considerable investment, as we merged the two businesses together. Looking ahead to 2013, our customers will continue to see the benefits of this investment, as we build upon the solid foundations we have put in place.

Commercial Banking

In 2012, Commercial Banking in Oman was restructured around the HSBC Group's target operating model, to further increase client coverage, and on-the-ground product expertise. The merger in June 2012 combined two complementary corporate portfolios, broadening and deepening our client base. Combined, these two changes significantly strengthened our Commercial Banking platform in Oman.

Trade Finance and International Business remain at the core of our Commercial Banking proposition, with particular emphasis placed on international connectivity and meeting the needs of our corporate clients. The objective is to lead the way for Omani businesses, small and large, to trade with regional and global partners. Our trade proposition was further strengthened in 2012 with the launch of Receivables Finance in Oman, well received by clients and which opened up an attractive structured alternative to their working capital needs. Innovative electronic solutions remain our hallmark with good traction on electronic banking and instant email advice services.

We also invested in our on-the-ground Payments and Cash Management proposition, significantly strengthening our client coverage capabilities and commencing a rollout of tried and tested HSBC payments and cash management solutions in Oman. Business Internet Banking was demised in 4Q12 in favour of a more comprehensive and sophisticated core global solution “HSBCnet”, now available to all Commercial Banking customers. The demand for fully integrated host-to-host solutions has increased in the latter half of 2012 - an area in which HSBC globally has both an established track record and considerable expertise.

Oil & Gas, Petrochem and Infrastructure are key areas of potential where we continue to build momentum. Our close local relationships with public sector and large corporate clients enabled us to deliver world class investment banking capabilities to clients in 2012 and we continue to invest in this business. Increased focus on providing connectivity to local offices of multinationals and local corporates has shown traction and continues to provide us with a competitive advantage. Post-merger focus for Business Banking has been on delivering our international trade and payments capability to support this important segment.

2013 will be a year where we aim to consolidate and leverage the strength of HBON’s platforms and deliver the full strength of HSBC's global Commercial Banking capability across the portfolio, while continuing to fulfill our ongoing commitment to provide innovative solutions and technology to corporates in Oman.

Global Markets

Leveraging HBON's extensive branch network, strong corporate banking propositions and access to leading systems and products worldwide, Global Markets is one of the leading providers of treasury services in the spot and forward foreign exchange, options and money market and risk advisory products, being the preferred choice for most multinational companies operating in the Sultanate. Global Markets works closely with HSBC offices in over 60 countries and territories, and our clients are served by teams that bring together relationship managers and product specialists, to develop and deploy financial solutions that meet individual client needs.

Clients have access to world-class in house research, produced regionally by a dedicated team based in Dubai, providing a tailored macroeconomic analysis and forecasts for investments in the region. Corporate requirements are continuously changing as financial risk management becomes increasingly complex, and HBON provides dynamic risk management solutions in response.

Management Discussion and Analysis

HSBC Technology and Services

The infrastructure of the Bank received significant investment in 2012 to build a robust platform on which our customers could transact, our businesses could grow, and our staff could work effectively. This included a complete upgrade of the entire communications network with state of the art connectivity between branches/offices/ATMs and our data centres, along with new computer equipment for all former OIB staff and branches. In addition, a completely new Wincor ATM fleet was rolled out to replace the previous ageing ATM fleet, in addition to providing customers with access via any ATM across the Sultanate following the Bank's connection to the OmanNet switch in July 2012.

A critical part of any merger is the unification of data between institutions, which was completed in November 2012, migrating all customer records and data to the HSBC Oman systems, to allow staff to see all customers from a single platform. Customers immediately benefited from the additional services this switch brought online, such as Internet Banking, PIN on IVR, SMS updates, dedicated contact centre support, and many other services that were not previously available to OIB customers. The bank is now underpinned by a technology-based infrastructure that we aim to keep fit-for-purpose for years to come.

Our aim to be the best place to bank for our customers and the best place to work for our staff, converges at branch level, therefore considerable investment was put into refurbishing branches. A full refurbishment of the iconic Al Khuwair Head Office and 21 branch refurbishments were completed by end the of the year. Further investment will be made over the long term, as we review the entire portfolio through a five-year plan to improve both banking and working environments.

Human Resources

Performance Management, Reward and Benefits

Significant progress was made in 2012 in integrating the Human Resources policies of the two legacy organisations post-merger. We refreshed the employment propositions of our employees, including how individual performance is managed, how we pay all HBON staff and the level of benefits that can be provided.

A detailed review of salaries based on market analysis and job scope was carried out as we transitioned all HBON employees to the HSBC Global Career Band structure. This resulted in the alignment of allowances, salary and bonus levels, providing a solid foundation for future reward policy management and pay decisions based on the HSBC Group Reward strategy and Group Values. As we moved to Global Career Banding, extensive internal communication also advised employees of alignment to the HSBC Performance Management framework, effective from 1 January 2013, which will be deployed to all employees during the first quarter of 2013 through a series of training programmes and performance objective setting activities.

In addition, a number of changes to employee benefits were introduced during 2012 based on the philosophy of ensuring benefits are the same across the Bank irrespective of individual Global Career Band. These include adjustments to staff loan benefits, alignment of club memberships and service awards, an extension of medical insurance coverage to all HBON employees, adoption and paternity leave to legacy OIB employees, alignment of maternity leave with annual leave policy, as well as equal opportunity for business education and career development.

All the changes made and outlined above were undertaken through a detailed review of historic practices in both legacy organisations, bringing in international standards of best practice and in line with required governance commitments.

Learning and Development

Significant Learning and Development activity was undertaken in 2012, including the deployment of a team dedicated to the delivery of training on HSBC Retail Banking systems and products, KYC, welcome pack, cultural awareness and management programmes, in addition to mandatory HSBC training on Risk, Compliance, Money Laundering, Information Security Risk and Fraud. Over 4,300 delegate days of training were given over 300 sessions in the second half of the year alone.

Learning and Development in 2013 will focus on HSBC strategy, products and systems. Programmes targeted for delivery include the introduction of the HSBC Performance Management system to all HBON employees, a bespoke syllabus for Customer Service Representatives and Branch Managers, and a Bank-wide programme called "Together to Lead" which aligns cultural integration underpinned by HSBC brand values and Group global strategy.

Internal Audit

The Internal Audit (IA) department focuses on key risks across the Bank and assesses the design of the risk management framework(s) as well as the effectiveness of primary and secondary controls.

Management Discussion and Analysis (continued)

The IA function provides independent, objective assurance to Management and the Risk and Audit Committees over risk management, governance and control frameworks (including financial controls) adding value and improving operations through process and control enhancement recommendations. Internal Audit objectives are achieved through a systematic, disciplined approach to improving the effectiveness of risk management, control, and governance processes, thereby helping HBON achieve its objectives within the limitations of its stated risk appetite and in accordance with Group ethics, values and standards.

To ensure independence of the internal audit function, the Head of Internal Audit has a direct reporting line to the Chairman of the HBON Audit Committee.

Corporate Social Responsibility

HBON recognises its responsibility to invest in the long term prosperity of the community in the Sultanate of Oman. To us, a long term, intergenerational view is a prerequisite of true business sustainability. Our Corporate Sustainability strategy focuses on education, environment and the community.

During 2012, we worked extensively with the Ministry of Education and the British Council on the "Kids Read" programme, which aims to promote reading for pleasure among young school children. In addition, HBON supported the education of Omani high school graduates from underprivileged families through the Chamber of Commerce's educational programme, 'Al Najah'. HBON continues to be the sole partner for the Frankincense Project, a four-year research project undertaken by the Environment Society of Oman which examines the efficient and sustainable Frankincense harvest of the "Bosweilia Sacra", an ancient fauna species indigenous to the Sultanate. In line with the rest of our group, we also drove a national Earth Hour pledge campaign to raise climate impact awareness in communities and encourage support for change.

Our Purpose and Values

Throughout our history we have connected customers to opportunities by being present in areas of growth. We enable businesses to thrive and economies to prosper, helping people fulfil their hopes and dreams and realise their ambitions. This is our role and purpose. Our ambition is to be the leading bank in Oman and our purpose and values will help us achieve that goal.

We will be led by our values in everything we do: Being open to different cultures and ideas, dependable by doing the right thing, delivering on commitments, and being connected to customers, communities, our regulators and each other. We are ensuring that all our employees live by these values and feel empowered to act with courageous integrity.

Looking Ahead

Oman is expected to benefit from further investment in 2013, with a suggested 29% increase in government expenditures to RO12.9bn, budgeted to fund new infrastructure projects, boosting economic growth and creating opportunities. The government forecasts a 7% growth in Oman's overall economy in 2013 and significantly, the budget for the year (based on an oil price of US$85 per barrel), includes sizeable increases in social (16% or RO446m) and housing (45% or RO469m) expenditure. In addition, the government continues to demonstrate its commitment to education and health, with a 16% (to RO1,340m) increase in spend on education and 32% (to RO505m) on health.

Oman's budget surplus in 2012 was the highest ever recorded in absolute terms, at approximately RO3.2bn (10% of GDP), underscoring Oman's capacity to maintain its expansionary fiscal stance into 2013 and beyond.

In 2013, as the second largest bank in terms of network with global reach, HBON will focus on a new growth plan for the business, to give customers added convenience and functionality in managing their finances. We will develop existing relationships, connecting customers to more opportunities and delivering an increasingly consistent and superior customer experience.

KPMG
4th Floor, HSBC Bank Building
MBD
P.O. Box 641
P.C. 112
Sultanate of Oman

Tel 968 24709181
Fax 968 24700839

Report to the Board of Directors of HSBC Bank Oman SAOG in respect of the Basel II – Pillar III Disclosures

We have performed the procedures agreed with you and as prescribed in the Central Bank of Oman ("CBO") Circular No. BM 1027 dated 4 December 2007 ("the Procedures") with respect to the Basel II – Pillar III disclosures ("the Disclosures") of HSBC Bank Oman SAOG (the "Bank") set out on pages 28 to 39 as at and for the year ended 31 December 2012. The Disclosures were prepared by the Management in accordance with CBO Circular No. BM 1009 dated 13 September 2006 and Circular No. BM 1027 dated 4 December 2007, as amended. Our engagement was undertaken in accordance with the International Standard on Related Services applicable to agreed-upon procedures engagements. The Procedures were performed solely to assist you in evaluating the Bank's compliance with the disclosure requirements set out in CBO Circular No. BM 1009 dated 13 September 2006, as amended.

We report our findings as follows:

Based solely on performance of the Procedures, we found no exceptions which require to be reported herein.

Because the Procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the Disclosures.

Had we performed additional procedures or had we performed an audit or review of the Disclosures in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties other than Central Bank of Oman; and we accept no liability to any third party. This report relates only to the Bank's Disclosures and does not extend to the financial statements of the Bank taken as a whole or to any other reports of the Bank.

29 January 2013

KPMG

Statutory Disclosure Under Basel II – Pillar III Framework

For the year ended 31 December 2012

HSBC Bank Oman S.A.O.G. (formerly Oman International Bank S.A.O.G.), is an Omani joint stock company, which was incorporated on 1 January 1979, operating as a commercial bank through a network of branches in the Sultanate of Oman, (the Bank). Additionally, the Bank has branches in India and Pakistan (overseas branches).

The operations of HSBC Bank Middle East Limited Oman branches merged with OIB and the combined listed entity was renamed as HSBC Bank Oman S.A.O.G. Following the merger, HSBC Bank Middle East Limited ('HBME') holds 51% of the shares in the combined entity.

Disclosure Policy

The Bank has developed a formal policy on the disclosure requirements forming part of Basel II Norms which is approved by the Board of Directors in line with the requirements of the Central Bank of Oman regulations.

Scope of Application

The information provided in this statement is consolidated for the Bank's operations in Oman, India and Pakistan. The Bank has no subsidiaries.

Capital Structure

Objectives & Strategy:

Central Bank of Oman sets and monitors regulatory requirements. The Bank's objectives when managing capital are to:

- Safeguard the Bank's ability to continue as a growing entity and increase the returns for its ultimate shareholders;
- Comply with regulatory capital requirements set by the Central Bank of Oman;
- Maintain Capital Adequacy Ratios above the minimum specified by the Central Bank of Oman and Basel II Accord guidelines; and
- Manage the investments in short term money market placements in Central Bank of Oman instruments or above investment grade financial institutions.

Qualitative Disclosures:

- The Bank uses Standardised Approach for estimating the Capital Charge for Credit Risk.
- The Bank uses Basic Indicator Approach for estimating the Capital Charge for Operational Risk.
- In implementing current capital requirements the Bank calculates Risk Assets Ratio in accordance with the Capital Adequacy guidelines established by the Central Bank of Oman prescribing the ratio of total capital to total Risk Weighted Assets (RWA).

Quantitative Disclosure:

Capital Structure

Tier I Capital comprises of share capital, legal reserves and retained earnings. The book values of goodwill, intangible assets, cumulative unrealised losses on available for sale investments/loans are deducted in arriving at Tier I capital. Currently, the Bank does not have any goodwill on its book.

Tier II Capital comprises of general loan loss provisions and cumulative fair value gains or losses on available for sale instruments. The fair value gains are recognised after a haircut of 55% on the difference between the historical cost book value and market value and are applied in order to cushion against market volatility and tax charges.

In line with Central Bank of Oman guidelines, non-strategic investments made in banks/financial entities up to either 5% of the capital of the investee bank/financial entity or 5% of the net worth of the investing bank, whichever is lower, has been risk weighted at 100%.

The Bank at present does not have any Tier III capital.

Statutory Disclosure Under Basel II – Pillar III Framework
For the year ended 31 December 2012

The composition of the Capital structure is as follows:

	RO'000
Paid up share capital	200,031
Legal reserve	33,909
Retained earnings	56,562
Other regulatory adjustments (deferred tax, intangible assets)	(19,221)
Total Tier 1	**271,281**
Fair value reserve for available-for-sale equity securities	459
Collective allowances for impairment	16,280
Total Tier II	**16,739**
Total eligible capital	**288,020**

Capital Adequacy

The Bank's policy is to maintain a strong capital base so as to maintain investor, depositor and market confidence and to sustain future business developments.

The Bank is fully committed in implementing the Basel II Norms as adopted by the Central Bank of Oman and currently follows the Standardised approach for credit and market risk and the Basic Indicator Approach for operational risk.

The Bank currently uses a benchmark minimum Capital requirement ratio of 12 per cent for the purposes of long term capital planning.

The capital to support current and future activities is discussed in the Bank's Asset Liability Committee ("ALCO") and documented.

In line with Central Bank of Oman, Capital Adequacy regulations and HSBC Group practices we monitor the Capital Adequacy on a daily basis. Further, a full Basel II Return in line with Central Bank of Oman format is submitted each quarter as per standard requirements.

Credit Risk

The Bank has implemented the Standardised Approach across its Banking Book.

Operational Risk

The Bank uses the Basic Indicator Approach for the allocation of operational risk capital. The Bank allocates capital for operational risk based on the average annual gross income for the past three years.

Statutory Disclosure Under Basel II – Pillar III Framework (continued)
For the year ended 31 December 2012

Market Risk

The Bank is using VAR (Value at Risk methodology) discussed in detail later in this document in calculating Market Risk on exposures on the Balance Sheet.

The details of capital, risk weighted assets and capital adequacy ratio as at 31 December 2012 are as follows:

RO'000

Details	Gross balance (Book value)	Net balances (Book value)*	Risk weighted assets
On-balance sheet items	2,277,786	2,237,234	1,301,063
Off-balance sheet items	385,040	385,040	333,124
Derivatives	3,474	3,474	3,474
Total	**2,666,300**	**2,625,748**	**1,637,661**
Market risk			80,101
Operational risk			78,827
Total			**1,796,589**
Tier I capital			271,281
Tier II capital			16,739
Tier III capital			-
Total regulatory capital			**288,020**
Capital requirement for credit risk			196,520
Capital requirement for market risk			9,612
Capital requirement for operational risk			9,459
Total required capital			**215,591**
Tier I Ratio			15.10%
Total capital ratio			**16.03%**

* Net of provisions and reserve interest and eligible collaterals.

Risk Exposure and Assessment

All of the Bank's activities involve, to varying degrees, the analysis, evaluation, acceptance and management of risks or combinations of risks. The most important categories of risk that the Bank is exposed to are credit risk (including cross-border country risk), market risk, operational risks in various forms, liquidity risk, reputational risk, legal risk and sustainability (environmental and social) risks. Market risk includes foreign exchange, interest rate and equity price risks. The management of these various risk categories is discussed below.

The risk profiles of the Bank change constantly under the influence of a wide range of factors. The risk management framework established by the Bank fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interdependencies.

The Bank's Risk Management framework is set out in Note 31 of the financial statements.

Credit Risk

Credit Risk is the risk of financial loss to the Bank if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending, trade finance and from off-balance sheet products such as guarantees and from the holding of debt and other securities. Credit risk generates the largest regulatory capital requirement of the risks we incur.

The Bank has standards, policies and procedures dedicated to controlling and monitoring risk from all such activities. These are similar to those applied to all HSBC Group offices in various regions.

The Bank follows the high-level credit policies formulated by HSBC Holdings plc. This includes application of credit risk rating system for corporate counterparties for which the Bank uses a 22-point credit risk rating system called CRR. Each CRR is mapped to a Probability of Default (PD), which is also reviewed and updated periodically. Since such accounts are individually significant, risk ratings are reviewed regularly and amendments made as and when appropriate.

Statutory Disclosure Under Basel II – Pillar III Framework
For the year ended 31 December 2012

Within the Bank's retail business, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

A comparison of HSBC Credit Risk Ratings compared to those with Central Bank of Oman's classification categories is as follows:

HBON CRR	Central Bank of Oman Classification
1.1 – 6.2	Standard
7.1 – 8.3	Special Mention
9.0	Substandard / Doubtful / Loss
10.0	Loss

The management of credit risk, credit approval process, credit quality of loans and advances, impaired loans, credit administration is set out in Note 31.3 of the financial statements.

The Bank's credit risk limits to counterparties in the financial and government sectors are managed centrally at HSBC Group Head Office in London through the HSBC Middle East in Dubai. The main purpose is to optimise the use of credit availability and avoid excessive risk concentration. Cross-border risk is subject to limits which are centrally managed by the HSBC Group and are subject to Group approval.

The Bank has an established risk management process encompassing credit approvals, the control of exposures, credit policy direction to business units and the monitoring and reporting of exposures both on an individual and a portfolio basis which includes the management of adverse trends. The Bank is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality. Regular reviews are undertaken to assess and evaluate levels of risk concentration, including those to individual industry sectors and products, or to individual geographic areas.

Special attention is paid to the management of problem loans. A specialist unit exists to provide intensive management and control to maximise recoveries of doubtful debts.

Risk reporting

In addition to the quantitative disclosures and other reporting/returns submitted to our regulators in Oman, the Bank provides various reports to HSBC Regional Head Office in Dubai and HSBC Group Head Office in London. These reports include Large Exposures to banks, sovereigns, corporates and exposures to the property sector. In addition, exposure to the key sectors is monitored through the monthly HBON Risk Management Meeting.

Policies for hedging and/or mitigating risk

The Bank follows the policies and processes for mitigating risks as per the instructions given under the HSBC Group Business Functional Instruction Manual (FIM).

Past Dues

The basic definition of past due is when a loan instalment is not paid by the due date.

Impairment

A financial asset is impaired and an impairment loss is incurred if, and only if, there is objective evidence of impairment as a result of an event after initial recognition of the asset, and this event has an effect on future cash flows that can be estimated reliably. Impairment allowances are calculated by way of assessment either:

- at individual account level (using discounted cash flow techniques as appropriate); or
- on a collective basis for assets with similar credit risk characteristics.

Description of approaches followed for specific and general provisions and statistical methods used

It is the Bank's policy to make an allowance for impaired loans promptly when required and on a consistent basis with established Group guidelines.

Statutory Disclosure Under Basel II – Pillar III Framework (continued)

For the year ended 31 December 2012

The rating process for credit facilities is designed to highlight exposures requiring greater management attention based on a higher probability of default and potential loss. Management is required to particularly focus on facilities to those borrowers and portfolio segments classified as below satisfactory. Amendments to risk grades, where necessary, are undertaken promptly. Management regularly evaluates the adequacy of the established allowances for impaired loans by conducting a detailed review of the loan portfolio, comparing performance and delinquency statistics with historical trends and assessing the impact of current economic conditions.

Two types of impairment allowances are in place: individually assessed and collectively assessed.

The Bank's policy requires a review of the level of impairment allowances on individual facilities that are above materiality thresholds at least half-yearly, and more regularly, where individual circumstances require. The policy requires that this will normally include a review of collateral held (including re-confirmation of its enforceability) and an assessment of actual and anticipated receipts.

Portfolio allowances for Retail customers are generally reassessed monthly and charges for new allowances, or releases of existing allowances, are calculated for each separately identified portfolio.

The assessment for collective impairment in the corporate portfolio includes analysis of both economic and political factors existing at the time. Economic factors include the level of external indebtedness, the debt service burden and access to external sources of funds to meet the debtor country's financing requirements. Political factors taken into account include the stability of the country and its government, threats to security and the quality and independence of the legal system.

Non-performing loans

For individually assessed accounts, loans are required to be designated as non-performing as soon as there is objective evidence that an impairment loss has been incurred. Objective evidence of impairment includes observable data such as when contractual payments of principal or interest are 90 days overdue. Portfolios of homogenous loans are designated as non-performing if facilities are 90 days or more overdue. The Bank has adopted the HSBC Group Flow Rate Model by which an impairment allowance is booked for all past due loans commencing day 1 of delinquency. However, in the financial statements provisions are recorded in line with CBO requirements.

Total gross credit risk exposures, plus average gross exposure over the period, broken down by major types of credit exposure are listed as under:

RO'000

Type of Credit Exposure	**Average gross exposure**		**Total gross exposure as at**	
	31 Dec 2012	31 Dec 2011	**31 Dec 2012**	31 Dec 2011
Overdraft	**24,293**	17,286	**90,702**	23,526
Personal loans	**452,534**	95,211	**421,143**	105,124
Loans against trust receipts	**152,943**	120,972	**164,751**	118,941
Other loans	**746,792**	251,442	**586,751**	200,336
Bills purchased / discounted	**22,521**	19,993	**30,063**	17,028
Total	**1,399,083**	504,904	**1,293,410**	464,955

Geographical distribution

Geographic distribution of exposures, broken down in significant areas by major types of credit exposure are listed as under:

RO'000

Type of Credit Exposure	**Oman**	**Other GCC countries**	**OECD Countries**	**India**	**Pakistan**	**Other**	**Total**
Overdraft	89,384	-	-	257	1,061	-	**90,702**
Personal loans	417,723	1,631	1,458	122	23	186	**421,143**
Loans against trust receipts	164,730	-	-	-	21	-	**164,751**
Other loans	586,553	-	-	-	198	-	**586,751**
Bills purchased / discounted	24,621	2,101	2,996	-	-	345	**30,063**
Total	**1,283,011**	**3,732**	**4,454**	**379**	**1,303**	**531**	**1,293,410**

Statutory Disclosure Under Basel II – Pillar III Framework
For the year ended 31 December 2012

Industry or counterparty type distribution of exposures, broken down by major types of credit exposure:

RO'000

Economic Sector	Overdraft	Loans	Bills purchased / discounted	Total	Off-balance sheet exposure
Import trade	27,167	150,285	860	178,312	61,619
Export trade	375	61	7,301	7,737	22,966
Wholesale & retail trade	3,379	31,210	471	35,060	21,050
Mining & quarrying	-	54,065	-	54,065	2,001
Construction	24,492	37,056	7,769	69,317	63,713
Manufacturing	7,053	179,395	771	187,219	18,340
Electricity, gas and water	2,118	88,002	60	90,180	365
Transport and communication	642	41,562	-	42,204	2,853
Financial institutions	189	6,201	-	6,390	2,066
Services	5,178	143,368	12,747	161,293	123,672
Personal loans	6,508	411,428	-	417,936	190
Agriculture and allied activities	869	4,637	-	5,506	16
Government	1,450	18,400	-	19,850	113
Non-resident lending	-	4,776	-	4,776	-
All others	11,282	2,199	84	13,565	102,495
Total	**90,702**	**1,172,645**	**30,063**	**1,293,410**	**421,459**

Residual contractual maturity of the loan portfolio, broken down by major types of credit exposure:

RO'000

Time Band	Overdraft	Loans	Bills purchased / discounted	Total	Off-balance sheet exposure
Up to1 month	32,148	253,141	21,412	306,701	126,915
1-3 months	280	65,529	6,101	71,910	74,003
3-6 months	-	62,228	197	62,425	41,155
6-9 months	-	18,550	-	18,550	53,617
9-12 months	-	10	-	10	22
1-3 years	1	180,629	-	180,630	60,610
3-5 years	-	550,346	-	550,346	9,376
Over 5 years	58,273	42,212	2,353	102,838	55,761
Total	**90,702**	**1,172,645**	**30,063**	**1,293,410**	**421,459**

Statutory Disclosure Under Basel II – Pillar III Framework (continued)

For the year ended 31 December 2012

Risk exposure by major industry

RO'000

Economic Sector	Gross Loans	Of which, NPLs	General provisions held	Specific provisions held	Reserve interest	Provisions made during the year*	Advances written off during the year
Import trade	178,312	25,559	1,528	10,146	9,738	9	595
Export trade	7,737	436	73	408	28	408	15
Wholesale & retail trade	35,060	2,000	331	594	1,289	-	557
Mining & quarrying	54,065	-	541	-	-	-	2
Construction	69,317	9,799	595	2,686	7,067	1,157	133
Manufacturing	187,219	20,705	1,761	12,244	6,479	2,046	40
Electricity, gas and water	90,180	2,043	881	64	1,979	-	7
Transport and communication	42,204	3,032	392	1,720	1,070	-	9
Financial institutions	6,390	6,390	-	731	5,659	-	-
Services	161,293	4,546	1,567	1,338	2,205	4	354
Personal loans	417,936	3,584	8,286	4,803	359	3,802	18,774
Agriculture and allied activities	5,506	1,036	45	172	373	-	2
Government	19,850	-	199	-	-	-	1
Non-resident lending	4,776	-	78	-	-	-	321
All others	13,565	13,315	3	2,696	8,839	725	1,730
Total	**1,293,410**	**92,445**	**16,280**	**37,602**	**45,085**	**8,151**	**22,540**

*The provision made during the year is after consideration of adjustment as a result of the fair value adjustment amounting to RO5.7million.

Amount of impaired loans broken down by significant geographic areas including specific and general allowances related to each geographical area.

RO'000

Country	Gross loans	Of which, NPLs	General provision held	Specific provision held	Reserve interest	Provisions made during the year*	Advances written off during the year
Oman	1,283,011	91,472	16,272	36,712	45,002	7,340	22,540
Other GCC countries	3,732	-	-	-	-	-	-
OECD countries	4,454	-	-	-	-	-	-
India	379	-	5	-	-	1	-
Pakistan	1,303	973	3	890	83	810	-
Others	531	-	-	-	-	-	-
Total	**1,293,410**	**92,445**	**16,280**	**37,602**	**45,085**	**8,151**	**22,540**

*The provision made during the year is after consideration of adjustment as a result of the fair value adjustment amounting to RO5.7million.

Statutory Disclosure Under Basel II – Pillar III Framework
For the year ended 31 December 2012

Movements of Gross Loans:

RO'000

Details	Performing loans		Non-performing loans			
	Standard	S.M	Sub-standard	Doubtful	Loss	Total
Opening balance	**429,584**	**29,944**	**493**	**1,181**	**3,753**	**464,955**
Migration / changes (+/-)	(16,077)	(12,676)	1,975	15,016	983	**(10,779)**
New loans	1,565,717	9,549	4,145	1,579	89,523	**1,670,513**
Recovery of loans	(796,279)	(8,797)	(869)	(1,863)	(931)	**(808,739)**
Loans written off	-	-	(1,422)	(119)	(20,999)	**(22,540)**
Closing balance	**1,182,945**	**18,020**	**4,322**	**15,794**	**72,329**	**1,293,410**
Provisions held	**18,878**	**574**	**3,088**	**8,564**	**22,778**	**53,882**
Reserve Interest	**117**	**9**	**142**	**1,380**	**43,437**	**45,085**

Credit Risk disclosures relating to the Standardised Approach

The Bank uses credit rating agencies such as Fitch, Moody's and S&P for the assessment of credit risk under the Basel II Standardised Approach. Each of the rating agencies is used for the purpose of assessing Sovereign, Bank and Corporate credit assessments. The process of transferring the public issue rating into comparable assets in the banking book is not widely applied in Oman as most Corporate clients are unrated. However, the exposure to banks through money market placements, balances with other banks and counter guarantees are governed by the ratings applied by the rating agencies.

The total Banking Book risk weighted assets amounted to RO 1,638 million as at 31 December 2012 after the application of credit risk mitigants.

Credit Risk Mitigation: Disclosures for Standardised Approach

The Bank endeavours to obtain collateral for all corporate credits unless the business case warrants clean lending. Collaterals stipulated are usually mortgages, charges over business, stock and debtors, financial instruments and cash. Security is however recognised only as a fall back option and repayment of facilities is primarily predicated on cash flow from the borrower's business. However, collateral may be an important mitigant of risk.

In the Retail loan segment, facilities granted are predominately salary-linked loans for personal purposes. Prudent norms as well as regulatory guidelines are applied to ensure that the borrower is not overstretched to repay his dues. For housing loans and auto loans, besides the salary assignments, the underlying asset is mortgaged.

Where reliance is placed on real estate as collateral, professional valuations by a Bank approved valuer are required. Revaluations are obtained every two years. If equities are taken as collateral, only shares quoted on the MSM can be accepted and the value of shares will be based on the average value over the 15 days preceding the drawn down. For both mortgage and financial instruments, values should have margin cover as defined in the Banks Lending Guidelines will be applied.

The Bank uses the Basel II Simple Approach for Credit Risk Mitigation - Collateral. HBON's policies, procedures and processes including collateral valuation and management are governed by HSBC Group guidelines.

The total value of eligible financial collateral, for example deposits under lien and other bank guarantees, for the credit risk portfolio is RO 40.552 million.

Information about (market or credit) risk concentrations within the mitigation taken

Credit risk concentrations are monitored through monthly ALCO and Risk Management Meetings.

Statutory Disclosure Under Basel II – Pillar III Framework (continued)

For the year ended 31 December 2012

Market risks in the trading book

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads, will affect the Bank's income or the value of its holding of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The management of market risk is set out in Note 31.5 of the financial statements.

One of the principal tools used by the Bank to monitor and limit market risk exposure is VAR. VAR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence (for the Bank, 99 per cent). The Bank calculates VAR daily. The VAR model used by the Bank is based on historical simulation. The historical simulation model derives plausible future scenarios from historical market rates times series, taking account of inter-relationships between different markets and rates, for example between interest rates and foreign exchange rates. Potential movements in market prices are calculated with reference to market data from the last two years.

Although a useful guide to risk, VAR should always be viewed in the context of its limitations.
For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The Bank recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures.

Market risk in trading portfolios is monitored and controlled at both portfolio and position levels using a complementary set of techniques, such as VAR and present value of a basis point, together with stress and sensitivity testing and concentration limits.

Other controls include restricting individual operations to trading within a list of pre-approved permissible instruments, and enforcing rigorous new product approval procedures.

The VAR for Global Markets was as follows:

	2012	**Average**	**Maximum**	**Minimum**	2011	Average	Maximum	Minimum
	RO'000	**RO'000**	**RO'000**	**RO'000**	RO'000	RO'000	RO'000	RO'000
Total VAR	**193**	**140**	**193**	**80**	65	62	271	33
Trading VAR	**98**	**59**	**99**	**15**	2	4	15	-

The principal objective of market risk management of non-trading portfolios is to optimise net interest income. Market risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost as a result of interest rate changes. Analysis of this risk is complicated by having to make behavioral assumptions regarding the economic duration of liabilities which are contractually repayable on demand, for example, current accounts. In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Global Markets or to separate books managed under the auspices of ALCO. ALCO regularly reviews that these portfolios are managed within pre-approved interest rate risk limits.

Interest Rate Risk

Interest rate risk is the sensitivity of the Bank's financial condition to movements in interest rates. Mismatches or gaps in the amount of assets, liabilities and off-balance sheet instruments can generate interest rate risk, the impact of which is a function of the interest rate changes and the maturity profile of the assets and liabilities. Positions are monitored regularly and hedging strategies are used to manage the interest rate risk. The impact of an incremental / decreased 100 basis points parallel shift on net interest income for the next 12 months is given as follows:

	2012	2011
	RO'000	RO'000
1% up - Increase in NII by	**5,213**	3,769
1% down - Decrease in NII by	**(5,213)**	(3,769)
Ramp up scenario		
25bp increase per quarter	**3,258**	2,355
25bp decrease per quarter	**(3,258)**	(2,355)

The capital requirements for market risk are as follows:

	RO'000
Interest rate risk	-
Equity position risk	-
Commodities position risk	-
Foreign exchange risk	9,612
Total	**9,612**

Liquidity Risk

Liquidity risk is the risk that the Bank does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained on the expected terms and when required.

The objective of the Bank's liquidity and funding management is to allow it to withstand severe liquidity stresses. It is designed to be adaptable to changing business models and regulations.

The Bank employs a number of measures to monitor liquidity risk.

The management of liquidity risk is set out in Note 31.4 of financial statements.

ALCO monitors adherence to liquidity and funding limits and ensures that all commitments, both contractual and those determined on the basis of behavioural patterns, which are required to be funded, can be met out of readily available and secure sources of funding. It is impossible to provide explicit rules for every eventuality.

To ensure that all commitments, both contractual and those determined on the basis of behavioural patterns, which are required to be funded, can be met out of readily available and secure sources of funding.

The objective of funding management is to ensure that necessary funds will be available at all times to finance assets. ALCO usually delegates this responsibility to the Treasurer.

Liquidity and funding management depends on the following factors:

- a bank's expected cash flow;
- its capacity to borrow in the market; and
- its stock of readily available, high quality, liquid assets.

The Bank's approach to liquidity and funding management takes these factors into account.

The main elements of the Bank's liquidity and funding management are:

- compliance with Central Bank of Oman regulations;
- reporting of projected future cash flows stressed under varying scenarios and consideration of the level of liquid assets and maturing funding relative to the cash flow position;
- maintenance of a stock of high quality liquid assets sufficient to repay defined liabilities at the balance sheet date; and
- maintenance of liquidity and funding contingency plans.

Liquidity Management- important factors considered by the Bank are:

- projected net cumulative cash flows by time period stressed under various scenarios termed as Operational Cash Flow Projections (OCPs). Under this scenario HBON has to remain positive for a cumulative Cash Flow position up to three months of time band maturity. Accordingly, the Bank remained positive OCPs up to the three months cumulative bucket as at 31 December 2012;
- monitoring of structural liquidity measures including balance sheet maturity analysis;
- monitoring of depositor concentration by stratification of deposits into retail, commercial and global banking and markets both at the higher level of commercial/professional funding (Non Core) and at the lower level of reliance on large individual depositors; and
- where the emphasis is on funding management, monitoring the maturity profile of wholesale debt issues with the aim of avoiding "bunching" (i.e. large maturities of debt in the same time period) and maintaining diverse sources of funding and adequate back-up lines.

Daily and weekly Liquidity Statements

The Bank measures its liquidity position daily/weekly as per the internal guidelines set by the Bank.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. Operational risk is relevant to every aspect of the Bank's business and covers a wide spectrum of issues. Losses arising through fraud, unauthorised activities, errors, omission, inefficiency, systems failure or from external events all fall within the operational risk definition.

A formal governance structure provides oversight over the management of operational risk. The Risk Management Meeting convenes monthly to discuss operational risk issues and the effectiveness of internal controls. In addition, there is a quarterly Operational Risk and Internal Control (ORIC) meeting with the regional HSBC ORIC function. The capital requirement of RO 9.459 million is based on the average gross income for the three year period ending 31 December 2012.

The management of operational risk is set out in Note 31.7 of financial statements.

Statutory Disclosure Under Basel II – Pillar III Framework

For the year ended 31 December 2012

Basic Indicator Approach calculation

Year	Business line	Total gross income	Total gross (after negative GI adjustment)	Alpha	Capital charge
2010	Total business	29,401	29,750	15%	4,463
2011	Total business	34,851	35,433	15%	5,315
2012	Total business	60,529	60,940	15%	9,141
Number of years with positive total gross income					3
Basic Indicator Approach capital charge @ 12.50%					6,306
Total Risk Weighted Assets - Operational Risk					**78,827**

KPMG
4th Floor, HSBC Bank Building
MBD
P.O. Box 641
P.C. 112
Sultanate of Oman

Tel 968 24709181
Fax 968 24700839

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF HSBC BANK OMAN SAOG

Report on the financial statements
We have audited the financial statements of HSBC Bank Oman SAOG ("the Bank"), set out on pages 41 to 87, which comprise the statement of financial position as at 31 December 2012, the statements of 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.

Management's responsibility for the financial statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, the disclosure requirements of the Capital Market Authority and the Commercial Companies Law of 1974, as amended, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

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

Report on other legal and regulatory requirements
In our opinion the financial statements of the Bank as at and for the year ended 31 December 2012, in all material respects, comply with:

- the relevant disclosure requirements of the Capital Market Authority; and
- the Commercial Companies Law of 1974, as amended.

KPMG

29 January 2013

Michael G. W. Armstrong

Statement of Comprehensive Income
For the year ended 31 December

2011 Refer note 3 US$'000	2012 US$'000		Notes	2012 RO'000	2011 Refer note 3 RO'000
68,421	**128,610**	Interest income		**49,515**	26,342
(11,060)	**(24,517)**	Interest expense		**(9,439)**	(4,258)
57,361	**104,093**	**Net interest income**		**40,076**	22,084
19,309	**26,008**	Net fee income		**10,013**	7,434
13,499	**23,398**	Net trading income		**9,008**	5,197
-	**34**	Dividend income		**13**	-
353	**3,686**	Other operating income	*4*	**1,419**	136
90,522	**157,219**	**Net operating income before loan impairment charges and other credit risk provisions**		**60,529**	34,851
2,779	**(12,010)**	Loan impairment charges and other credit risk provisions - net of recoveries	*5*	**(4,624)**	1,070
93,301	**145,209**	**Net operating income**		**55,905**	35,921
(48,873)	**(123,119)**	Operating expenses	*6*	**(47,401)**	(18,816)
-	**(3,462)**	Amortisation and impairment of intangible assets	*8*	**(1,333)**	-
(48,873)	**(126,581)**	**Total operating expenses**		**(48,734)**	(18,816)
44,428	**18,628**	**Profit before tax**		**7,171**	17,105
(4,096)	**(3,571)**	Tax expense	*7*	**(1,375)**	(1,577)
40,332	**15,057**	**Profit for the year**		**5,796**	15,528
		Other comprehensive income/(expense)			
364	**3,423**	Fair value gain on available-for-sale investments	*12*	**1,318**	140
-	**485**	Effect of currency translation		**187**	-
-	**(342)**	Income tax on fair value gain on available- for-sale investments		**(132)**	-
40,696	**18,623**	**Total comprehensive income for the year**		**7,169**	15,668
US$ 0.041	**US$ 0.010**	**Earnings per share - basic**	*9(a)*	**RO 0.004**	RO 0.016

The accompanying notes on pages 45 to 87 form an integral part of these financial statements.

Statement of Financial Position
As at 31 December

2011 Refer note 3 US$'000	2012 US$'000		Notes	2012 RO'000	2011 Refer note 3 RO'000
		Assets			
107,535	**313,091**	Cash and balances with central banks		**120,540**	41,401
263,325	**477,554**	Due from banks	*10*	**183,858**	101,380
1,179,948	**3,102,449**	Loans and advances to customers - net	*11*	**1,194,443**	454,280
791,527	**1,767,979**	Financial investments	*12*	**680,672**	304,738
173,691	**489,811**	Other assets	*13*	**188,577**	66,871
-	**38,088**	Intangible assets	*14*	**14,664**	-
3,787	**78,084**	Property and equipment	*15*	**30,062**	1,458
2,519,813	**6,267,056**	**Total assets**		**2,412,816**	970,128
		Liabilities and equity			
		Liabilities			
66,751	**119,921**	Due to banks	*16*	**46,170**	25,699
1,942,208	**4,809,266**	Deposits from customers	*17*	**1,851,567**	747,750
214,402	**573,874**	Other liabilities	*18*	**220,942**	82,545
2,223,361	**5,503,061**	**Total liabilities**		**2,118,679**	855,994
		Equity			
251,442	**519,562**	Share capital	*19*	**200,031**	96,805
83,358	**84,865**	Legal reserve	*20(a)*	**32,673**	32,093
2,527	**3,211**	Statutory reserve	*20(b)*	**1,236**	973
(215,210)	**-**	Merger reserve	*20(c)*	**-**	(82,856)
-	**4,248**	Available-for-sale fair value reserve	*20(d)*	**1,635**	-
174,335	**152,109**	Retained profits		**58,562**	67,119
296,452	**763,995**	**Total equity**		**294,137**	114,134
2,519,813	**6,267,056**	**Total equity and liabilities**		**2,412,816**	970,128
US$ 0.301	**US$ 0.381**	**Net assets per share**	*9(b)*	**RO 0.147**	RO 0.118
		Off-balance sheet items:			
		Contingent liabilities and commitments			
221,644	**225,408**	- Documentary credits		**86,782**	85,333
540,616	**869,291**	- Guarantees		**334,677**	208,137
1,595,283	**2,889,430**	- Others		**1,114,228**	614,184
2,357,543	**3,984,129**		*21*	**1,535,687**	907,654

The accompanying notes on pages 45 to 87 form an integral part of these financial statements.

The financial statements were authorised for issue on 29 January 2013 in accordance with a resolution of the Board of Directors.

Simon N Cooper
Chairman

Ewan Stirling
Chief Executive Officer

Statement of Changes in Equity

For the year ended 31 December 2012

Statement of Changes in Equity for the year ended 31 December 2012

	Share capital RO'000	Legal reserve RO'000	Statutory reserve RO'000	Available-for-sale fair value reserve RO'000	Merger reserve (note 3) RO'000	Retained profits RO'000	Total RO'000
At 1 January 2011 (refer note 3)	91,325	30,442	912	-	(75,664)	51,451	98,466
Total comprehensive income for the year							-
Profit for the year	-	-	-	-	-	15,528	15,528
Other comprehensive income / (expense) for the year net of income tax							
Effect of currency translation	-	-	(147)	-	147	-	-
Net movement in fair value of available-for-sale investments		-	-	-	-	140	140
Total other comprehensive income for the year	-	-	(147)	-	147	140	140
Total comprehensive income for the year	-	-	(147)	-	147	15,668	15,668
Transfer to legal and statutory reserve	-	1,651	208	-	(1,859)	-	-
	-	1,651	61	-	(1,712)	15,668	15,668
Transaction with shareholders, recorded directly in equity							
Stock dividend issued for 2010	5,480	-	-	-	(5,480)	-	-
At 31 December 2011 (refer note 3)	96,805	32,093	973	-	(82,856)	67,119	114,134
Total comprehensive income for the year							
Profit for the year	-	-	-	-	-	**5,796**	**5,796**
Other comprehensive income / (expense) for the year net of income tax							
Effect of currency translation	-	-	**(32)**	-	-	**219**	**187**
Net movement in fair value of available-for-sale investments	-	-	-	**1,186**	-	-	**1,186**
Total other comprehensive income for the year	-	-	**(32)**	**1,186**	-	**219**	**1,373**
Total comprehensive income for the year	-	-	**(32)**	**1,186**	-	**6,015**	**7,169**
Reclassification from retained earnings	-	-	-	**449**	-	**(140)**	**309**
Movements as a result of merger	-	-	-	-	**84,066**	**(13,557)**	**70,509**
Transfer to legal and statutory reserve	-	**580**	**295**	-	-	**(875)**	-
	-	**580**	**263**	**1,635**	**84,066**	**(8,557)**	**77,987**
Transaction with shareholders, recorded directly in equity							
Share capital issued	**102,016**	-	-	-	-	-	**102,016**
Stock dividend issued for 2011	**1,210**	-	-	-	**(1,210)**	-	-
At 31 December 2012	**200,031**	**32,673**	**1,236**	**1,635**	-	**58,562**	**294,137**
At 31 December 2012 (US$'000)	**519,562**	**84,865**	**3,211**	**4,248**	-	**152,109**	**763,995**
At 31 December 2011 (US$'000) (refer note 3)	251,442	83,358	2,527	-	(215,210)	174,335	296,452

The accompanying notes on pages 45 to 87 form an integral part of these financial statements.

Statement of Cash Flows

For the year ended 31 December

2011 Refer note 3 US$'000	2012 US$'000		Note	2012 RO' 000	2011 Refer note 3 RO'000
		Cash flows from operating activities			
44,429	**18,627**	Profit before tax		**7,171**	17,105
		Adjustments for:			
(1,943)	**25,204**	non-cash items included in profit before tax		**9,703**	(748)
(636)	**(138,360)**	change in operating assets		**(53,269)**	(245)
214,213	**263,696**	change in operating liabilities		**101,524**	82,472
(3,349)	**(7,322)**	income tax paid		**(2,819)**	(1,289)
252,714	**161,845**	Net cash generated from operating activities		**62,310**	97,295
		Cash flows used in investing activities			
(7,910,197)	**(11,730,513)**	Purchase of financial investments		**(4,516,247)**	(3,045,426)
7,545,455	**11,209,865**	Proceeds from maturity of financial investments		**4,315,798**	2,905,000
(1,382)	**(5,844)**	Purchase of property, plant and equipment		**(2,250)**	(532)
-	**638,396**	Cash and cash equivalents acquired as a result of merger (net)		**245,782**	-
-	**(476)**	Effect of currency translation		**(183)**	-
(366,124)	**111,428**	Net cash generated from / (used in) investing activities		**42,900**	(140,958)
		Cash flows from financing activities			
-	**53,379**	Additional capital contribution		**20,551**	-
-	**53,379**	Net cash generated from financing activities		**20,551**	-
(113,410)	**326,652**	**Net change in cash and cash equivalents**		**125,761**	(43,663)
416,220	**302,810**	Cash and cash equivalents at the beginning of the year		**116,582**	160,245
302,810	**629,462**	Cash and cash equivalents at the end of the year	***26***	**242,343**	116,582

The accompanying notes on pages 45 to 87 form an integral part of these financial statements.

Notes to the Financial Statements
As of 31 December 2012

1 Legal status and principal activities

HSBC Bank Oman S.A.O.G. ('the Bank'), formerly Oman International Bank S.A.O.G. ('OIB'), is an Omani joint stock company, which was incorporated on 1 January 1979, operating as a commercial bank through a network of branches in the Sultanate of Oman. Additionally the Bank has branches in India and Pakistan (overseas branches). The registered office of the head office of the Bank is P.O. Box 1727, CPO Seeb, Postal Code 111, Sultanate of Oman. The Bank has its shares listed on Muscat Securities Market.

As further explained in note 3, on 3 June 2012, the operations of HSBC Bank Middle East Limited, Oman branches merged with OIB and the combined listed entity was renamed as HSBC Bank Oman S.A.O.G. Following the merger, HSBC Bank Middle East Limited ('HBME') holds 51% of the shares in the combined entity. HBME is a subsidiary of HSBC Holdings Plc.

2 Summary of significant accounting polices

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented.

2.1 Basis of preparation

(a) Statement of compliance

The financial statements of the Bank at 31 December 2012 were prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the IASB, the disclosure requirements and the applicable regulations of the Capital Market Authority ("CMA"), Central Bank of Oman ("CBO") and Commercial Companies Law of 1974, as amended.

IFRSs comprise accounting standards issued by the IASB and its predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') and its predecessor body.

The financial statements have been prepared on the historical cost basis except for available-for-sale investments and derivative financial instruments which are measured at fair value.

(b) Functional and presentation currency

The financial statements are presented in Rials Omani ("RO"), which is the functional currency of the primary economic environment in which the Bank operates. The United States Dollar amounts (rounded off to nearest thousand) shown in the financial statements have been translated from Rial Omani at the exchange rate of RO 0.385 to each US Dollar, and are shown for the convenience of the reader only.

(c) Comparative information

These financial statements include comparative information as required by IFRS.

As further explained in note 3, on 3 June 2012, the operations of HSBC Bank Middle East Limited, Oman branches merged with OIB. Following the merger, HBME holds 51% of the shares in the combined entity. The merger is accounted for as a reverse acquisition under IFRS 3 – 'Business Combinations' due to HBME acquiring a controlling stake in OIB through the issue of new shares by OIB. Accordingly, OIB is treated as the 'accounting acquiree' and HSBC Bank Middle East Limited, Oman branches are treated as the 'accounting acquirer' for accounting purposes. As a result, the financial statements of HSBC Bank Oman S.A.O.G. are shown as a continuation of the financial statements of HSBC Bank Middle East Limited, Oman branches with one adjustment to reflect the legal capital and statutory reserves of OIB.

2 Summary of significant accounting polices *(continued)*

2.1 Basis of preparation *(continued)*

(d) Accounting for Business combination

The purchase method of accounting is used to account for the business combination. The cost of an acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange. Acquisition-related costs are recognised as an expense in the statement of income in the period in which they are incurred. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Goodwill is measured as the excess of the aggregation of the consideration transferred, the amount of non-controlling interest and the fair value of the acquirer's previously held equity interest, if any, over the net of the amounts of the identifiable assets acquired and the liabilities assumed. In the event that the amount of net assets acquired is in excess of the aggregation of the consideration transferred, the difference is recognised immediately in the statement of income.

(e) Use of estimates and assumptions

The preparation of the financial statements in confirmation with IFRS requires the use of estimates and assumptions about future conditions. The use of available information and the application of judgement are inherent in the formation of estimates; actual results in the future may differ from those reported. Management believes that the bank's critical accounting policies where judgement is necessarily applied are those which relate to the valuation of separately identifiable assets and liabilities acquired during merger, the useful lives of intangible assets, impairment of loans and advances, the valuation of financial instruments and the impairment of available-for-sale financial assets.

(f) Future accounting developments

At 31 December 2012, a number of standards and interpretations, and amendments thereto, had been issued by the IASB, which are not effective for these financial statements. In addition to the projects to complete financial instrument accounting, the IASB is continuing to work on projects on insurance, revenue recognition and lease accounting, which together with the standards described below, will represent widespread and significant changes to accounting requirements from 2013.

Amendments issued by the IASB

Standards applicable in 2013

In May 2011, the IASB issued IFRS 10 'Consolidated Financial Statements' ('IFRS 10'), IFRS 11 'Joint Arrangements' ('IFRS 11') and IFRS 12 'Disclosure of Interests in Other Entities' ('IFRS 12'). In June 2012, the IASB issued amendments to IFRS 10, IFRS 11 and IFRS 12 'Transition Guidance'. The standards are effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRSs 10 and 11 are required to be applied retrospectively.

Under IFRS 10, there will be one approach for determining consolidation for all entities, based on the concept of power, variability of returns and their linkage. This will replace the current approach which emphasises legal control or exposure to risks and rewards, depending on the nature of the entity. IFRS 11 places more focus on the investors' rights and obligations than on structure of the arrangement, and introduces the concept of a joint operation. IFRS 12 includes the disclosure requirements for subsidiaries, joint arrangements and associates and introduces new requirements for unconsolidated structured entities.

Based on our assessment to date, we do not expect the overall impact of IFRS 10, IFRS 11 and IFRS 12 on these financial statements to be material.

2 Summary of significant accounting polices *(continued)*

2.1 Basis of preparation (continued)

(f) Future accounting developments (continued)

Amendments issued by the IASB *(continued)*

Standards applicable in 2013 (continued)

In May 2011, the IASB issued IFRS 13 'Fair Value Measurement' ('IFRS 13'). This standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IFRS 13 is required to be applied prospectively from the beginning of the first annual period in which it is applied. The disclosure requirements of IFRS 13 do not require comparative information to be provided for periods prior to initial application.

IFRS 13 establishes a single source of guidance for all fair value measurements required or permitted by IFRSs. The standard clarifies the definition of fair value as an exit price, which is defined as a price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions, and enhances disclosures about fair value measurement.

Based on our assessment to date, we do not expect the overall impact of IFRS 13 on these financial statements to be material.

In June 2011, the IASB issued amendments to IAS 19 'Employee Benefits' ('IAS 19 revised'). The revised standard is effective for annual periods beginning on or after 1 January 2013 with early adoption permitted. IAS 19 revised is required to be applied retrospectively.

The most significant amendment for HSBC is the replacement of interest cost and expected return on plan assets by a finance cost component comprising the net interest on the net defined benefit liability or asset. This finance cost component is determined by applying the same discount rate used to measure the defined benefit obligation to the net defined benefit liability or asset. The difference between the actual return on plan assets and the return included in the finance cost component in the statement of income will be presented in other comprehensive income. The effect of this change is to increase the pension expense by the difference between the current expected return on plan assets and the return calculated by applying the relevant discount rate.

Based on our assessment to date, we do not expect the overall impact of IAS 19 on these financial statements to be material.

In December 2011, the IASB issued amendments to IFRS 7 'Disclosures – Offsetting Financial Assets and Financial Liabilities' which requires the disclosures about the effect or potential effects of offsetting financial assets and financial liabilities and related 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. The amendments are required to be applied retrospectively.

Standards applicable in 2014

In December 2011, the IASB issued amendments to IAS 32 'Offsetting Financial Assets and Financial Liabilities' which clarified the requirements for offsetting financial instruments and addressed inconsistencies in current practice when applying the offsetting criteria in IAS 32 'Financial Instruments: Presentation'. The amendments are effective for annual periods beginning on or after 1 January 2014 with early adoption permitted and are required to be applied retrospectively.

The Bank is currently assessing these clarifications but it is impracticable to quantify their effect as at the date of approval of these financial statements.

2 Summary of significant accounting polices *(continued)*

2.1 Basis of preparation (continued)

(f) Future accounting developments (continued)

Amendments issued by the IASB *(continued)*

Standards applicable in 2014 (continued)

In October 2012, the IASB issued amendments to IFRS 10, IFRS 12 and IAS 27 'Investment Entities', which introduced an exception to the principle that all subsidiaries shall be consolidated. The amendments require a parent that is an investment entity to measure its investments in particular subsidiaries at fair value through profit or loss instead of consolidating all subsidiaries in its consolidated and separate financial statements. The amendments are effective from 1 January 2014 with early adoption permitted. Based on our initial assessment, we do not expect the amendments to have a material impact on these financial statements.

Standards applicable in 2015

In November 2009, the IASB issued IFRS 9 'Financial Instruments' ('IFRS 9') which introduced new requirements for the classification and measurement of financial assets. In October 2011, the IASB issued additions to IFRS 9 relating to financial liabilities. Together, these changes represent the first phase in the IASB's planned replacement of IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39') with a less complex and improved standard for financial instruments.

Following the IASB's decision in December 2011 to defer the effective date, the standard is effective for annual periods beginning on or after 1 January 2015 with early adoption permitted. IFRS 9 is required to be applied retrospectively but prior periods need not be restated.

The second and third phases in the IASB's project to replace IAS 39 will address the impairment of financial assets measured at amortised cost and hedge accounting.

The IASB is in the process of amending the requirements for classification and measurement in IFRS 9 to address practice and other issues.

In December 2012, the IASB added the requirements related to general hedge accounting, to IFRS 9 which align hedge accounting more closely with risk management and established a more principle-based approach to hedge accounting while address inconsistencies and weaknesses in the IAS 39 hedge accounting model. The revised hedge accounting requirements are effective for annual periods beginning on or after 1 January 2015 on a prospective basis. The requirements do not address macro hedge accounting, which is still being considered by the IASB. HSBC is currently assessing the impact of the hedge accounting draft standard.

As a result of uncertainties with regard to the final IFRS 9 requirements for classification and measurement and impairment, the Bank remains unable to provide a date by which it will apply IFRS 9 as a whole and it remains impracticable to quantify the effect of IFRS 9 as at the date of the approval of these financial statements.

2.2 Foreign currency transactions

2.2.1 Transactions and balances

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at the reporting date. Foreign exchange differences arising on translation are recognised in the statement of income.

2 Summary of significant accounting polices *(continued)*

2.2* Foreign currency transactions *(continued)

2.2.2 Translation of financial statements of overseas branches

The assets and liabilities of the overseas branches that have a functional currency other than the Rial Omani are translated into Rial Omani at the period-end rates of exchange. The income and expenses of these overseas branches are translated into Rial Omani at average exchange rates for the period. Differences resulting from the translation of the opening net investment in these overseas branches are taken to other comprehensive income.

2.3 Financial instruments

All financial instruments are recognised initially at fair value. In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (that is, the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Bank recognises a trading gain or loss on inception of the financial instrument, being the difference between the transaction price and the fair value. When unobservable market data has a significant impact on the valuation of financial instruments, the entire initial difference in fair value indicated by the valuation model from the transaction price is not recognised immediately in the statement of income. Instead, it is recognised over the life of the transaction on an appropriate basis, or when the inputs become observable, or the transaction matures or is closed out, or when the Bank enters into an offsetting transaction. Financial instruments include cash and balances with central banks, due from banks, loans and advances to customers, financial investments, acceptances, due to banks and deposits from customers.

2.3.1 Reclassification of financial assets

Non-derivative financial assets (other than those designated at fair value through profit or loss upon initial recognition) may be reclassified out of the fair value through profit or loss category in the following circumstances:

- financial assets that would have met the definition of loans and receivables at initial recognition (if the financial asset had not been required to be classified as held for trading) may be reclassified out of the fair value through profit or loss category if there is the intention and ability to hold the financial asset for the foreseeable future or until maturity; and

- financial assets (except financial assets that would have met the definition of loans and receivables at initial recognition) may be reclassified out of the fair value through profit or loss category and into another category in rare circumstances.

When a financial asset is reclassified as described in the above circumstances, the financial asset is reclassified at its fair value on the date of reclassification. Any gain or loss already recognised in the statement of income is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

2.3.2 Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by the Bank which are not classified either as held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to a borrower. They are derecognised when either the borrower repays their obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less any reduction for impairment or uncollectibility. Where exposures are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment relating only to the hedged risk.

Notes to the Financial Statements (continued)
As of 31 December 2012

2 Summary of significant accounting polices (continued)

2.3 Financial instruments *(continued)*

2.3.2 Loans and advances to banks and customers (continued)

Loans and advances are reclassified to held for sale when their carrying amounts are to be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable; however, such loans and advances continue to be measured in accordance with the policy described above.

The Bank may commit to underwrite loans on fixed contractual terms for specified periods of time, where the drawdown of the loan is contingent upon certain future events outside the control of the Bank. Where the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a derivative and measured at fair value through profit or loss. On drawdown, the loan is classified as held for trading and measured at fair value through profit or loss. Where it is not the Bank's intention to trade but hold the loan, a provision on the loan commitment is only recorded where it is probable that the Bank will incur a loss. This may occur, for example, where a loss of principal is probable or the interest rate charged on the loan is lower than the cost of funding. On inception of the loan, the hold portion is recorded at its fair value and subsequently measured at amortised cost using the effective interest method. For certain transactions, such as leverage finance and syndicated lending activities, the cash advanced is not necessarily the best evidence of the fair value of the loan. For these loans, where the initial fair value is lower than the cash amount advanced (for example, due to the rate of interest charged on the loan being below the market rate of interest), the write-down is charged to the statement of income. The write-down will be recovered over the life of the loan, through the recognition of interest income using the effective interest method, unless the loan becomes impaired. The write down is recorded as a reduction to other operating income.

Financial assets which have been reclassified into the loans and receivables category are initially recorded at the fair value at the date of reclassification and are subsequently measured at amortised cost, using the effective interest rate determined at the date of reclassification.

2.3.3 Available-for-sale financial assets

Treasury bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale or held-to-maturity. Financial investments are recognised on trade date, when the Bank enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either the securities are sold or the borrowers repay their obligations.

(i). Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income in 'Available-for-sale investments – fair value reserve until the financial assets are either sold or become impaired. When available-for-sale financial assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in the statement of income as 'Gains or losses from financial investments'.

Interest income is recognised on available-for-sale debt securities using the effective interest rate, calculated over the asset's expected life. Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective interest rates. Dividends are recognised in the statement of income when the right to receive payment has been established.

At each reporting date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

Notes to the Financial Statements
As of 31 December 2012

2 Summary of significant accounting polices (continued)

2.3 Financial instruments *(continued)*

2.3.3 Available-for-sale financial assets (continued)

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the statement of income, is removed from other comprehensive income and recognised in the statement of income.

Impairment losses for available-for-sale debt securities are recognised within 'Loan impairment charges and other credit risk provisions' in the statement of income and impairment losses for available-for-sale equity securities are recognised within 'Gains or losses from financial investments' in the statement of income. The impairment methodologies for available-for-sale financial assets are set out in more detail below:

a. Available-for-sale debt securities: When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date, the Bank considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer. These types of specific event and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.

b. Available-for-sale equity securities: Objective evidence of impairment for available-for sale equity securities may include specific information about the issuer as detailed above, but may also include information about significant changes in technology, markets, economics or the law that provides evidence that the cost of the equity securities may not be recovered.

A significant or prolonged decline in the fair value of the asset below its cost is also an objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the period in which the fair value of the asset has been below its original cost at initial recognition.

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the nature of the available-for-sale financial asset concerned:

For an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the statement of income when there is further objective evidence of impairment as a result of further decrease in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in fair value of the financial asset is recognised in other comprehensive income. If the fair value of the debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the statement of income, the impairment loss is reversed through the statement of income. If there is no longer objective evidence that the debt security is impaired, the impairment loss is also reversed through the statement of income;

For an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised directly in other comprehensive income. Impairment losses recognised on the equity security are not reversed through the statement of income. Subsequent decreases in the fair value of the available-for-sale equity security are recognised in the statement of income, to the extent that further cumulative impairment losses have been incurred in relation to the acquisition cost of the equity security.

2 Summary of significant accounting polices (continued)

2.3 Financial instruments *(continued)*

2.3.4 Fair value hierarchy

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

Level 1: Quoted market price (unadjusted) in an active market for an identical instrument. Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations.

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

Level 3: Valuation techniques using significant unobservable inputs. This category included 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 category includes instrument that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate swaps and forward foreign exchange contract that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps.

2.4 Derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

2.5 Cash and cash equivalents

Cash and cash equivalents consist of cash balances on hand; balances with banks and other financial institutions and CBO; items in the course of collection from other banks; deposits with banks and other financial institutions maturing within three months of the date of acquisition; and amounts due to banks and other financial institutions payable within three months.

2.6 Money market placements

Money market placements are classified as held to maturity assets.

2.7 Derecognition

A financial asset is derecognised when the Bank loses control over the contractual rights that comprise that asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when it is extinguished.

2 Summary of significant accounting polices *(continued)*

2.7 Derecognition *(continued)*

Available-for-sale assets and assets held for trading that are sold are derecognised and corresponding receivables from the buyer for the payment are recognised as of the date the Bank commits to sell the assets. The Bank uses the specific identification method to determine the gain or loss on derecognition.

Held-to-maturity instruments and loans and receivables are derecognised on the day they are transferred by the Bank.

2.8 Offsetting

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and the transactions are intended to be settled on a net basis.

2.9 Impairment - loans and advances

Specific provisions are made against the carrying amount of loans and advances that are identified as being impaired based on regular reviews of outstanding balances to reduce those loans and advances to their recoverable amounts. The recoverable amount of loans and advances is calculated at the present value of expected future cash flows discounted at the original effective interest rate. Short term balances are not discounted.

Collective impairment provisions are maintained in respect of incurred losses, which have not yet been specifically identified within the portfolio of loans and advances.

When a loan is known to be uncollectible, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off directly. The expected cash flows for portfolios of similar assets are estimated based on previous experience and considering the credit rating of the underlying customers and late payments of interest or penalties.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down or allowance is reversed through the profit or loss account.

2.10 Property and equipment

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated so as to write off the cost of property and equipment, other than freehold land, by equal installments over the estimated economic useful lives from the date the asset is brought into use, as follows:

Buildings	-	25 years
Leasehold improvements	-	Over the unexpired term of the lease
Motor vehicles	-	5 years
Equipment, furniture and fixtures	-	3 – 10 years
Computer software and equipment	-	3 – 5 years

Computer software includes both purchased and internally generated software. The cost of internally generally software comprises all directly attributable costs necessary to create, produce and prepare the software to be capable of operating in the manner intended by management. Costs incurred in the ongoing maintenance of software are expensed immediately as incurred.

2 Summary of significant accounting polices *(continued)*

2.10 Property and equipment *(continued)*

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit. Repairs and renewals are charged to the statement of income when the expense is incurred. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditure is recognised in the statement of income as an expense as incurred. Management annually reviews the appropriateness of useful lives, residual values and depreciation methods for property and equipment. Property and equipment are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

2.11 Intangible assets

Intangible assets are recognised separately from goodwill when they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

Intangible assets includes core deposit relationships and customer relationships. Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable. Intangible assets that have a finite useful life are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected useful life.

Intangible assets with finite useful lives are amortised, generally on a straight-line basis, over their useful lives as follows:

Core deposit intangible .... 7 years
Customer relationship .... 7 years

Amortisation method, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

2.12 Provisions

A provision is recognised in the statement of financial position when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows using a rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. The unwinding of the discount is recognized as finance cost.

2.13 Other payables

Other payables are stated at amortised cost.

2.14 Revenue recognition

2.14.1 Interest income and expense

Interest income and expense for all financial instruments except for those classified as held-for-trading or designated at fair value (other than debt securities issued by the Bank and derivatives managed in conjunction with such debt securities issued) are recognised in 'Interest income' and 'Interest expense' in the statement of income using the effective interest method. The effective interest method is a way 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.

2 Summary of significant accounting polices *(continued)*

2.14 Revenue recognition *(continued)*

2.14.1 Interest income and expense *(continued)*

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the Bank that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

2.14.2 Non-interest income

Fee income is earned from a diverse range of services provided by the Bank to its customers. Fee income is accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as an arrangement for the acquisition of shares or other securities);

- income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and

- income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in ‘Interest income’.

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with related interest income, expense and dividends.

Net expense/income from financial instruments designated at fair value includes all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss. Interest income and expense and dividend income arising on these financial instruments are also included, except for interest arising from debt securities issued, and derivatives managed in conjunction with those debt securities, which is recognised in ‘Interest expense’.

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

2.15 Taxation

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the statement of income except to the extent it relates to a business combination or items recognised directly in equity or in other comprehensive income. Current tax comprises tax payable calculated on the basis of the expected taxable income, using the tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is calculated in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Temporary differences are not provided for in respect of initial recognition of assets and liabilities that affect neither accounting nor taxable profit. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date.

2 Summary of significant accounting polices *(continued)*

2.15 Taxation *(continued)*

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

2.16 Employee terminal benefits

Contributions to defined contribution retirement plans, for Omani employees in accordance with the Oman Social Insurance Scheme, and for international employees in accordance with the HSBC International Staff Retirement Benefit Scheme, are recognised as expenses in the statement of income as incurred.

The Bank's obligation in respect of non-Omani terminal benefits, which is an unfunded defined benefit retirement plan, is the amount of future benefit that such employees have earned in return for their service in the current and prior periods. The obligation is calculated using the projected unit credit method and is discounted to its present value. The discount rate used is the yield at the reporting date on government bonds that have maturity dates approximating to the terms of the Bank's obligations.

2.17 Operating segment reporting

An operating segment is a component of the Bank 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 Bank's other components, whose operating results are reviewed regularly by the ALCO (asset liability committee), the Chief Operating decision maker, to make decisions about resources allocated to the segment and assess its performance, and for which discrete financial information is available. Segment results that are reported to the ALCO (asset liability committee) include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly corporate assets (primarily the Bank's headquarters), head office expenses, and income tax assets and liabilities.

3 Business combination

On 3 June 2012, the operations of HSBC Bank Middle East Limited, Oman branches merged with OIB and the combined listed entity was renamed as HSBC Bank Oman S.A.O.G. As a result of the merger through the issue of new shares in OIB, HBME acquired 51% of the combined entity for a total consideration of RO 151.92m. As HBME acquired a controlling stake in OIB, the merger is accounted for as a reverse acquisition under IFRS 3. For accounting purposes, OIB is treated as the 'accounting acquiree' and HSBC Bank Middle East Limited, Oman branches are treated as the 'accounting acquirer'. Accordingly the financial statements of HSBC Bank Oman S.A.O.G. are shown as a continuation of the financial statements of HSBC Bank Middle East Limited, Oman branches with one adjustment to reflect the legal capital and statutory reserves of OIB. This adjustment was reflected in a 'merger reserve', which was adjusted against retained earnings as at 31 December 2012. The comparative information in these financial statements are those of HSBC Bank Middle East Bank, Oman branches, except for the legal capital and statutory reserves which are of OIB.

3 Business combination *(continued)*

The fair values of identifiable assets acquired and the liabilities assumed at 3 June 2012 were as follows:

	Fair value recognised on acquisition	Carrying value immediately prior to acquisition
	RO'000	RO'000
Cash and balances with central banks	**108,344**	108,344
Derivatives	**1,948**	1,948
Due from banks	**174,190**	174,190
Loans and advances to customers – net*	**685,370**	702,940
Financial investments	**173,977**	173,977
Other assets*	**120,609**	120,723
Prepayment and accrued income	**1,120**	1,120
Property, plant and equipment	**31,405**	37,038
Intangible assets – core deposit	**12,306**	-
Intangible assets – customer relationships	**3,691**	-
Deferred tax assets	**3,868**	950
Due to banks	**(21,281)**	(21,281)
Deposits from customers	**(1,014,455)**	(1,015,555)
Items in the course of transmission to other banks	**(4,519)**	(4,519)
Derivatives	**(2,342)**	(242)
Other liabilities	**(116,079)**	(116,079)
Current tax liabilities	**(563)**	(563)
Accruals and deferred income	**(4,428)**	(4,428)
Total identifiable net assets	**153,161**	
Total consideration transferred	**151,923**	
Negative goodwill arising on acquisition (note 4)	**(1,238)**	

Transaction costs of RO 0.39 m have been expensed and are included in general and administrative expenses (note 6).

* For acquired receivables, the best estimate at the acquisition date of the contractual cash flows not expected to be collected are as follows:

	Gross contractual cash flow RO'000	**Cash flow not expected to be collected RO'000**
Loans and advances	**746,335**	**60,965**
Other assets	**120,723**	**114**

The corresponding figures as at 31 December 2011 are presented differently from the 2011 audited financial statements to comply with the IFRS 3 requirement. The corresponding figures include the assets and liabilities of HBME Oman branches as at 31 December 2011 and the share capital and statutory reserves of OIB as at 31 December 2011 which were included in their respective audited financial statements as at for the year ended 31 December 2011.

Notes to the Financial Statements (continued)
As of 31 December 2012

The following table, prepared for illustrative purposes only, gives an indication of what the results for the year ended 31 December 2012 may have been had the merger occurred on 1 January 2012 and of OIB for the period from 1 January 2012 to the date of merger:

	Period 1 January 2012 to 2 June 2012 RO'000	Period 3 June 2012 to 31 December 2012 RO'000	Combined RO'000
OIB:			
- Operating income	17,071	23,090	40,161
- Operating expense	(12,369)	(18,482)	(30,851)
- Loan impairment charges	(7,510)	(216)	(7,726)
Profit before integration cost			**1,584**
HBME Oman branches:			
- Operating income	14,555	22,884	37,439
- Operating expense	(7,459)	(8,939)	(16,398)
- Loan impairment charges	(612)	(3,796)	(4,408)
Profit before integration cost			**16,633**
Combined profit before integration cost			**18,217**
Integration cost			**(13,854)**
Profit before tax			**4,363**
Tax			**(1,745)**
Profit for the year			**2,618**
Add: OIB net loss after tax for the period 1 January to 2 June 2012 reported under retained earnings			**3,178**
Profit for the year as reported in the Statement of comprehensive income			**5,796**

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4 Other operating income

	2012	2011
	RO'000	RO'000
Profit on sale of property and equipment	**3**	-
Negative goodwill (note 3)	**1,238**	-
Rent received	**93**	101
Other income	**85**	35
	1,419	136

5 Loan impairment charges and other credit risk provisions - net of recoveries

	2012	2011
	RO'000	RO'000
Provided during the year – general (note 11)	**(662)**	(5)
Provided during the year – specific (note 11)	**(13,193)**	(1,954)
Provisions released / written back (note 11)	**688**	1,620
Adjustments as a result of fair value unwind	**5,704**	-
Reserved interest released (note 11)	**411**	582
Written-off loans recovered	**2,589**	883
Bad debts directly written off to statement of income	**(161)**	(56)
	(4,624)	1,070

6 Operating expenses

	2012	2011
	RO'000	RO'000
Employee compensation and benefits	**(20,197)**	(8,478)
Depreciation and impairment of property and equipment	**(1,356)**	(322)
Advertising and publicity	**(1,440)**	(217)
Repairs and Maintenance	**(3,220)**	(125)
Communications	**(1,034)**	(355)
Insurance	**(669)**	(286)
Head office expenses	**(240)**	(90)
Other administrative expenses	**(19,245)**	(8,943)
	(47,401)	(18,816)

The integration related expenses of RO 13.9m included in operating expense above contains transaction cost of RO 0.39m.

Notes to the Financial Statements (continued)

As of 31 December 2012

7 Taxation

	2012 RO'000	2011 RO'000
Statement of income:		
Current year	**(1,012)**	(2,217)
Prior years	**61**	44
Deferred tax	**(424)**	596
	(1,375)	(1,577)

	2012 RO'000	2011 RO'000
Current liability:		
Current year	**617**	2,217
Prior years	**1,797**	-
	2,414	2,217

	2012 RO'000	2011 RO'000
Deferred tax asset:		
1 January	**1,103**	507
Transfer in as a result of Business combination	**3,868**	-
Movement during the year	**(456)**	596
	4,515	1,103

	2012 RO'000	2011 RO'000
Deferred tax liability:		
1 January	**-**	-
Transfer in as a result of Business combination	**533**	-
Movement during the year	**188**	-
	721	-

Income tax for the Oman operations has been assessed for all years up to 2008 for HSBC Oman Branches and up to 2006 for OIB. The Bank has lodged an appeal with the Tax Authorities contesting the above decision. All subsequent years are subject to agreement with the Tax Authorities.

Income tax for the Indian operations has been agreed for all years up to 2008; all subsequent years are subject to agreement by the India Tax Authorities.

Income tax for the Pakistan operations has been assessed up to the year 2002. The Bank has lodged an appeal against the assessments for the years 1996 to 2002.

The tax rate applicable to the Bank in Oman is 12% (2011 : 12%). For the purpose of determining the tax expense for the year, the accounting profit has been adjusted for tax purposes. Adjustments for tax purposes include items relating to both income and expense. After giving effect to these adjustments, the average effective tax rate is estimated to be 19.17% (2011: 11.36 %).

The difference between the applicable tax rates of 12% and the effective tax rate of 19.17% arises mainly due to payment of minimum alternate tax for prior years by India Operations and the tax effect of income not considered to be taxable and expenses that are not considered to be deductible. The adjustments are based on the current understanding of the existing laws, regulations and practices.

Deferred tax asset has been computed at the tax rate of 12% (2011: 12%).

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8 Amortisation and impairment of intangible assets

	2012 RO'000	2011 RO'000
This represents amortisation of intangible assets as result of business combination (refer note 3) accounted for as follows :		-
Core deposits intangible	**(1,026)**	-
Customer relationships	**(307)**	-
	(1,333)	-

9 a) Earnings per share

Basic earnings per share amounts are calculated by dividing profit for the year attributable to ordinary equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year.

The following reflects the income and share data used in the basic and diluted earnings per share computations:

	2012	2011
Weighted average number of shares in issue ('000)	**1,571,065**	980,153
Profit for the year (RO'000)	**5,796**	15,528
Earnings per share (RO)	**0.004**	0.016

b) Net asset per share

Net assets (book value) per share is calculated by dividing the net assets (book value) at 31 December by the number of ordinary shares in issue at 31 December.

	2012	2011
Number of shares in issue ('000)	**2,000,312**	968,053
Net assets (RO'000)	**294,137**	114,134
Net asset per share (RO)	**0.147**	0.118

10 Due from banks

	2012 RO'000	2011 RO'000
Placements	**171,082**	97,724
Others	**12,776**	3,656
	183,858	101,380

11 Loans and advances to customers

Under IFRS 3 – Business Combinations, the acquirer does not recognise a provision for loan impairments on initial recognition of loans acquired in a business combination. The table below provides an analysis of gross loans and advances to customers as per the IFRS requirements.

	2012	2011
	RO'000	RO'000
Overdrafts	90,702	23,526
Loans	1,101,998	424,401
Bills discounted/purchased	30,063	17,028
Gross loans and advances	1,222,763	464,955
Provision for loan impairment – specific	(14,625)	(3,445)
Provision for loan impairment – general	(6,289)	(5,644)
Reserved interest	(7,406)	(1,586)
Loans and advances (net)	1,194,443	454,280

To comply with the CBO regulations, the table below includes the provision for loan impairment on loans acquired in the business combination.

	2012	2011
	RO'000	RO'000
Overdrafts	90,702	23,526
Loans	1,172,645	424,401
Bills discounted/purchased	30,063	17,028
Gross loans and advances	1,293,410	464,955
Provision for loan impairment – specific	(37,602)	(3,445)
Provision for loan impairment – general	(16,280)	(5,644)
Reserved interest	(45,085)	(1,586)
Loans and advances (net)	1,194,443	454,280

Provision for loan impairment and reserved interest:

The movement on provision for loan impairment for the year ended 31 December 2012 is analysed in the table below:

	Specific Provision RO'000	General Provision RO'000	Total Provision RO'000
Balance at 1 January 2012	3,445	5,644	9,089
Transfers as result of business combination	33,402	9,993	43,395
Currency translation effect on opening balance	(20)	(2)	(22)
Provided during the year	13,193	662	13,855
Released during the year:			
- Due to recoveries/releases	(486)	-	(486)
- Due to write back	(185)	(17)	(202)
Written off during the year	(11,747)	-	(11,747)
Balance at 31 December 2012	37,602	16,280	53,882

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11 Loans and advances to customers *(continued)*

The movement on provision for loan impairment for the year ended 31 December 2011 is analysed in the table below:

	Specific Provision RO'000	General Provision RO'000	Total Provision RO'000
Balance at 1 January 2011	4,980	5,639	10,619
Provided during the year	1,954	5	1,959
Released during the year:	(1,620)	-	(1,620)
Written off during the year	(1,869)	-	(1,869)
Balance at 31 December 2011	3,445	5,644	9,089

The movement on reserved interest during the year is analysed as follows:

	2012 RO'000	2011 RO'000
Balance at the beginning of the year	**1,586**	1,956
Transfers as result of business combination	**47,102**	-
Currency translation effect in opening balance	**(1)**	-
Reserved during the year	**7,441**	660
Released to the statement of income in loan impairments - credit	**(411)**	(582)
Written-off during the year	**(10,632)**	(448)
Balance at end of the year	**45,085**	1,586

The estimated fair value of loans and advances is not materially different from the book value of loans and advances, other than as disclosed in note 3.

Specific provision for loan impairment and reserved interest represent 89.44% of gross non-performing loans and advances.

12 Financial investments

	2012 RO'000	2011 RO'000
Available-for-sale	**680,672**	304,738
	680,672	304,738

Notes to the Financial Statements (continued)

As of 31 December 2012

12 Financial investments *(continued)*

Financial investments details are provided as follows

	Fair value	Fair value	**Carrying value**	Carrying value	**Cost**	Cost
	31 December 2012	31 December 2011	**31 December 2012**	31 December 2011	**31 December 2012**	31 December 2011
	RO'000	RO'000	**RO'000**	RO'000	**RO'000**	RO'000
Marketable securities – MSM						
Finance	**2,092**	-	**2,092**	-	**1,911**	-
Insurance	**377**	-	**377**	-	**340**	-
Services	**405**	-	**405**	-	**361**	-
Industrial	**44**	-	**44**	-	**54**	-
Government bonds	**47,998**	29,727	**47,998**	29,727	**47,670**	29,327
Other bonds	**220**	-	**220**	-	**220**	-
	51,136	29,727	**51,136**	29,727	**50,556**	29,327
Marketable securities – Foreign by Sector						
Government securities	**3,675**	-	**3,675**	-	**3,675**	-
Quoted foreign shares	**3,111**	-	**3,111**	-	**2,417**	-
	6,786	-	**6,786**	-	**6,092**	-
Unquoted and other investments						
Certificates of deposits			**610,000**	275,011	**610,000**	275,011
Unquoted Omani shares			**1,010**	-	**1,010**	-
Investment fund units			**11,740**	-	**11,696**	-
			622,750	275,011	**622,706**	275,011
Total			**680,672**	304,738	**679,354**	304,338

Details of classification of investments are given below:

Details of AFS investments are as follows

	2012	2011
	RO'000	RO'000
Cost of:		
Quoted - Foreign Government securities	**3,675**	-
Quoted - Equity and other securities-Oman	**674,669**	29,327
Unquoted investments	**1,010**	275,011
	679,354	304,338
Revaluation gain of:		
Quoted - Equity and other securities-Oman	**1,318**	400
	680,672	304,738

At 31 December 2012, available-for-sale investments in the amount of RO 7.77 million (2011: Nil) are measured using Level I, RO 671.89 million (2011: RO 304.7 million) are measured using Level II and RO 1.01 million (2011: Nil) are stated at cost.

Notes to the Financial Statements
As of 31 December 2012

13 Other assets

	2012 RO'000	2011 RO'000
Derivatives - positive mark-to-market	**2,108**	1,575
Prepayments and accrued income	**960**	651
Deferred tax asset	**4,515**	1,103
Acceptances	**136,646**	63,088
Others	**44,348**	454
	188,577	66,871

14 Intangible assets *(refer note 3)*

	2012 RO'000	2011 RO'000
Customer relationships	**3,691**	-
Core deposits	**12,306**	-
	15,997	-
Less: amortised	**(1,333)**	-
	14,664	-

15 Property and equipment

The movement in property and equipment during the year is as follows:

	Freehold land and buildings RO'000	Leasehold property and improvements RO'000	Equipment, furniture and fixtures RO'000	Motor vehicles RO'000	Computer equipment RO'000	Capital work in progress RO'000	Total RO'000
Cost / Valuation							
1 January 2012	3,346	1,260	1,893	81	1,121	-	7,701
Currency translation effect on opening balances	95	(2)	2	-	(1)	(2)	92
Transfer in as result of business combinations	29,942	3,032	8,350	954	14,280	4,181	60,739
Transfers from capital work in progress	-	-	-	-	670	(670)	-
Additions	-	92	382	45	1,731	-	2,250
Disposals / written off	-	(404)	(1,996)	(235)	(791)	(3,475)	(6,901)
31 December 2012	33,383	3,978	8,631	845	17,010	34	63,881
Depreciation							
1 January 2012	2,563	1,091	1,662	68	859	-	6,243
Currency translation effect on opening balances	25	(2)	1	(1)	3	-	26
Transfer in as result of business combination	5,217	2,616	7,268	882	13,007	-	28,990
Charge for the year	323	126	311	31	565	-	1,356
Disposals	-	(405)	(1,958)	(237)	(196)	-	(2,796)
31 December 2012	8,128	3,426	7,284	743	14,238	-	33,819
Net book value							
31 December 2012	25,255	552	1,347	102	2,772	34	30,062

Notes to the Financial Statements (continued)
As of 31 December 2012

15 Property and equipment *(continued)*

The movement in property and equipment for the year 2011 is as follows:

	Freehold land and buildings RO'000	Leasehold property and improvements RO'000	Equipment, furniture and fixtures RO'000	Motor vehicles RO'000	Computer equipment RO'000	Total RO'000
Cost /Valuation						
1 January 2011	3,344	1,068	1,802	81	946	7,241
Revaluation reserve	-	-	-	-	-	-
Additions	2	192	120	-	218	532
Disposals	-	-	(29)	-	(43)	(72)
31 December 2011	3,346	1,260	1,893	81	1,121	7,701
Depreciation						
1 January 2011	2,517	1,030	1,574	58	814	5,993
Charge for the year	46	61	117	10	88	322
Disposals	-	-	(29)	-	(43)	(72)
31 December 2011	2,563	1,091	1,662	68	859	6,243
Net book value						
31 December 2011	783	169	231	13	262	1,458

16 Due to banks

	2012 RO'000	2011 RO'000
Bank borrowings	**1,747**	-
Others	**44,423**	25,699
	46,170	25,699

17 Deposits from customers

	2012 RO'000	2011 RO'000
Current and call	**1,052,671**	414,687
Savings	**428,009**	83,668
Time deposits	**363,667**	245,675
Others	**7,220**	3,720
	1,851,567	747,750

Notes to the Financial Statements
As of 31 December 2012

18 Other liabilities

	2012 RO'000	2011 RO'000
Derivatives - negative mark-to-market	**3,221**	1,560
Deferred tax liability	**721**	-
Retirement benefit liability	**1,078**	349
Acceptances	**136,646**	63,088
Tax liability	**2,414**	4,924
Accruals and deferred income	**2,920**	9,322
Others	**73,942**	3,302
	220,942	82,545

As per the directives of the Capital Market Authority (CMA) the amount of unpaid dividend which is outstanding for more than six months is required to be transferred to the Investors' Trust Fund established by the CMA. The unpaid dividend amounting to RO 40,163 (2011: RO 44,638) outstanding for more than six months has been transferred to the Investors' Trust Fund during October 2012.

19 Share capital

The share capital of the Bank is divided into 2,000,312,790 fully paid shares of RO 0.100 each (31 December 2011: 968,052,611 shares of RO 0.100 each) against the authorised share capital of 7,500 million shares of RO 0.100 each.

Of the above share capital of the Bank ordinary shares of 1,020,159,523 were issued on 3 June 2012 to HBME as part of the merger with OIB (refer note 3).

Reconciliation of share capital	**Number of shares**		**Share Capital**	
	2012	2011	**2012** **RO'000**	2011 RO'000
In issue at 1 January	**968,052,610**	968,052,610	**96,805**	96,805
Bonus share issued during the year	**12,100,657**	-	**1,210**	-
Issued in business combination	**1,020,159,523**	-	**102,016**	-
As at 31 December	**2,000,312,790**	968,052,610	**200,031**	96,805

Major Shareholder

All those shareholders of the Bank who own 10% or more of the Bank's shares in their name, and the number of shares they hold are as follows:

	2012 **Number of shares**	2011 Number of shares
1 HSBC Bank Middle East Limited	**1,020,159,523**	-
2 H.E. Dr. Omar Bin Abdul Muneim Al Zawawi	**-**	97,483,598

20 Reserves

(a) Legal reserve

In accordance with the Commercial Companies Law of Oman 1974 as amended, annual appropriations of 10% of the profit for the year, are made to the legal reserve until the accumulated balance of the reserve is equal to one-third of the value of the Bank's paid-up share capital. This reserve is not available for distribution.

(b) Statutory reserve

Regulations issued on 30 September 2000 by the authority regulating the banking activities in India, in which certain branches operate, require the branches to appropriate 25% of their profits for the year to a statutory reserve, which is not distributable without the prior permission of the regulatory authority. An earlier regulation issued on 27 March 1989, required the branches in India to appropriate 20% of their profits to a statutory reserve until the year 2000. In this respect an amount of RO 295,000 has been transferred to statutory reserve during the year ended 31 December 2012 (2011: RO 208,000).

Notes to the Financial Statements (continued)
As of 31 December 2012

20 Reserves *(continued)*

(c) Merger reserve

The merger reserve arises from the application of the principles of reverse acquisition accounting for the business combination of HSBC Bank Middle East Limited, Oman branches and OIB in June 2012. In accordance with IFRS the acquisition has been accounted for as a reverse acquisition as explained in note 3.

(d) Available-for-sale fair value reserve

Available-for-sale fair value reserve represents fair value changes in available-for-sale financial assets.

21 Contingent liabilities, commitments and derivatives

(a) Contingent liabilities and other commitments

	2012 **RO'000**	2011 RO'000
Letters of credit	**86,782**	85,333
Guarantees and performance bonds	**334,677**	208,137
Forward forex contracts – sales	**131,533**	48,635
Forward forex contracts – purchases	**133,100**	48,635
Currency swaps	**136,479**	-
Options	**3,594**	2,586
Interest rate swaps	**21,965**	28,913
Undrawn unconditionally cancellable commitments	**667,840**	473,512
Undrawn unconditionally non-cancellable commitments	**19,717**	11,903
	1,535,687	907,654

(b) Legal case

As at 31 December 2012, there were certain legal suits pending against the Bank. Based on the opinion of the Bank's legal counsel, the Bank's management believes that no additional liability is expected to arise from these cases and it therefore does not consider it necessary to make any additional provisions in this regard.

(c) Capital and investment commitments

At 31 December 2012, there were capital and investment commitments amounting to RO 0.49million (2011: Nil).

(d) Derivatives

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

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

The notional amounts indicate the volume of transactions outstanding at the year end and are neither indicative of the market risk nor the credit risk.

21 Contingent liabilities, commitments and derivatives *(continued)*

(d) Derivatives (continued)

Forward foreign exchange contracts are measured using Level I and interest rate swaps and currency swaps are measured using Level II of fair value hierarchy.

31 December 2012:

	Positive fair value RO'000	**Negative fair value RO'000**	**Notional amount Total RO'000**
Derivatives held for trading:			
Forward foreign exchange contracts	**980**	**720**	**268,227**
Currency swaps	**-**	**1,373**	**136,479**
Interest rate swaps	**1,128**	**1,128**	**21,965**
	2,108	**3,221**	**426,671**

31 December 2011:

	Positive fair value RO'000	Negative fair value RO'000	Notional amount Total RO'000
Derivatives held for trading:			
Forward foreign exchange contracts	501	495	99,856
Interest rate swaps	1,074	1,065	28,913
	1,575	1,560	128,769

Derivative product types

Forwards are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market.

Swaps are contractual agreements between two parties to exchange movements in interest or foreign currency rates to make payments with respect to defined credit events based on specified notional amounts.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity, foreign currency or financial instrument at a fixed price, either at a fixed future date or at any time within a specified year. The bank transacts only in currency options for its customers.

(e) Lease commitments

At the year end annual commitments under non-cancelable operating leases were RO 0.44m (2011 : RO 0.11m)

22 Analysis of significant assets and liabilities

22.1 Nature of customer advances

	2012	2011
Gross	**RO' 000**	RO' 000
Overdrafts	**90,702**	14,341
Credit card	**13,067**	9,185
Loans	**994,848**	305,460
Clean import loans	**164,730**	118,941
Other bills	**30,063**	17,028
	1,293,410	464,955

Notes to the Financial Statements (continued)
As of 31 December 2012

23 Maturities of assets and liabilities

Maturity analysis of assets and liabilities as per CBO circular BM 955 is as follows:

At 31 December 2012	**On demand or within 3 months RO' 000**	**3 to 12 months RO' 000**	**Over 1 year RO' 000**	**Total RO' 000**
Assets				
Cash and balances with central banks	**72,895**	**19,650**	**27,995**	**120,540**
Due from banks	**182,315**	**1,543**	**-**	**183,858**
Loans and advances to customers - net	**235,182**	**118,136**	**841,125**	**1,194,443**
Financial investments	**611,466**	**6,381**	**62,825**	**680,672**
Other assets	**182,858**	**298**	**5,421**	**188,577**
Intangible assets	**-**	**-**	**14,664**	**14,664**
Property and equipment	**-**	**-**	**30,062**	**30,062**
Total assets	**1,284,716**	**146,008**	**982,092**	**2,412,816**
Liabilities and equity				
Due to banks	**46,170**	**-**	**-**	**46,170**
Deposits from customers	**566,798**	**514,377**	**770,392**	**1,851,567**
Other liabilities	**210,532**	**5,857**	**4,553**	**220,942**
Equity	**-**	**6,101**	**288,036**	**294,137**
Total liabilities and equity	**823,500**	**526,335**	**1,062,981**	**2,412,816**

At 31 December 2011	On demand or within 3 months RO' 000	3 to 12 months RO' 000	Over 1 year RO' 000	Total RO' 000
Assets				
Cash and balances with central banks	40,901	-	500	41,401
Due from banks	101,380	-	-	101,380
Loans and advances to customers - net	182,394	51,868	220,018	454,280
Financial investments	275,013	-	29,725	304,738
Other assets	50,444	10,091	6,336	66,871
Property and equipment	-	-	1,458	1,458
Total assets	650,132	61,959	258,037	970,128
Liabilities and equity				
Due to banks	25,699	-	-	25,699
Deposits from customers	265,326	192,102	290,322	747,750
Other liabilities	79,501	2,695	349	82,545
Equity	-	-	114,134	114,134
Liabilities and equity	370,526	194,797	404,805	970,128

Notes to the Financial Statements
As of 31 December 2012

24 Interest rate sensitivity gap

Sensitivity to interest rates arises from mismatches in the year to repricing of assets and that of the corresponding liability funding. The Bank manages these mismatches in accordance with HSBC Group policy guidelines and reduces risk by matching the repricing of assets and liabilities through various means. Significant changes in gap positions can be made to adjust the profile as market outlooks change. Additionally, whilst mismatches exist, liabilities maturing are to a great extent historically rolled over rather than withdrawn.

At 31 December 2012	Effective average interest rate%	within 3 months RO' 000	3 to 12 months RO' 000	Over 1 year RO' 000	Not interest sensitive RO' 000	Total RO' 000
Assets						
Cash and balances with central banks	-	-	-	-	120,540	120,540
Due from banks	0.62%	177,651	1,543	-	4,664	183,858
Loans and advances to customers – net	4.62%	235,182	118,136	841,125	-	1,194,443
Financial investments	0.42%	611,466	6,381	62,825	-	680,672
Other assets	-	2,000	-	-	186,577	188,577
Intangible assets	-	-	-	-	14,664	14,664
Property and equipment	-	-	-	-	30,062	30,062
Total assets		1,026,299	126,060	903,950	356,507	2,412,816
Liabilities and equity						
Due to banks	-	2,507	-	-	43,663	46,170
Deposits from customers	0.60%	619,948	170,494	9,682	1,051,443	1,851,567
Other liabilities	-	3,220	-	-	217,722	220,942
Equity	-	-	-	-	294,137	294,137
Total liabilities and equity		625,675	170,494	9,682	1,606,965	2,412,816
Interest sensitivity gap:						
- net		400,624	(44,434)	894,268		
- cumulative		400,624	356,190	1,250,458		

Sensitivity analysis – equity price risk

Quoted investments of the bank are listed on Muscat Securities Market ("MSM") and Foreign Government securities. For such investments classified as available for sale investments, a 5% increase in MSM 30 index would have increased Equity by RO 145,915 after tax; an equal change in the opposite direction would have decreased equity by RO 145,915 after tax.

Notes to the Financial Statements (continued)
As of 31 December 2012

24 Interest rate sensitivity gap *(continued)*

At 31 December 2011	Effective average interest rate%	within 3 months RO' 000	3 to 12 months RO' 000	Over 1 year RO' 000	Not interest sensitive RO' 000	Total RO' 000
Assets						
Cash and balances with central banks	-	-	-	-	41,401	41,401
Due from banks	0.72%	97,724	-	-	3,656	101,380
Loans and advances to customers – net	5.08%	201,423	50,398	202,459	-	454,280
Financial investments	0.41%	275,013	-	29,725	-	304,738
Other assets	-	1,575	-	-	65,296	66,871
Intangible assets	-	-	-	-	-	-
Property and equipment	-	-	-	-	1,458	1,458
Total assets		575,735	50,398	232,184	111,811	970,128
Liabilities and equity						
Due to banks	-	-	-	-	25,699	25,699
Deposits from customers	0.57%	284,691	45,696	2,898	414,465	747,750
Other liabilities	-	1,560	-	-	80,985	82,545
Equity	-	-	-	-	114,134	114,134
Total liabilities and equity		286,251	45,696	2,898	635,283	970,128
Interest sensitivity gap:						
- net		289,484	4,702	229,286		
- cumulative		289,484	294,186	523,472		

25 Financial assets and liabilities

25.1 Fair value information

Based on the valuation methodology outlined in note 2.3.5, the fair values of all financial instruments at 31 December 2012 were not significantly different to their net book values at 31 December 2012.

The table below analyses financial instruments carried at fair value, by valuation method.

The fair values of derivatives and certain financials investments have determined using the following hierarchy of valuation levels

		Valuation techniques		
	Quoted market price Level 1 RO'000	Using observable inputs Level 2 RO'000	With significant unobservable inputs Level 3 RO'000	Total RO'000
At 31 December 2012				
Assets				
Derivatives	**-**	**2,108**	**-**	**2,108**
Financial investments: available-for-sale	**7,771**	**671,891**	**1,010**	**680,672**
Liabilities				
Derivatives	**-**	**3,221**	**-**	**3,221**
At 31 December 2011				
Assets				
Derivatives	-	1,575	-	1,575
Financial investments: available-for-sale	-	304,738	-	304,738
Liabilities				
Derivatives	-	1,560	-	1,560

Loans and advances to customers

Fair value is calculated based on discounted expected future principal and interest cash flows. Loan repayments are assumed to occur at contractual repayment dates, where applicable. For loans that do not have fixed repayment dates or that are subject to prepayment risk, repayments are estimated based on experience in previous years when interest rates were at levels similar to current levels, adjusted for any differences in interest rate outlook. Expected future cash flows are estimated considering credit risk and any indication of impairment. Expected future cash flows for homogeneous categories of loans are estimated on a portfolio basis and discounted at current rates offered for similar loans to new borrowers with similar credit profiles. The estimated fair values of loans reflect changes in credit status since the loans were made and changes in interest rates in the case of fixed rate loans.

Notes to the Financial Statements (continued)

As of 31 December 2012

25 Financial assets and liabilities *(continued)*

25.1 Fair value information *(continued)*

Investments carried at cost and derivatives

Fair value is based on quoted market prices at the reporting date without any deduction for transaction costs. If a quoted market price is not available, fair value is estimated using pricing models or discounted cash flow techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate for a similar instrument at the reporting date.

Foreign exchange contracts are valued based on market prices. The market value adjustment of foreign exchange contracts are included in the book value of other assets.

Bank and customer deposits

For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the reporting date. The estimated fair value of fixed-maturity deposits, including certificates of deposit, is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. The value of long-term relationships with depositors is not taken into account in estimating fair values.

26 Cash and cash equivalents

The reconciliation of the components of cash and cash equivalents with the equivalent items shown in the statement of financial position is shown below:

	2012	2011
	RO'000	RO'000
Statement of financial position items comprise:		
Cash and balances with central banks	**120,540**	41,401
Due from other banks	**183,858**	101,380
Due to banks	**(46,170)**	(25,699)
	258,228	117,082
Adjustment for items maturing after three months from date of acquisition and restricted balances	**(15,885)**	(500)
	242,343	116,582
Cash and cash equivalents comprise:		
Cash and balances with central banks	**104,655**	40,901
Due from other banks	**183,858**	101,380
Due to banks	**(46,170)**	(25,699)
	242,343	116,582

27 Related parties and holders of 10% of the Bank's shares

Holders of 10% or more of the Bank's shares may include companies, individuals, or families. Families are included if the shares of the family members total 10% or more of the Bank's shares. Members of the family of an individual are those that may be expected to influence, or be influenced by that person in their dealings with the Bank.

Related parties also includes key management personnel and HSBC Group and related entities. Details are provided separately where amounts relating to an individual director and/or significant shareholder and his/her related parties are greater than 5% of the total of related party loans and advances. Others represent transactions with parties related to more than one director.

Notes to the Financial Statements
As of 31 December 2012

27 Related parties and holders of 10% of the Bank's shares *(continued)*

Analysis of the related party transactions with related parties or holders of 10% or more of the Bank's shares, ("Significant shareholders") or their family members during the year is as follows:

31 December 2012	**Significant shareholder- HSBC and related group entities RO'000**	**Directors RO'000**	**Key management personnel RO'000**	**Others RO'000**	**Total RO'000**
Loans and advances	**-**	**2**	**376**	**20,890**	**21,268**
Current, deposit and other accounts	**-**	**90**	**-**	**44,692**	**44,782**
Letters of credit and guarantees	**-**	**-**	**-**	**4,736**	**4,736**
Provision for loans and advances	**-**	**-**	**-**	**-**	**-**
Due from banks	**4,353**	**-**	**-**	**-**	**4,353**
Due to banks	**(14,842)**	**-**	**-**	**-**	**(14,842)**
For the year ended 31 December 2012					
Interest income	**-**	**-**	**-**	**944**	**944**
Interest expense	**(86)**	**-**	**-**	**(203)**	**(289)**
Net fee income	**104**	**-**	**-**	**13**	**117**
Other operating expenses:	**(6,464)**	**(6)**	**(1,107)**	**(538)**	**(8,115)**
Purchase of property and equipment	**-**	**-**	**-**	**69**	**69**

Loans and advances include non-performing loans amounting to RO 1.68m which are fully secured by cash collaterals and bank guarantees.

31 December 2011	Significant shareholder - HSBC and related group entities RO'000	Directors RO'000	Key management personnel RO'000	Others RO'000	Total RO'000
Loans and advances	-	-	180	-	180
Current, deposit and other accounts	-	-	-	-	-
Letters of credit and guarantees	-	-	-	-	-
Provision for loans and advances	-	-	-	-	-
Due from banks	2,301	-	-	-	2,301
Due to banks	(9,147)	-	-	-	(9,147)
For the year ended 31 December 2011					
Interest income	-	-	-	-	-
Interest expense	(2)	-	-	-	(2)
Net fee income	815	-	-	-	815
Other operating expenses:	(5,518)	-	-	-	(5,518)

Notes to the Financial Statements (continued)

As of 31 December 2012

28 Distribution by economic sector

The table below analyses the concentration of gross loans and advances by economic sector:

	2012 RO'000	2011 RO'000
Personal and consumer loans	**421,211**	105,124
Corporate and commercial		
Import trade	**178,312**	104,803
Construction	**69,317**	17,894
Manufacturing	**187,219**	76,479
Wholesale and retail trade	**35,060**	26,272
Export trade	**7,737**	7,996
Electricity, gas, water, transportation and communication	**132,384**	5,320
Services	**161,293**	83,044
Mining and quarrying	**54,065**	18,510
Others	**40,422**	19,228
	865,809	359,546
Financial institutions	**6,390**	285
Total gross loans and advances	**1,293,410**	464,955
Provision for loan impairment - specific	**(37,602)**	(3,445)
Provision for loan impairment - general	**(16,280)**	(5,644)
Reserved interest	**(45,085)**	(1,586)
Net loans and advances	**1,194,443**	454,280
Non-performing loans	**92,445**	5,427

The table below analyses the concentration of letters of credit, guarantees and other commitments by economic sector:

	2012 RO'000	2011 RO'000
Personal and consumer	**190**	75
Import trade	**61,619**	90,412
Construction	**63,713**	58,816
Financial institutions	**2,066**	146
Manufacturing	**18,340**	23,145
Wholesale and retail trade	**21,050**	12,439
Electricity, gas, water, transportation and communication	**3,218**	1,965
Services	**123,672**	103,809
Mining and quarrying	**2,001**	713
Others	**125,590**	1,950
	421,459	293,470

29 Operating Segment

The factors used to identify the bank's reporting segment are discussed in the 'Summary of significant accounting policies' in Note 2.17.

Products and services

The Bank provides a comprehensive range of banking and related financial services to its customers. The products and services offered to customers are organised by global business.

- Retail Banking and Wealth Management ('RBWM') offers a broad range of products and services to meet the personal banking need, consumer finance and wealth management needs of individual customers. Typically, customer offerings include personal banking products (current and savings accounts, mortgages and personal loans, credit cards, debit cards and local and international payment services) and wealth management services (insurance and investment products and financial planning services).

- Commercial Banking ('CMB') product offerings include the provision of receivables financing services, payments and cash management, international trade finance, treasury and capital markets, commercial cards, insurance, cash and derivatives in foreign exchange and rates, and online and direct banking offerings

- Global Banking and Markets ('GB&M') provides tailored financial solutions to government, corporate and institutional clients. The client focused business lines deliver a full range of banking capabilities including financing, advisory and transaction services; a markets business that provides services in credit, rates, foreign exchange, money markets and securities services; and principle investment activities.

Information about operating segments:

	31 December 2012			
	Corporate Banking RO' 000	**Retail Banking RO' 000**	**Treasury RO' 000**	**Total RO' 000**
Net interest income	**16,145**	**19,835**	**4,096**	**40,076**
Net fees and commission	**4,961**	**4,098**	**954**	**10,013**
Net trading income	**3,426**	**1,084**	**4,498**	**9,008**
Other operating income	**665**	**742**	**25**	**1,432**
Total	**25,197**	**25,759**	**9,573**	**60,529**
Profit for the year before income tax	**8,905**	**(9,778)**	**8,044**	**7,171**
Reportable segment assets	**923,302**	**407,757**	**985,070**	**2,316,129**
Reportable segment liabilities	**1,347,894**	**640,289**	**46,170**	**2,034,353**

	31 December 2011			
	Corporate Banking RO' 000	Retail Banking RO' 000	Treasury RO' 000	Total RO' 000
Net interest income	12,963	7,780	1,341	22,084
Net fees and commission	5,117	2,032	285	7,434
Net trading income	1,895	478	2,824	5,197
Other operating income	47	86	3	136
Total	20,022	10,376	4,453	34,851
Profit for the year before income tax	13,262	54	3,789	17,105
Reportable segment assets	415,362	102,006	447,519	964,887
Reportable segment liabilities	598,476	212,362	25,699	836,537

Notes to the Financial Statements (continued)
As of 31 December 2012

29 Operating segment *(continued)*

Reconciliation of reportable segment assets and liabilities

	2012 RO' 000	2011 RO' 000
Assets		
Total assets for reportable segments	**2,316,129**	964,887
Other unallocated amounts	**96,687**	5,241
Total assets	**2,412,816**	970,128
Liabilities		
Total liabilities for reportable segments	**2,034,353**	836,537
Other unallocated amounts	**84,326**	19,457
Total liabilities	**2,118,679**	855,994

Operating segments geographical areas

	Oman RO'000	**Others RO'000**	**Adjustments RO'000**	**Total RO'000**
As at 31 December 2012				
Income from customers	**68,816**	**1,152**	**-**	**69,968**
Net segment result	**6,101**	**(305)**	**-**	**5,796**
Assets	**2,404,244**	**34,738**	**(26,166)**	**2,412,816**
Liabilities	**2,113,236**	**14,543**	**(9,100)**	**2,118,679**
Capital expenditure	**2,236**	**14**	**-**	**2,250**
Depreciation	**1,099**	**257**	**-**	**1,356**
Provision for loan impairment (net of fair value unwind)	**(7,340)**	**(811)**	**-**	**(8,151)**

	Oman RO'000	Others RO'000	Adjustments RO'000	Total RO'000
As at 31 December 2011				
Income from customers	39,109	-	-	39,109
Net segment result	15,528	-	-	15,528
Assets	970,128	-	-	970,128
Liabilities	855,994	-	-	855,994
Capital expenditure	532	-	-	532
Depreciation	322	-	-	322
Provision for loan impairment	(1,959)	-	-	(1,959)

30 Dividend per share

The Board of Directors at the forthcoming Ordinary Annual General meeting will propose a cash dividend of RO 0.001 per share of nominal value of RO 0.100 each amounting to RO 2.0 million for the year 2012. (2011: cash dividend of RO 0.01125 per share of nominal value of RO 0.100 each amounting to RO 10.891 million and stock dividend of 1.25% equal to 12,100,657 shares). These financial statements do not reflect these dividends, which will be accounted for in shareholders' equity as an appropriation of retained earnings for the year ending 31 December 2013.

31 Risk management

All of the Bank's activities involve, to varying degrees, the analysis, evaluation, acceptance and management of risks or combinations of risks. The most important categories of risk that the Bank is exposed to are credit risk (including cross-border country risk), market risk, operational risks in various forms, liquidity risk, reputational risk, legal risk and sustainability (environmental and social) risks. Market risk includes foreign exchange, interest rate and equity price risks. The management of these various risk categories is discussed below.

The risk profiles of the Bank change constantly under the influence of a wide range of factors. The risk management framework established by the Bank fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interdependencies.

This section provides details of the Bank's exposure to risk and describes the methods used by management to control risk.

31.1 Risk governance and ownership

A well-established risk governance and ownership structure ensures oversight of and accountability for the effective management of risk. The Board approves the Bank's risk appetite framework, plans and performance targets, the appointment of senior officers, the delegation of authorities for credit and other risks and the establishment of effective control procedures.

The Board Audit and Risk Committee are responsible for advising the Board on material risk matters and providing non-executive oversight of risk.

Under authority delegated by the Board the separately convened, monthly Risk Management Meeting (RMM) oversees risk management policy and the implementation of risk appetite and controls. The RMM together with the Asset and Liability Committee (ALCO) monitors all categories of risk, receives reports on actual performance and emerging issues, determines action to be taken and reviews the efficacy of the Bank's risk management framework.

In its oversight and stewardship of risk management, RMM is supported by a dedicated Risk function headed by the Chief Risk Officer (CRO), who is the chairperson of RMM and reports to the Board Risk Committee and to the regional HSBC CRO.

Risk has functional responsibility for the principal financial risk types, namely retail and wholesale credit, market, operational, security and fraud risks. For these it establishes policy, exercises bank-wide oversight and provides reporting and analysis of portfolio composition.

31.2 Risk appetite

The Bank's approach to risk is encapsulated within our Risk Appetite Statement (RAS) which is approved by the Board.

The Risk Appetite Statement defines the qualitative and quantitative expressions of the risks which the Bank is prepared to embrace in alignment with its strategy and business plans. Quantitative metrics are assigned to five key categories: earnings, capital and liquidity, impairment and expected losses, risk category and diversification and scenario stress testing. Measurement against the metrics serves to:

- guide underlying business activity, ensuring it is aligned to the Risk Appetite Statement;
- enable the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles;
- promptly identify business decisions needed to mitigate risk.

Credit risk management

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending and trade finance, but also from off-balance sheet products such as guarantees and from the Bank's holdings of debt and other securities. Credit risk generates the largest regulatory capital requirement of the risks we incur.

Notes to the Financial Statements (continued)
As of 31 December 2012

31 Risk management *(continued)*

31.3 Credit risk

Credit risk management (continued)

The Wholesale (corporate) and Retail Risk functions report to the Chief Risk Officer. Their responsibilities include:

- Formulating and recording detailed credit policies and procedures, consistent with local regulations and HSBC Group policy.
- Issuing policy guidelines on appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain high-risk sectors.
- Undertaking independent reviews and objective assessment of risk. Wholesale Risk assesses all commercial non-bank credit facilities and exposures prior to the facilities being committed to customers or transactions being undertaken. Above certain designated limits exposures require Board (under delegated authority) or HSBC Group approval.
- Monitoring the performance and management of portfolios.
- Maintaining policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the Bank's capital base and remain within regulatory and internal limits.
- Maintaining the governance and operation of the Bank's risk rating framework and systems, to classify exposures taking into account regulatory requirements.
- Reporting on retail portfolio performance, high risk portfolios, risk concentrations, country limits and cross-border exposures, large impaired accounts, impairment allowances and stress testing results and recommendations to the Risk Management Meeting, the Audit and Risk Committees and the Board of Directors.
- Acting on behalf of the Bank as the primary interface, for credit-related issues, with external parties.

The Bank implements credit policies, procedures and lending guidelines that meet local requirements and conform to the HSBC Group standards.

Credit quality

The Bank's credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts, risk ratings are reviewed regularly and any amendments are implemented promptly. Within the Bank's retail business, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

Special attention is paid to problem exposures in order to accelerate remedial action. The Bank uses a specialist unit to manage non-performing accounts and provide customers with support in order to help them avoid default wherever possible.

Periodic risk-based audits of the Bank's credit processes and portfolios are undertaken by an independent function.

Impairment assessment

It is the Bank's policy to create allowances for impaired loans promptly and consistently.

Impairment allowances may be assessed and created either for individually significant accounts or on a collective basis for groups of individually significant accounts for which no evidence of impairment has been individually identified or for high-volume groups of homogeneous loans that are not considered individually significant.

Impairment allowances are taken in conformity with regulatory requirements and HSBC Group policy.

Write-off of loans and advances:

Loans are normally written off, either partially or in full, when there is no realistic prospect of further recovery. For secured loans, write-off generally occurs after receipt of any proceeds from the realisation of security.

31 Risk management *(continued)*

31.3 Credit risk *(continued)*

Write-off of loans and advances (continued)

Unsecured personal facilities, including credit cards, are generally written off at the end of the month in which the account becomes 180 days contractually delinquent.

In the event of bankruptcy or analogous proceedings, write off may occur earlier than at the periods stated above. Collections procedures may continue after write off.

Cross-border exposures

Cross border exposures are subject to limits which are centrally managed by the HSBC Group and are subject to HSBC Group approval.

Maximum exposure to credit risk

The Bank's exposure to credit risk is spread across a broad range of asset classes, including derivatives, trading assets, loans and advances to customers, loans and advances to banks, and financial investments.

For financial assets recognised on the statement of financial position, the maximum exposure to credit risk equals their carrying amount; for financial guarantees granted, it is the maximum amount that the Bank would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, the maximum exposure to credit risk is the full amount of the committed facilities.

Collateral and other credit enhancements

Although collateral can be an important mitigant of credit risk, it is the Bank's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. However, for other lending decisions a charge over collateral is obtained and is considered in determining the credit decision and pricing. In the event of default the Bank may utilise the collateral as a source of repayment. The fair value of collateral on unclassified loans and advances at 31 December 2012 is approximately RO 403.9m.

Concentration of exposure

Exposure to a person, company or group (the Single Borrower Lending Limit) is restricted to maximum 15% of the Bank's regulatory net worth or 10% of the Bank's regulatory net worth for related parties, subject to any regulatory dispensations. In addition, the total of all facilities granted to related parties must not exceed 35% of the Bank's net worth.

	Loans and advances		**Due from other banks**		**Investments**	
	2012	2011	**2012**	2011	**2012**	2011
	RO'000	RO'000	**RO'000**	RO'000	**RO'000**	RO'000
Concentration by sector:						
Sovereign	**19,850**	18,273	**-**	-	**661,673**	304,738
Corporate	**766,836**	334,001	**-**	-	**-**	-
Banks	**-**	-	**183,858**	101,380	**220**	-
Retail	**407,757**	102,006	**-**	-	**-**	-
Equity	**-**	-	**-**	-	**18,779**	-
Carrying amount	**1,194,443**	454,280	**183,858**	101,380	**680,672**	304,738

31 Risk management *(continued)*

31.3 Credit risk *(continued)*

Exposure to credit risk

	Loans and advances		Due from other banks		Investments	
	2012	2011	**2012**	2011	**2012**	2011
	RO'000	RO'000	**RO'000**	RO'000	**RO'000**	RO'000
Individually impaired	**92,445**	5,427	**-**	-	**-**	-
Allowance for impairment	**(82,687)**	(5,031)	**-**	-	**-**	-
Carrying amount	**9,758**	396	**-**	-	**-**	-
Past due and not impaired	**21,471**	5,351	**-**	-	**-**	-
Neither past due nor impaired	**1,163,214**	448,533	**183,858**	101,380	**680,672**	304,738
Total carrying amount	**1,194,443**	454,280	**183,858**	101,380	**680,672**	304,738

Credit quality of financial instruments

All loans and advances in the Bank are classified according to asset quality. Standard accounts include all facilities which demonstrate good financial condition, risk factors and capacity to pay in line with the original terms of sanction.

Accounts categorized as 'Specially Mentioned' carry no impairment provision but are below standard and require monitoring by reason of one or more adverse factors. This may for example relate to poor profitability, low tangible net worth or deteriorating business prognosis. The Bank complies with all regulatory requirements as regards credit quality classification.

The Bank has adopted the HSBC Group methodologies for credit assessment. These include the use of techniques and systems for assessing credit risks, rating and pricing them and for calculating collective impairment charges on retail and wholesale portfolios. For example and as regards wholesale credit, the HSBC methodology provides a granular 22 grade scale of an obligor's Probability of Default (PD).

31.4 Liquidity and funding management

Liquidity risk is the risk that the Bank does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained on the expected terms and when required.

The objective of the Bank's liquidity and funding management is to allow it to withstand severe liquidity stresses. It is designed to be adaptable to changing business models and regulations. The Bank employs a number of measures to monitor liquidity risk.

Policies and procedures

The management of liquidity and funding is implemented in accordance with the limits and practices set by the Board and HSBC Group and in line with the guidelines provided by the CBO. The Global Markets unit is responsible for liquidity management under the guidance and supervision of ALCO.

The Bank's liquidity and management process includes:

- Projecting cash flows by major currency and considering maintenance of liquid assets in relation thereto;
- Monitoring statement of financial position liquidity ratios against internal and regulatory requirements;
- Monitoring depositor concentration with particular focus on stable retail deposits complemented by wholesale and institutional deposits.

Notes to the Financial Statements
As of 31 December 2012

31 Risk management *(continued)*

31.4 Liquidity and funding management

Primary sources of funding

Current accounts, savings deposits and term deposits form a significant part of the Bank's funding. The Bank places considerable importance on the stability of these deposits.

Of total liabilities of RO 2,118.6 million at 31 December 2012, funding from customers amounted to RO 1,851.6 million, of which RO 1,081.2 million was repayable within one year. However, although the contractual repayments of many customer accounts are on demand or at short notice, in practice short-term deposit balances remain stable as inflows and outflows broadly match.

Assets available to meet these liabilities and to cover outstanding commitments to lend RO 2,179.5 million included cash and central bank balances (RO 120.5 million), loans to banks (RO 183.9 million, all repayable within one year), loans to customers (RO1,194.4 million, including RO 353.3 million repayable within one year) and financial investment including certificate of deposit (RO 680.7million including RO 617.8million repayable within one year). In the normal course of business, a proportion of customer loans contractually repayable within one year will be extended.

The Bank would meet unexpected net cash outflows by selling securities and accessing additional funding sources such as inter-bank or asset-backed markets.

Core deposits

A key assumption of the group's internal framework is the categorisation of customer deposits into core and non-core. This characterisation takes into account the inherent liquidity risk categorisation of the entity originating the deposit, the nature of the customer and the size and pricing of the deposit. No deposit is considered to be core in its entirety unless it is contractually collateralising a loan.

Advances to core funding ratio

Core customer deposits are an important source of funds to finance lending to customers, and discourage reliance on short-term professional funding. This is achieved by placing limits which restrict ability to increase loans and advances to customers without corresponding growth in core customer deposits or long term debt funding. This measure is referred to as the 'Advances to Core Funding' ratio. This ratio describes current loans and advances to customers as a percentage of the total of core customer deposit and term funding with a remaining term to maturity in excess of one year.

The liquidity ratios of the Bank as per the methodology followed for HSBC globally as at 31 December 2012 and 31 December 2011 were as follows:

	2012	2011
	RO	RO
Operational Cash Flow Projection (OCP)	**81.45 million**	62.45 million
Advances to Core Deposit Ratio (ACF Ratio)	**104.16%**	115.40%

OCP is a measure of liquidity and for which the Bank was required to be positive for cumulative cash flows up to three months (2011: six months).

31 Risk management *(continued)*

31.5 Market risk management

The objective of the Bank's market risk management is to manage and control market risk exposures in order to optimize return on risk while maintaining a market profile consistent with the Bank's status as a premier provider of financial products and services.

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

The Bank is required to assess the market risks which arise on each product in its business and to transfer these risks to its Global Markets unit for management. The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to professionally manage such risks.

Derivative financial instruments

Derivative financial instruments used by the Bank include swaps, forwards and other similar types of contracts whose value changes in response to changes in interest rates, foreign exchange rates, or other market forces. Derivatives are individually negotiated over-the-counter contracts (referred to as OTC-products). A description of the main types of derivative instruments used by the Bank is set out below.

Swaps

Swaps are over-the-counter agreements between the Bank and other parties to exchange future cash flows based upon agreed notional amounts. Swaps most commonly used by the Bank are interest rate swaps. Under interest rate swaps, the Bank agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed notional amount. The Bank is subject to credit risk arising from the respective counterparties' failure to perform. Market risk arises from the possibility of unfavorable movements in interest rates relative to the contractual rates of the contract and the Bank covers the market risk by entering into offsetting transactions.

Forwards

Forward contracts are commitments to either purchase or sell a designated financial instrument, or currency, at a specified future date for a specified price and may be settled in cash or another financial asset. Forwards are individually-traded over-the-counter contracts. Forward contracts result in credit exposure to the counterparty. Forward contracts result in exposure to market risk based on changes in market prices relative to contracted amounts. The market risk on such transaction is managed within pre- approved limits.

Options

Options are derivative financial instruments that give the buyer, in exchange for a premium payment, the right, but not the obligation, to either purchase from (call option) or sell to (put option) the writer a specified underlying at a specified price on or before a specified date. The Bank enters into foreign currency options. Foreign currency options provide protection against rising or falling currency rates. The Bank as a buyer of over-the-counter options is subject to market risk and credit risk since the counterparty is obliged to make payments under the terms of the contract if the Bank exercises the option. The Bank covers the market risk on such transactions by entering into offsetting arrangements.

Value at risk ('VAR')

VAR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence (for the Bank, 99 per cent). The group calculates VAR daily. The VAR model used by the Bank is predominantly based on historical simulation. The historical simulation model derives plausible future scenarios from historical market rates time series, taking account of inter-relationships between different markets and rates, for example between interest rates and foreign exchange rates.

Notes to the Financial Statements
As of 31 December 2012

31 Risk management *(continued)*

31.5 Market risk management *(continued)*

Although a useful guide to risk, VAR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding year assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding year may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures

The Bank recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures. The VAR for Global Markets was as follows:

	2012	**Average**	**Maximum**	**Minimum**	2011	Average	Maximum	Minimum
	RO'000	**RO'000**	**RO'000**	**RO'000**	RO'000	RO'000	RO'000	RO'000
Total VAR	**193**	**140**	**193**	**80**	65	62	271	33
Trading VAR	**98**	**59**	**99**	**15**	2	4	15	-

Trading

Market risk in trading portfolios is monitored and controlled at both portfolio and position levels using a complementary set of techniques, such as VAR and present value of a basis point, together with stress and sensitivity testing and concentration limits.

Other controls include restricting individual operations to trading within a list of pre-approved permissible instruments, and enforcing rigorous new product approval procedures.

Non-trading

The principal objective of market risk management of non-trading portfolios is to optimize net interest income. Market risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost as result of interest rate changes. Analysis of this risk is complicated by having to make behavioral assumptions regarding the economic duration of liabilities which are contractually repayable on demand, for example, current accounts, in order to manage this risk optimally. Market risk in non-trading portfolios is transferred to Global Markets or to separate books managed under the auspices of the ALCO. ALCO regularly reviews that these portfolios are managed within pre-approved interest risk limits.

Currency risk

As a risk control mechanism limits are put in place for foreign exchange open positions. Positions are managed and monitored on an on going basis by the Treasury. Periodical reporting is made to ALCO who deliberate on the issue and give necessary guidance to Treasury.

The Bank had the following significant net exposures denominated in foreign currencies as at 31 December:

	Overall exposure in RO' 000	
Currency	**2012**	2011
US Dollars	**54,596**	3,600
Pound Sterling	**54**	34
Euro	**11**	-
Japanese Yen	**-**	9
U.A.E.Dirhams	**707**	19
Indian Rupee	**1**	-
Other currencies	**115**	90
Total Exposure	**55,484**	3,752

31 Risk management *(continued)*

31.6 Legal risk

The Bank is required to implement procedures to manage legal risk that conform to HSBC Group standards. Legal risk falls within the definition of operational risk and includes contractual risk, dispute risk, legislative risk and non-contractual rights risk.

- Contractual risk is the risk that the rights and/or obligations of the Bank within a contractual relationship are defective.
- Dispute risk is the risk that the Bank is subject to when it is involved in or managing a potential or actual dispute.
- Legislative risk is the risk that the Bank fails to adhere to the laws of the jurisdictions in which it operates.

Non-contractual rights risk is the risk that the Bank's assets are not properly owned or are infringed by others, or the Bank infringes another party's rights.

The Bank has a legal function to assist management in controlling legal risk. The function provides legal advice and support in managing claims against the Bank companies, as well as in respect of non-routine debt recoveries or other litigation against third parties.

The legal department must be immediately advised of any action by a regulatory authority, where the proceedings are criminal, or where the claim might materially affect the Bank or HSBC Group's reputation.

31.7 Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. Operational risk is relevant to every aspect of the Bank's business and covers a wide spectrum of issues. Losses arising through fraud, unauthorised activities, errors, omission, inefficiency, systems failure or from external events all fall within the operational risk definition.

A formal governance structure provides oversight over the management of operational risk. The Risk Management Meeting convenes monthly to discuss operational risk issues and the effectiveness of internal controls. In addition, there is a quarterly Operational Risk and Internal Control (ORIC) meeting with the regional HSBC ORIC function.

Business units are responsible for maintaining an acceptable level of internal control, commensurate with the scale and nature of operations. They are responsible for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The operational risk management framework helps managers to fulfil these responsibilities by defining a standard risk and control assessment methodology and loss reporting policy.

A centralised database is used to record the results of the operational risk management process. Operational risk and control assessments, and losses, are input and maintained by the business units.

Management is responsible for implementing the required standards of operational risk control throughout their operations and where deficiencies are evident, rectifying them within a reasonable timeframe.

The Bank maintains and tests contingency facilities to support operations in the event of unforeseen disasters.

31 Risk management (continued)

31.8 Capital management

Capital management is guided by the local regulator through CBO circular BM 1009 (Guidelines on BASEL II). Capital adequacy is calculated on quarterly intervals and reported to the CBO. The Banks are required to maintain minimum capital adequacy ratio in excess of 12% (2011: 12%) in accordance with CBO stipulated guidelines.

The Bank's regulatory capital position at 31 December was as follows:

	2012	2011
	RO'000	RO'000
Tier 1 capital		
Ordinary share capital	**200,031**	47,015
Legal and statutory reserves	**33,909**	-
Retained earnings	**56,562**	67,119
Other regulatory adjustments	**(19,221)**	-
Total	**271,281**	114,134
Tier 2 capital		
Fair value reserve for available-for-sale equity securities	**459**	(1,103)
Collective allowances for impairment	**16,280**	5,644
Total	**16,739**	4,541
Total regulatory capital	**288,020**	118,675
Risk-weighted assets		
Banking book	**1,637,661**	629,075
Operational risk	**78,827**	55,608
Market risk	**80,101**	3,450
Total risk-weighted assets	**1,796,589**	688,133
Capital ratios		
Total regulatory capital expressed as a percentage of total risk-weighted assets	**16.03%**	17.25%
Total tier 1 capital expressed as a percentage of risk-weighted assets	**15.10%**	16.59%

32 Comparative balances

Certain corresponding figures for 2011 have been reclassified in order to conform to the presentation for the current year except for note 31.8.