2009
ANNUAL REPORT

ANNUAL REPORT 2009 التقرير السنوي ٢٠٠٩

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بنك الفجيرة الوطني ش.م.ع.

NATIONAL BANK OF FUJAIRAH P.S.C.

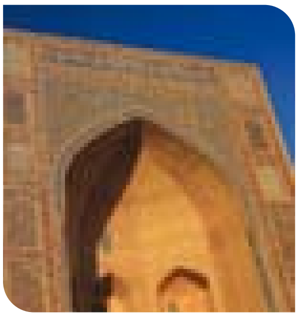
His Highness Sheikh Khalifa Bin Zayed Al Nahyan
President of the UAE and Ruler of Abu Dhabi

His Highness Sheikh Mohammed Bin Rashid Al Maktoum
Vice President and Prime Minister of the UAE and Ruler of Dubai

His Highness Sheikh Hamad Bin Mohammed Al Sharqi

Member of the Supreme Council and Ruler of Fujairah

2009
ANNUAL REPORT



Arabic Architecture

Among the oldest Architecture styles in the world, Arabic Architecture has been identified with certain basic design elements inherited from the very first structure built, such as the muqarnas, iwan, minaret, cupolas, etc. World-renowned for its distinct beauty and harmony and its meticulous design and attention to detail, Arabic Architecture is also distinguished for its ability to provide both aesthetic appeal and efficient function.

As NBF celebrates the principles of Arabic Architecture, we affirm our commitment to provide a solid foundation to support your aspirations in life and help you build a brighter future.

Board of Directors

His Highness Sheikh Saleh Bin Mohammed Al Sharqi
Chairman

- **His Excellency Easa Saleh Al Gurg, KCVO, CBE**
  Deputy Chairman and Chairman of the Executive Committee

- Dr. Sulaiman Mousa Al Jassim
- Hussain Mirza Al Sayegh
- Saif Sultan Al Salami
- Nasser Ali Khamas
- Mohammed Obaid Bin Majed

  Ali Ahmed Al Mehairi

- Vince Cook
  Chief Executive Officer

- *Members of the Executive Committee*

Branches

Fujairah
Dibba
Masafi
Qidfah
Tawian
Dubai
Deira
Jebel Ali
Ajman
Sharjah
Abu Dhabi
Mussafah

Pillars provide all-around support and a solid foundation.

Chairman's Report

I have pleasure in presenting on behalf of the Board of Directors the Annual Report of National Bank of Fujairah PSC and its subsidiary for the year ended 31 December 2009.

The Bank posted a solid set of results in one of the most challenging economic environments we have ever seen and marked a welcome return to profitable operations. The Bank recorded a profit of AED 104.3 million for the year compared to a loss of AED 50.3 million for 2008. The results reflect the strength of the Bank's core customer base and were achieved despite difficult credit conditions. The provision for possible loan losses was AED 214.3 million for the year compared to AED 179.7 million for 2008. These provisions include an amount of AED 73.5 million in respect of the Bank's exposure of AED 91.8 million to the Al Gosaibi and Saad Groups of Saudia Arabia. The Bank continues to be prudent and proactive in providing for potential loan losses in view of continuing uncertain market conditions.

Operating income reduced to AED 506.5 million in comparison to AED 537.9 million for 2008 reflecting lower volumes due to general slowdown in economic activity and higher cost of funds. The liquidity cost in the market continues to be at unprecedented levels and has had an adverse impact on net interest income and profit. However, the Bank has been able to grow its core earnings, quarter on quarter, which coupled with the recovery of the investment portfolio helped in absorbing credit losses and maintaining profitable operations.

In line with the Bank's strategy to reduce market risk and its enhanced focus on the long standing core business, investment in funds was reduced to AED 56.6 million from AED 227.4 million as at 31 December 2008. The investment portfolio also saw some recovery and as a result, a gain on investment of AED 37.6 million was recognized through the statement of income, compared to a loss of AED 227.0 million for the corresponding period of 2008.

Financial stability was underpinned by further strengthening of the capital adequacy ratio to 22.4% (Tier 1 Ratio: 14.2%) and the advances to deposits ratio to 78.4% which are among the strongest in the UAE banking sector. The stronger liquidity and capital adequacy ratios and the build-up in provisioning levels have enabled the Bank to face uncertain credit conditions in the Gulf with confidence. In order to competitively position the Bank in current market conditions and to increase long term shareholder value, I on behalf of the Board of Directors, am recommending the Bank to retain 100% of 2009's profit in reserves.

The Bank's strategy going forward is to leverage its current strong position by growing its business prudently and efficiently in the local economy in existing core areas of Corporate and Commercial Banking, Trade Finance and Treasury. Our broader proposition in the Fujairah Region will continue to be developed in line with the Bank's diversification strategy. Technology and process re-engineering initiatives are at the core of our strategy which will ensure that the Bank has strong operational capability to deliver growth in line with the aspirations of the shareholders and superior quality of service to our customers.

The Bank remains committed to playing its role during these challenging times towards the progress of the UAE economy, under the wise guidance of our President, His Highness Sheikh Khalifa Bin Zayed Al Nahyan, and our Vice President and Prime Minister of UAE and Ruler of Dubai, His Highness Sheikh Mohammed Bin Rashid Al Maktoum. In particular, I would like to thank His Highness Sheikh Hamad Bin Mohammed Al Sharqi, member of the Supreme Council and Ruler of Fujairah for his continued support and encouragement of the Bank. I would also like to thank my fellow directors, the management of the Bank and the Bank's staff for their hard work and commitment in these challenging times.

Finally, I would like to take this opportunity to thank the Bank's customers for their trust and to assure them that the Bank is committed to supporting its customers in achieving their business goals.

Saleh Bin Mohammed Al Sharqi

Business Overview

Operating Environment

The aftermath of the global financial crisis continues to be felt, although the local economy has been helped immensely by the introduction of a number of measures to increase banking sector liquidity, reduce borrowing costs and spur credit growth. Despite these government measures, credit growth will heavily depend upon banks' confidence in the market and their ability to generate fresh liquidity. In general, banks are being more conservative and businesses are facing difficulties due to the slow down in economic activity and limited liquidity. The debt market is recovering but funding costs remain high in view of higher perceived risks, in turn putting pressure on margins in the short run. The successful restructuring of Dubai World and the avoidance of further such shocks are vital to restore market confidence.

The Government is considering an Industry law to allow greater foreign ownership (up from 49%) outside the free trade zone areas. The increase in budgetary spend is lower compared to previous years and focuses on infrastructure, health care and education. However, overall government expenditure is likely to remain more expansionary, with the bulk occurring at an individual Emirate level. Real Gross Domestic Product contracted in 2009 and is expected to increase in 2010 but at a relatively low rate. Improved oil prices will augment levels of economic activity and Government infrastructure projects. Credit demand is likely to remain subdued and loan losses are expected to remain high for 2010.

The Bank's business plan takes into consideration the challenges posed and opportunities offered by the current operating environment, and will be managed prudently with a focus on financial stability and sustainable core business growth. The economic development in the Fujairah Emirate is progressive with its Port's bunkering facilities ranking second only in global terms to Singapore. The strategic importance of the Emirate will be further strengthened upon completion of the oil pipeline from Abu Dhabi which is in progress. The Tourism sector is developing at the Al Aqah area to the north of the Emirate. An important part of the Bank's strategy is to leverage and support the progress and development of Fujairah Emirate.

Financial Results

The Bank achieved a profit of AED 104.3 million compared to a loss of AED 50.3 million for 2008. The Bank's progress amidst the global financial crisis is a testament to its prudent and balanced approach to these challenging times. The Bank's net profit was impacted by difficult credit conditions. Loan losses of AED 214.3 million (2008: AED 179.7 million) were recorded for the year. The Bank's operating income from Wholesale and Consumer businesses showed a growth of 9% which shows the strength of core customer base and effective price management. The Bank invested in infrastructure and human capital, and as a result operating expenses increased by 24%.

The high risk fund investment portfolio has been reduced to AED 56.6 million from AED 227.4 million to increase focus on core business. The Portfolio saw a recovery and a gain on investment of AED 37.6 million was recognized through the statement of income, compared to a loss of AED 227.0 million for 2008. The Bank will continue to leverage opportunities in debt market within its liquidity and credit risk appetites to enhance earnings.

The conditions in the financial sector will remain challenging in the short term, particularly in the credit market. The Bank follows a prudent provisioning approach and recognizes impairment provisions upon exposures becoming 90 days past due. The collective impairment provisions were increased by AED 46.2 million (2008: AED 45.0 million) during the year, which improved coverage to performing portfolio to 1.8%.

The Bank has achieved financial stability and profitable operations by following prudent risk appetite and effective balance sheet and interest rate management. The Bank's advances to deposits ratio of 78.4%, capital adequacy ratio of 22.4% and Tier 1 ratio of 14.2% are amongst the strongest of the UAE's banks. UAE bank credit ratings were generally reviewed downward by rating agencies during the year. However, NBF's long term credit rating of A- was maintained by Capital Intelligence reflecting the Bank's prudent approach and sound business model.

The Board and Management are confident that the Bank is well positioned to grow in the coming year on the back of continued focus on financial stability, risk management and core business.

Wholesale Banking

The Segment, comprising Corporate, Commercial and Financial Institution businesses, represents 89.6% of the Bank's operating income. The Segment generated operating income of AED 453.8 million (2008: AED 415.7 million) showing a growth of 9.2% over 2008. The results reflect the strength of core customer base and strong relationship management. Commercial Banking, representing small and medium sized business, saw a strong growth in operating income of 26.7% followed by Corporate Banking which saw an operating income increase of 7.4%. Segment assets decline reflects lower trade volumes, subdued credit demand and credit risk appetite. Segment liabilities were aligned with assets and liquidity risk appetite.

Treasury and Investments

The Segment results improved significantly due to fair value gain on investments of AED 37.6 million for the year compared to a loss of AED 227.0 million in 2008. The Segment maintained a strong foreign exchange income at AED 35.3 million compared to AED 40.2 million for 2008 through increased derivative transactions, demonstrating increased importance of treasury offering to the Bank.

Consumer Banking

The Segment operates primarily in the Fujairah region in line with the Bank's diversification strategy. The Fujairah region business delivered a growth across both retail and commercial operations of 8.9% in operating income. The decline in segment volumes reflects the Bank's prudent risk appetite.

Risk Management

The Group has reinforced enterprise wide risk management by reviewing its risk governance structure. There are various projects in progress for the development of the Bank's internal capital adequacy assessment process to align with the best practices. A comprehensive plan is being developed to implement economic capital model and Internal Risk Based (IRB) approach of Basel II. The Bank will be migrating to Standardized approach of Basel II for measuring operational risk capital charge in 2010.

Corporate Governance

Corporate governance remains at the core of our business philosophy and is being developed in line with the best practice. The Board of Directors comprises eight members who were re-appointed on 24 March 2008 for a term of three years. The Board met six times in 2009 to perform its role and responsibilities.

People

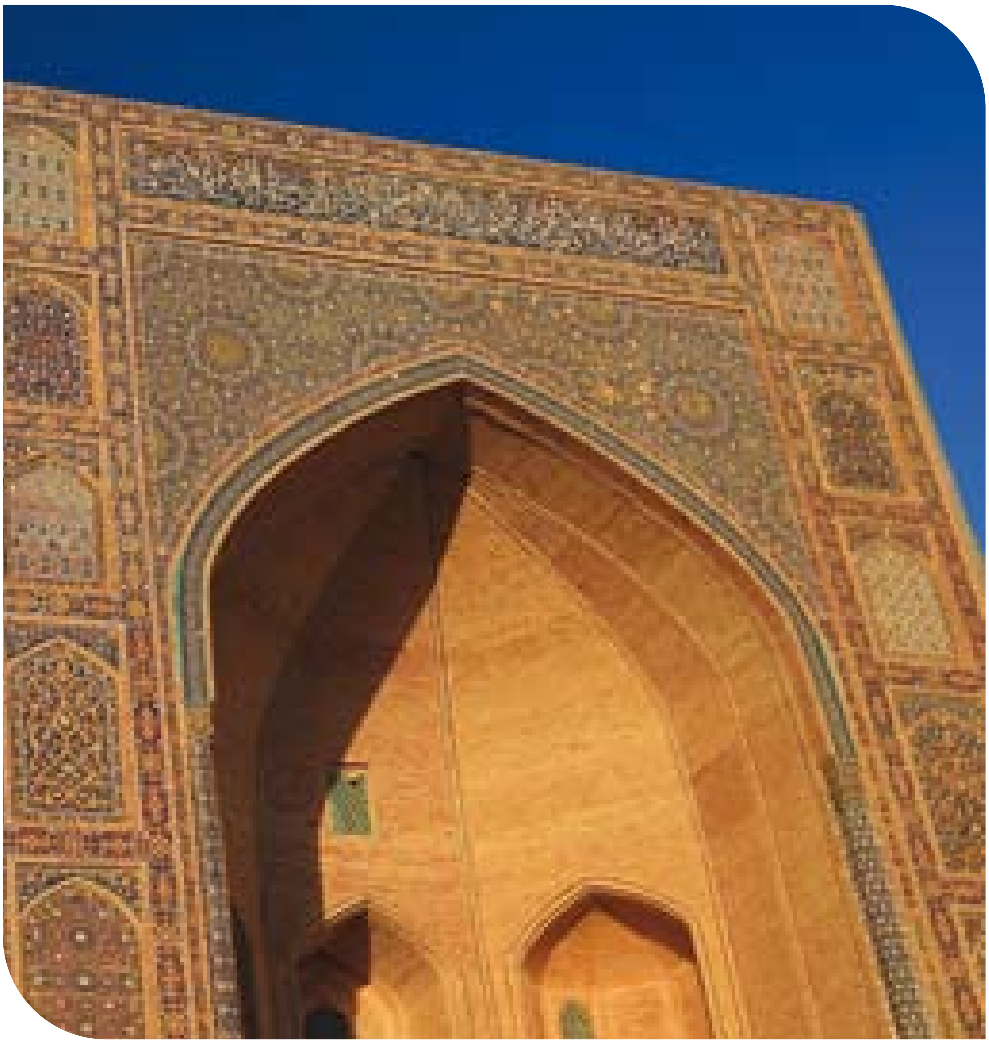
The Bank believes that the success of an organization is driven by its people. The Bank covets being the Employer of Choice. The Bank is committed to offer a work environment which embraces trust, transparency, fairness, respect, opportunities and recognition. The Bank, in order to meet the expectations of its customers and stakeholders, is committed to recruit and develop the right people through training and development programs and benchmarking rewards in line with the market. The Bank has established an Emiratisation Committee as part of its commitment to improve Emiratisation and roles of UAE nationals.

Corporate Social Responsibility

The Bank's Corporate Social Responsibility (CSR) program operates as a self regulating mechanism whereby adherence to laws, ethical standards and international norms are ensured. The Bank considers CSR as part of doing business and an important investment in the future of societies in which we do business. The Bank, by installing recycling bins, participating in local environment initiatives, charity and fund raising events, is committed to increasing its efforts in the coming year.

Easa Saleh Al Gurg, KCVO, CBE

Deputy Chairman



An **Iwan** is a large vaulted hall typically used as an entrance.

Independent auditors' report to the shareholders

The Shareholders
National Bank of Fujairah PSC

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of National Bank of Fujairah PSC ("the Bank") and its subsidiary (collectively referred to as "the Group"), which comprise the consolidated statement of financial position as at 31 December 2009, and the consolidated statement of comprehensive income (comprising a consolidated statement of comprehensive income and a separate consolidated income statement), consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

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

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

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

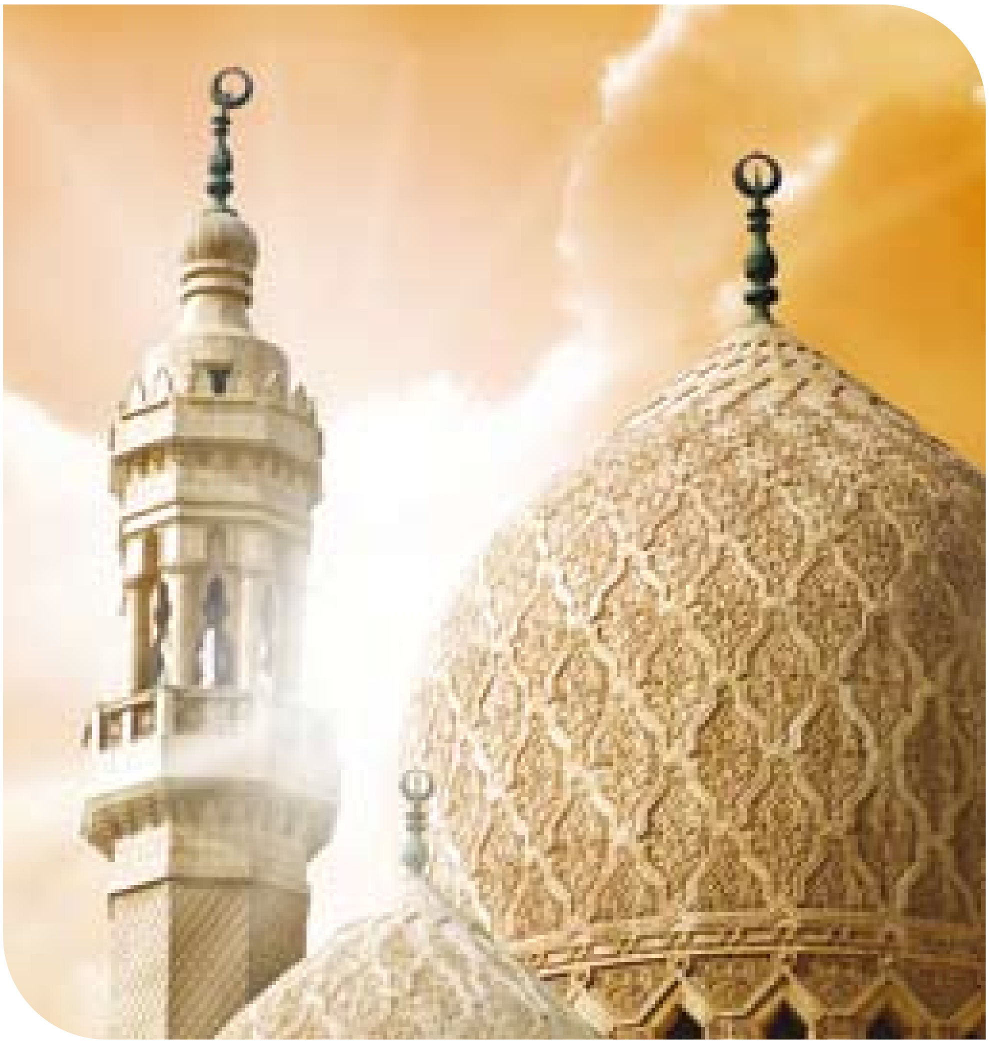
Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2009, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and comply with the relevant Articles of the Company and the UAE Federal Law No. 8 of 1984 (as amended).

Report on other legal and regulatory requirements

As required by the Federal Law No. 8 of 1984 (as amended), we further confirm that we have obtained all information and explanations necessary for our audit, that proper financial records have been kept by the Group and the contents of the Chairman's report which relate to these consolidated financial statements are in agreement with the Group's financial records. We are not aware of any violation of the above mentioned Law and the Articles of Association having occurred during the year ended 31 December 2009, which may have had a material adverse effect on the business of the Group or its financial position.

Vijendranath Malhotra
Registration No: 48 B
KPMG



Domes enable Arabic structures to be distinguished and seen from a distance.

Consolidated statement of financial position

As at 31 December 2009

	Note	2009 AED'000	2008 AED'000
Assets			
Cash and balances with UAE Central Bank	7	2,345,424	1,735,449
Due from banks	8	275,964	437,298
Loans and advances	9	7,816,835	9,037,759
Investments	11	716,221	1,034,941
Property and equipment	12	90,436	90,908
Intangible assets	13	14,159	19,425
Capital work-in-progress	14	1,081	1,199
Other assets	15	630,761	475,175
Total assets		**11,890,881**	**12,832,154**
Liabilities			
Due to banks	16	405,364	944,892
Term borrowings	16	766,681	764,506
Customer deposits	17	8,394,487	9,003,041
Other liabilities	18	655,825	561,162
Total liabilities		**10,222,357**	**11,273,601**
Shareholders' equity			
Share capital	19	1,100,000	1,100,000
Statutory reserve	19	238,360	227,929
Special reserve	19	133,360	122,929
Available-for-sale revaluation reserve		(17,508)	(23,162)
Retained earnings		214,312	130,857
Total shareholders' equity		**1,668,524**	**1,558,553**
Total liabilities and shareholders' equity		**11,890,881**	**12,832,154**

These consolidated financial statements were approved by the Board of Directors on 27 January 2010 and are signed on their behalf by:

Saleh Bin Mohammed Al Sharqi
Chairman

Easa Saleh Al Gurg, KCVO, CBE
Deputy Chairman

The notes on pages 15 to 70 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 8.

Consolidated statement of income

For the year ended 31 December 2009

	Note	2009 AED'000	2008 AED'000
Interest income	*20*	652,579	670,060
Interest expense	*21*	(325,724)	(335,564)
Net interest income		**326,855**	**334,496**
Net fees and commission income	*22*	136,571	155,221
Foreign exchange income		35,293	40,188
Net gain on revaluation of derivative financial instruments		-	1,588
Other operating income	*23*	7,741	6,456
Operating income		**506,460**	**537,949**
Impairment losses (net)	*10*	(214,285)	(179,723)
Income / (loss) from investments	*24*	37,597	(226,973)
Net operating income		**329,772**	**131,253**
Operating expenses			
Employee benefits expense	*25*	(157,417)	(133,505)
Depreciation and amortised cost	*12 &13*	(15,939)	(12,351)
Other operating expenses		(52,099)	(35,667)
Total operating expenses		**(225,455)**	**(181,523)**
Profit / (loss) for the year		**104,317**	**(50,270)**
Earnings / (loss) per share (basic and diluted)	*26*	**AED 0.09**	**AED (0.04)**

Appropriations have been reflected in consolidated statement of changes in equity.

The notes on pages 15 to 70 form an integral part of these consolidated financial statements.

The report of the independent auditors is set out on page 8.

Consolidated statement of comprehensive income

For the year ended 31 December 2009

	Note	2009 AED'000	2008 AED'000
Profit / (loss) for the year		**104,317**	**(50,270)**
Other comprehensive income:			
Changes in available-for-sale investments:			
Amortisation of reclassified investments		7,206	1,277
Revaluation of available-for-sale investments		(1,552)	(24,439)
Net change in available-for-sale investments		5,654	(23,162)
Total comprehensive income / (loss) for the year		**109,971**	**(73,432)**

The notes on pages 15 to 70 form an integral part of these consolidated financial statements.

The report of the independent auditors is set out on page 8.

Consolidated statement of cash flows

For the year ended 31 December 2009

Operating activities	***Note***	**2009**	**2008**
		AED'000	**AED'000**
Profit / (loss) for the year		**104,317**	**(50,270)**
Adjustments for:			
Depreciation and amortised cost		15,939	12,351
(Gain) / loss on disposal of property and equipment		(86)	-
Impairment losses (net)		214,285	179,723
Realised (gains) / losses on investments		(27,629)	8,117
Unrealised (gains) / losses on investments		(9,968)	218,856
Operating profit before working capital changes		**296,858**	**368,777**
Change in due from banks		10,252	(10,252)
Change in loans and advances		1,006,639	(2,133,268)
Change in other assets		(155,586)	203,608
Change in due to banks		(3,580)	(148,070)
Change in customer deposits		(608,554)	1,047,597
Change in other liabilities		96,863	(89,662)
Net cash from / (used in) operating activities		**642,892**	**(761,270)**
Investing activities			
Purchase of property and equipment and capital work-in-progress		(10,084)	(11,109)
Proceeds from sale of property and equipment		87	186
Purchase of investments		(561,784)	(423,049)
Proceeds from sale of investments		923,755	350,989
Net cash from / (used in) investing activities		**351,974**	**(82,983)**
Financing activities			
Directors' attendance fees		(2,200)	(2,200)
Cash dividend		-	(165,000)
Repayment of syndicated debt		-	(477,490)
Change in syndicated borrowing		2,175	764,506
Net cash (used in) / from financing activities		**(25)**	**119,816**
Net increase / (decrease) in cash and cash equivalents		994,841	(724,437)
Cash and cash equivalents at beginning of the year		1,292,234	2,016,671
Cash and cash equivalents at end of the year	*27*	**2,287,075**	**1,292,234**

The notes on pages 15 to 70 form an integral part of these consolidated financial statements.

The report of the independent auditors is set out on page 8.

Consolidated statement of changes in equity

For the year ended 31 December 2009

	Share capital AED'000	Statutory reserve AED'000	Special reserve AED'000	Retained earnings AED'000	Available-for-sale revaluation reserve AED'000	Proposed dividends AED'000	Directors' attendance fees AED'000	Total AED'000
At 1 January 2008	1,100,000	227,929	122,929	181,127	-	165,000	2,200	1,799,185
Total comprehensive expense for the year	-	-	-	(50,270)	(23,162)	-	-	(73,432)
Proposed dividends	-	-	-	-	-	-	-	-
2007 cash dividends paid	-	-	-	-	-	(165,000)	-	(165,000)
2007 directors' attendance fees paid	-	-	-	-	-	-	(2,200)	(2,200)
At 31 December 2008	**1,100,000**	**227,929**	**122,929**	**130,857**	**(23,162)**	**-**	**-**	**1,558,553**
At 1 January 2009	1,100,000	227,929	122,929	130,857	(23,162)	-	-	1,558,553
Total comprehensive income for the year	-	-	-	104,317	5,654	-	-	109,971
Transfer to reserves	-	10,431	10,431	(20,862)	-	-	-	-
At 31 December 2009	**1,100,000**	**238,360**	**133,360**	**214,312**	**(17,508)**	**-**	**-**	**1,668,524**

The notes on pages 15 to 70 form an integral part of these consolidated financial statements.

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Notes to the consolidated financial statements

For the year ended 31 December 2009

1. Legal status and activities

National Bank of Fujairah (''the Bank") is a Public Shareholding Company registered under the laws of the United Arab Emirates. The Bank operates under a banking license issued on 29 August 1984 by the Central Bank of the United Arab Emirates ('the Central Bank') and commenced operations on 20 September 1984. The shares of the Bank were listed on Abu Dhabi Securities Exchange (ADX) on 23 October 2005.

The principal activity of the Bank is commercial banking which is carried out from its twelve branches in Fujairah, Abu Dhabi, Dubai, Sharjah, Dibba, Jebel Ali, Musaffah, Masafi, Qidfah, Deira, Ajman and Tawian.

The Bank has one fully owned subsidiary company, NBF Financial Services FZC which was established in December 2004 with limited liability status in the Fujairah Free Trade Zone to provide support services to the Bank.

During the year, the Bank liquidated its fully owned subsidiary, NBF Securities LLC ("the Company"), with effect from 4 October 2009 after obtaining necessary approvals from regulatory authorities. The Company was registered in the Emirate of Fujairah as a limited liability company under United Arab Emirates ("UAE") Federal Law No.8 of 1984 as applicable to commercial companies. The Company was established on 30 April 2006 and commenced operations on 21 May 2006 through a branch in the Emirate of Dubai. The principal activity of the Company was to deal on behalf of its customers in local shares and bonds.

The consolidated financial statements comprise the Bank and its subsidiary (together referred to as "the Group").

The registered address of the Group is Hamad Bin Abdullah Street, P O Box 887, Fujairah, United Arab Emirates.

2. Disclosure policy

The Group has established a disclosure policy to ensure compliance with all applicable laws and regulations concerning disclosure of material non public information, including International Financial Reporting Standards, the rules of the Central Bank of UAE (lead regulator) ("UAECB") and their Basel II Pillar 3 guidelines, and the listing requirements of Securities and Commodities Authority (SCA) and ADX.

The following are the key features of the Group's disclosure policy concerning disclosure of financial information:

(a) Materiality thresholds

Information is considered material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions and/or any material information that might affect the share price. The Group, in order to ensure adequate disclosure lays down a materiality threshold, so that no material information is omitted or misstated; at the same time it does not jeopardize its competitive position.

Notes (continued)

2. Disclosure policy (continued)

(b) Frequency and medium of disclosure

Interim financial results are disclosed on a quarterly basis while complete financial statements on an annual basis in compliance with the requirements of IFRS, Basel II Pillar 3 and other guidelines from UAECB. Disclosures of material non public financial information are made by the Finance Department of the Group through the following mediums:

- Sending reviewed quarterly and annual audited financial statements along with Management Discussion Analysis or Directors' report and any other price sensitive information to ADX and SCA;
- Hosting quarterly and annual financial statements on the Group's website;
- Publication of annual audited financial statements in both Arabic and English newspapers after the approval in the Annual General Meeting (AGM);
- Management analysis in Arabic and English newspapers in a manner that ensures wide dissemination; and
- Publication of annual report.

3. Basis of preparation

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB).

Along with these consolidated financial statements, the Group has presented Basel II Pillar 3 disclosures in accordance with the guidelines issued by the UAECB. The adoption of Basel II Pillar 3 guidelines has impacted the type and amount of disclosures made in these consolidated financial statements, but had no impact on the reported profits or financial position of the Group. In accordance with the requirements of Basel II, the Group has provided full comparative information.

The standards and interpretations that are issued but not yet effective for accounting periods beginning on 1 January 2009 are as follows:

- IFRS – 1 (Revised) - First-time Adoption of International Financial Reporting Standards: Effective 1 July 2009;
- IFRS – 3 (Revised) - Business Combinations: Effective 1 July 2009;
- IFRS – 5 (Amended) - Non-current Assets Held for Sale and Discontinued Operations: Effective 1 July 2009;
- IFRS – 9 Financial Instruments: Effective 1 January 2013;
- IAS – 24 (Revised) - Related Party Disclosures: Effective 1 January 2011;
- IAS – 27 (Amended) - Consolidated and Separate Financial Statements: Effective 1 July 2009;
- IAS – 32 (Amended) - Financial Instruments: Presentation: Effective 1 February 2010;
- IAS – 39 (Amended) - Financial Instruments: Recognition and Measurement: Effective 1 July 2009;
- IFRIC – 9 (Amended) - Reassessment of Embedded Derivatives: Effective 1 July 2009;
- IFRIC – 14 (Amended) - Prepayments of a Minimum Funding Requirement: Effective 1 January 2011;
- IFRIC – 17 Distributions of Non-cash Assets to Owners: Effective 1 July 2009; and
- IFRIC – 19 Extinguishing Financial Liabilities with Equity Instruments: Effective 1 July 2010.

Notes (continued)

3. Basis of preparation (continued)

(a) Statement of compliance (continued)

Management has assessed the impact of the new standards, amendments to standards and interpretations and amendments to publish standards, and concluded that they are either not relevant to the Group or their impact is limited to the disclosures and presentation requirement in the financial statements except for IFRS 9 as stated below:

IFRS 9 is the first standard issued as part of a wider project to replace IAS 39, key features of IFRS 9 are:

- IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value;
- The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset; and
- The guidance in IAS 39 on impairment of financial assets and hedge accounting continues to apply.

The Group is currently in the process of evaluating the potential effect of this standard.

(b) Basis of measurement

The consolidated financial statements are prepared under the historical cost basis except for the following:

- derivative financial instruments are measured at fair value;
- financial instruments at fair value through profit or loss are measured at fair value; and
- available-for-sale financial assets are measured at fair value.

(c) Functional and presentation currency

Items included in the consolidated financial statements of the Group are measured and presented in United Arab Emirates Dirham ("AED") which is the functional currency of the Group, rounded to the nearest thousand.

4. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and have been applied consistently by Group entities except for the following standards:

The Group has adopted IAS 1 'Presentation of financial statements' (Revised 2007), IFRS 8 'Operating segments' and amendments to IFRS 7 'Disclosures' for the first time in preparation of these consolidated financial statements. These new and revised IASs / IFRSs and amendments to IFRS, which became applicable for annual periods beginning on or after 1 January 2009, affects the presentation and disclosure of these consolidated financial statements and does not affect the Group's reported profit or loss, earnings per share or equity.

IAS 1 – Presentation of financial statements (Revised 2007)

The revised IAS introduces the term 'total comprehensive income' which represents changes in equity during a period other than those resulting from transactions with owners in their capacity as owners. The Group has applied the revised IAS 1 retrospectively and has adopted two statement approach to present comprehensive income i.e. income statement and a separate statement of comprehensive income. Further, the revised IAS 1 has also changed the title of 'balance sheet' to 'statement of financial position'.

Notes (continued)

4. Significant accounting policies (continued)

IFRS 8 – Operating segments

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, whose operating results are reviewed regularly by the management committees, as discussed in note 5, and Chief Executive Officer (together referred to as the "Chief Operating Decision Maker" or "CODM") 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 CODM of the Group 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 Group's head office), unallocated other assets, liabilities and expenses.

The Group's segment reporting follows the organizational structure as reflected in its internal management reporting systems, which are the basis for assessing the financial performance of the business segments and for allocating resources to the business segments. Segment information is disclosed in note 29.

Amendments to IFRS 7

In March 2009, the IASB issued "Improving Disclosures about Financial Instruments – Amendments to IFRS 7 Financial Instruments: Disclosures." The amendments require disclosures of financial instruments measured at fair value to be based on a three-level fair value hierarchy that reflects the significance of the inputs in such fair value measurements. Specific disclosures are required when fair value measurements are categorized as Level 3 (significant unobservable inputs) in the fair value hierarchy. The amendments require that any significant transfers between Level 1 and Level 2 of the fair value hierarchy be disclosed separately, distinguishing between transfers into and out of each level. Furthermore, changes in valuation techniques from one period to another, including the reasons for the changes, are required to be disclosed for each class of financial instruments.

Fair value hierarchy

The Group 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. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry, group, pricing service or regulatory agency, and those prices represent actual and regularly recurring market transactions on an arm's length basis.
- Level 2: Valuation techniques based on observable input, 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; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Pursuant to these amendments, the Group has disclosed the respective information under note 6.2.

4. Significant accounting policies (continued)

(a) Basis of consolidation

Subsidiary

Subsidiary is an entity controlled by the Group. Control exists when the Group has power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of the subsidiary are included in the consolidated financial statements from the date the control commences until the date that control ceases.

Transactions eliminated on consolidation

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

(b) Financial instruments

Classification

A financial instrument is any contract that gives rise to both a financial asset for the Group and a financial liability or equity instrument of another party. All assets and liabilities in the statement of financial position are financial instruments, except property and equipment, capital work in progress, intangible assets, prepayments, advance receipts and shareholders' equity.

Financial instruments are categorised as follows:

Financial assets at fair value through profit or loss (FVPL): This category has two sub-categories: financial assets held-for-trading, and those designated to be fair valued through profit or loss at inception. The Group has designated financial assets at fair value through profit or loss when the assets are managed, evaluated and reported internally on a fair value basis. Derivatives are also categorized as held for trading unless they are designated as hedges.

Loans and advances are non-derivative financial assets with fixed and determinable payments that are not quoted in an active market. They arise when the Group provides money directly to the borrower with no intention of trading the receivable.

Held-to-maturity (HTM) assets are non-derivative financial assets with fixed or determinable payments and fixed maturities where the Group has the positive intent and ability to hold to maturity. Where the Group sells other than an insignificant amount of held-to-maturity assets, the entire category would be reclassified as available-for-sale.

Available-for-sale (AFS) assets are those non-derivative financial assets that are designated as available-for-sale or not classified as (a) loans and advances, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

Notes (continued)

4. Significant accounting policies (continued)

(b) Financial instruments (continued)

Initial recognition

Purchases and sales of investment securities are recognized on the trade date which is the date on which the Group commits to purchase or sell the securities. Loans and advances are recognized when cash is advanced to the borrowers.

Derecognition

Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all the risks and rewards of ownership. A financial liability is derecognized when it is extinguished.

Measurement

A financial asset or financial liability is initially measured at fair value plus (for an item not subsequently measured at fair value through profit or loss) transaction costs that are directly attributable to its acquisition or issue.

Subsequent to initial recognition, all financial instruments to be fair valued through profit or loss and available-for-sale assets are measured at fair value, except any instrument that does not have a reliably measurable fair value, in which case financial instruments are measured as set out in fair value measurement principles below.

All held-to-maturity financial instruments and loans and advances for which the fair value has not been hedged are measured at amortised cost less impairment losses.

Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment. Premiums and discounts including initial transaction costs are included in the carrying amount of the related instrument.

Fair value measurement principles

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

When available, the fair value of a financial instrument is based on quoted market prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis. If a quoted market price is not available or if a market for a financial instrument is not active, the fair value is determined by using valuation techniques. Valuation techniques include net present value techniques, discounted cash flow methods, comparison to similar instruments for which market observable prices exist. For investments under management with external fund managers, fair value is provided by the external fund managers, and is determined based on the market value of underlying investments of each fund. In all other cases, the instruments are measured at acquisition cost, including transaction cost, less impairment losses, if any.

Notes (continued)

4. Significant accounting policies (continued)

(b) Financial instruments (continued)

Fair value measurement principles (continued)

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 at the date of statement of financial position for an instrument with similar terms and conditions.

Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group and the counterparty, where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Group believes a third-party market participant would take them into account in pricing a transaction.

The fair value of derivatives that are not exchange traded is estimated at the amount that the Group would receive or pay to terminate the contract at the date of statement of financial position, taking into account current market conditions and the current creditworthiness of the counterparty.

Gains and losses on subsequent measurement

Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the statement of income in the period in which they arise.

Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised in other comprehensive income, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in other comprehensive income is reclassified to the statement of income. In case where the available-for-sale investments with fixed maturity are reclassified to held-to-maturity investments, the fair value gain or loss till the date of the reclassification is held in equity and are amortised to statement of income over the remaining life of the held-to-maturity investments using the effective interest rate method.

Impairment

Financial assets are reviewed at each reporting date to determine whether there is objective evidence of impairment. If any such evidence exists, the asset's recoverable amount is estimated. Impairment loss is the difference between the net carrying value of an asset and its recoverable amount. Any such impairment loss is recognised in the income statement. The recoverable amount of loans and advances is calculated as the present value of the expected future cash flows, discounted at the instrument's original effective interest rate. Short-term (up to one year maturity) balances are not discounted.

The Group considers evidence of impairment for loans and advances and held-to-maturity investment securities at both a specific asset and collective level. All individually significant loans and advances and held-to-maturity investment securities are assessed for specific impairment. All individually significant loans and advances and held-to-maturity investment securities found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar risk characteristics.

Notes (continued)

4. Significant accounting policies (continued)

(b) Financial instruments (continued)

Impairment (continued)

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 statement of income.

In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale investments, the cumulative loss is measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in statement of income, and is removed from statement of other comprehensive income and recognised in the statement of income. Impairment losses recognised in the statement of income on equity instruments are not reversed through the statement of income and are reversed through the cumulative changes in fair value under equity.

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

(c) Derivatives held for risk management purposes

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets or liabilities. Derivatives may be embedded in another contractual arrangement (a "host contract"). The Group accounts for embedded derivatives separately from the host contract when the host contract is not itself carried at fair value through profit or loss, and the characteristics of the embedded derivative are not clearly related.

Recognition and fair valuation

Derivative financial instruments are initially recognised at fair value which is normally the transaction price. Subsequent to their initial recognition, derivative financial instruments are stated at fair value. Fair values are generally obtained by reference to quoted market prices, discounted cash flow models and pricing models, as appropriate. Where there is a hedging relationship between a derivative instrument and a related item being hedged, the hedging instrument is measured at fair value.

Derivative financial instruments with positive market values (unrealised gains) are included in assets, and derivative financial instruments with negative market values (unrealised losses) are included in liabilities.

Where a derivative financial instrument hedges the exposure to changes in the fair value of a recognised asset or liability, the hedged item is stated at fair value in respect of the risk being hedged.

Notes (continued)

4. Significant accounting policies (continued)

(c) Derivatives held for risk management purposes (continued)

Gains and losses on subsequent measurement

Gains or losses on the re-measurement of both the hedging instruments and the hedged items are recognised in the statement of income.

(d) Key accounting estimates and judgments

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Management discusses and agrees to the development, selection and disclosure of the Group's critical accounting policies and estimates and the application of these policies and estimates. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may therefore differ resulting in future changes in these estimates. These disclosures supplement the commentary on financial risk management set out in note 5. In particular, considerable management's judgment is required in the following:

Impairment losses on loans and advances and held-to-maturity and available-for-sale investments

The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgments about a counter party's financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function. Judgment is also exercised while reviewing factors indicating and determining the objective evidence of impairment in respect of loans and advances and held-to-maturity and available-for-sale investments.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of loans and advances and held-to-maturity investment securities with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired loans and advances and held-to-maturity investment securities, but the individual impaired items cannot yet be identified. In assessing the need for collective loss allowances, management considers factors such as credit quality, portfolio size, concentrations and economic factors.

Notes (continued)

4. Significant accounting policies (continued)

(d) Key accounting estimates and judgments (continued)

Held-to-maturity investments

The Group follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgment. In making this judgment, the Group evaluates its intention and ability to hold such investments to maturity.

(e) Property and equipment and depreciation

Property and equipment are stated at cost less accumulated depreciation and impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of replacing an item of property and equipment is recognised in the carrying value of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The day-to-day servicing of property and equipment are recognised in the statement of income as incurred. Depreciation is charged to the statement of income on a straight line basis over the estimated useful lives of property and equipment. Freehold land is not depreciated. Where the carrying value of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount. Gains and losses on disposal are taken to income. The estimated useful lives for various types of assets are as follows:

Buildings	20 to 30 years
Leasehold improvements	Over the period of lease
Furniture, EDP and other equipment	4 years
Motor vehicles	3 years

Useful life and depreciation method are re-assessed at each reporting date.

(f) Intangible assets

Intangible assets represent software acquired by the Group which is stated at cost less accumulated amortisation and impairment losses, if any. Costs of the software represent the costs incurred to acquire and bring to use the specific software.

Amortisation is recognised in the statement of income on a straight-line basis over the estimated useful life of the software, from the date it is available for use. The useful life of software is estimated to be five years.

(g) Government grants

Land granted by Government of Fujairah is recorded at nominal value.

Notes (continued)

4. Significant accounting policies (continued)

(h) Due to banks, term borrowings and customer deposits

Due to banks, term borrowings and customers' deposits are initially measured at fair value plus directly attributable transaction costs. Subsequently, these are measured at amortised cost using the effective interest method except where the Group chooses to carry the liabilities at fair value through the statement of income. Amortised cost is calculated by taking into account any discount or premium on settlement.

(i) Provisions

A provision is recognised if as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability.

(j) Guarantees

Guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment or provide agreed service when due in accordance with the terms of a debt.

Guarantee liabilities are initially recognized at their fair value, and the initial fair value is amortised over the life of the guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Guarantees are included within other liabilities.

(k) Employee terminal benefits

Provision is made for employee terminal benefits payable under UAE labour law and is calculated as the liability that would arise if the employment of all expatriate staff was terminated at the reporting date. The Group pays its contributions in respect of UAE citizens under UAE pension and social security law and no further liability exists.

(l) Interest income and expense

Interest income and expense for all interest bearing financial instruments are recognised in the statement of income on an accruals basis using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that discounts estimated future cash receipts and payments earned or paid on a financial asset or a liability through its expected life or, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

Notes (continued)

4. Significant accounting policies (continued)

(l) Interest income and expense (continued)

When calculating effective interest rates, the Group estimates cash flows considering all contractual terms of the financial instruments excluding future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset to the carrying amount as reduced by any allowance for impairment and is not recognised as interest income.

(m) Net fees and commission income

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

Other fees and commission income earned and expense incurred from the provision of services are recognised as revenue and expense, as and when the services are rendered.

(n) Income from investments

Income from investments at fair value through profit or loss, which arises from gains and losses resulting from disposal and from the fair valuation of such investments, are recognised when they occur.

(o) Dividend income

Dividend income is recognised when the Group's right to receive the payment is established.

(p) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand and balances with the Central Bank, including deposits, and other balances due from and due to banks maturing within three months of the date of statement of financial position. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(q) Foreign currencies

Foreign currency transactions are recorded at the rate of exchange ruling at the value date of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into AED at the rate of exchange ruling at the reporting date. Any resultant gains and losses are recognised in the statement of income. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at the date of the transaction. Forward foreign exchange contracts are translated into AED at the mid market rate of exchange applicable to their maturities ruling at the reporting date. Any resultant gains and losses are taken to income.

Notes (continued)

4. Significant accounting policies (continued)

(r) Segment reporting

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

(s) Offsetting

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when, and only when, the Group has a legally enforceable right to set off the recognized amounts and it intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

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

(t) Earnings per share

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

(u) Impairment of non-financial assets

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

(v) Operating leases

Leases of assets under which the lessor effectively retains all the risks and rewards of ownership are classified as operating leases. Payments made under operating leases are recognised in the statement of income on a straight-line basis over the term of the lease.

Notes (continued)

5. Financial risk management

(a) Introduction

Risk is inherent in the Group's activities and is managed through a process of ongoing identification, measurement, mitigation, reporting and monitoring. The Group's exposure can be broadly categorized into the following risks:

- Credit risk
- Liquidity risk
- Market risk
- Operational risk

The Group has been improving its risk management infrastructure and projects are in various stages of completion and implementation is being planned for Economic Capital and Basel II IRB approach. The Group has strengthened its risk governance by establishing a Risk Committee and reviewing charters and roles and responsibilities of existing governance committees which have been explained in note 5(b).

(b) Enterprise risk management framework

This note presents broad information about the Group's objectives, policies and processes for identifying, measuring, reporting and mitigating the above mentioned risks and the Group's management of capital. This note also covers enhanced disclosures relating to Pillar 3 (Market Discipline) of Basel II.

The Board of Directors has overall responsibility for the establishment and oversight of the Group's enterprise risk management framework. The Board sets the overall risk appetite and strategy in consultation with the senior management and approves all policies and guidelines to manage the above mentioned risks. The Board has set up an Executive Committee, consisting of six members of the Board and the Chief Executive Officer, to assist them in the credit approval process.

In order to discharge its responsibilities effectively, the Board has established the Management Committee, Risk Committee, Asset and Liability Committee (ALCO), Central Credit Committee (CCC), Operational Risk Committee (ORC) and Product Committee (PC). These committees ensure and oversee the implementation of the day-to-day activities of the Group in line with the guidelines set by the Board. These committees comprise key officers, who convene frequently to appraise the Group's risk profile and various risk issues. The Group's policies and procedures are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, to monitor risks and adherence to limits, and to ensure effective escalation and reporting. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered.

The Management Committee, steered by the Chief Executive Officer, is responsible for the development and monitoring of execution plan of the Group's strategy approved by the Board, implementation of corporate governance, performance measurement and monitoring, deciding on staff related matters, policies and any other administrative matters other than risk matters.

Notes (continued)

5. Financial risk management (continued)

(b) Enterprise risk management framework (continued)

The Risk Committee steered by the Chief Executive Officer is responsible to develop and recommend to the Board the Group's risk appetite, develop and review the Group's risk policies and ICAAP (Internal Capital Adequacy Assessment Process), recommend allocations of regulatory and economic capital to portfolio segments and business lines, approve scenarios for stress testing for all risk categories and evaluate potential changes to market conditions. Further, the Committee reviews significant financial or other risks and the steps management have taken to monitor, control and report such risks, including, but without limitation to, review of credit, market, fiduciary, liquidity, reputation, operational, compliance, legal, fraud and strategic risks. It obtains assurance that significant risks are being measured, monitored, evaluated, and appropriately escalated through periodic updates, risk reporting, and risk performance indicator reviews from ALCO, CCC and ORC.

The Asset and Liability Committee steered by the Chief Financial Officer is responsible for directing asset and liability growth and allocations in order to achieve the Group's strategic goals. It monitors the Group's liquidity and market risks and the Group's risk profile in the context of economic developments and market fluctuations, to ensure that the Group's ongoing activities are compatible with the risk appetite approved by the Board. The Committee is also responsible for developing and establishing ALCO metrics and MIS for review, measurement, monitoring and control of all market and liquidity risks and stress testing.

The Central Credit Committee steered by the Head of Wholesale and Institutional Banking is responsible for credit decisions for the Group's lending portfolio, setting country and other high level Group limits, oversee portfolio reviews with particular focus on quality, dealing with impaired assets and re-grading of credit facilities. The Committee is also responsible for developing and establishing credit risk metrics and MIS for review, measurement, monitoring and control of all credit risks, stress testing and making recommendation to the Chief Risk Officer for reviews of credit risk policies, enhancement of credit risk reporting and processing.

The Operational Risk Committee steered by the Chief Operations Officer is responsible for independently assessing and monitoring the operational risks of the Group against the Group's operational risk management policies, internal control framework and operational risk appetite as approved by the Board. It is responsible to review operational procedures, adequacy of the internal control systems, develop and establish operation risk metrics and MIS for review, measurement, monitor and control of operational risks. Further, it is also responsible for the implementation of the Business Continuity (BCP) and Disaster Recovery Programme (DR), review of anti-money laundering unit reports and adequacy of compliance with relevant laws, regulations and license conditions. The Committee also reviews reports from internal, external and Central Bank audits and monitors progress on actions initiated to address all operational risks covered by these reports.

Notes (continued)

5. Financial risk management (continued)

(b) Enterprise risk management framework (continued)

The Product Committee steered by the Chief Risk Officer is responsible to review and approve all risks, designs, pricing, financials, risk ratings, processes for distribution, product control and MIS processes of proposed new products and services. It ensures that the products and services fall within the risk appetite and the Group's strategic plans. It is responsible for monitoring the Group's competitiveness in product positioning and developments in technology that could have an impact on risk profile and profitability of products and services.

Apart from Risk Management, all other functions and departments are also involved in the execution and implementation of policies and procedures within their activities.

The role of the Internal Audit Function within the Group is to provide independent and objective assurance that the process for identifying, evaluating and managing significant risks faced by the Group is appropriate and effectively applied. In addition, it also provides an independent check on the compliance with laws and regulations and measuring compliance with the Group's policies and procedures. Additionally, Internal Audit provides consulting services which are advisory in nature, and are generally performed at the specific request of the Senior Management.

It is led by the Head of Internal Audit who reports to the Board of Directors, with administrative reporting to the Chief Executive Officer.

To perform its role effectively, Internal Audit has organizational independence from management, to enable unrestricted evaluation of management activities and personnel.

(c) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's loans and advances to customers and banks and investment securities.

The Group is mainly engaged in wholesale business which comprises the majority of loans and advances of the Group. The wholesale business comprises corporate, small and medium enterprise and financial institution businesses where credit is assessed based on specific guidelines. The Group also carries out selective consumer banking, mainly in Fujairah region.

Management of credit risk

Independent Credit Departments are responsible for review, recommending and approving underwriting proposals, while the Risk management is responsible for managing credit risk and formulation of credit policies in line with strategic objectives, business growth, regulatory requirements and risk management standards. An independent loan review function within risk management is responsible for loan review, on a post fact and sample basis, to assess compliance with underwriting approvals according to the policies and review the underwriting standards of the Group.

Independent departments are responsible for documentation and collateral management and custody.

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

The credit risk management framework includes:

- Risk appetite setting;
- An authorization structure and limits for the approval and renewal of credit facilities;
- Review and assessment of credit risk in line with credit policies, and authorization and limit structure. Renewals of facilities are subject to the same review process;
- Diversification and limiting concentrations of exposure to counterparties, geographies, industries and asset classes; and
- Reviewing compliance, on an ongoing basis, with agreed exposure limits relating to counterparties, industries, countries and products and reviewing limits in accordance with the risk management strategy and market trends.

Concentration risk

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political, or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentration of risk, Group policies and procedures include specific guidelines to ensure maintenance of diversified portfolios through a series of country, counterparty, sector and product limits.

Credit exposures to individual customers or customer groups are controlled through a tiered hierarchy of delegated approval authorities. Approval is required from the Central Bank of the UAE (Central Bank) for any planned exposure to single counterparty / group exceeding 7% of the regulatory capital base and for a public sector entity / group counterparty(ies) exceeding 25% of the regulatory capital base. The combined exposure of such excess should not exceed 800% of the regulatory capital base. The Group has adhered to these requirements.

The Group monitors concentrations of credit risk by sector and geographic location. The Group has further defined portfolio caps for its specialized businesses like Ship Finance and Precious Metal Unit.

The following tables illustrate the sectoral, geographical and currency wise analysis of loans and advances. Information about other areas from where credit risk arises has been included in the respective notes.

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

Sector analysis

An analysis of sector concentrations of credit risk arising out of loans and advances at 31 December 2009 and 2008 is shown below:

2009	Loans and advances							
	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded & unfunded)	Past due but not impaired	
							Up to 90 days	90 days to 180 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Trade	2,680,689	1,188,284	3,868,973	121,494	80,558	19,772	22,921	4,483
Construction	481,305	2,340,013	2,821,318	14,386	12,914	7,366	8,462	-
Government	57,619	45,946	103,565	-	-	-	-	-
Manufacturing	1,076,749	301,384	1,378,133	31,502	16,890	7,651	9,813	13,667
Financial institutions	1,130,008	345,544	1,475,552	148,144	101,620	-	5,183	-
Service industries	645,282	298,299	943,581	29,135	8,070	-	16,061	6,906
Real estate	882,627	-	882,627	42,810	22,517	-	740	-
Individuals	1,330,676	14,866	1,345,542	194,976	89,955	818	222	-
Gross amount	**8,284,955**	**4,534,336**	**12,819,291**	**582,447**	**332,524**	**35,607**	**63,402**	**25,056**
Impairment	**(468,120)**	**-**	**(468,120)**	**(332,524)**	**-**	**-**	**-**	**-**
Carrying amount	**7,816,835**	**4,534,336**	**12,351,171**	**249,923**	**332,524**	**35,607**	**63,402**	**25,056**

In addition to the specific provision, the Group holds AED 135.5 million (2008: AED 89.4 million) as collective provisions.

Past due but not impaired exceeding 90 days represent exposures where past dues were settled or restructurings approved prior to year end but were executed subsequently.

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

2008	Loans and advances						Past due but not impaired	
	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded & unfunded)	Up to 90 days	90 days to 180 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Trade	3,024,146	1,026,529	4,050,675	125,847	54,856	-	106,982	-
Construction	453,048	2,279,935	2,732,983	17,846	15,996	-	15,694	-
Government	51,635	28,161	79,796	-	-	-	-	-
Manufacturing	1,004,131	351,470	1,355,601	37,253	22,429	-	27,411	-
Financial institutions	1,409,772	691,877	2,101,649	91,825	22,956	-	-	-
Service industries	779,215	365,810	1,145,025	19,982	5,174	-	3,743	-
Real estate	994,831	-	994,831	24,589	7,801	-	1,144	-
Individuals	1,608,509	14,573	1,623,082	111,812	68,959	-	1,381	-
Gross amount	**9,325,287**	**4,758,355**	**14,083,642**	**429,154**	**198,171**	**-**	**156,355**	**-**
Impairment	**(287,528)**	**-**	**(287,528)**	**(198,171)**	**-**	**-**	**-**	**-**
Carrying amount	**9,037,759**	**4,758,355**	**13,796,114**	**230,983**	**198,171**	**-**	**156,355**	**-**

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

Geographic location analysis

Based on the location of the borrower, an analysis of geographic concentrations of credit risk arising out of loans and advances at 31 December 2009 and 2008 is shown below:

2009	Loans and advances							
	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded & unfunded)	Past due but not impaired	
							Up to 90 days	90 days to 180 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Within UAE	7,822,933	4,305,853	12,128,786	434,303	230,904	35,607	57,433	24,146
GCC countries	369,227	76,261	445,488	128,555	91,825	-	4,843	910
Others	92,795	152,222	245,017	19,589	9,795	-	1,126	-
Total	**8,284,955**	**4,534,336**	**12,819,291**	**582,447**	**332,524**	**35,607**	**63,402**	**25,056**

2008	Loans and advances							
	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded & unfunded)	Past due but not impaired	
							Up to 90 days	90 days to 180 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Within UAE	8,718,616	4,186,736	12,905,352	337,329	175,215	-	156,355	-
GCC countries	380,311	137,639	517,950	91,825	22,956	-	-	-
Others	226,360	433,980	660,340	-	-	-	-	-
Total	**9,325,287**	**4,758,355**	**14,083,642**	**429,154**	**198,171**	**-**	**156,355**	**-**

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

Currency wise analysis

The Group's credit exposure by currency type is as follows:

	2009			2008		
	Funded AED'000	Unfunded AED'000	Gross exposure AED'000	Funded AED'000	Unfunded AED'000	Gross exposure AED'000
AED	6,425,944	3,191,571	9,617,515	7,570,902	3,183,121	10,754,023
USD	1,331,994	1,104,926	2,436,920	1,297,291	1,202,294	2,499,585
EURO	117,182	116,226	233,408	141,747	231,721	373,468
GBP	154	5,898	6,052	90	18,956	19,046
XAU	301,501	-	301,501	267,350	-	267,350
Others	108,180	115,715	223,895	47,907	122,263	170,170
Total	**8,284,955**	**4,534,336**	**12,819,291**	**9,325,287**	**4,758,355**	**14,083,642**

Settlement risk

The Group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of counterparty to honour its obligations to deliver cash, securities or other assets as contractually due. Any delays in settlement are rare and are monitored and quantified as part of the Group's Operational Risk Management.

For certain types of transactions, the Group mitigates this risk by conducting settlements through a settlement / clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval / limit monitoring process. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from the Risk Management.

Risk mitigation, collateral and credit enhancements

The Group manages credit exposure by obtaining security where appropriate, and in certain cases, the Group may also close out transactions or assign them to other counterparties to mitigate credit risk.

The amount and type of collateral depends on assessments of the credit risk of the counterparty. The types of collateral mainly include cash, guarantees, pledge over listed shares and mortgage and liens over properties or other securities over assets. Pledged interests over vehicles, ships and equipment are also obtained. Collateral generally is not held against non-trading investments and due from banks.

Management monitors the market value of collateral, and wherever necessary the Group requests additional collateral in accordance with the underlying agreement, and considers collateral obtained during its review of the adequacy of the allowance for impairment losses.

Estimates of fair value are generally assessed on an annual basis except in the case of mortgages which are updated when a loan is individually assessed as impaired. In case of debt / equity securities fair value estimates are reviewed at each reporting date. Market values of listed shares are monitored on a daily basis and in the event of a shortfall, the Group requests additional collateral in accordance with the underlying requirements. An estimate of fair value of collateral and other security enhancements held against the loan portfolio is shown on the next page.

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

Particulars	Loans and advances		Collaterals	
	2009	2008	2009	2008
	AED'000	AED'000	AED'000	AED'000
Individually impaired				
Pledged deposits	53,606	199,531	15,874	47,414
Debt / Equity securities	108,249	22,025	86,410	9,760
Property	50,413	41,845	55,812	44,400
Others	370,179	165,753	20,000	35,000
Gross amount	**582,447**	**429,154**	**178,096**	**136,574**
Impairment loss	**(332,524)**	**(198,171)**	**-**	**-**
Carrying amount	**249,923**	**230,983**	**178,096**	**136,574**
Past due but not impaired				
Pledged deposits	26,047	75,151	9,948	21,347
Debt / Equity securities	-	11,161	-	25,311
Property	1,477	8,504	3,110	6,018
Others	60,934	61,539	-	-
Gross amount	**88,458**	**156,355**	**13,058**	**52,676**
Impairment loss	**-**	**-**	**-**	**-**
Carrying amount	**88,458**	**156,355**	**13,058**	**52,676**
Neither past due nor impaired				
Pledged deposits	1,662,067	2,410,199	713,437	993,810
Debt / Equity securities	150,771	183,246	255,152	299,669
Property	727,947	1,083,357	1,317,416	1,548,035
Others	5,073,265	5,062,976	-	-
Gross amount	**7,614,050**	**8,739,778**	**2,286,005**	**2,841,514**
Collective impairment provision	**(135,596)**	**(89,357)**	**-**	**-**
Carrying amount	**7,478,454**	**8,650,421**	**2,286,005**	**2,841,514**
Total	**7,816,835**	**9,037,759**	**2,477,159**	**3,030,764**
Renegotiated exposure	**251,590**	**117,258**	**149,749**	**31,581**
Contingent liabilities				
Pledged deposits	2,589,425	1,864,902	633,768	492,402
Others	1,944,911	2,893,453	27,098	-
Total	**4,534,336**	**4,758,355**	**660,866**	**492,402**

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

Past due but not impaired portfolio ageing is as follows:

	2009 AED'000	2008 AED'000
Less than 1 month	35,566	109,730
1 month to 3 months	27,836	46,625
3 months to 6 months	25,056	-
Total	**88,458**	**156,355**

Impaired loans and advances

Impaired loans are those financial assets where it is probable that the Group will be unable to collect all principal and interest due according to the contractual terms of the loan agreements.

Past due but not impaired loans

Loans and advances are recognised as past due but not impaired where contractual interest or principal payments are past due but the Group believes that the assets are not impaired on the basis of the level of security / collateral available and / or the stage of collection of amounts owed to the Group.

Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Group has made concessions that it would not otherwise consider. The personal loan product includes the facility to top-up loans and request deferment of one instalment in a year. Top-up and deferrals as part of the approved program are not considered as renegotiated exposures.

Allowances for impairment

On a monthly basis, the Group establishes an allowance for impairment losses that represents its estimate of losses in the loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for groups of homogenous assets in respect of losses that may have been incurred but have not been identified on loans subject to individual assessment for impairment. The methods of assessment of allowances for impairment have been summarized in note 4.

Write-off policy

The Group writes off loan balances (and any related allowances for impairment losses) when it has generally exhausted all possible efforts for collection and determines that the loans are no longer collectible.

Notes (continued)

5. Financial risk management (continued)

(d) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Management of liquidity risk

The Group's approach to managing liquidity is to maintain, as far as possible, sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or putting the Group's reputation at risk.

Treasury is entrusted with the responsibility of ensuring compliance with both statutory liquidity requirements and internal limits. All liquidity policies and procedures are subject to review and approval by ALCO, Risk Committee and the Board.

The Group maintains a portfolio of short-term liquid assets, largely made up of investment grade marketable securities and Central Bank certificates of deposit, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained both under normal conditions and simulated stress scenarios. 19% (2008: 20.4%) of the Group's deposits are pledged against customer loans and advances and contingencies and commitments.

The Group uses advances to deposits ratio of 1:1 as stipulated by the Central Bank as one of the key risk indicators and monitors this on a regular basis. The Group uses more prudent internal advances to deposits ratio measure of 0.9:1 as a trigger point for liquidity management. During the year, the advances to deposits ratio was as follows:

	2009	2008
31 December	0.78:1	0.86:1
Minimum	0.76:1	0.71:1
Average	0.81:1	0.89:1
Maximum	0.87:1	0.99:1

The Group manages its concentration of deposits by continuing to widen the customer base and setting in place caps on individual size and varying maturities.

Liquidity risk appetite has been reviewed prudently taking into consideration the recent global events and relevant risk management standards. Adherence to the longer stress period is being achieved through reliance on both higher quality and amount of liquid assets. The Group monitors 4 week stress test under two scenarios of local market crisis and one / two notch downgrade in line with its liquidity risk appetite. There is an enhanced focus on liability diversification and improving duration to manage liquidity gaps effectively.

Notes (continued)

5. Financial risk management (continued)

(d) Liquidity risk (continued)

The table below shows the undiscounted cash flows of the Group's financial assets and liabilities and commitments on the basis of their earliest possible contractual maturity and / or expected date of settlement or realization. The amounts set out below may not necessarily represent actual cash flows. For example, demand deposits from customers are expected to maintain a stable balance and term deposits are often rolled over on maturity. Loans and advances are partly of revolving nature. Cash and balances with UAE Central Bank include certificate of deposits which are readily convertible into cash under repurchase arrangements with Central Bank.

	Less than 1 month AED'000	1 month to 3 months AED'000	Over 3 months to 6 months AED'000	Over 6 months to 1 year AED'000	Over 1 year to 5 years AED'000	Over 5 years AED'000	Total AED'000
At 31 December 2009							
Cash and balances with UAE Central Bank	980,542	476,154	251,195	643,015	-	-	2,350,906
Due from banks	275,965	-	-	-	-	-	275,965
Loans and advances	2,575,672	1,336,960	854,896	910,436	2,682,929	998,843	9,359,736
Investments	365,017	12,661	1,794	41,539	322,525	-	743,536
Other assets	177,927	248,857	107,499	14,406	-	-	548,689
Total assets	**4,375,123**	**2,074,632**	**1,215,384**	**1,609,396**	**3,005,454**	**998,843**	**13,278,832**
At 31 December 2009							
Due to banks	308,039	26,624	55,880	16,009	-	-	406,552
Term borrowings	3,171	5,076	8,247	16,494	856,438	-	889,426
Customer deposits	5,180,182	1,159,250	448,436	395,048	223,876	1,303,337	8,710,129
Other liabilities	234,710	248,857	107,499	14,406	-	-	605,472
Total liabilities	**5,726,102**	**1,439,807**	**620,062**	**441,957**	**1,080,314**	**1,303,337**	**10,611,579**
On Balance Sheet Gap	**(1,350,979)**	**634,825**	**595,322**	**1,167,439**	**1,925,140**	**(304,494)**	**2,667,253**
At 31 December 2008							
Assets	4,116,374	2,984,564	1,081,008	2,128,674	2,273,802	1,221,797	13,806,219
Liabilities	6,703,285	1,348,980	349,671	790,193	1,840,413	917,393	11,949,935
On Balance Sheet Gap	**(2,586,911)**	**1,635,584**	**731,337**	**1,338,481**	**433,389**	**304,404**	**1,856,284**

Notes (continued)

5. Financial risk management (continued)

(d) Liquidity risk (continued)

Further, the table incorporates guarantees, letters of credit and notional amounts of derivative financial instruments, entered into by the Group, outstanding at the date of statement of financial position, analyzed by the earliest period these can be called. The notional amount is the value of the derivative's underlying asset and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicators of either the market risk or the credit risk.

	Less than 1 month AED'000	1 month to 3 months AED'000	Over 3 months to 6 months AED'000	Over 6 months to 1 year AED'000	Over 1 year to 5 years AED'000	Over 5 years AED'000	Total AED'000
At 31 December 2009							
Off balance sheet items							
Guarantees	3,567,875	-	-	-	-	-	3,567,875
Letters of credit	193,415	566,450	160,762	45,099	735	-	966,461
Forward foreign exchange contracts	1,558,027	1,230,894	110,926	267,212	-	-	3,167,059
Currency options	-	165,640	69,206	183,688	-	-	418,534
Interest rate swaps	-	38,900	-	-	-	114,522	153,422
	5,319,317	**2,001,884**	**340,894**	**495,999**	**735**	**114,522**	**8,273,351**
At 31 December 2008							
Off balance sheet items							
Guarantees	3,851,688	-	-	-	-	-	3,851,688
Letters of credit	140,134	452,960	178,131	86,817	48,625	-	906,667
Forward foreign exchange contracts	1,572,351	354,365	245,145	125,832	-	-	2,297,693
Currency options	-	-	113,698	308,058	-	-	421,756
Interest rate swaps	-	-	-	-	31,469	406,663	438,132
	5,564,173	**807,325**	**536,974**	**520,707**	**80,094**	**406,663**	**7,915,936**

Notes (continued)

5. Financial risk management (continued)

(d) Liquidity risk (continued)

The positive / negative fair values of derivative financial instruments, entered into by the Group, at the reporting date are depicted below:

	2009		2008	
	Positive fair value AED'000	Negative fair value AED'000	Positive fair value AED'000	Negative fair value AED'000
Derivates				
Forward foreign exchange contracts	18,374	18,698	28,008	29,047
Currency options	4,209	4,209	1,556	1,556
Interest rate swaps	-	10,820	675	9,602
	22,583	**33,727**	**30,239**	**40,205**

(e) Market risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates, commodity prices and credit spreads will affect the Group's income or the value of its holdings of financial instruments.

Management of market risks

The Group distinguishes its exposure to market risk between trading and non-trading portfolios. The Group manages market risk positions within the risk management limits set out by the Board. Overall responsibility for market risk management is vested in ALCO.

Credit risk arising on securities is managed independently by the RC and CCC but reported as a component of market risk exposure for reporting purposes.

Investment price risk

The risk originates primarily from the investment portfolio of the Group which is managed on a fair value basis. The Group manages the risk through diversification of investments in terms of counterparty, industry and country. Part of the investments is managed through external investment managers, who operate in accordance with the mandate approved by the Board. The Group has liquidated significant part of the portfolio during the year as covered in note 11. The Group monitors and reviews portfolio performance on a monthly basis.

ALCO reviews sensitivity of investment price volatility on annualized income. The stop loss limit of 10% is followed unless ALCO believes a different level is appropriate, when Board approval is obtained. During the year, management has liquidated a significant component of managed funds with a view to reduce market risk and enhance focus on core business.

Notes (continued)

5. Financial risk management (continued)

(e) Market risk (continued)

The table below shows the impact of decline in fair value of investments by 10% on net income and equity for 2009 and 2008:

	Assumed level of change %	Impact on net income 2009 AED'000	Impact on net income 2008 AED'000
Investments carried at fair value through the income statement			
Reference benchmarks:			
Quoted debt securities	10%	9,679	34,873
Net asset value of managed funds	10%	5,660	22,744

	Assumed level of change %	Impact on equity 2009 AED'000	Impact on equity 2008 AED'000
Available-for-sale investments			
Reference benchmarks:			
Quoted debt securities	10%	26,458	11,767
Net asset value of managed funds	10%	-	-

The impact of sensitivity on net income has been significantly reduced compared to 2008 to manage volatility in earnings and enhance focus on core business.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates and arises from financial instruments denominated in a foreign currency. The Board of Directors has set limits on positions by currencies which are closely monitored. Exceptions, if any, are only allowed by seeking prior approval of ALCO supported by a business case and ratification by the Board. During the year, the Group complied with the open position limits and exception approval process.

The Group carries out sensitivity analysis on the basis of 5% shift in exchange rate and analyzes their impact on annualized exchange income. ALCO reviews currency limits based on these sensitivities.

The UAE currency is pegged to the US Dollar and this is considered while setting the limits and analyzing the sensitivity impact.

5. Financial risk management (continued)

(e) Market risk (continued)

At 31 December, the Group's open positions and potential impact of a shift in exchange rate on the statement of income are as follows:

Currency	USD	EUR	Others
Open position			
2009 (AED'000)	46,365	230	3,060
2008 (AED'000)	(4,800)	569	3,527
Assumed change in exchange rates	5%	5%	5%
Impact on exchange income from increase in exchange rates:			
2009 (AED'000)	2,318	12	153
2008 (AED'000)	(240)	28	176
Impact on exchange income from decrease in exchange rates:			
2009 (AED'000)	(2,318)	(12)	(153)
2008 (AED'000)	240	(28)	(176)

At 31 December 2009, the impact on exchange income due to change in exchange rate by 5% is ±7% (2008: ±0.1%). Excluding the impact of US$ open position, the impact is ±0.5% (2008: ±0.5%).

Interest rate risk

The principal risk to which financial assets and liabilities are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market interest rates.

The Group's Treasury manages interest rate risk principally through monitoring interest rate gaps and matching the interest repricing profile of financial assets and liabilities. The Group's financial assets are priced on a floating rate basis, which tracks the changes in market interest rates, except for retail personal loans which are priced on a fixed rate basis and constitutes 6.3% (2008: 4.9%) of the total loan portfolio. The pricing of these loans reflect the fixed rate nature of the product and are generally priced at higher spread.

Notes (continued)

5. Financial risk management (continued)

(e) Market risk (continued)

The Group also carries out sensitivity analysis on the net interest income for one year assuming changes (whether increase or decrease) in interest rates. An analysis of the Group's sensitivity to an increase or decrease in market interest rates based on the financial assets and financial liabilities, denominated in various currencies, held at 31 December, assuming no asymmetrical movement in yield curves and a constant statement of financial position, is as follows:

Currency	**AED**	**USD**	**EUR**	**Others**	**Total**
Assumed change in interest rates	±200 bps	±200 bps	±200 bps	±200 bps	±200 bps
Impact on net interest income from increase in interest rates:					
2009 (AED'000)	14,000	1,000	-	2,000	17,000
2008 (AED'000)	7,000	(1,000)	(1,000)	1000	6,000
Impact on net interest income from decrease in interest rates:					
2009 (AED'000)	3,000	(10,000)	(1,000)	(3,000)	(11,000)
2008 (AED'000)	5,000	(1,000)	1,000	-	5,000

The results of shift analysis are reviewed monthly by ALCO who has the overall responsibility for managing pricing policy. An impact of 5% or higher on net interest is followed as a trigger event based on which action plan is agreed. At 31 December 2009, the impact of 200 bps shift analysis on net interest is +4.79% / -3.10% (2008: +1.72% / +1.43%) and regulatory capital is 0.83% / -0.54% (2008: 0.29% / 0.24%).

Notes (continued)

5. Financial risk management (continued)

(e) Market risk (continued)

The Group's interest rate gap position on financial assets and liabilities based on the earlier of contractual re-pricing or maturity date is as follows:

	Less than 1 month AED'000	1 month to 3 months AED'000	Over 3 months to 6 months AED'000	Over 6 months to 1 year AED'000	Over 1 to 5 years AED'000	Over 5 years AED'000	Non-interest bearing items AED'000	Total AED'000
At 31 December 2009								
Cash and balances with UAE Central Bank	535,000	475,000	250,000	640,000	-	-	445,424	2,345,424
Due from banks	237,603	-	-	-	-	-	38,361	275,964
Loans and advances	3,893,992	2,239,839	734,042	336,203	221,807	251,215	139,737	7,816,835
Investments	82,649	401,386	86,241	-	89,343	-	56,602	716,221
Other assets	-	-	-	-	-	-	612,581	612,581
Total assets	**4,749,244**	**3,116,225**	**1,070,283**	**976,203**	**311,150**	**251,215**	**1,292,705**	**11,767,025**
Due to banks	290,875	26,594	55,095	15,956	-	-	16,844	405,364
Term borrowings	766,681	-	-	-	-	-	-	766,681
Customers' deposits	3,400,908	1,728,079	442,842	372,900	646,935	-	1,802,823	8,394,487
Other liabilities	-	-	-	-	-	-	636,391	636,391
Total liabilities	**4,458,464**	**1,754,673**	**497,937**	**388,856**	**646,935**	**-**	**2,456,058**	**10,202,923**
Interest rate sensitivity gap								
On-balance sheet	290,780	1,361,552	572,346	587,347	(335,785)	251,215	(1,163,353)	
Off-balance sheet	30,440	122,982	-	-	-	-	-	
Cumulative	**321,220**	**1,805,754**	**2,378,100**	**2,965,447**	**2,629,662**	**2,880,877**	**1,717,524**	
At 31 December 2008								
Cumulative interest rate sensitivity gap	(1,211,033)	466,231	1,267,363	1,053,051	1,817,741	2,406,088	1,866,261	

Interest rate yields

The average earning on placements and balances with banks was 0.81% (*2008:* 1.88%), on loans and advances was 6.89% (*2008:* 6.65%) and on investments was 3.88% (*2008:* 3.76%). The average cost of customer deposits was 3.27% (*2008:* 2.9%) and of bank borrowings (inclusive of syndicated borrowings) was 3.00% (*2008:* 3.56%).

Notes (continued)

5. Financial risk management (continued)

(f) Operational risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Group's processes, personnel, technology and infrastructure and from external factors other than credit, market and liquidity risks, such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Group's operations and are faced by all business entities. Potential loss may be in the form of financial loss or other damages, for example loss of reputation and public confidence that will impact the Group's credibility and ability to do business.

The Group's objective in managing operational risk is to balance avoidance of financial losses and damage to the Group's reputation with overall cost effectiveness.

The Group has defined policies and procedures which are followed to manage operational risk through the ORC forum. Compliance with Group standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the businesses and functional units to which they relate and regular reports are provided to the Board of Directors.

(g) Management of capital

The Group's lead regulator, the Central Bank of the UAE, sets and monitors regulatory capital requirements. The requirements of capital for subsidiary NBF Financial Services FZC are determined by Free Zone Authority of Fujairah.

The Group's objectives and strategy when managing capital are:

- To safeguard the Group's ability to support the business growth strategy;
- To increase capital resources by a hybrid strategy of profit retention and generation of Tier 2 capital;
- To provide for any unforeseen losses;
- To efficiently allocate capital to various businesses leading to enhanced shareholder value; and
- To adhere to the capital requirements set out by the above mentioned regulators.

The Group's capital management is carried out centrally and determines the level of risk weighted assets growth and the optimal amount and mix of capital required to support planned business growth.

The Group and its subsidiary have complied with all externally imposed capital requirements throughout the year.

During the year, the Group converted its Ministry of Finance deposits into subordinated debt which qualifies for Tier 2 capital for the purposes of capital adequacy calculation.

In implementing capital requirements, the Group calculates its capital adequacy ratio in accordance with the guidelines issued by the Central Bank dated November 2009. The Central Bank introduced the phased implementation of Basel II with Standardized Approach, and it is expected that all internationally active UAE banks – larger institutions as notified on case by case basis will be required to migrate to the Foundation internal rating-based approach (IRB) in due course.

The Central Bank places considerable emphasis on the ICAAP and the first submission is due by 1st March 2010. The Group will continue to develop and implement economic capital model and will comply with Central Bank requirements.

Notes (continued)

5. Financial risk management (continued)

(g) Management of capital (continued)

During the year, the Central Bank has increased the capital adequacy ratio required to be maintained by Banks to 11% analysed into two Tiers, of which Tier 1 capital adequacy must not be less than 7% by 30 September 2009 and 12% analysed in two Tiers, of which Tier 1 capital adequacy must not be less than 8% by 30 June 2010. Accordingly, the Bank has complied with its capital adequacy calculation in accordance with Basel II Standardized Approach for credit and market risks and for the operational risk charge on Basic Indicator Approach.

The Bank's regulatory capital is analyzed into two tiers:

- Tier 1 capital, which includes ordinary share capital and retained earnings (excluding current year profit); and
- Tier 2 capital, which includes fair value reserves relating to unrealized gains / losses on investments classified as available-for-sale, collective impairment provision and subordinated facilities. The following limits have been applied for Tier 2 capital:

  - Total tier 2 capital shall not exceed 67% of tier 1 capital;
  - Subordinated liabilities shall not exceed 50% of total tier 1 capital; and
  - General provision shall not exceed 1.25% of total risk weighted assets.

	31 Dec 2009 AED'000	31 Dec 2008 AED'000
Tier 1 Capital		
Share capital	1,100,000	1,100,000
Statutory reserve	227,929	227,929
Special reserve	122,929	122,929
Retained earnings	141,264	186,887
Total Tier 1	**1,592,122**	**1,637,745**
Tier 2 Capital		
Available-for-sale revaluation reserve	(17,508)	(23,162)
Subordinated facilities (note 17.2 & 17.3)	796,061	400,000
Collective impairment provision	135,596	89,358
Total Tier 2	**914,149**	**466,196**
Deductions from Tier 1 and Tier 2 Capital		
Investments in unconsolidated subsidiaries	-	**(30,150)**
Total capital base (a)	**2,506,271**	**2,073,791**

Notes (continued)

5. Financial risk management (continued)

(g) Management of capital (continued)

Risk weighted assets

	31 Dec 2009	31 Dec 2008
	Risk weighted equivalent AED'000	Risk weighted equivalent AED'000
Credit risk	**10,430,736**	11,712,474
Market risk	**47,121**	2,864
Operational risk	**733,235**	547,571
Total risk weighted assets (b)	**11,211,092**	12,262,909
Capital adequacy ratio (a) / (b) - %	**22.36**	16.91
Capital adequacy ratio (Basel I)	**24.16**	17.75

Risk weights for credit risk

The Group has a diversified funded and unfunded credit portfolio. The exposures are classified as per the Standard Portfolio approach mentioned under the Central Bank of UAE Basel II Capital Adequacy Framework covering the standardized approach for credit risk. The descriptions of the counterparty classes along with the risk weights used to derive the risk weighted assets are as follows:

Claims on sovereigns

These pertain to exposures to governments and their central banks. Claims on central banks and sovereigns are risk weighted in accordance with their ratings from acceptable ECAIs, except that, for all GCC sovereigns a 0% weight has been applied.

Claims on public sector entities (PSEs)

Domestic currency claims on GCC non commercial PSE are treated as claims on GCC sovereign if their Central Bank or monetary authority treats them as such. Foreign currency claims on GCC PSE are treated one grade less favourable than its sovereign i.e. 20% risk weight are applied. Claims on other foreign non commercial PSE are treated one grade less favourable than its sovereign. Claims on commercial PSE are treated as claims on corporate.

Claims on multilateral development banks (MDBs)

All MDBs are risk weighted in accordance with the respective credit rating except for those members listed in the World Bank Group which are risk weighted at 0%.

Claims on banks

Claims on banks are risk weighted based on the ratings assigned to them by external rating agencies, however, short term claims denominated in local currency are assigned more favourable risk weighting.

Notes (continued)

5. Financial risk management (continued)

(g) Management of capital (continued)

Risk weights for credit risk (continued)

Claims on corporate portfolio

Claims on corporate are risk weighted in accordance with ratings from acceptable ECAIs. Risk weightings for unrated corporate claims are assigned at 100%.

Claims on regulatory retail exposures

Retail claims that are included in the regulatory retail portfolio are assigned risk weights of 75%, if it meets the criteria mentioned in the Central Bank of UAE Basel-II guidelines. Claims which do not meet the criteria are assigned risk weights of 100%.

Claims secured by residential property

A preferential risk weight of 35% is applied on claims that did not exceed AED 10 million and the claim is secured by residential property with LTV of up to 85%. Other claims secured on residential property are risk weighted 100%.

Claims secured by commercial property

100% risk weight is applied on claims secured by commercial property.

Past due exposures

The unsecured portion of any loan (other than a qualifying residential mortgage loan) that is past due for more than 90 days, net of specific provisions (including partial write-offs), is risk weighted as follows:

- 150% risk weight where specific provisions are less than 20% of the outstanding amount of the loan; and
- 100% risk weight where specific provisions are greater than 20% of the outstanding amount of the loan.

Equity portfolios

Equity in banking book is risk weighted at 150%.

Other exposures

These are risk weighted at 100%.

Notes (continued)

5. Financial risk management (continued)

(g) Management of capital (continued)

Credit risk and risk weights

2009	On balance sheet	Off balance sheet	Credit risk mitigation (CRM)			
	Gross outstanding	Net exposure after CCF	Exposure before CRM	CRM	After CRM	Risk weighted assets
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Claims on sovereigns	2,393,288	182	2,393,470	-	2,393,470	11,832
Claims on public sector entities	409,497	-	409,497	-	409,497	368,829
Claims on banks	931,406	360,314	1,291,720	351	1,291,369	550,492
Claims on corporates	5,237,651	2,904,506	8,142,157	1,030,292	7,111,865	7,111,865
Regulatory retail exposures	1,242,342	11,849	1,254,191	93,878	1,160,313	1,160,313
Residential retail portfolio	313,456	-	313,456	2,599	310,857	310,857
Commercial real estate	531,618	-	531,618	-	531,618	531,618
Past due exposures	544,574	4,118	169,899	3,914	165,985	165,985
Higher-risk categories	56,603	-	56,603	-	56,603	84,903
Other exposures	206,328	-	206,328	-	206,328	134,042
Total	**11,866,763**	**3,280,969**	**14,768,939**	**1,131,034**	**13,637,905**	**10,430,736**

Notes (continued)

5. Financial risk management (continued)

(g) Management of capital (continued)

Credit risk and risk weights (continued)

2008	On balance sheet	Off balance sheet	Credit risk mitigation (CRM)			
	Gross outstanding	Net exposure after CCF	Exposure before CRM	CRM	After CRM	Risk weighted assets
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Claims on sovereigns	1,802,946	1,444	1,804,390	-	1,804,390	23,034
Claims on public sector entities	164,869	-	164,869	-	164,869	124,279
Claims on banks	1,233,225	670,821	1,904,046	681	1,903,365	793,874
Claims on corporates	6,412,110	2,749,505	9,138,659	1,097,794	8,040,865	8,040,865
Regulatory retail exposures	1,483,088	12,731	1,495,819	322,474	1,173,345	1,173,345
Residential retail portfolio	365,935	-	365,935	4,627	361,308	361,308
Commercial real estate	634,561	-	634,561	-	634,561	634,561
Past due exposures	281,763	2,703	68,681	4,900	63,781	63,781
Higher-risk categories	227,116	-	227,116	-	227,116	340,675
Other exposures	243,998	-	243,998	-	243,998	156,752
Total	**12,849,611**	**3,437,204**	**16,048,074**	**1,430,476**	**14,617,598**	**11,712,474**

Notes (continued)

5. Financial risk management (continued)

(g) Management of capital (continued)

Credit risk and risk weights (continued)

The Group uses the following external credit assessment institutions (ECAIs): Standards & Poor, Moodys and Fitch. The external rating of ECAI is mapped to the prescribed credit quality assessment scale that in turn produces standard risk weightings. The Group also uses various Credit Risk Mitigation techniques (CRM). However, only cash and bank guarantees are used in calculation of Pillar I Capital requirements.

Market risk and risk weights

The Group's capital charge in respect of market risk in accordance with the standardized methodology is as follows:

	2009	2008
	AED'000	AED'000
Interest rate risk		
- Specific interest rate risk	-	-
- General interest rate risk	-	-
Equity position risk	-	-
Foreign exchange risk	4,712	286
Option risk	-	-
Total market risk capital charge	**4,712**	**286**
Market risk - risk weighted assets	**47,121**	**2,864**

In line with Basel II Accord, investments designated as fair value through profit or loss form part of the banking book rather than the trading book. Accordingly, the designated investment portfolio has been covered under credit risk.

Capital charge against option risk is nil (2008: nil), as all currency options are covered through back-to-back transactions with the respective counter parties.

Operational risk and risk weights

Capital requirement for operational risk is calculated using the Basic Indicator Approach. The total capital charge is calculated as 15% of the last three years average income.

Notes (continued)

6. Financial assets and liabilities

6.1 Classification

The fair values and carrying values of the financial assets and liabilities at 31 December are shown below:

2009	At fair value through profit or loss AED'000	At fair value through equity AED'000	Held-to-maturity AED'000	Loans and advances AED'000	Other amortised cost AED'000	Carrying amount AED'000
Assets						
Cash and balances with Central Bank of the UAE	-	-	-	-	2,345,424	2,345,424
Due from banks	-	-	-	-	275,964	275,964
Loans and advances	-	-	-	7,816,835	-	7,816,835
Investments	153,389	264,583	298,249	-	-	716,221
Other assets	-	-	-	-	612,581	612,581
Total assets	**153,389**	**264,583**	**298,249**	**7,816,835**	**3,233,969**	**11,767,025**
Liabilities						
Due to banks	-	-	-	-	405,364	405,364
Medium term borrowings	-	-	-	-	766,681	766,681
Customer deposits	153,422	-	-	-	8,241,065	8,394,487
Other liabilities	-	-	-	-	636,391	636,391
Total liabilities	**153,422**	**-**	**-**	**-**	**10,049,501**	**10,202,923**

2008	At fair value through profit or loss AED'000	At fair value through equity AED'000	Held-to-maturity AED'000	Loans and advances AED'000	Other amortised cost AED'000	Carrying amount AED'000
Assets						
Cash and balances with Central Bank of the UAE	-	-	-	-	1,735,449	1,735,449
Due from banks	-	-	-	-	437,298	437,298
Loans and advances	-	-	-	9,037,759	-	9,037,759
Investments	576,171	117,671	341,099	-	-	1,034,941
Other assets	-	-	-	-	444,194	444,194
Total assets	**576,171**	**117,671**	**341,099**	**9,037,759**	**2,616,941**	**12,689,641**
Liabilities						
Due to banks	-	-	-	-	944,892	944,892
Medium term borrowings	-	-	-	-	764,506	764,506
Customer deposits	438,118	-	-	-	8,564,923	9,003,041
Other liabilities	-	-	-	-	549,073	549,073
Total liabilities	**438,118**	**-**	**-**	**-**	**10,823,394**	**11,261,512**

Notes (continued)

6. Financial assets and liabilities (continued)

6.2 Fair value measurement – fair value hierarchy

2009	Level 1	Level 2	Level 3
	AED'000	AED'000	AED'000
On balance sheet items			
Investments			
- Debt securities	361,370	-	-
- Externally managed portfolios	-	33,730	-
- Overseas trust	-	10,679	-
- Other investments	3,647	8,546	-
Customer deposits	-	153,422	-
Off balance sheet items - derivates			
Forward foreign exchange contracts	-	3,167,059	-
Currency options	-	418,534	-
Interest rate swaps	-	153,422	-

2008	Level 1	Level 2	Level 3
	AED'000	AED'000	AED'000
On balance sheet items			
Investments			
- Debt securities	466,406	-	-
- Externally managed portfolios	-	204,316	-
- Overseas trust	-	10,620	-
- Other investments	3,307	9,193	-
Customer deposits	-	438,132	-
Off balance sheet items - derivates			
Forward foreign exchange contracts	-	2,297,693	-
Currency options	-	421,756	-
Interest rate swaps	-	438,118	-

During the year there were no transfers between Level 1 and Level 2 of the fair value hierarchy above. Further, there has been no change in the valuation techniques in relation to valuation of financial instruments as discussed in note 4 during the year.

Notes (continued)

7. Cash and balances with UAE Central Bank

	2009 AED'000	2008 AED'000
Cash on hand	72,366	59,614
Certificates of deposit with Central Bank of UAE (note 7.1)	1,900,000	1,300,000
Other balances with UAE Central Bank (note 7.2)	373,058	375,835
	2,345,424	**1,735,449**

7.1 Under the terms of issue of the Certificates of deposit, the Central Bank makes available repurchase facilities to the Group.

7.2 Other balances with the Central Bank include non-interest bearing regulatory cash reserve deposits of AED 302 million (2008: AED 301 million).

8. Due from banks

	2009 AED'000	2008 AED'000
By geographical area		
Within UAE	137,664	389,899
GCC countries	1,987	7,881
Others	136,313	39,518
	275,964	**437,298**

8.1 The currency wise analysis of due from banks is set out below:

	2009 AED'000	2008 AED'000
AED	82,570	338,321
USD	133,644	23,026
EURO	23,368	37,052
GBP	19,951	33,981
Others	16,431	4,918
	275,964	**437,298**

Notes (continued)

9. Loans and advances

	2009 AED'000	2008 AED'000
9.1 Loans and advances by type		
Overdrafts	1,153,397	1,041,783
Term loans	5,211,880	5,872,303
Loans against trust receipts	926,769	1,122,543
Bills discounted	536,010	605,417
Bills drawn under letters of credit	456,899	683,241
	8,284,955	9,325,287
Allowance for impairment losses (note 10)	(468,120)	(287,528)
Net loans and advances	**7,816,835**	**9,037,759**

9.2 Contingent liabilities and commitments

Contingent liabilities represent credit related commitments under letters of credit and guarantees which are designed to meet the requirements of the Group's customers towards third parties. Commitments represent contractually binding commitments to extend credit and other capital expenditure commitments of the Group which are undrawn at the date of statement of financial position.

Contingent liabilities	2009 AED'000	2008 AED'000
- Letters of credit covering movement of goods	966,461	906,667
- Financial guarantees and other direct credit substitutes	372,182	315,685
- Bid bonds, performance bonds and other transaction related contingencies	3,195,693	3,536,003
	4,534,336	**4,758,355**

Commitments	2009 AED'000	2008 AED'000
- Undrawn commitments - credit related	6,815,277	4,465,211
- Others	8,803	9,764

These contingent liabilities and commitments have off balance sheet credit risk and related fees and accruals for probable losses are recognised in the statement of financial position until the commitments are fulfilled or expired. Many of the contingent liabilities and commitments will expire without being advanced in whole or in part. Therefore, the amounts do not represent expected future cash flows.

Notes (continued)

10. Allowance for impairment losses on loans and advances

Movement in allowances for impairment losses		2009 AED'000		2008 AED'000
Balance at 1 January		287,528		107,805
Provided during the year	252,734		184,659	
Released during the year	(38,449)		(4,936)	
Net allowance for impairment losses		214,285		179,723
Written-off during the year		(33,693)		-
Balance at 31 December		**468,120**		**287,528**

11. Investments

	2009 AED'000	2008 AED'000
Investments at fair value through profit or loss (FVPL)		
Designated:		
Debt securities (note 11.1)	96,787	348,735
Externally managed portfolios (note 11.2)	33,730	204,316
Overseas trust (note 11.3)	10,679	10,620
Other investments (note 11.4)	12,193	12,500
	153,389	576,171
Available-for-sale (AFS)		
Debt securities (note 11.1)	264,583	117,671
Held-to-maturity (HTM)		
Debt securities (note 11.1)	298,249	341,099
	716,221	**1,034,941**

11.1 Debt securities represent the Group's investments in bonds and notes. These include floating rate securities amounting to **AED 570 million** (2008: AED 768 million). These securities are quoted on internationally recognised platforms of Reuter and Bloomberg and are liquid in normal market conditions.

11.2 Externally managed portfolios include various international funds and funds with no fixed maturities and coupon rates. The portfolio is segregated into liquid and growth portfolios with a view to enhancing returns on liquid funds and profitability respectively. The fair values of these investments are based on the net asset values provided by the fund managers. During the year, the management has liquidated significant component of investment portfolio with a view to enhance focus on core business.

11.3 Overseas trust investment represents funds invested in a bond through a discretionary trust to secure employee termination benefits calculated in accordance with UAE Labour Laws.

Notes (continued)

11. Investments (continued)

11.4 Other investments mainly comprise investments in private equity.

11.5 The counterparty dispersion of the investment portfolio is set out below:

	2009 AED'000	2008 AED'000
Government	99,966	91,936
Banks and financial institutions	489,906	521,029
Others	126,349	421,976
	716,221	**1,034,941**

11.6 An analysis of investments based on external credit ratings is as follows:

2009	Debt securities AED'000	Externally managed portfolios AED'000	Overseas trust AED'000	Other investments AED'000	Total AED'000
AAA	13,028	-	-	-	13,028
AA+	-	-	-	-	-
AA	4,041	-	-	-	4,041
AA-	60,485	-	-	-	60,485
A+	74,001	-	-	-	74,001
A	412,307	-	-	-	412,307
A-	17,686	-	-	-	17,686
BBB+	25,038	-	-	-	25,038
BBB	10,921	-	-	-	10,921
Unrated	42,112	33,730	10,679	12,193	98,714
	659,619	**33,730**	**10,679**	**12,193**	**716,221**

Notes (continued)

11. Investments (continued)

2008	**Debt securities AED'000**	**Externally managed portfolios AED'000**	**Overseas trust AED'000**	**Other investments AED'000**	**Total AED'000**
AAA	2,288	-	-	-	2,288
AA+	-	-	-	-	-
AA	11,228	-	-	-	11,228
AA-	86,918	-	-	-	86,918
A+	131,993	-	-	-	131,993
A	485,680	-	-	-	485,680
A-	60,892	-	-	-	60,892
BBB+	24,526	-	-	-	24,526
BBB	2,940	-	-	-	2,940
Unrated	1,040	204,316	10,620	12,500	228,476
	807,505	**204,316**	**10,620**	**12,500**	**1,034,941**

Notes (continued)

11. Investments (continued)

11.7 The geographic dispersion of the investment portfolio is as follows:

	2009 AED'000	2008 AED'000
Within UAE	580,682	706,506
GCC Countries	46,405	80,612
Others	89,134	247,823
	716,221	**1,034,941**

11.8 The currency wise analysis of the investment portfolio is set out below:

	2009 AED'000	2008 AED'000
AED	517,932	529,468
USD	162,111	474,066
EURO	29,679	22,356
GBP	6,499	9,051
	716,221	**1,034,941**

11.9 Reclassification of investments

The Group, as a result of the adoption of amendments of IAS-39 Financial Instruments: Recognition and Measurement and IFRS-7 Financial Instruments: Disclosures, introduced in October 2008, had reclassified investments amounting to AED 268 million, being the fair value as at 1 July 2008, from the fair value through income statement classification to the available-for-sale investments category. As there was no trading in the reclassified investments during the last year, the management considered that the reclassification provided a more appropriate presentation of the investments in accordance with the Group's long-term investment strategy. As required by the amendments, the effects of such a reclassification are set out below:

	2009 AED'000	2008 AED'000
Before reclassification		
Unrealised fair value loss recognised in income statement	**-**	**994**
After reclassification		
Unrealised fair value loss recognised in cumulative changes in fair values	**7,635**	**16,105**

The Group has reclassified certain fixed maturity bonds amounting to Nil (2008: AED 231.56 million being the fair value as at 1 October 2008), from available-for-sale investments to held-to-maturity investments primarily due to change in the intentions and ability of the Group to hold these bonds till maturity.

Notes (continued)

12. Property and equipment

	Freehold land AED'000	Buildings & leasehold improvements AED'000	Motor vehicles, furniture, EDP & other equipment AED'000	Total AED'000
Cost				
At 1 January 2008	14,066	84,350	33,911	132,327
Additions	-	11,275	7,020	18,295
Disposals	-	-	(425)	(425)
At 31 December 2008	14,066	95,625	40,506	150,197
At 1 January 2009	14,066	95,625	40,506	150,197
Additions	-	3,006	7,196	10,202
Disposals	-	-	(2,219)	(2,219)
At 31 December 2009	14,066	98,631	45,483	158,180
Depreciation				
At 1 January 2008	-	29,404	23,340	52,744
Charge for the year	-	3,536	3,248	6,784
On disposals	-	-	(239)	(239)
At 31 December 2008	-	32,940	26,349	59,289
At 1 January 2009	-	32,940	26,349	59,289
Charge for the year	-	3,680	6,993	10,673
On disposals	-	-	(2,218)	(2,218)
At 31 December 2009	-	36,620	31,124	67,744
Net book value				
At 31 December 2009	**14,066**	**62,011**	**14,359**	**90,436**
At 31 December 2008	**14,066**	**62,685**	**14,157**	**90,908**

The buildings in Fujairah, Dibba, Masafi, Qidfah and Tawian are constructed on land granted to the Group by the Government of Fujairah. The land is shown at a nominal value of AED 1 each *(2008: AED 1 each)*.

Notes (continued)

13. Intangible assets

	2009 AED'000	2008 AED'000
Cost		
At 1 January	26,854	26,854
Additions	-	-
At 31 December	26,854	26,854
Amortisation		
At 1 January	7,429	1,862
Charge for the year	5,266	5,567
At 31 December	12,695	7,429
Net book value	**14,159**	**19,425**

The cost of intangible assets comprises the cost of purchase of the Group's new core banking software, license cost including customization cost, and directly attributable implementation costs of the project necessarily incurred to bring the software to the state of use. The cost is being amortised over the system's estimated useful life of 5 years.

14. Capital work-in-progress

	2009 AED'000	2008 AED'000
Tangible assets		
Premises and equipment (note 14.1)	378	496
Intangible assets (note 14.2)	703	703
	1,081	**1,199**

14.1 Premises and equipment costs were incurred in respect of refurbishment of the Group's building in Fujairah (2008: costs incurred in respect of refurbishment of the Group's building in Dubai).

14.2 The cost of intangible assets is in respect of the purchase of software and directly attributable costs relating to the implementation of the Group's Basel II Project.

15. Other assets

	2009 AED'000	2008 AED'000
Accrued interest	63,892	91,221
Prepayments and deposits	4,111	8,423
Customer liabilities for acceptances	538,507	340,793
Others	24,251	34,738
	630,761	**475,175**

Notes (continued)

16. Due to banks and term borrowings

	2009 AED'000	2008 AED'000
By type:		
Syndicated borrowings from banks (note 16.1)	766,681	764,506
Short-term borrowings	405,364	944,892
	1,172,045	**1,709,398**
By geographical area:		
Within UAE	91,836	467,059
GCC Countries	19,002	125,192
Others	1,061,207	1,117,147
	1,172,045	**1,709,398**

16.1 On 31 July 2008, the Group arranged a term loan facility of AED 766.68 million (comprising US$ 190 million and Euro 13 million) through a syndicate of banks. The facility carries a floating rate which is the aggregate of margin and LIBOR and is repayable in full on 25 June 2011. Under the terms of the agreement, the Group is required to maintain a minimum capital adequacy ratio calculated on the basis of Basel II Accord as applicable in the UAE and to maintain a minimum tangible net worth of US$ 350 million.

17. Customer deposits

	2009 AED'000	2008 AED'000
By type:		
Demand and margin deposits	1,649,337	1,570,289
Saving deposits	34,915	45,262
Fixed term and notice deposits (note 17.1, 17.2 & 17.3)	6,710,235	7,387,490
	8,394,487	**9,003,041**
By geographical area:		
Within UAE	7,954,899	8,437,770
Others	439,588	565,271
	8,394,487	**9,003,041**

17.1 Fixed term and notice deposits include structured deposit notes which are fair valued through statement of income amounting to AED 153 million (31 December 2008: AED 438 million), being the fair value as at 31 December 2009.

17. Customer deposits (continued)

17.2 The Group received deposits aggregating to AED 643 million in October and November 2008 from the Ministry of Finance of the UAE. On 31 December 2009, the Group entered into an agreement with UAE Ministry of Finance, through which these deposits are now subordinate to equity subject to certain conditions as set out in the agreement and included in Tier 2 capital. As per the terms of the conversion and subordination agreement and subject to certain conditions to be adhered to, the tenure of the loan extends to 7 years from the date of conversion and is payable in full on maturity with an early repayment option. The loan carries stepped up pricing over the tenure, with interest payable quarterly.

17.3 On 19 August 2008, the Group arranged a term subordinated loan facility with a finance company amounting to AED 400 million. The facility carries interest rate which is the aggregate of margin and EIBOR, payable quarterly commencing from 19 November 2008. As per the terms of the facility, the full principal amount of the facility is to be repaid on 19 August 2018. The Central Bank has approved the facility to be considered as Tier 2 capital for regulatory purposes.

18. Other liabilities

	2009 AED'000	2008 AED'000
Accrued interest	30,919	46,786
Employee terminal and other long term benefits	19,073	17,810
Accrued expenses	22,583	10,622
Directors' attendance fees	2,200	2,200
Liabilities under acceptances	538,507	340,793
Others	42,543	142,951
	655,825	**561,162**

19. Shareholders' equity

19.1 Share capital

	2009 AED'000	2008 AED'000
Authorised, issued and fully paid: 1,100,000,000 shares of AED 1 each (2008: 1,100,000,000 shares of AED 1 each)	**1,100,000**	**1,100,000**

The Board of Directors proposed nil (2008: nil) dividend for the year.

Notes (continued)

19. Shareholders' equity (continued)

19.2 Statutory and special reserve

In accordance with the Bank's Articles of Association, the provisions of Article 82 of Union Law No. 10 of 1980 and Article 192 of Federal Law No. 8 of 1984 (as amended), 10% of the profit for the year shall be transferred to a statutory reserve which is not distributable. Additionally, in accordance with the Bank's Articles of Association, another 10% of the profit for the year shall be transferred to a special reserve which is to be used for purposes to be determined by the ordinary general meeting upon the proposal of the Board of Directors.

20. Interest income

	2009 AED'000	2008 AED'000
Loans and advances	604,972	583,995
Due from banks	18,066	51,499
Investments	29,541	34,566
	652,579	**670,060**

21. Interest expense

	2009 AED'000	2008 AED'000
Due to banks	54,800	88,684
Customer deposits	270,924	246,880
	325,724	**335,564**

22. Net fees and commission income

	2009 AED'000	2008 AED'000
Fees and commission income		
Letters of credit	40,573	44,743
Letters of guarantee	33,163	33,928
Lending fees	47,046	55,883
Asset management and investment services	2,331	13,789
Commission on transfers	14,315	7,694
Others	1,194	1,093
Total fees and commission income	**138,622**	**157,130**
Fees and commission expense		
Brokerage expense	231	211
Credit card charges	1,354	590
Other commission	466	1,108
Total fees and commission expense	**2,051**	**1,909**
Net fees and commission income	**136,571**	**155,221**

Notes (continued)

23. Other operating income

	2009 AED'000	2008 AED'000
Rental income	3,906	3,206
Rebates	2,966	1,961
Other miscellaneous income	869	1,289
	7,741	**6,456**

24. Income / (loss) from investments

	2009 AED'000	2008 AED'000
Gain / (loss) in fair value through profit or loss	37,539	(226,998)
Dividend income	58	25
	37,597	**(226,973)**

25. Employee benefits expense

Employee benefits expense includes employee bonus of AED 12,265,000 (2008: AED 3,816,000). The number of employees at 31 December 2009 was 513 (including 482 relating to the Bank) of which 170 (relating to the Bank) were UAE nationals (2008: 549 (including 530 relating to the Bank) of which 194 (relating to the Bank) were UAE nationals).

26. Earnings / (loss) per share

The calculation of earnings / (loss) per share is based on earnings / (loss) of AED 104,317,000 (2008: AED (50,270,000)) divided by the weighted average number of shares of 1,100,000,000 (2008: 1,100,000,000 shares) outstanding during the year.

27. Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise the following balances from the date of acquisition:

	2009 AED'000	2008 AED'000
Cash on hand	72,366	59,614
Balances with Central Bank of UAE	2,273,058	1,675,835
Due from banks with less than three months maturity	275,964	427,046
	2,621,388	2,162,495
Due to banks with less than three months maturity	(334,313)	(870,261)
	2,287,075	**1,292,234**

Notes (continued)

28. Related parties

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In the case of the Group, related parties, as defined in the International Accounting Standard No. 24, include major shareholders of the Group, directors and officers of the Group and companies of which they are principal owners and key management personnel. Banking transactions are entered into with related parties on agreed terms and conditions approved by the Board of Directors. The significant transactions included in the financial statements are as follows:-

	31 December 2009 AED'000	Average balances during 2009 AED'000	31 December 2008 AED'000	Average balances during 2008 AED'000
Balance sheet items				
Loans and advances	314,218	290,793	279,036	222,147
Customer deposits	1,834,474	1,867,843	1,786,869	1,329,210
Letters of credit	113,562	108,188	125,911	90,326
Acceptances and other direct credit substitutes	23,443	20,768	37,016	34,711
Transaction related contingencies	112,719	131,180	135,041	131,547
Income statement items				
Interest income	18,520		13,573	
Interest expense	81,166		46,418	
Other income	6,579		4,779	
Key management personnel				
Salaries and other short-term benefits	12,891		13,840	
Employee terminal and other long-term benefits	451		658	
Directors' attendance fees	2,200		2,200	

Notes (continued)

29. Segmental reporting

The Group uses business segments for presenting its segment information in line with the Group's management and internal reporting structure. The Group's operations are confined mainly in the UAE.

Business segments pay and receive interest, to and from Treasury on an arm's length basis to reflect allocation of capital and funding costs.

During the year, the transactional services based small businesses and liability acquisition team have been merged into Wholesale Banking from Consumer Banking to generate business synergies.

Business segments

The Group conducts its activity through the following clearly defined business segments:

Wholesale banking

The segment offers a range of products and services including credit and trade finance products, and services to large sized and small to medium size corporate customers through separate units and to financial institutions, and accepts deposits. The segment also offers transactional services to small-sized businesses.

Consumer banking

The segment offers a range of products and services to individuals and high net worth individuals including personal and mortgage loans, credit cards, other transactions and balances, and accepts their deposits.

Treasury and investments

The segment undertakes the Group's liquidity management centrally and is responsible for optimum utilization of resources in productive assets and management of exchange and interest positions within the limits and guidelines set by management and approved by the Board. Treasury also offers various foreign exchange and derivative products to customers and is entrusted with the responsibility of managing the Group's investment portfolio together with ALCO.

Head office and others

The Group's capital and investment in subsidiary is recognised under Head Office. The Head Office lends capital to treasury on an arms length basis for the purposes of segment performance. The Group has central shared services which include Operations, Risk Management, Human Resources, Finance, Information Technology and Internal Audit which are recognised centrally under Head Office. The Group allocates the shared services cost to business segments based on transaction and relevant drivers.

Notes (continued)

29. Segmental reporting (continued)

The segment analysis based on business segments is set out below:

2009	**Wholesale banking AED'000**	**Consumer banking AED'000**	**Treasury and investments AED'000**	**Head office and others AED'000**	**Consolidated AED'000**
Segment revenue	453,768	66,766	(1,524)	25,047	544,057
Segment operating cost	(177,399)	(42,137)	(5,919)	-	(225,455)
Impairment losses	(196,970)	(17,315)	-	-	(214,285)
Profit / (loss)	79,399	7,314	(7,443)	25,047	104,317
Segment assets	7,795,323	636,274	3,353,608	105,676	11,890,881
Segment liabilities	7,633,594	499,729	2,079,857	9,177	10,222,357
Capital expenditure	-	-	-	10,202	10,202

2008	**Wholesale banking AED'000**	**Consumer banking AED'000**	**Treasury and investments AED'000**	**Head office and others AED'000**	**Consolidated AED'000**
Segment revenue	415,728	53,993	(226,372)	67,627	310,976
Segment operating cost	(139,179)	(37,010)	(5,334)	-	(181,523)
Impairment losses	(99,983)	(79,740)	-	-	(179,723)
Profit / (loss)	176,566	(62,757)	(231,706)	67,627	(50,270)
Segment assets	8,605,342	882,404	3,232,876	111,532	12,832,154
Segment liabilities	7,884,392	761,418	2,619,611	8,180	11,273,601
Capital expenditure	-	-	-	18,295	18,295

Notes (continued)

29. Segmental reporting (continued)

An analysis based on revenues derived by products and services is set out below:

	2009 AED'000	2008 AED'000
Revenues derived by products and services		
Interest income on loans and advances		
Overdrafts	75,529	74,001
Term loans	329,654	282,365
Loans against trust receipts	85,835	95,775
Bills discounted	69,302	72,189
Bills drawn under letters of credit	44,652	59,665
	604,972	**583,995**
Fees and commission income		
Letters of credit	40,573	44,743
Letters of guarantee	33,163	33,928
Lending fees	47,046	55,883
Asset management and investment services	2,331	13,789
Commission on transfers	14,315	7,694
Others	1,194	1,093
	138,622	**157,130**

30. Comparative figures

Certain comparative figures have been re-classified where necessary to conform to the current year's presentation.

Quality Banking with a Personal Focus

بنك الفجيرة الوطني ش.م.ع
NATIONAL BANK OF FUJAIRAH P.S.C.
Forward Together