2010
ANNUAL REPORT

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

2010
ANNUAL REPORT

Fujairah Fort

The Fujairah emirate boasts scenic mountains, untouched beaches and spectacular waterfalls. All of this natural splendor, combined with Fujairah's rich heritage, makes it one of the major tourist destinations in the UAE.

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

Chairman's Report

It brings me great pleasure to present, 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 2010.

We are pleased to see the Bank achieve its best operating performance even during these challenging times. The Bank recorded its highest operating profit of AED 375.9 million in 2010 compared to AED 318.6 million in 2009. The Bank has grown its core earnings which, coupled with robust cost and balance sheet management, have helped absorb credit losses and grow profitable operations. The Bank recorded a profit of AED 170.9 million for the year compared to a profit of AED 104.3 million for 2009, a solid growth of 64%, by continuing to focus on its core business. The provision for loan losses was AED 205.0 million for the year compared to AED 214.3 million for 2009. The Bank continues to be prudent and proactive in providing for potential loan losses in view of ongoing uncertain market conditions.

Operating income increased by 12.2% to AED 568.0 million compared to AED 506.5 million for 2009. The Bank leveraged its strong liquidity and capital positions by growing its business prudently and efficiently in the local economy. Our business in Fujairah in particular saw record growth in 2010. Overall, the loan book grew by 11.5% in an environment of subdued credit demand and reflected the Bank's strong relationships with its core customers. The sharper focus on improving operating efficiency helped the Bank's profitability. Operating expenses of AED 207.7 million were 7.9% lower than 2009's AED 225.5 million. The Bank's cost to income ratio improved to 36.6% compared to 44.5% in 2009.

The Bank's capital adequacy ratio and liquidity position continue to be among the strongest in the UAE. As of 31 December, the Bank's total capital adequacy ratio was 21.4% and Tier 1 ratio was 13.6%. The advances to deposits ratio was 87.2% after absorbing a 6% drop caused by the maturity of our syndicated borrowing falling within six months. The Bank's syndicated borrowing, amounting to USD 210 million, is set to mature on 25 June 2011. In view of the strong position and performance of the Bank, I, on behalf of the Board of Directors, am pleased to recommend a distribution of profits by way of cash dividends of 6.2% of the paid-up capital.

The Bank's strategy going forward focuses on improving its market position by strengthening its customer-centric approach and product focus. Our successful broader proposition in the Fujairah Region will continue to be developed and extended to other Emirates in line with the Bank's diversification strategy. Technology and process re-engineering initiatives will align the Bank more closely to customer needs and will strengthen our operational capability to deliver superior customer service and achieve growth in line with shareholder aspirations. We have plans to offer alternative electronic channels to our customers to further enhance their service experience.

The Bank remains committed to playing a role in 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 the 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 achieving these encouraging results during these challenging times.

Finally, I would like to take this opportunity to thank the Bank's customers for their trust and assure them of the Bank's commitment in supporting their business goals.

Saleh Bin Mohammed Al Sharqi

Business Overview

Operating Environment

2010 saw a period of slow stabilisation and the banking sector, in particular, was helped by an improvement in liquidity and international confidence. Nevertheless, bank profitability remains under pressure due to the drawn out period of economic recovery and related loan losses.

The economic outlook is expected to be stable on the back of public spending and strong hydrocarbon revenues, with GDP projected to show moderate growth, far from the exceptional rates seen from 2005 to 2008. This growth will largely depend on the oil, infrastructure, trade and tourism sectors. In the meantime, the tightening of the Iranian Sanctions is causing an adverse impact on the transshipment business as banks strengthen their controls to comply with revised regulations. The effects of the combined challenges of higher cost of liquidity and difficult credit conditions are also yet to be fully settled but measures implemented by the various authorities across the region should underpin future recovery. New rules and regulations have also been introduced to address loan losses recognition and more are expected to be introduced to regulate credit expansion and liquidity in line with the principles of Basel III.

Fujairah's economy shows further signs of development, and the Emirate continues to provide UAE exports safe and direct access to the Indian Ocean. Significant infrastructure projects are underway in the Emirate including additional oil-storage facilities. They include a $ 3.3 billion oil pipeline, the country's biggest power and water treatment plant and a facility to store imported grain. Fujairah's strategic location attracts a broad array of marine services and the Port of Fujairah is poised to increase its number of warehouses from 125 to 250 stores, with total storage capacity expanding from three million cubic metres to eight million cubic metres of fuel products. On the aviation front, the Fujairah International Airport has also won the International Transport Award this year for its efforts in providing remarkable services and facilities.

Financial Results

The Bank's performance is a testament to the success of its well-balanced strategy in these difficult times. The Bank recorded a profit of AED 170.9 million for the year, up 64% compared to a profit of AED 104.3 million for 2009. The provision for loan losses was AED 205.0 million for the year compared to AED 214.3 million for 2009. The non-performing loans and advances (NPL) ratio of the Bank was 7.6% marginally higher than 7.2% as at 31 December 2009 and specific provision coverage was at 68.3% as at 31 December 2010 (2009: 57.9%). The specific provision coverage improved to 89.8% after taking into account the value of collateral held. Including the exposure to Dubai World Group Finance Limited, the NPL ratio stood at 11.5%. Operating income increased by 12.2% to AED 568.0 million compared to AED 506.5 million for 2009, reflecting strong core business performance and balance sheet management. Net interest income grew by 10.2% to AED 360.1 million compared to AED 326.9 million in 2009 due to effective asset and liability management. Non-interest income, at AED 207.9 million, was 15.8% higher than the AED 179.6 million in 2009, showing an increase primarily in trade business and credit growth. Exchange income, including derivative income, saw a growth of 20.0% to a record high of AED 42.3 million. Operating expenses of AED 207.7 million were 7.9% lower than 2009 operating expenses of AED 225.5 million. The Bank's cost to income ratio improved to 36.6% as compared to 44.5% in 2009.

A gain on investment of AED 15.7 million was recognised through the statement of income compared to AED 37.6 million for the corresponding period of 2009. The decline is in line with the Bank's strategy to change the mix of its investment portfolio to reduce market risk and focus on its core business. Investment in funds was reduced to AED 42.3 million.

The lending growth of 11.5% reflected the strength of the Bank's customer relationships and its commitment to the development of the UAE economy. Total assets grew to AED 12.9 billion from AED 11.9 billion at the end of 2009. The strong performance improved profitability ratios despite the negative impact of the current high level of loan losses. The return on equity rose from 6.3% to 9.2%, and return on assets rose from 0.9% to 1.3%.

The Bank's financial stability is underpinned by its strong capital adequacy ratio, which coupled with build-up in provisioning levels, have enabled the Bank to face uncertain credit conditions with confidence. UAE bank credit ratings were generally lowered by rating agencies during the last few years. However, the Bank's long term credit rating of A- was maintained by Capital Intelligence, a reflection of its prudent approach and sound business model.

The Board and Management are confident that the Bank is well-positioned to grow in the coming years on the back of strong customer and product focus, asset and liability best practices and prudent risk management. The Bank will continue to improve its market position and seek new lending opportunities as the economy continues to recover.

Wholesale Banking

This segment, comprising Corporate, Commercial and Financial Institution businesses, represents 87.6% of the Bank's operating income. The segment generated operating income of AED 497.8 million, which was 9.7% higher than 2009's operating income of AED 453.8 million. The results reflect strong growth on the back of the Bank's core customer base. Segment assets grew by 17.3% from AED 7,795.3 million to AED 9,147.4 million. Commercial Banking, comprising of our small and medium-sized business customers, saw a growth in operating income of 15.7%, followed by Corporate Banking, which saw an operating income increase of 9.5%.

Consumer Banking

This segment was refocused primarily on the Fujairah region in 2010. A revised business model will now be extended to other Emirates in line with the Bank's diversification strategy. Profit from this segment declined by 14.2%, reflecting the refocused strategy and the Bank's adoption of a more prudent general provision policy.

Treasury and Investments

Treasury recorded a strong foreign exchange income growth of 20% from AED 35.3 million for 2009 to a record high of AED 42.3 million. Larger volumes and increasingly sophisticated derivative transactions demonstrate the increased importance of our Treasury offering to the Bank's overall product suite. At the same time, Treasury contributed to the Bank's net interest growth through effective balance sheet management.

Management and Governance

The Bank has reinforced its management and governance structure by adopting the implementation of best practices.

The Bank has established a Marketing Committee to more clearly align its activities to customer needs and a Human Resources Committee to provide greater oversight in all staff matters. Risk awareness and compliance-related activities were accelerated during the year and embedded in the control environment. The implementation of the Economic Capital Model and Internal Risk Based (IRB) approach of Basel II is progressing according to plan. The Bank implemented the standardised approach of Basel II for measuring operational risk capital charges in 2010.

Corporate Governance

Strong corporate governance remains at the core of our business philosophy and is being developed in line with best practices. The Board of Directors comprises eight members who were re-appointed on 24 March 2008 for a term of three years. The Board met eight times in 2010 to fulfill its duties and responsibilities. The Board plays a key role in corporate governance by approving and overseeing the organisation's strategy, directional policies, senior appointments and supervision and remuneration of senior executives. It also ensures the accountabilility of the organisation to its owners and authorities. The Board carries out all stipulated responsibilities in accordance with the highest corporate governance standards and best practices, and is committed to achieving the required form progressively, as and when considered appropriate.

People

The Bank is committed to offering a stimulating work environment which embraces trust, transparency, fairness, respect, and provides opportunities and recognition. The Bank has launched a series of initiatives in line with its ambition of becoming an Employer of Choice. The Vision and Mission Statements of the Bank have been refreshed and supporting core values introduced to the workplace. Management offsite meetings, employee focus groups, an employee satisfaction survey and a 360 degree feedback exercise starting with senior management were established to engage staff and reflect their views in the planning and management of the Bank. The Bank plans to increase its training and development spend over the next three years and continues to participate in the Hay Survey to benchmark and reward people in line with the market. The Bank is committed to reward its people fairly and progressively, commensurate to the Bank's and staff's performance.

The Bank's emiratisation ratio improved from 35.3% in 2009 to 37.2% and exceeds the industry average. As part of the Bank's commitment to emiratisation and the development of banking talent in the UAE, the Bank received its first batch of management trainees on 3 October 2010. These 24 UAE nationals were selected out of 130 candidates and are currently undergoing a 6-to-12 month job rotation programme before taking on permanent roles with the Bank.

Corporate Social Responsibility

The Bank considers CSR as an integral part of doing business and an important investment in the future of the communities where it operates. The Bank has demonstrated its commitment to this area through activities such as installing recycling bins, participating in local environmental initiatives, organising charity fundraising events and supporting disaster relief efforts. Specific activities in 2010 included contributions to the Terry Fox Run and Pakistan Relief Fund. In order to deepen its commitment to the community, the Bank has established a committee to pull together its efforts and seek new ways to enhance its CSR approach.

Easa Saleh Al Gurg, KCVO, CBE

Deputy Chairman

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 ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2010, the consolidated statements of comprehensive income (comprising a consolidated statement of comprehensive income and a separate consolidated income statement), changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2010, and of its consolidated financial performance and its consolidated 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 Requirement

As required by the UAE 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 2010, which may have had a material adverse effect on the business of the Group or its financial position.

KPMG
Vijendranath Malhotra
Registration No: 48 B

Dated: 26 January 2011

Consolidated statement of financial position

As at 31 December 2010

	Note	**2010 AED'000**	**2009 AED'000**
Assets			
Cash and balances with UAE Central Bank	*7*	2,202,366	2,345,424
Due from banks	*8*	192,976	275,964
Loans and advances	*9*	8,716,694	7,816,835
Investments	*11*	678,362	716,221
Property and equipment	*12*	86,229	90,436
Intangible assets	*13*	9,010	14,159
Capital work-in-progress	*14*	2,009	1,081
Other assets	*15*	1,028,967	630,761
Total assets		**12,916,613**	**11,890,881**
Liabilities			
Due to banks	*16*	446,457	405,364
Term borrowings	*16*	908,105	766,681
Customer deposits	*17*	8,657,591	8,394,487
Other liabilities	*18*	1,056,921	655,825
Total liabilities		**11,069,074**	**10,222,357**
Shareholders' equity			
Share capital	*19*	1,100,000	1,100,000
Statutory reserve	*19*	255,447	238,360
Special reserve	*19*	150,447	133,360
Available-for-sale revaluation reserve		(9,364)	(17,508)
Proposed dividends	*19*	68,200	-
Retained earnings		282,809	214,312
Total shareholders' equity		**1,847,539**	**1,668,524**
Total liabilities and shareholders' equity		**12,916,613**	**11,890,881**

These consolidated financial statements were approved and authorized for issue by the Board of Directors on 26 January 2011 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 12 to 66 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 6.

Consolidated statement of income

For the year ended 31 December 2010

	Note	2010 AED'000	2009 AED'000
Interest income	20	610,756	652,579
Interest expense	21	(250,650)	(325,724)
Net interest income		**360,106**	**326,855**
Net fees and commission income	22	158,215	136,571
Foreign exchange income		41,645	35,293
Income from derivatives		692	-
Other operating income	23	7,345	7,741
Operating income		**568,003**	**506,460**
Net Impairment losses	10	(205,045)	(214,285)
Income from investments	24	15,658	37,597
Net operating income		**378,616**	**329,772**
Operating expenses			
Employee benefits expense	25	(148,751)	(157,417)
Depreciation and amortisation	12,13	(16,086)	(15,939)
Other operating expenses		(42,908)	(52,099)
Total operating expenses		**(207,745)**	**(225,455)**
Profit for the year		**170,871**	**104,317**
Earnings per share (basic and diluted)	26	**AED 0.16**	**AED 0.09**

Appropriations have been reflected in consolidated statement of changes in equity.
The notes on pages 12 to 66 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 6.

Consolidated statement of comprehensive income

For the year ended 31 December 2010

	Note	2010 AED'000	2009 AED'000
Profit for the year		**170,871**	**104,317**
Other comprehensive income:			
Changes in available-for-sale investments:			
Adjustment on maturity of available-for-sale investment		-	500
Amortisation of re-classified investments		4,895	7,206
Realised gains on sale of available-for-sale investments		7,916	2,782
Revaluation of available-for-sale investments		(4,667)	(4,834)
Net change in available-for-sale investments		**8,144**	**5,654**
Total comprehensive income for the year		**179,015**	**109,971**

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Consolidated statement of cash flows

For the year ended 31 December 2010

Operating activities	*Note*	**2010 AED'000**	**2009 AED'000**
Profit for the year		**170,871**	**104,317**
Adjustments for:			
Depreciation and amortised cost		16,086	15,939
Gain on disposal of property and equipment		(12)	(86)
Net impairment losses		205,045	214,285
Realised gains on investments		(9,628)	(27,629)
Unrealised gains on investments		(6,030)	(9,968)
Directors' attendance fees		(2,200)	(2,200)
Operating profit before working capital changes		**374,132**	**294,658**
Change in due from banks		-	10,252
Change in loans and advances		(1,104,904)	1,006,639
Change in other assets		(398,206)	(155,586)
Change in due to banks		(13,116)	(3,580)
Change in customer deposits		263,104	(608,554)
Change in other liabilities		403,296	96,863
Net cash (used in) / generated from operating activities		**(475,694)**	**640,692**
Investing activities			
Purchase of property and equipment and capital work-in-progress		(7,658)	(10,084)
Proceeds from sale of property and equipment		12	87
Purchase of investments		(502,525)	(561,784)
Proceeds from sale of investments		564,186	923,755
Net cash from investing activities		**54,015**	**351,974**
Financing activities			
Change in term borrowings		141,424	2,175
Net cash from financing activities		**141,424**	**2,175**
Net (decrease) / increase in cash and cash equivalents		**(280,255)**	**994,841**
Cash and cash equivalents at beginning of the year		2,287,075	1,292,234
Cash and cash equivalents at end of the year	*27*	**2,006,820**	**2,287,075**

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Consolidated statement of changes in equity

For the year ended 31 December 2010

	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**	**Total AED'000**
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**
At 1 January 2010	1,100,000	238,360	133,360	214,312	(17,508)	-	1,668,524
Total comprehensive income for the year	-	-	-	170,871	8,144	-	179,015
Proposed dividends	-	-	-	(68,200)	-	68,200	-
Transfer to reserves	-	17,087	17,087	(34,174)	-	-	-
At 31 December 2010	**1,100,000**	**255,447**	**150,447**	**282,809**	**(9,364)**	**68,200**	**1,847,539**

The notes on pages 12 to 66 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 6.

Notes to the consolidated financial statements

For the year ended 31 December 2010

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 licence 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.

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 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.

(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 the Central Bank. Disclosures of material non public financial information are made by the Finance Department of the Group through the following mediums:

Notes (continued)

2. Disclosure policy (continued)

(b) Frequency and medium of disclosure (continued)

- 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 Central Bank. 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 2010 are as follows:

- IFRS – 9 Financial Instruments: Effective 1 January 2013;
- IAS – 24 (Revised) - Related Party Disclosures: Effective 1 January 2011;
- IAS – 32 (Amended) - Financial Instruments: Presentation: Effective 1 February 2010;
- IFRIC – 14 (Amended) - Prepayments of a Minimum Funding Requirement: Effective 1 January 2011;
- IFRIC – 19 Extinguishing Financial Liabilities with Equity Instruments: Effective 1 July 2010

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.

3. Basis of preparation (continued)

(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.

(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.

4. Significant accounting policies (continued)

(b) Financial instruments (continued)

Classification **(continued)**

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 re-classified 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.

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

4. Significant accounting policies (continued)

(b) Financial instruments (continued)

Fair value measurement principles **(continued)**

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.

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.

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 disclosure requirements of IFRS 7 Financial Instruments: Disclosures, the Group has disclosed the respective information under note 6.2.

4. Significant accounting policies (continued)

(b) Financial instruments (continued)

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 re-classified to the statement of income. In case where the available-for-sale investments with fixed maturity are re-classified 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 statement of income. 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.

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.

Notes (continued)

4. Significant accounting policies (continued)

(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.

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.

4. Significant accounting policies (continued)

(d) Key accounting estimates and judgments (continued)

Impairment losses on loans and advances and held-to-maturity and available-for-sale investments **(continued)**

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.

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 expenditure that is 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.

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 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 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 statement of income.

(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.

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

5. Financial risk management (continued)

(a) Introduction (continued)

The Group has been improving its risk management infrastructure and projects are in various stages of completion and implementation is in progress for Economic Capital and Basel II IRB approach. The Group has reinforced its management and governance structure by adopting the implementation of best practices. The Group has established a Marketing Committee to more clearly align its activities to customer needs and a Human Resources Committee to provide greater oversight in all staff related matters. In order to deepen its commitment to the community, the Bank has established a committee to pull together its efforts and seek new ways to enhance its Corporate Social Responsibility approach. In order to provide a holistic approach to manage Technology investments and align the spend to business generation and customer service, IT Steering Committee has been established. The roles and responsibilities of existing governance committees have been explained in note 5(b).

(b) Governance and 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, Marketing Committee (MC), Human Resources Committee (HRC), Corporate Social Responsibility Committee (CSRC), IT Steering Committee (ITSC), 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. It oversees and provides direction to MC, HRC, CSRC and ITSC.

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,

5. Financial risk management (continued)

(b) Governance and risk management framework (continued)

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, ORC and PC.

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 licence 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.

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.

5. Financial risk management (continued)

(b) Governance and risk management framework (continued)

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 debt 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.

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 within the 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;
- 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; and
- Remedial management and recoveries.

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.

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

Concentration risk **(continued)**

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 for any planned exposure to single counterparty / group exceeding 7 percent of the regulatory capital base and for a public sector entity / group counterparty(ies) exceeding 25 percent of the regulatory capital base. The combined exposure to these large borrowers should not exceed 800% of the regulatory capital base. The Group has adhered to these requirements.

The Group monitors concentrations of credit risk by industry, sector and geographic location. The Group has further defined portfolio caps for its specialized businesses like Marine 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.

Sector analysis

An analysis of sector concentrations of credit risk arising out of loans and advances at 31 December 2010 and 2009 is shown below:

2010	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	3,345,771	1,195,431	4,541,202	132,789	75,408	3,558	55,468	6,760
Construction	596,719	2,802,805	3,399,524	18,161	16,527	-	5,705	-
Government	155,292	6,742	162,034	-	-	-	1,896	-
Manufacturing	1,617,721	587,260	2,204,981	201,408	145,488	13,613	15,882	132
Financial institutions	676,588	208,575	885,163	108,949	82,022	8,988	866	-
Service industries	1,016,134	203,525	1,219,659	398,673	58,026	-	5,911	3,486
Real estate	821,212	-	821,212	19,971	13,400	-	1,809	-
Individuals	1,145,322	14,687	1,160,009	199,006	129,712	43	7,614	-
Gross amount	**9,374,759**	**5,019,025**	**14,393,784**	**1,078,957**	**520,583**	**26,202**	**95,151**	**10,378**

In addition to the specific provision, the Group holds AED 137.5 million (2009: AED 135.5 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)

Sector analysis (continued)

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	2,685,593	1,188,284	3,873,877	126,398	85,462	19,772	22,921	4,483
Construction	481,527	2,340,013	2,821,540	14,608	13,136	7,366	8,462	-
Government	57,619	45,946	103,565	-	-	-	-	-
Manufacturing	1,115,179	301,384	1,416,563	69,932	36,955	7,651	9,813	13,667
Financial institutions	726,008	345,544	1,071,552	111,414	83,255	-	5,183	-
Service industries	1,016,521	298,299	1,314,820	33,104	12,039	-	16,061	6,906
Real estate	882,627	-	882,627	42,810	22,517	-	740	-
Individuals	1,330,983	14,866	1,345,849	195,283	90,262	818	222	-
Gross amount	**8,296,057**	**4,534,336**	**12,830,393**	**593,549**	**343,626**	**35,607**	**63,402**	**25,056**

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 2010 and 2009 is shown below:

2010	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	8,990,604	4,837,773	13,828,377	932,922	408,820	17,215	94,418	10,378
GCC countries	335,986	75,976	411,962	146,035	111,763	-	-	-
Other	48,169	105,276	153,445	-	-	8,987	733	-
Total	**9,374,759**	**5,019,025**	**14,393,784**	**1,078,957**	**520,583**	**26,202**	**95,151**	**10,378**

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	7,834,035	4,305,853	12,139,888	445,405	242,006	35,607	57,433	24,146
GCC countries	369,227	76,261	445,488	128,555	91,825	-	4,843	910
Other	92,795	152,222	245,017	19,589	9,795	-	1,126	-
Total	**8,296,057**	**4,534,336**	**12,830,393**	**593,549**	**343,626**	**35,607**	**63,402**	**25,056**

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:

	2010			2009		
	Funded AED'000	Unfunded AED'000	Gross exposure AED'000	Funded AED'000	Unfunded AED'000	Gross exposure AED'000
AED	7,706,775	3,723,729	11,430,504	6,437,046	3,191,571	9,628,617
USD	1,126,039	982,207	2,108,246	1,331,994	1,104,926	2,436,920
EURO	21,281	181,005	202,286	117,182	116,226	233,408
GBP	-	8,005	8,005	154	5,898	6,052
XAU	442,663	-	442,663	301,501	-	301,501
Others	78,001	124,079	202,080	108,180	115,715	223,895
Total	**9,374,759**	**5,019,025**	**14,393,784**	**8,296,057**	**4,534,336**	**12,830,393**

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 agreement with the customer. 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)

Credit Quality

The credit quality of the loans and advances portfolio is managed by the Group using 22 grades internal credit ratings. The risk rating system is used as a credit risk management tool whereby any risks taken on the Group's books are rated against a set of predetermined standards which also comply with the Central Bank guidelines.

The Group's Credit Risk Rating Methodology follows the categorization of credit risk assets under the following risk classification / grading system:

Risk Grade	2010 AED'000	2009 AED'000
Neither past due nor impaired / Past due but not impaired (RR 1-19)		
Grades 1-18: Performing or normal	8,075,934	7,449,035
Grade 19: Other Loans Especially Mentioned	219,868	253,473
	8,295,802	7,702,508
Individually impaired (RR 20-22)		
Grade 20: Sub-standard	503,246	264,453
Grade 21: Doubtful	134,082	125,735
Grade 22: Loss	441,629	203,361
	1,078,957	593,549
	9,374,759	8,296,057

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

Particulars	Loans and advances 2010 AED'000	Loans and advances 2009 AED'000	Collaterals 2010 AED'000	Collaterals 2009 AED'000
Individually impaired				
Pledged deposits	57,595	54,177	11,411	15,874
Debt / Equity securities	111,428	108,249	85,399	86,410
Property	84,533	50,471	52,986	55,812
Others	825,401	380,652	20,000	20,000
Gross amount	1,078,957	593,549	169,796	178,096
Impairment loss	(520,583)	(343,626)	-	-
Carrying amount	558,374	249,923	169,796	178,096
Past due but not impaired				
Pledged deposits	53,919	26,047	16,194	9,948
Debt / Equity securities	2,000	-	1,702	-
Property	5,206	1,477	6,162	3,110
Others	44,404	60,934	-	-
Gross amount	105,529	88,458	24,058	13,058
Impairment loss	-	-	-	-
Carrying amount	105,529	88,458	24,058	13,058
Neither past due nor impaired				
Pledged deposits	2,805,014	1,662,067	876,963	713,437
Debt / Equity securities	184,938	150,771	247,936	255,152
Property	798,434	727,947	1,340,684	1,317,416
Others	4,401,887	5,073,265	-	-
Gross amount	8,190,273	7,614,050	2,465,583	2,286,005
Collective impairment provision	(137,482)	(135,596)	-	-
Carrying amount	8,052,791	7,478,454	2,465,583	2,286,005
Total	8,716,694	7,816,835	2,659,437	2,477,159
Renegotiated exposure	680,770	251,590	405,476	149,749
Contingent liabilities				
Pledged deposits	2,936,788	2,589,425	607,011	633,768
Others	2,082,237	1,944,911	145,241	27,098
Total	5,019,025	4,534,336	752,252	660,866

5. Financial risk management (continued)

(c) Credit risk (continued)

Past due but not impaired portfolio ageing is as follows:

	2010 AED'000	2009 AED'000
Less than 1 month	57,286	35,566
1 month to 3 months	37,865	27,836
3 months to 6 months	10,378	25,056
Total	**105,529**	**88,458**

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.

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. 19.13% (2009: 18.98%) 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 action planning. During the year, the advances to deposits ratio was as follows:

	2010	2009
December 31	**0.87:1**	**0.78:1**
Minimum	**0.76:1**	**0.76:1**
Average	**0.79:1**	**0.81:1**
Maximum	**0.87:1**	**0.87:1**

The advances to deposits ratio was 87.2% after absorbing a 6% drop caused by the maturity of our syndicated borrowing falling within six months. The Bank's syndicated borrowing, amounting to USD 210 million, is set to mature on 25 June 2011.

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 is prudently and proactively reviewed taking into consideration the market events and relevant risk management standards. Adherence to the longer stress period is being achieved through reliance on both higher quality and adequate level 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 the Central Bank include the certificate of deposits which are readily convertible into cash under repurchase arrangements with the Central Bank. Investments include available-for-sale investments which can be redeemed before their contractual maturity.

	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 2010							
Cash and balances with UAE Central Bank	1,027,984	276,372	351,659	552,059	-	-	2,208,074
Due from banks	167,978	25,141	-	-	-	-	193,119
Loans and advances	2,437,205	1,776,217	934,883	789,612	2,747,447	1,025,817	9,711,181
Investments	105,327	4,010	29,998	23,466	564,248	54,834	781,883
Other assets	244,588	359,121	323,061	7,982	-	-	934,752
Total assets	**3,983,082**	**2,440,861**	**1,639,601**	**1,373,119**	**3,311,695**	**1,080,651**	**13,829,009**
At 31 December 2010							
Due to banks	306,836	82,269	21,414	36,550	-	-	447,069
Term borrowings	323	3,691	767,347	1,730	151,046	-	924,137
Customer deposits	4,554,000	1,177,918	444,438	1,326,983	346,633	1,223,223	9,073,195
Other liabilities	288,525	359,121	323,061	7,982	-	-	978,689
Total liabilities	**5,149,684**	**1,622,999**	**1,556,260**	**1,373,245**	**497,679**	**1,223,223**	**11,423,090**
On Balance Sheet Gap	**(1,166,602)**	**817,862**	**83,341**	**(126)**	**2,814,016**	**(142,572)**	**2,405,919**
At 31 December 2009							
Assets	4,010,923	2,076,240	1,251,280	1,582,002	3,392,339	998,843	13,311,627
Liabilities	5,726,102	1,439,807	620,062	441,957	1,080,314	1,303,337	10,611,579
On Balance Sheet Gap	**(1,715,179)**	**636,433**	**631,218**	**1,140,045**	**2,312,025**	**(304,494)**	**2,700,048**

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. The amounts set out below do not represent expected cash flows.

	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 2010							
Off balance sheet items							
Guarantees	3,837,350	-	-	-	-	-	3,837,350
Letters of credit	188,574	633,787	312,798	46,516	-	-	1,181,675
Forward foreign exchange contracts	1,144,535	536,659	301,538	113,262	-	-	2,095,994
Currency options	-	4,870	173,240	330,064	82,998	-	591,172
Interest rate swaps	278	73,750	833	1,667	369,800	-	446,328
	5,170,737	**1,249,066**	**788,409**	**491,509**	**452,798**	**-**	**8,152,519**
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**

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:

	2010		2009	
	Positive fair value AED'000	Negative fair value AED'000	Positive fair value AED'000	Negative fair value AED'000
Derivatives				
Forward foreign exchange contracts	18,391	17,464	18,374	18,698
Currency options	8,320	8,320	4,209	4,209
Interest rate swaps	7,427	8,582	-	10,820
	34,138	**34,366**	**22,583**	**33,727**

(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. 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 15% is followed unless ALCO believes a different level is appropriate, when Board approval is obtained.

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 2010 and 2009:

	Assumed level of change %	Impact on net income 2010 AED'000	Impact on net income 2009 AED'000
Investments carried at fair value through the income statement			
Reference benchmarks:			
Quoted debt securities	10%	-	9,679
Net asset value of managed funds	10%	4,162	5,660

	Assumed level of change %	Impact on equity 2010 AED'000	Impact on equity 2009 AED'000
Available-for-sale investments			
Reference benchmarks:			
Quoted debt securities	10%	34,757	26,458
Investments in listed equity	10%	69	-

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 and RC 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.

Notes (continued)

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			
2010 (AED in 000's)	160,010	377	6,312
2009 (AED in 000's)	46,365	230	3,060
Assumed change in exchange rates	5%	5%	5%
Impact on exchange income from increase in exchange rates:			
2010 (AED in 000's)	8,001	19	316
2009 (AED in 000's)	2,318	12	153
Impact on exchange income from decrease in exchange rates:			
2010 (AED in 000's)	(8,001)	(19)	(316)
2009 (AED in 000's)	(2,318)	(12)	(153)

At 31 December 2010, the impact on exchange income due to change in exchange rate by 5% is ±20% (2009: ±7%). Excluding the impact of US$ open position, the impact is ±0.8% (2009: ±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 instruments 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 5.62% (2009: 6.32%) 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:					
2010 (AED in 000's)	27,000	(1,000)	-	2,000	28,000
2009 (AED in 000's)	14,000	1,000	-	2,000	17,000
Impact on net interest income from decrease in interest rates:					
2010 (AED in 000's)	(11,000)	(2,000)	-	(10,000)	(23,000)
2009 (AED in 000's)	3,000	(10,000)	(1,000)	(3,000)	(11,000)

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 total shareholders' equity is followed as a trigger event based on which action plan is agreed. At 31 December 2010, the impact of 200 bps shift analysis on net interest is +7.8% / -6.4% (2009: +5.2% / -3.4%) and regulatory capital is 1.05% / -0.87% (2009: 0.68% / -0.44%).

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:

At 31 December 2010	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
Cash and balances with UAE Central Bank	725,000	275,000	350,000	550,000	-	-	302,366	2,202,366
Due from banks	103,637	25,000	-	-	-	-	64,339	192,976
Loans and advances	2,836,127	4,366,900	467,517	140,085	307,846	543,315	54,904	8,716,694
Investments	179,301	276,889	179,861	-	-	-	42,311	678,362
Other assets	-	-	-	-	-	-	1,007,660	1,007,660
Total assets	**3,844,065**	**4,943,789**	**997,378**	**690,085**	**307,846**	**543,315**	**1,471,580**	**12,798,058**
Due to banks	292,759	81,979	21,407	36,528	-	-	13,784	446,457
Term borrowings	55,095	853,010	-	-	-	-	-	908,105
Customers' deposits	2,891,376	1,666,484	431,298	1,280,246	667,017	-	1,721,170	8,657,591
Other liabilities	-	-	-	-	-	-	1,026,412	1,026,412
Total liabilities	**3,239,230**	**2,601,473**	**452,705**	**1,316,774**	**667,017**	**-**	**2,761,366**	**11,038,565**
Interest rate sensitivity gap								
On-balance sheet	604,835	2,342,316	544,673	(626,689)	(359,171)	543,315	(1,289,786)	
Off-balance sheet	278	73,750	184,484	1,666	186,150	-	-	
Cumulative	**605,113**	**3,021,179**	**3,750,336**	**3,125,313**	**2,952,292**	**3,495,607**	**2,205,821**	
At 31 December 2009								
Cumulative interest rate sensitivity gap	321,220	1,805,754	2,378,100	2,965,447	2,629,662	2,880,877	1,717,524	

Interest rate yields

The average earning on placements and balances with banks was 0.78% (2009: 0.81%), on loans and advances was 6.44% (2009: 6.89%) and on investments was 3.40% (2009: 3.88%). The average cost of customer deposits was 2.67% (2009: 3.27%) and of bank borrowings (inclusive of syndicated borrowings) was 1.51% (2009: 3.00%).

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 and Operational Risk and Compliance. The results of 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 2009, 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 Group is developing and implementing economic capital model to comply with the Central Bank requirements.

Notes (continued)

5. Financial risk management (continued)

(g) Management of capital (continued)

Pursuant to the Central Bank guidelines, the Central Bank has increased the capital adequacy ratio required to be maintained by Banks to 11% analysed in two tiers, of which Tier 1 capital adequacy ratio must not be less than 7% by 30 September 2009 and 12 % analysed in two tiers, of which Tier 1 capital adequacy ratio 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, market and operational risks (2009: 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
  - Collective impairment provision shall not exceed 1.25% of total risk weighted assets.

	AED'000 31 Dec 2010	AED'000 31 Dec 2009
Tier 1 Capital		
Share capital	1,100,000	1,100,000
Statutory reserve	238,360	227,929
Special reserve	133,360	122,929
Retained earnings	214,312	141,264
Total Tier 1	**1,686,032**	**1,592,122**
Tier 2 Capital		
Available-for-sale revaluation reserve	(9,364)	(17,508)
Subordinated facilities (note 17.2 & 17.3)	843,016	796,061
Collective impairment provision	137,482	135,596
Total Tier 2	**971,134**	**914,149**
Deductions from Tier 1 and Tier 2 Capital		
Investments in unconsolidated subsidiaries	-	-
Total capital base (a)	**2,657,166**	**2,506,271**

Notes (continued)

5. Financial risk management (continued)

(g) Management of capital (continued)

Risk weighted assets

	31 Dec 2010 Risk weighted equivalent AED'000	31 Dec 2009 Risk weighted equivalent AED'000
Credit risk	11,768,098	10,430,736
Market risk	5,166	47,121
Operational risk	646,334	733,235
Total risk weighted assets (b)	12,419,598	11,211,092
Capital adequacy ratio (a) / (b) - %	21.39	22.36
Capital adequacy ratio (Basel I)	22.63	24.16

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.

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

2010	On balance sheet Gross outstanding	Off balance sheet Net exposure after CCF	Credit risk mitigation (CRM)			Risk weighted assets
			Exposure before CRM	CRM	After CRM	
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Claims on sovereigns	2,407,781	2,410	2,410,191	-	2,410,191	-
Claims on public sector entities	897,459	104,714	1,002,173	2,575	999,598	971,576
Claims on banks	920,611	198,859	1,119,470	-	1,119,470	493,430
Claims on corporates	5,423,538	3,485,589	8,909,127	1,151,587	7,757,540	7,744,704
Regulatory retail exposures	954,995	11,612	966,607	72,705	893,902	893,902
Residential retail portfolio	341,644	-	341,644	14,833	326,811	326,811
Commercial real estate	441,131	-	441,131	-	441,131	441,131
Past due exposures	1,179,011	7,850	596,150	66,893	529,257	698,397
Higher-risk categories	42,312	-	42,312	-	42,312	63,468
Other exposures	210,489	-	210,489	-	210,489	134,679
Total	**12,818,971**	**3,811,034**	**16,039,294**	**1,308,593**	**14,730,701**	**11,768,098**

Notes (continued)

5. Financial risk management (continued)

(g) Management of capital (continued)

Credit risk and risk weights (continued)

2009	On balance sheet Gross outstanding	Off balance sheet Net exposure after CCF	Credit risk mitigation (CRM) 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)

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:

	2010	2009
	AED'000	AED'000
Interest rate risk		
- Specific interest rate risk	-	-
- General interest rate risk	-	-
Equity position risk	-	-
Foreign exchange risk	517	4,712
Option risk	-	-
Total market risk capital charge	**517**	**4,712**
Market risk - risk weighted assets	**5,166**	**47,121**

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 (2009: 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 Standardized Approach. The total capital charge is calculated by multiplying the specified eight business line's three (3) - year average net interest and net non-interest income by a percentage (beta) assigned to each of the business lines. The beta factors range from 12% to 18%, as specified in the Basel II Accord. (2009: 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.)

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:

2010	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	-	-	-	-	2,202,366	2,202,366
Due from banks	-	-	-	-	192,976	192,976
Loans and advances	-	-	-	8,716,694	-	8,716,694
Investments	41,621	348,263	288,478	-	-	678,362
Other assets	-	-	-	-	1,007,660	1,007,660
Total assets	**41,621**	**348,263**	**288,478**	**8,716,694**	**3,403,002**	**12,798,058**
Liabilities						
Due to banks	-	-	-	-	446,457	446,457
Term borrowings	-	-	-	-	908,105	908,105
Customer deposits	73,195	-	-	-	8,584,396	8,657,591
Other liabilities	-	-	-	-	1,026,412	1,026,412
Total liabilities	**73,195**	**-**	**-**	**-**	**10,965,370**	**11,038,565**

6. Financial assets and liabilities (continued)

6.1 Classification (continued)

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**

6. Financial assets and liabilities (continued)

6.2 Fair value measurement – fair value hierarchy:

2010	Level 1 AED'000	Level 2 AED'000	Level 3 AED'000
On balance sheet items			
Investments			
- Debt securities	347,573	-	-
- Other investments	690	41,621	-
Customer deposits	-	73,195	-
Off balance sheet items - derivatives			
Forward foreign exchange contracts	-	2,095,994	-
Currency options	-	591,172	-
Interest rate swaps	-	446,328	-

2009	Level 1 AED'000	Level 2 AED'000	Level 3 AED'000
On balance sheet items			
Investments			
- Debt securities	361,370	-	-
- Other investments	3,647	52,955	-
Customer deposits	-	153,422	-
Off balance sheet items - derivatives			
Forward foreign exchange contracts	-	3,167,059	-
Currency options	-	418,534	-
Interest rate swaps	-	153,422	-

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.

7. Cash and balances with UAE Central Bank

	2010 AED'000	2009 AED'000
Cash on hand	75,866	72,366
Certificates of deposit with Central Bank of UAE (note 7.1)	1,900,000	1,900,000
Other balances with UAE Central Bank	226,500	373,058
	2,202,366	**2,345,424**

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

8. Due from banks

	2010 AED'000	2009 AED'000
By geographical area		
Within UAE	56,988	137,664
GCC countries	61,903	1,987
Others	74,085	136,313
	192,976	**275,964**

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

	2010 AED'000	2009 AED'000
AED	32,637	82,570
USD	29,867	133,644
EURO	93,790	23,368
GBP	4,822	19,951
Others	31,860	16,431
	192,976	**275,964**

9. Loans and advances

9.1 Loans and advances by type

	2010 AED'000	2009 AED'000
Overdrafts	1,281,624	1,153,397
Term loans	5,635,922	5,222,982
Loans against trust receipts	1,130,484	926,769
Bills discounted	805,877	536,010
Bills drawn under letters of credit	520,852	456,899
	9,374,759	8,296,057
Allowance for impairment losses (note 10)	(658,065)	(479,222)
Net loans and advances	**8,716,694**	**7,816,835**

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	2010 AED'000	2009 AED'000
- Letters of credit covering movement of goods	1,181,675	966,461
- Financial guarantees and other direct credit substitutes	331,695	372,182
- Bid bonds, performance bonds and other transaction related contingencies	3,505,655	3,195,693
	5,019,025	**4,534,336**

Commitments	2010 AED'000	2009 AED'000
- Undrawn commitments - credit related	7,633,211	6,815,277
- Others	9,928	8,803

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	2010 AED'000	2009 AED'000
Balance at 1 January	479,222	298,630
Provided during the year	238,955	252,734
Released during the year	(33,910)	(38,449)
Net allowance for impairment losses	205,045	214,285
Written-off during the year	(26,202)	(33,693)
Balance at 31 December	**658,065**	**479,222**

11. Investments

	2010 AED'000	2009 AED'000
Investments at fair value through profit or loss (FVPL)		
Designated:		
Debt securities (note 11.1)	-	96,787
Other investments (note 11.2)	41,621	56,602
	41,621	153,389
Available-for-sale (AFS)		
Debt securities (note 11.1)	347,573	264,583
Other investments	690	-
	348,263	264,583
Held-to-maturity (HTM)		
Debt securities (note 11.1)	288,478	298,249
	678,362	**716,221**

11.1 **Debt securities** represent the Group's investments in bonds and notes. These include floating rate securities amounting to **AED 585 million** (2009: AED 570 million). These securities are quoted on internationally recognised platforms of Reuter and Bloomberg and are liquid in normal market conditions.

11.2 **Other investments** include various international funds and funds with no fixed maturities and coupon rates. The fair values of these investments are based on the net asset values provided by the fund managers. These also comprise investments in private equity and funds invested in an insurance bond previously maintained in a discretionary trust.

11. Investments (continued)

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

	2010 AED'000	2009 AED'000
Government	87,010	99,966
Banks and financial institutions	433,102	489,906
Others	158,250	126,349
	678,362	**716,221**

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

2010

	Debt securities AED'000	Other investments AED'000	Total AED'000
AAA	-	-	-
AA+	-	-	-
AA	-	-	-
AA-	189,858	-	189,858
A+	186,689	-	186,689
A	135,828	-	135,828
A-	32,351	-	32,351
BBB+	7,139	-	7,139
BBB	-	-	-
BBB-	43,580	-	43,580
BB	-	690	690
Unrated	40,606	41,621	82,227
	636,051	**42,311**	**678,362**

11. Investments (continued)

2009

	Debt securities 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
BBB-	-	-	-
BB+	-	3,647	3,647
Unrated	42,112	52,955	95,067
	659,619	**56,602**	**716,221**

Notes (continued)

11. Investments (continued)

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

	2010 AED'000	2009 AED'000
Within UAE	528,929	580,682
GCC Countries	57,360	46,405
Others	92,073	89,134
	678,362	**716,221**

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

	2010 AED'000	2009 AED'000
AED	485,079	517,932
USD	142,833	162,111
EURO	33,622	29,679
GBP	16,828	6,499
	678,362	**716,221**

11.7 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 re-classified investments amounting to AED 268 million, being the fair value as at 1 July 2008, from the fair value through profit or loss classification to the available-for-sale investments category. As there was no trading in the re-classified investments, 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, had the investment not been re-classified, the impact would be as follows:

	2010 AED'000	2009 AED'000
After reclassification		
Unrealised fair value gain / (loss) recognised in cumulative changes in fair values	**12,000**	**(7,635)**

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 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
At 1 January 2010	14,066	98,631	45,483	158,180
Additions	-	3,730	3,000	6,730
Disposals	-	-	(91)	(91)
At 31 December 2010	14,066	102,361	48,392	164,819
Depreciation				
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
At 1 January 2010	-	36,620	31,124	67,744
Charge for the year	-	3,514	7,423	10,937
On disposals	-	-	(91)	(91)
At 31 December 2010	-	40,134	38,456	78,590
Net book value				
At 31 December 2010	**14,066**	**62,227**	**9,936**	**86,229**
At 31 December 2009	**14,066**	**62,011**	**14,359**	**90,436**

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 (2009: AED 1 each).

Notes (continued)

13. Intangible assets

	2010 AED'000	2009 AED'000
Cost		
At 1 January	26,854	26,854
Additions	-	-
At 31 December	26,854	26,854
Amortisation		
At 1 January	12,695	7,429
Charge for the year	5,149	5,266
At 31 December	17,844	12,695
Net book value	**9,010**	**14,159**

The cost of intangible assets comprises the cost of purchase of the Group's new core banking software, licence 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

	2010 AED'000	2009 AED'000
Tangible assets		
Premises and equipment (note 14.1)	1,165	378
Intangible assets (note 14.2)	844	703
	2,009	**1,081**

14.1 Premises and equipment costs were incurred in respect of refurbishment of the Group's building in Sharjah (2009: costs incurred in respect of refurbishment of the Group's building in Fujairah).

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

	2010 AED'000	2009 AED'000
Accrued interest	72,908	63,892
Prepayments and deposits	7,022	4,111
Customer liabilities for acceptances	918,407	538,507
Others	30,630	24,251
	1,028,967	**630,761**

Notes (continued)

16. Due to banks and term borrowings

	2010 AED'000	2009 AED'000
By type:		
Syndicated and bilateral borrowings from banks (note 16.1)	908,105	766,681
Short-term borrowings	446,457	405,364
	1,354,562	**1,172,045**
By geographical area:		
Within UAE	98,258	91,836
GCC Countries	2	19,002
Others	1,256,302	1,061,207
	1,354,562	**1,172,045**

16.1 On 31 July 2008, the Group arranged a term loan facility of AED 761.2 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. During the year, the Group arranged term loan facilities through banks amounting to AED 146.9 million. The facilities carry floating rate which is the aggregate of margin and LIBOR. As per the terms of the agreements, the tenure of the facilities extends to 2 years after the disbursement date.

17. Customer deposits

	2010 AED'000	2009 AED'000
By type:		
Demand and margin deposits	1,680,503	1,649,337
Saving deposits	38,103	34,915
Fixed term and notice deposits (note 17.1, 17.2 & 17.3)	6,938,985	6,710,235
	8,657,591	**8,394,487**
By geographical area:		
Within UAE	8,144,332	7,954,899
Others	513,259	439,588
	8,657,591	**8,394,487**

17.1 Fixed term and notice deposits include structured deposit notes which are fair valued through statement of income amounting to AED 73 million (31 December 2009: AED 153 million), being the fair value as at 31 December 2010.

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

	2010 AED'000	2009 AED'000
Accrued interest	47,723	30,919
Employee terminal and other long term benefits	20,182	19,073
Accrued expenses	29,297	22,583
Directors' attendance fees	2,200	2,200
Liabilities under acceptances	918,407	538,507
Others	39,112	42,543
	1,056,921	**655,825**

19. Shareholders' equity

19.1 Share capital

	2010 AED'000	2009 AED'000
Authorised, issued and fully paid: 1,100,000,000 shares of AED 1 each (2009: 1,100,000,000 shares of AED 1 each)	**1,100,000**	**1,100,000**

The Board of Directors proposed a cash dividend of 6.2% (2009: nil) of the share capital for the year ended December 31, 2010.

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

	2010 AED'000	2009 AED'000
Loans and advances	571,883	604,972
Due from banks	17,477	18,066
Investments	21,396	29,541
	610,756	**652,579**

21. Interest expense

	2010 AED'000	2009 AED'000
Due to banks	19,523	54,800
Customer deposits	231,127	270,924
	250,650	**325,724**

22. Net fees and commission income

	2010 AED'000	2009 AED'000
Fees and commission income		
Letters of credit	58,034	40,573
Letters of guarantee	38,576	33,163
Lending fees	50,609	47,046
Asset management and investment services	531	2,331
Commission on transfers	12,094	14,315
Others	708	1,194
Total fees and commission income	**160,552**	**138,622**
Fees and commission expense		
Brokerage expense	241	231
Card related charges	2,083	1,759
Other commission	13	61
Total fees and commission expense	**2,337**	**2,051**
Net fees and commission income	**158,215**	**136,571**

23. Other operating income

	2010 AED'000	2009 AED'000
Rental income	2,026	3,906
Rebates	3,078	2,966
Other miscellaneous income	2,241	869
	7,345	**7,741**

24. Income from investments

	2010 AED'000	2009 AED'000
Realised / unrealised gains in fair value through profit or loss	15,606	37,539
Dividend income	52	58
	15,658	**37,597**

25. Employee benefits expense

Employee benefits expense includes employee bonus of AED 13,798 thousand (2009: AED 12,265 thousand). The number of employees at 31 December 2010 was 539 (including 508 relating to the Bank) of which 189 (relating to the Bank) were UAE nationals (2009: 513 (including 482 relating to the Bank) of which 170 (relating to the Bank) were UAE nationals).

26. Earnings per share

The calculation of earnings per share is based on earnings of AED 170,871 thousand (2009: AED 104,317 thousand) divided by the weighted average number of shares of 1,100,000 thousand (2009: 1,100,000 thousand 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:

	2010 AED'000	2009 AED'000
Cash on hand	75,866	72,366
Balances with Central Bank of UAE	2,126,500	2,273,058
Due from banks with less than three months maturity	192,976	275,964
	2,395,342	2,621,388
Due to banks with less than three months maturity	(388,522)	(334,313)
	2,006,820	**2,287,075**

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 2010 AED'000	Average balances during 2010 AED'000	31 December 2009 AED'000	Average balances during 2009 AED'000
Statement of financial position items				
Loans and advances	463,903	385,759	333,965	309,529
Customer deposits	1,923,423	1,890,388	1,835,822	1,869,138
Letters of credit	76,037	139,085	113,562	108,188
Acceptances and other direct credit substitutes	18,601	19,349	23,443	20,768
Transaction related contingencies	132,093	120,072	112,720	131,181
Statement of income items				
Interest income	25,096		19,290	
Interest expense	67,049		81,195	
Other income	6,866		6,601	
Key management compensation				
Salaries and other short-term benefits	12,990		12,891	
Employee terminal and other long-term benefits	295		451	
Directors' attendance fees	2,200		2,200	

No provisions for impairment have been recognized in respect of loans given to related parties (2009: Nil).

The loans given to related parties amounting to AED 463.903 million (2009: AED 333.965 million) have been secured against collateral amounting to AED 84.356 million (2009: AED 90.791 million).

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.

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.

29. Segmental reporting (continued)

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

2010	Wholesale banking AED'000	Consumer banking AED'000	Treasury and investments AED'000	Head office and others AED'000	Consolidated AED'000
Segment revenue	497,779	56,583	26,187	3,112	583,661
Segment operating cost	(171,344)	(25,302)	(11,099)	-	(207,745)
Impairment losses	(182,406)	(22,639)	-	-	(205,045)
Profit	144,029	8,642	15,088	3,112	170,871
Segment assets	9,147,411	588,236	3,083,718	97,248	12,916,613
Segment liabilities	8,474,948	391,931	2,195,896	6,299	11,069,074
Capital expenditure	-	-	-	6,730	6,730

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	(176,177)	(39,376)	(9,902)	-	(225,455)
Impairment losses	(196,970)	(17,315)	-	-	(214,285)
Profit / (loss)	80,621	10,075	(11,426)	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

Notes (continued)

29. Segmental reporting (continued)

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

Revenues derived by products and services	2010 AED'000	2009 AED'000
Interest income on loans and advances		
Overdrafts	77,962	75,529
Term loans	300,659	329,654
Loans against trust receipts	90,085	85,835
Bills discounted	56,357	69,302
Bills drawn under letters of credit	46,820	44,652
	571,883	**604,972**

Fees and commission income		
Letters of credit	58,034	40,573
Letters of guarantee	38,576	33,163
Lending fees	50,609	47,046
Asset management and investment services	531	2,331
Commission on transfers	12,094	14,315
Others	708	1,194
	160,552	**138,622**

30. Comparative figures

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