2011
ANNUAL REPORT

بنك الفجيرة الوطني
National Bank of Fujairah


nbf
Wherever you see your business going,
NBF can help you get there.
Take your business further with a partner who understands
the market and knows your needs.
As the UAE's business partner of choice for thirty years,
it just makes good business sense to bank on the
National Bank of Fujairah.
In good hands
www.nbf.ae

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

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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
Al Ain

Chairman's Report

On behalf of the Board of Directors, I am pleased to present the Annual Report for the National Bank of Fujairah PSC and its subsidiary for the year ended 31 December 2011.

Strong earnings despite market uncertainty

The Bank has achieved an improvement in operating performance and outperformed the industry for the second consecutive year. Our loan book grew by 20.5%, outpacing the industry average. This is despite the environment of subdued credit demand, perpetuated by tumultuous global financial markets.

Operating income grew by 14.1% to AED 648.3 million. Operating profit stood at AED 394.3 million in 2011, up from 375.9 million in 2010. A strong focus on core business enabled the Bank to grow its profit by a solid 64.4% to AED 280.9 million, up from AED 170.9 million.

Loan losses provision was reduced to AED 113.3 million compared to AED 205.0 million. This improvement has been possible and is a result of the Bank's strategy to be prudent and proactive in provisioning for potential loan losses early in the economic cycle. NBF remained well-capitalised with a capital adequacy ratio of 20.3% and Tier 1 ratio of 12.8% and liquid with advances to deposits ratio of 84.8%.

The Bank's positive performance is testament to its well-balanced strategy and prudent policies during these challenging times. It also underscores the deep business relationships that the Bank has established over the years and the high levels of trust and confidence that clients have placed on us.

On behalf of the Directors, I am pleased to recommend a distribution of profits, in lieu of cash dividends, of 10% of the paid up capital.

Leveraging further opportunities in the UAE

We believe that good business opportunities continue to exist across the UAE and will continue to leverage them for further growth. Backed by strong liquidity and prudent policies, we will continue to improve our market position by service differentiation and an enhanced product focus. We continue to develop our successful retail proposition in the Fujairah Region and expand it to encompass the other Emirates. We will continue to invest in technology and enhance our operational capabilities, accessibility and service proposition so as to better align the Bank to customer needs and achieve growth in line with shareholder expectations.

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, management and staff of the Bank for their hard work and commitment.

Last but not least, I would like to take this opportunity to thank the Bank's customers for their unwavering support throughout the years and assure them of our commitment to their success.

Saleh Bin Mohammed Al Sharqi

Business Overview

Operating Environment

2011 saw a resurgence of uncertainty in the global economic landscape due to the US Downgrade and deteriorating Eurozone crisis. Business confidence has been impacted and customers and investors, witnessing significant volatility in the prices of equities, debt and commodities, remain cautious.

Growth rates are forecast to fall across the globe. A number of international banks have been downgraded due to their need for re-capitalisation, while governments display limited ability to support domestic financial sectors due to their own fiscal imbalances.

Even though the UAE and Middle East region have yet to experience a direct impact, deteriorating conditions in regional financial markets remain a key risk and further stress might be experienced in the local credit environment.

The UAE's GDP is projected to show moderate growth; while the Arab Spring has undoubtedly bolstered the country's reputation as a regional "safe haven", the UAE's dependence on oil export revenues and trade, services, logistics and tourism industries inevitably creates some vulnerability to a weakening global economy.

Fujairah: Growing in Stature

Despite the uncertain global markets, Fujairah's economy is growing apace as it builds on its status as the World's second largest fuel bunkering hub to become a leading center for oil and petrochemicals trading, refining, storage and other marine industry activities.

The Port of Fujairah is poised to increase its number of warehouses from 125 to 250, with total fuel storage capacity expanding from three to eight million cubic metres. This goes hand-in-hand with infrastructure projects that will significantly enhance Fujairah's stature as an economic powerhouse, ranging from the newly-completed Dubai-Fujairah highway and the upcoming Etihad Rail network, to a $3.3 billion oil pipeline and a power and water treatment plant projected to be the biggest in the UAE.

The retail and services sectors have also flourished. The Al Aqah Resort continues to be a popular tourist destination. Carrefour has opened its first store, while established car brands like Nissan, Volkswagen, Audi and Porsche all have established local service points. In 2012, the retail scene is slated to add another jewel to its crown with the launch of the Fujairah City Centre Mall. Other projects also in the pipeline include; gas projects that would revolutionise the manufacturing industry, plans to develop the Al Hayl Free Zone and the Fujairah Airport, and 32 new factories due to come on stream over the next three years.

Born and bred in Fujairah and committed to the future of the UAE, NBF is well-positioned to play a critical role in the Emirate's economic transformation.

Financial Results

NBF's performance reflects its underlying strength and resilience during these challenging times. The Bank leveraged its strong liquidity and capital positions by growing its business prudently and efficiently in the local economy.

NBF recorded a profit of AED 280.9 million for the year, up 64.4% compared to AED 170.9 million for 2010. The provision for loan losses was AED 113.3 million for the year compared to AED 205.0 million. The non-performing loans and advances (NPL) ratio of the Bank was 5.0%, lower than the 7.6% in 2010. Specific provision coverage was 73.0% as of 31 December 2011 (2010: 68.3%), and improved to 96.8% after taking into account the value of collateral held with the respective hair-cuts. Our NPL ratio stood at 10.9% including the exposure to Dubai Government Related Entities (GREs), down from 11.5% in 2010.

Operating income increased by 14.1% to AED 648.3 million compared to AED 568.0 million for 2010, reflecting strong core business performance and asset and liability management. Net interest income grew 18.4% to AED 426.5 million compared to AED 360.1 million. Non-interest income, at AED 221.8 million, was 6.7% higher than the AED 207.9 million in 2010, showing an increase primarily in trade business and credit growth. Exchange income, including derivative income, grew 18.1% to a record high of AED 50.0 million. Operating expenses were AED 256.5 million and the cost to income ratio stood at 39.4% (2010: 35.6%) which reflects investment in new growth initiatives.

A gain on investment income of AED 2.5 million was recognised compared to AED 15.7 million for the corresponding period of 2010. The scaling back of the Bank's investment portfolio is in line with the Bank's strategy to reduce exposure to market risk and concentrate on its core business.

The lending growth of 20.5% and deposit growth of 19.4% reflected the strength of the Bank's customer relationships and its commitment to the development of the UAE economy. Total assets grew by 15.5% to AED 14.9 billion from AED 12.9 billion at end 2010. The return on average equity rose from 9.7% to 14.4%, and return on average assets rose from 1.4% to 2.0%.

The Bank's financial stability is underpinned by its strong liquidity and capital adequacy ratios, while a focus on building up provisioning levels has enabled it to face uncertain credit conditions with confidence. 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 NBF is well-positioned to grow in the coming years by maintaining an unwavering focus on customer service and product development, asset and liability best practices and prudent risk management.

Wholesale Banking

NBF's Wholesale Banking segment comprises Corporate, Commercial and Financial Institution businesses and represents 89.1% of the Bank's operating income. The segment recorded a strong growth of 16.4% in operating income to AED 579.5 million, up from AED 497.8 million in 2010. Growth in segment assets outpaced the industry average at AED 10,957.7 million, which was 19.8% higher than 2010's AED 9,147.4 million.

The Bank's Corporate Banking business grew its operating income by 17.2% while Commercial Banking, comprising of small and medium-sized businesses, grew its operating income by 16.9%.

Such results reflect the Bank's renewed focus on segmenting its client base for enhanced marketing efforts, a continuous dedication to customer service and relationship management, and last but not the least, the strong confidence that customers have in NBF.

Consumer Banking

NBF has a long established retail presence in the Fujairah Region and is now expanding this offering across the UAE in line with the Bank's diversification strategy. A dedicated team has been tasked with developing innovative solutions catering to changing consumer needs and a number of products were successfully launched in 2011. Operating income from this segment increased by 3.6% despite the impact of new Central Bank regulations on volumes and fee income.

Treasury and Asset and Liability Management (ALM)

Our Treasury business marked another year of strong growth with an 18.1% increase in foreign exchange income to a record high of AED 50.0 million. Larger business volumes and increasingly sophisticated derivative transactions demonstrate the increasing importance of our Treasury offering to the Bank's overall product suite. NBF's sharper focus on asset and liability management during the year also resulted in a strong net interest growth of 18.4%.

Corporate Governance

Strong corporate governance remains at the heart of our business. The Board of Directors comprises eight members who were re-appointed on 27 March 2011 for a term of three years, and have met nine times in 2011 to fulfill its duties and responsibilities.

The Board plays a key role in the approval and oversight of the organisation's strategy, directional policies, senior appointments and supervision and remuneration of senior executives. It also ensures the accountability 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. As part of its commitment to constantly benchmark itself to international standards, the Board organised a corporate governance seminar by Nestor Advisor Limited during the year to review best practices. It has also established three committees in addition to the Executive Committee to increase oversight of the Bank's activities: Board Risk Committee, Board Audit Committee and Board Nomination and Remuneration Committee. All committees report to the Board.

People

NBF's achievements would not have been possible without the hard work and dedication of its people, and the Bank is committed to providing a stimulating work environment that provides ample opportunities for development and due recognition for success.

To foster a communicative and performance-based culture that embraces trust, transparency, fairness and positive change, the Bank has introduced initiatives such as management and teambuilding off sites, employee town halls, an annual staff satisfaction survey and a 360 degree feedback survey for senior management.

The Bank is also increasing its investment in training and development, and has taken steps to ensure that training days per staff have been improved to seven days or more. Equally important is the adoption of Hay Job Evaluation Methodology in 2011 and continuing benchmarking of staff remuneration in line with the Hay Survey, which serves as a foundation for NBF's commitment towards rewarding its people fairly and progressively, commensurate with its performance.

The Bank's Emiratisation ratio currently stands at 40.4%, up from 37.2% in 2010 and well above the industry average. As part of the Bank's commitment to Emiratisation and the development of banking talent in the UAE, the Bank is in the final stages of launching a career advancement programme for existing UAE nationals to develop them for higher roles. It will also build on the success of its inaugural management trainee programme; launched in October 2010 with 24 graduates who have since taken on permanent roles, a second batch of 16 UAE Nationals have enrolled in the programme in 2011.

Corporate Social Responsibility (CSR)

The Bank continues to invest in the communities from whence it operates. A strategic framework to better organise the Bank's CSR efforts was developed and approved by the Board in 2011. Meanwhile, the Bank continues to play its part by supporting initiatives such as the Terry Fox Run, Earth Hour and making donations to the Dibba Municipality and Hospital and the UAE Ministry of Culture.

Sir Easa Saleh Al Gurg, KCVO, CBE
Deputy Chairman

Independent Auditors' Report

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 2011, 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 2011, 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 Bank 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 Bank and the contents of the Chairman's report which relate to these consolidated financial statements are in agreement with the Bank'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 2011, which may have had a material adverse effect on the business of the Bank or its financial position.

KPMG
Vijendranath Malhotra
Registration No: 48 B
Dated: 23 January 2012

Consolidated statement of financial position

As at 31 December 2011

	Note	2011 AED'000	2010 AED'000
Assets			
Cash and balances with UAE Central Bank	7	2,103,840	2,202,366
Due from banks	8	614,091	192,976
Loans and advances	9	10,505,260	8,716,694
Investments	11	583,898	678,362
Property and equipment	12	82,230	86,229
Intangible assets	13	3,861	9,010
Capital work-in-progress	14	4,820	2,009
Other assets	15	1,015,364	1,028,967
Total assets		**14,913,364**	**12,916,613**
Liabilities			
Due to banks	16	540,212	446,457
Term borrowings	16	918,250	908,105
Customer deposits	17	10,338,580	8,657,591
Other liabilities	18	1,055,135	1,056,921
Total liabilities		**12,852,177**	**11,069,074**
Shareholders' equity			
Share capital	19	1,100,000	1,100,000
Statutory reserve	19	283,539	255,447
Special reserve	19	178,539	150,447
Available-for-sale revaluation reserve		(8,441)	(9,364)
Proposed dividends	19	110,000	68,200
Retained earnings		397,550	282,809
Total shareholders' equity		**2,061,187**	**1,847,539**
Total liabilities and shareholders' equity		**14,913,364**	**12,916,613**

These consolidated financial statements were approved and authorized for issue by the Board of Directors on 23 January 2012 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 63 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 2011

	Note	2011 AED'000	2010 AED'000
Interest income	20	**664,713**	610,756
Interest expense	21	**(238,179)**	(250,650)
Net interest income		**426,534**	**360,106**
Net fees and commission income	22	**163,562**	158,215
Foreign exchange and derivatives income		**50,015**	42,337
Other operating income	23	**8,179**	7,345
Operating income		**648,290**	**568,003**
Net impairment losses	10	**(113,329)**	(205,045)
Income from investments	24	**2,461**	15,658
Net operating income		**537,422**	**378,616**
Operating expenses			
Employee benefits expense	25	**(182,790)**	(148,751)
Depreciation and amortization	12, 13	**(16,528)**	(16,086)
Other operating expenses		**(57,179)**	(42,908)
Total operating expenses		**(256,497)**	**(207,745)**
Profit for the year		**280,925**	**170,871**
Earnings per share (basic and diluted)	26	**AED 0.26**	**AED 0.16**

Appropriations have been reflected in consolidated statement of changes in equity.
The notes on pages 12 to 63 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 2011

	Note	2011 AED'000	2010 AED'000
Profit for the year		**280,925**	**170,871**
Other comprehensive income:			
Changes in available-for-sale investments:			
Amortization of reclassified investments		4,895	4,895
Realised gains on sale of available-for-sale investments		(5,274)	(7,916)
Revaluation of available-for-sale investments		1,302	11,165
Net change in available-for-sale-investments		**923**	**8,144**
Total comprehensive income for the year		**281,848**	**179,015**

The notes on pages 12 to 63 form an integral part of these consolidated financial statements.

The report of the independent auditors is set out on page 6.

Consolidated statement of cash flows

For the year ended 31 December 2011

Operating activities		**2011**	**2010**
	Note	**AED'000**	**AED'000**
Profit for the year		**280,925**	**170,871**
Adjustments for :			
Depreciation and amortized cost		**16,528**	16,086
Gain on disposal of property and equipment		**(161)**	(12)
Net impairment losses		**113,329**	205,045
Realised gains on investments		**(5,285)**	(9,628)
Unrealised losses / (gains) on investments		**2,824**	(6,030)
Operating profit before working capital changes		**408,160**	**376,332**
Change in due from banks		**(50,000)**	-
Change in loans and advances		**(1,901,895)**	(1,104,904)
Change in other assets		**13,603**	(398,206)
Change in due to banks		**(57,935)**	(13,116)
Change in customer deposits		**1,680,989**	263,104
Change in other liabilities		**(1,786)**	401,096
Net cash generated from / (used in) operating activities		**91,136**	**(475,694)**
Investing activities			
Purchase of property and equipment			
and capital work-in-progress		**(10,191)**	(7,658)
Proceeds from sale of property and equipment		**161**	12
Purchase of investments		**(535,270)**	(502,525)
Proceeds from sale of investments		**633,118**	564,186
Net cash from investing activities		**87,818**	**54,015**
Financing activities			
Change in term borrowings		**10,145**	141,424
Cash dividends		**(68,200)**	-
Net cash (used in) / from financing activities		**(58,055)**	**141,424**
Net increase / (decrease) in cash and cash equivalents		**120,899**	**(280,255)**
Cash and cash equivalents at beginning of the year		**2,006,820**	2,287,075
Cash and cash equivalents at end of the year	*27*	**2,127,719**	**2,006,820**

The notes on pages 12 to 63 form an integral part of these consolidated financial statements.
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Consolidated statement of changes in equity

For the year ended 31 December 2011

	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 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**
At 1 January 2011	**1,100,000**	**255,447**	**150,447**	**282,809**	**(9,364)**	**68,200**	**1,847,539**
Total comprehensive income for the year	**-**	**-**	**-**	**280,925**	**923**	**-**	**281,848**
Proposed dividends	**-**	**-**	**-**	**(110,000)**	**-**	**110,000**	**-**
Transfer to reserves	**-**	**28,092**	**28,092**	**(56,184)**	**-**	**-**	**-**
2010 cash dividends paid	**-**	**-**	**-**	**-**	**-**	**(68,200)**	**(68,200)**
At 31 December 2011	**1,100,000**	**283,539**	**178,539**	**397,550**	**(8,441)**	**110,000**	**2,061,187**

The notes on pages 12 to 63 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 2011

1. Legal status and activities

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

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

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.

In addition the Group's Corporate Communication Department discloses and disseminates information through press releases and media coverage.

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), interpretations issued by International Financial Reporting Interpretations Committee (IFRIC) and applicable requirements of laws of the United Arab Emirates.

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 2011 are as follows:

- IFRS – 9 Financial Instruments: Effective 1 January 2013;
- IFRS – 7 (Amendments to IFRS 7) – Disclosures – Transfers of Financial Assets: Effective 1 July 2011;
- IFRS – 1 (Amendments to IFRS 1) – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters: Effective 1 July 2011;
- IAS – 12 (Amendments to IAS 12) – Deferred Tax: Recovery of Underlying Assets: Effective 1 January 2012;
- IAS – 1 (Amendments to IAS 1) Presentation of Items of Other Comprehensive Income: Effective 1 July 2012;
- IFRS – 10 Consolidated Financial Statements: Effective 1 January 2013;
- IFRS – 11 Joint Arrangements: Effective 1 January 2013;
- IFRS – 12 Disclosure of Interests in Other Entities: Effective 1 January 2013;
- IFRS – 13 Fair Value Measurement: Effective 1 January 2013;
- IAS – 19 (Amended 2011) Employee Benefits: Effective 1 January 2013;
- IAS – 27 (2011) Separate Financial Statements: Effective 1 January 2013;
- IAS – 28 (2011) Investments in Associates and Joint Ventures: Effective 1 January 2013.

Notes (continued)

3. Basis of preparation (continued)

(a) Statement of compliance (continued)

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

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

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

The Group has evaluated the potential effect of this standard and is planning for implementation from the effective date.

(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. The Group has adopted IAS 24 'Related Party Disclosures' (Revised) which become applicable for annual periods beginning on or after 1 January 2011, in the preparation of these consolidated financial statements. IAS 24 amends the definition of a related party and modifies certain related party disclosure requirements for government related entities. The revised requirements under IAS 24 affect the presentation and disclosure of these consolidated financial statements and do not have any effect on the reported amounts in the consolidated statement of financial position and consolidated statement of comprehensive income.

Notes (continued)

4. Significant accounting policies (continued)

(a) Basis of consolidation

Subsidiary

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

Transactions eliminated on consolidation

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

(b) Financial instruments

Classification

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

Financial instruments are categorised as follows:

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

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

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

Notes (continued)

4. Significant accounting policies (continued)

(b) Financial instruments (continued)

Derecognition

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

Measurement

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

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

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

Amortised cost measurement

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

Fair value measurement principles

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

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

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.

Notes (continued)

4. Significant accounting policies (continued)

(b) Financial instruments (continued)

Fair value measurement principles (continued)

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.

Gains and losses on subsequent measurement

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

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

Notes (continued)

4. Significant accounting policies (continued)

(b) Financial instruments (continued)

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.

(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.

Notes (continued)

4. Significant accounting policies (continued)

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

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.

Gain 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.

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the assets, liabilities or group thereof that are attributable to the hedged risk.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income. Any gain or loss in fair value relating to an ineffective portion is recognized immediately in the income statement.

(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:

Notes (continued)

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

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

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

Held-to-maturity investments

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

(e) Property and equipment and depreciation

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

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

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

(f) Intangible assets

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

Notes (continued)

4. Significant accounting policies (continued)

(f) Intangible assets (continued)

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.

(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.

(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.

Notes (continued)

4. Significant accounting policies (continued)

(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

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 governance structure by adopting the implementation of best practices and establishment of Board committees. The Board Audit Committee, Board Risk Committee and Board Nomination and Remuneration Committee have been established in addition to the Board Executive Committee to deepen the oversight mechanism and the control environment. The roles and responsibilities of existing governance committees have been explained in note 5(b).

Notes (continued)

5. Financial risk management (continued)

(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 established following committees to enhance the oversight mechanism to carry out its responsibilities effectively:

Board Executive Committee: consists of six members of the Board and the Chief Executive Officer, to assist them in the credit and investment approval process in line with the Board delegated authorities.

Board Risk Committee: consists of two board members, Chief Executive Officer, Chief Risk Officer and Chief Financial Officer to assist the Board in fulfilling its oversight responsibilities in respect of the risks inherent in the businesses of the Group and the control processes with respect to such risks, the risk profile of the Group, and the risk management, compliance and control activities of the Group. The responsibilities of the Committee would include, but not be restricted to the following:

- Review the Group's Enterprise Risk Management and Internal Control Framework;
- Review risk appetite of the Group and establish risk policies for implementation;
- Review credit risk rating system;
- Review basic policies for Asset and Liability management;
- Review financial and other risk exposures and the steps management has taken to identify, measure, monitor, control and report such exposures including and without limitation review of credit, market, fiduciary, liquidity, reputation, insurance, operational (including fraud, Business Continuity, Information Security and legal) and strategic risks;
- Review appropriate transaction or trading limits;
- Review reports and significant findings from the Risk Management Division, Risk Committee of the Management and from the regulatory agencies relating to risk issues and management response;
- Review ICAAP submission to the Central Bank of the UAE;
- Review Basel II implementation and economic capital allocation methodology;
- Review Basel III, liquidity and leverage review methodology;
- Monitor the Group's compliance with legal and regulatory obligations; and
- Review major disclosure documentation prior to the issue to the market.

Board Audit Committee: steered by the Deputy Chairman of the Board receives and considers reports and recommendations from the Head of Internal Audit and the external auditors and make recommendations to the Board in respect of the financial reporting, systems of internal control and both internal and external audit processes of the Group. The responsibilities of the Committee include, but are not restricted to the following:

- Confirm and assure the independence of the Internal Auditors;
- Review with the Head of Internal Audit and the External Auditor the scope, plan, coordination and effectiveness of internal and external audit efforts;

Notes (continued)

5. Financial risk management (continued)

(b) Governance and risk management framework (continued)

- Oversight of the preparation of the financial statements including a review of the interim and year end accounts to monitor that such accounts have been prepared in accordance with proper accounting principles and recommend them for adoption by the Board;
- Review the Group's Internal Control Systems for effectiveness; and
- Review all Internal Audit reports concerning any investigation or significant fraud that occurs at the Group.

Board Nomination and Remuneration Committee: comprises the Board's Chairman, the Board's Deputy Chairman and a board member. The responsibilities of the Committee include, but are not restricted to the following:

- Make recommendations to the Board concerning the appointment, reappointment and succession planning of the Directors except for the position of the Chairman;
- Consider appointment, termination and succession planning for the CEO and deemed as required, other senior Management positions in the Group;
- Review the remuneration policy for the Board and the CEO position and determine their terms of service. The CEO and the full Board will determine and review the Group's Human Resources policy and remuneration levels for the Group;
- Review the structure, size and composition required of the Board and make recommendations to the Board with regard to any changes;
- Evaluate the balance of skills, knowledge and experience on the Board; and
- Review the performance of the Board, and work with the members of the Board to develop recommendations to the Board for any performance adjustments deemed advisable.

In order to discharge its responsibilities effectively, the Board has established the Management Committee (MANCOM), 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), Product Committee (PC) and Grievance and Disciplinary Committee (GDC). These committees oversee and direct 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.

Notes (continued)

5. Financial risk management (continued)

(b) Governance and risk management framework (continued)

The Risk Committee steered by the Chief Executive Officer is responsible to develop and recommend to the Board and the Board Risk Committee, the Group's risk appetite, develop and review the Group's risk policies and ICAAP (Internal Capital Adequacy Assessment Process), recommend allocations of regulatory and economic capital to portfolio segments and business lines, approve scenarios for stress testing for all risk categories and evaluate potential changes to market conditions. Further, the Committee reviews significant financial or other risks and the steps management have taken to monitor, control and report such risks, including, but without limitation to, review of credit, market, fiduciary, liquidity, reputation, operational, compliance, legal, fraud and strategic risks. It obtains assurance that significant risks are being measured, monitored, evaluated, and appropriately escalated through periodic updates, risk reporting, and key risk 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 Credit Risk is responsible for credit decisions for the Group's lending portfolio, setting country and other high level Group limits, oversee portfolio reviews with particular focus on quality, dealing with impaired assets and re-grading of credit facilities. The Committee is also responsible for developing and establishing credit risk metrics and MIS for review, measurement, monitoring and control of all credit risks, stress testing and making recommendation to the Chief Risk Officer for reviews of credit risk policies, enhancement of credit risk reporting and processing.

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

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.

The Marketing Committee steered by the Chief Executive Officer is responsible for challenging marketing strategies or plans proposed by the Business Segments and recommending to the MC the changes for improving marketing and selling activities. It co-ordinates and monitors the support and resources required, new product and channels development and pricing strategies. It oversees plans for developing business with the Group's key customers and monitors progress together with setting customer service standards.

Notes (continued)

5. Financial risk management (continued)

(b) Governance and risk management framework (continued)

The Human Resources Committee steered by the Chief Executive Officer is responsible for ensuring internal equity of compensation and overall evaluation of jobs for consistent and accurate assessment. It is responsible for grade and compensation structure together with benchmarking in line with the market conditions. In order to achieve its objectives, the Committee reviews the organization design and changes / improvements to the rewards and benefits structure and discusses future human resources planning, policies and procedure guidelines.

The IT Steering Committee steered by the Chief Executive Officer is responsible to provide direction to the Group's key initiatives and assist in the alignment of IT spend with business needs. It is responsible for providing oversight on IT projects and direction on technology dependent projects including prioritization and resource alignment.

The Corporate Social Responsibility Committee steered by the Head of Internal Audit is responsible for the oversight of environmental management, community initiatives and communication of CSR initiatives within and outside the Group.

The Grievance and Disciplinary Committee steered by Head of Internal Audit is empowered by the Bank's MANCOM to act impartially when dealing with staff grievances and disciplinary cases in accordance with Group rules, policies and UAE laws.

Enterprise-wide Risk Management and Internal Control Framework: The Board set the risk appetite, policies and the enterprise-wide risk management and internal control framework. The principal responsibility for the execution and implementation of policies and procedures and internal controls rests with respective functions and departments in accordance with the approved framework. An independent Risk Management function carries out the oversight through independent review and approval of procedures, spot checks, operational risk management, credit review and middle office activities for market and liquidity risks.

The Group follows the whistle blowing policy where staff can independently raise matters to the CEO, the Head of Internal Audit or the Board Secretary. The Group has also implemented disciplinary and grievance committee comprising Head of Internal Audit, Head of Human Resources and Head of Legal for promoting transparent and fair dealings among staff.

The role of the Internal Audit Function within the Group is to provide independent and objective assurance that the process for identifying, evaluating and managing significant risks faced by the Group is appropriate and effectively applied. In addition, it also provides an independent check on the compliance with laws and regulations and measuring compliance with the Group's policies and procedures. Additionally, Internal Audit provides consulting services which are advisory in nature, and are generally performed at the specific request of the Senior Management. It is led by the Head of Internal Audit who reports to the Board of Directors, with administrative reporting to the Chief Executive Officer. To perform its role effectively, Internal Audit has organizational independence from management, to enable unrestricted evaluation of management activities and personnel.

(c) Credit risk

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

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 which is being expanded across the UAE.

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

Management of credit risk

Independent Credit Department is responsible for review, recommending and approving underwriting proposals and together with 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 and policy 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;
- Remedial management and recoveries; and
- Stress testing

Concentration risk

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

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

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

Concentration risk (continued)

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 2011 and 2010 is shown below:

	Loans and advances						Past due but not impaired	
2011	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded & unfunded)	Upto 90 days	90 days to 180 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Trade	4,198,849	1,203,044	5,401,893	76,107	69,187	13,685	89,712	-
Construction	714,071	2,901,648	3,615,719	6,438	6,411	11,266	21,710	-
Government	260,739	5,845	266,584	-	-	-	-	-
Manufacturing	2,111,387	531,877	2,643,264	166,407	132,962	37,303	37,686	-
Financial institutions	618,358	153,096	771,454	54,224	27,112	55,095	-	-
Service Industries	1,319,267	197,579	1,516,846	693,205	112,148	33	11,674	-
Real estate	886,409	-	886,409	19,532	14,261	-	2,537	-
Individuals	1,048,398	16,892	1,065,290	194,125	134,058	1,794	11,940	-
Gross amount	11,157,478	5,009,981	16,167,459	1,210,038	496,139	119,176	175,259	-

In addition to the specific provision, the Group holds **AED 156.08 million** (2010: AED 137.5 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.

	Loans and advances						Past due but not impaired	
2010	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded & unfunded)	Upto 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**

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 2011 and 2010 is shown below:

2011	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded & unfunded)	Past due but not impaired	
							Upto 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	10,919,788	4,889,759	15,809,547	1,155,814	469,027	27,351	174,526	-
GCC countries	180,642	80,126	260,768	54,224	27,112	91,825	-	-
Other	57,048	40,096	97,144	-	-	-	733	-
Total	11,157,478	5,009,981	16,167,459	1,210,038	496,139	119,176	175,259	-

2010	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded & unfunded)	Past due but not impaired	
							Upto 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**

Currency wise analysis

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

	2011			2010		
	Funded	Unfunded	Gross exposure	Funded	Unfunded	Gross exposure
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
AED	9,369,053	3,741,623	13,110,676	7,706,775	3,723,729	11,430,504
USD	1,115,979	1,113,334	2,229,313	1,126,039	982,207	2,108,246
EURO	41,147	87,713	128,860	21,281	181,005	202,286
GBP	-	3,987	3,987	-	8,005	8,005
XAU	474,297	-	474,297	442,663	-	442,663
Others	157,002	63,324	220,326	78,001	124,079	202,080
TOTAL	11,157,478	5,009,981	16,167,459	**9,374,759**	**5,019,025**	**14,393,784**

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

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 in accordance with the approved credit framework.

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 below. Pursuant to the disclosure requirements of revised IFRS 7 Financial Instruments: Disclosures, the Group has disclosed the respective information in accordance with the requirements.

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

Risk mitigation, collateral and credit enhancements (continued)

Particulars	**Loans and Advances**		**Collaterals**	
	2011	**2010**	**2011**	**2010**
	AED'000	**AED'000**	**AED'000**	**AED'000**
Individually impaired				
Pledged deposits	**34,664**	61,927	**5,071**	11,528
Debt / Equity securities	**109,428**	111,428	**85,286**	85,399
Property	**103,461**	132,281	**54,723**	90,099
Others	**962,485**	773,321	**20,000**	20,000
Gross amount	**1,210,038**	**1,078,957**	**165,080**	**207,026**
Impairment loss	**(496,139)**	**(520,583)**	**-**	-
Carrying amount	**713,899**	**558,374**	**165,080**	**207,026**
Past due but not impaired				
Pledged deposits	**74,014**	53,923	**15,823**	16,643
Debt / Equity securities	**844**	2,000	**844**	1,702
Property	**50,882**	5,202	**50,433**	4,532
Others	**49,519**	44,404	**-**	-
Gross amount	**175,259**	**105,529**	**67,100**	**22,877**
Impairment loss	**-**	-	**-**	-
Carrying amount	**175,259**	**105,529**	**67,100**	**22,877**
Neither past due nor impaired				
Pledged deposits	**3,441,099**	2,820,044	**1,000,861**	884,458
Debt / Equity securities	**257,423**	186,168	**156,032**	151,329
Property	**1,334,000**	782,171	**1,193,966**	686,702
Others	**4,739,659**	4,401,890	**-**	-
Gross amount	**9,772,181**	**8,190,273**	**2,350,859**	**1,722,489**
Collective impairment provision	**(156,079)**	**(137,482)**	**-**	-
Carrying amount	**9,616,102**	**8,052,791**	**2,350,859**	**1,722,489**
Total	**10,505,260**	**8,716,694**	**2,583,039**	**1,952,392**
Renegotiated exposure	**692,965**	**563,032**	**341,669**	**187,788**
Contingent liabilities				
Pledged deposits	**2,623,996**	2,327,638	**448,906**	417,816
Others	**2,385,985**	2,691,387	**120,662**	67,369
Total	**5,009,981**	**5,019,025**	**569,568**	**485,185**

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

Risk mitigation, collateral and credit enhancements (continued)

Past due but not impaired portfolio ageing is as follows:

	2011	2010
	AED'000	AED'000
Less than 1 month	99,231	57,286
1 month to 3 months	76,028	37,865
3 months to 6 months	-	10,378
Total	**175,259**	**105,529**

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 complies 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	2011	2010
	AED'000	AED'000
Neither past due nor impaired / Past due but not impaired (RR 1-19)		
Grades 1-18: Performing or normal	9,680,699	8,075,934
Grade 19: Other Loans Especially Mentioned (OLEM)	266,741	219,868
	9,947,440	**8,295,802**
Individually impaired (RR 20-22)		
Grade 20: Sub-standard	664,724	503,246
Grade 21: Doubtful	101,167	134,082
Grade 22: Loss	444,147	441,629
	1,210,038	**1,078,957**
Total	11,157,478	**9,374,759**

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 recognized 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.

Notes (continued)

5. Financial risk management (continued)

(c) Credit risk (continued)

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 installment 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.

(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. **16.22%** (2010: 19.13%) 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:

	2011	**2010**
December 31	**0.85:1**	0.87:1
Minimum	**0.80:1**	0.76:1
Average	**0.86:1**	0.79:1
Maximum	**0.93:1**	0.87:1

Notes (continued)

5. Financial risk management (continued)

(d) Liquidity risk (continued)

Management of liquidity risk (continued)

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.

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 certificates of deposit 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.

At 31 December 2011	Less than 1 month	1 month to 3 months	Over 3 months to 6 months	Over 6 months to 1 year	Over 1 year to 5 years	Over 5 years	Total
	AED'000	AED'000	AED'000	AED'0000	AED'000	AED'000	AED'000
Cash and balances with UAE Central Bank	905,743	50,261	652,489	450,907	50,197	-	2,109,597
Due from banks	564,100	-	-	51,042	-	-	615,142
Loans and advances	2,857,065	2,043,106	1,075,893	711,517	3,622,721	1,434,160	11,744,462
Investments	593	2,516	29,244	15,122	563,298	-	610,773
Other assets	294,487	468,421	143,450	5,999	13,290	-	925,647
Total financial assets	4,621,988	2,564,304	1,901,076	1,234,587	4,249,506	1,434,160	16,005,621
At 31 December 2011							
Due to banks	515,943	24,616	-	-	-	-	540,559
Term borrowings	2,192	-	2,192	59,930	866,795	-	931,109
Customer deposits	4,823,832	1,876,455	689,491	813,754	2,054,735	471,558	10,729,825
Other liabilities	294,020	526,025	143,450	5,999	13,655	-	983,149
Total financial liabilities	5,635,987	2,427,096	835,133	879,683	2,935,185	471,558	13,184,642
On Balance Sheet Gap	(1,013,999)	137,208	1,065,943	354,904	1,314,321	962,602	
At 31 December 2010							
Financial Assets	3,983,082	2,440,861	1,639,601	1,373,119	3,311,695	1,080,651	13,829,009
Financial 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**

Notes (continued)

5. Financial risk management (continued)

(d) Liquidity risk (continued)

Management of 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	1 month to 3 months	Over 3 months to 6 months	Over 6 months to 1 year	Over 1 year to 5 years	Over 5 years	Total
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
At 31 December 2011							
Guarantees	**3,949,910**	**-**	**-**	**-**	**-**	**-**	**3,949,910**
Letters of credit	**162,517**	**637,507**	**203,869**	**54,709**	**1,469**	**-**	**1,060,071**
Forward foreign exchange contracts	**2,449,828**	**739,031**	**393,808**	**226,647**	**-**	**-**	**3,809,314**
Currency options	**91,872**	**244,270**	**38,928**	**187,666**	**-**	**-**	**562,736**
Interest rate swaps	**3,105**	**45,384**	**9,315**	**17,797**	**537,714**	**-**	**613,315**
Interest rate future options	**-**	**91,825**	**183,650**	**91,825**	**-**	**-**	**367,300**
	6,657,232	**1,758,017**	**829,570**	**578,644**	**539,183**	**-**	**10,362,646**
At 31 December 2010							
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
Interest rate future options	-	-	-	-	-	-	-
	5,170,737	**1,249,066**	**788,409**	**491,509**	**452,798**	**-**	**8,152,519**

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

	2011		**2010**	
	Positive fair value	**Negative fair value**	**Positive fair value**	**Negative fair value**
	AED'000	**AED'000**	**AED'000**	**AED'000**
Derivatives				
Forward foreign exchange contracts	**29,138**	**23,725**	18,391	17,464
Currency options	**20,210**	**20,210**	8,320	8,320
Interest rate swaps	**14,666**	**14,034**	7,427	8,582
Interest rate future options	**21**	**15**	-	-
	64,035	**57,984**	**34,138**	**34,366**

Notes (continued)

5. Financial risk management (continued)

(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 monitoring market risk is vested in ALCO.

Credit risk arising on investments 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 20% is followed unless ALCO and RC believe a different level is appropriate, when Board approval is obtained.

The table below shows the impact of decline in fair value of investments by 10% on net income and equity for 2011 and 2010:

	Assumed level of change %	Impact on net income and equity 2011 AED'000	Impact on net income and equity 2010 AED'000
Investments carried at fair value through the income statement			
Reference benchmarks:			
Net asset value of managed funds	10%	**3,777**	4,162

	Assumed level of change %	Impact on equity 2011 AED'000	Impact on equity 2010 AED'000
Available-for-sale investments			
Reference benchmarks:			
Quoted debt securities	10%	**21,893**	34,757
Investments in listed equity	10%	**52**	69

Notes (continued)

5. Financial risk management (continued)

(e) Market risk (continued)

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.

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			
2011 (AED in 000's)	**107,316**	**494**	**(3,465)**
2010 (AED in 000's)	160,010	377	6,312
Assumed change in exchange rates	5%	5%	5%
Impact on exchange income from increase in exchange rates:			
2011 (AED in 000's)	**5,366**	**25**	**(173)**
2010 (AED in 000's)	8,001	19	316
Impact on exchange income from decrease in exchange rates:			
2011 (AED in 000's)	**(5,366)**	**(25)**	**173**
2010 (AED in 000's)	(8,001)	(19)	(316)

At 31 December 2011, the impact on exchange income due to change in exchange rate by 5% is **±10.4%** (2010: ±19.7%). Excluding the impact of US$ open position, the impact is **±0.3%** (2010: ±0.8%).

Notes (continued)

5. Financial risk management (continued)

(e) Market risk (continued)

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 re-pricing profile of financial assets and liabilities. The Group's financial assets and liabilities which are primarily long term 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 **4.62%** (2010: 5.62%) 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.

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:					
2011 (AED in 000's)	**24,000**	**(4,000)**	**1,000**	**2,000**	**23,000**
2010 (AED in 000's)	27,000	(1,000)	-	2,000	28,000
Impact on net interest income from decrease in interest rates:					
2011 (AED in 000's)	**(42,000)**	**2,000**	**(1,000)**	**(7,000)**	**(48,000)**
2010 (AED in 000's)	(11,000)	(2,000)	-	(10,000)	(23,000)

The results of shift analysis are reviewed monthly by ALCO who coupled with MC 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 2011, the impact of 200 bps shift analysis on net interest is **+5.4%** / **-11.3%** (2010: +7.8% / -6.4%) and regulatory capital is **+0.81%** / **-1.70%** (2010: +1.05% / -0.87%).

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 2011	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	325,000	100,000	650,000	450,000	-	-	578,840	2,103,840
Due from banks	507,832	-	-	50,000	-	-	56,259	614,091
Loans and advances	3,362,987	4,852,707	824,062	101,237	696,213	485,369	182,685	10,505,260
Investments	63,448	307,530	118,949	-	55,681	-	38,290	583,898
Other assets	-	-	-	-	-	-	991,588	991,588
Total financial assets	4,259,267	5,260,237	1,593,011	601,237	751,894	485,369	1,847,662	14,798,677
Due to banks	489,403	24,558	-	-	-	-	26,251	540,212
Term borrowings	918,250	-	-	-	-	-	-	918,250
Customers' deposits	3,077,780	2,399,011	911,532	1,315,367	896,677	-	1,738,213	10,338,580
Other liabilities	-	-	-	-	-	-	1,016,003	1,016,003
Total financial liabilities	4,485,433	2,423,569	911,532	1,315,367	896,677	-	2,780,467	12,813,045
Interest rate sensitivity gap								
On-balance Sheet	(226,166)	2,836,668	681,479	(714,130)	(144,783)	485,369	(932,805)	
Off-balance Sheet	10,475	336,040	9,316	201,444	56,040	-	-	
Cumulative	(215,691)	2,957,017	3,647,812	3,135,126	3,046,383	3,531,752	2,598,947	
At 31 December 2010								
Cumulative interest rate sensitivity gap	605,113	3,021,179	3,750,336	3,125,313	2,952,292	3,495,607	2,205,821	

Interest rate yields

The average earning on placements and balances with banks was **0.61%** *(2010:* 0.78%*)*, on loans and advances was **6.08%** *(2010:* 6.44%*)* and on investments was **2.91%** *(2010:* 3.40%*)*. The average cost of customer deposits was **2.19%** *(2010:* 2.67%*)* and of bank borrowings (inclusive of syndicated borrowings) was **1.84%** *(2010:* 1.51%*)*.

Notes (continued)

5. Financial risk management (continued)

(f) Operational risk

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 maintain adequate level and achieve an optimum structure for the Group's capital commensurate to its strategy, risk profile and relative positioning in the market
- To ensure compliance with the regulatory requirements
- To plan for replacement of Tier 2 capital and the Group's liquidity management
- To efficiently allocate capital to various businesses leading to enhanced shareholder value
- To ensure effective internal organisation and processes and to assess and manage material risks on an ongoing basis
- To provide for any unforeseen losses

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.

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 Internal Capital Adequacy Assessment Planning (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)

The Group's regulatory capital adequacy ratio is set by the Central Bank which is 12 % analyzed in two tiers, of which Tier 1 capital adequacy ratio must not be less than 8%. The Group has complied with its capital adequacy calculation in accordance with Basel II Standardized Approach for credit, market and operational risks.

The Group'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.

	31 Dec 2011	31 Dec 2010
	AED'000	AED'000
Tier 1 Capital		
Share capital	1,100,000	1,100,000
Statutory reserve	255,447	238,360
Special reserve	150,447	133,360
Retained earnings	282,809	214,312
Total Tier 1	**1,788,703**	**1,686,032**
Tier 2 Capital		
Available-for-sale revaluation reserve	(8,441)	(9,364)
Subordinated facilities (note 17.1 & 17.2)	894,352	843,016
Collective impairment provision	156,079	137,482
Total Tier 2	**1,041,990**	**971,134**
Deductions from Tier 1 and Tier 2 Capital		
Investments in unconsolidated subsidiaries	-	-
Total capital base (a)	**2,830,693**	**2,657,166**

Notes (continued)

5. Financial risk management (continued)

(g) Management of capital (continued)

Risk weighted assets

	Risk weighted equivalent AED'000	Risk weighted equivalent AED'000
Credit risk	**13,359,472**	11,768,098
Market risk	**5,029**	5,166
Operational risk	**573,503**	646,334
Total risk weighted assets (b)	**13,938,004**	12,419,598
Capital adequacy ratio (a) / (b) - %	**20.31**	21.39

The Group has prepared an ICAAP document and submitted to the Central Bank for the years ended December 2009 and December 2010. The Group's ICAAP report includes assessment and review of:

- Risk management framework to assess, measure, monitor and control all the material elements of risks;
- Risk profile and business strategy;
- Capital required to cover all material risks;
- Stress testing risks to assess capital requirement under stressed conditions; and
- Capital planning and budgeting.

Apart from Credit, Market & Operational Risk covered in Pillar I, the ICAAP report covers other material risks like Liquidity risk, Concentration risk, Interest Rate Risk in Banking book, Strategic Risk, Residual risk, Reputational risk, etc. The ICAAP report also covers Stress Testing Framework for Credit, Market, Liquidity and Interest Rate Risk on banking book. The Pillar II CAR for the year ended 31 December 2011 was **18.41%** (2010: 19.05%).

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.

Notes (continued)

5. Financial risk management (continued)

(g) Management of capital (continued)

Risk weights for credit risk (continued)

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.

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 do not exceed AED 10 million and are secured by residential property with LTV of up to 85%. Other claims secured on residential property are risk weighted at 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 equal to or 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)

Risk weights for credit risk (continued)

Credit risk and risk weights

2011 (AED'000)	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
Claims on sovereigns	2,295,609	1,169	2,296,778	-	2,296,778	-
Claims on public sector entities	280,982	766	281,748	7,000	274,748	274,748
Claims on banks	953,370	175,607	1,128,977	-	1,128,977	361,467
Claims on corporates	7,933,997	3,572,154	11,506,151	1,195,550	10,310,601	10,182,912
Regulatory retail exposures	870,192	13,321	883,513	70,064	813,449	813,382
Residential retail portfolio	371,487	-	371,487	12,853	358,634	358,634
Commercial real estate	499,228	-	499,228	-	499,228	499,228
Past due exposures	1,320,976	3,382	717,373	45,916	671,457	671,457
Higher-risk categories	38,289	-	38,289	-	38,289	57,434
Other exposures	212,285	-	212,285	-	212,285	140,210
Total	14,776,415	3,766,399	17,935,829	1,331,383	16,604,446	13,359,472

2010 (AED'000)	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
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)

The Group uses the following external credit assessment institutions (ECAIs): Standards & Poor, Moody's 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 (CRM) techniques. 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:

	2011	2010
	AED'000	AED'000
Interest rate risk		
- Specific interest rate risk	-	-
- General interest rate risk	-	-
Equity position risk	-	-
Foreign exchange risk	603	517
Option risk	-	-
Total market risk capital charge	**603**	**517**
Market risk – risk weighted assets	**5,029**	**5,166**

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** (2010: 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.

Notes (continued)

6. Financial assets and liabilities

6.1 Classification

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

2011	At fair value through profit or loss	At fair value through equity	Held-to-maturity	Loans and advances	Other amortised cost	Carrying amount
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Financial assets						
Cash and balances with Central Bank of the UAE	-	-	-	-	2,103,840	2,103,840
Due from banks	-	-	-	-	614,091	614,091
Loans and advances	-	-	-	10,505,260	-	10,505,260
Investments	37,766	219,455	326,677	-	-	583,898
Other assets	-	-	-	-	991,588	991,588
Total financial assets	37,766	219,455	326,677	10,505,260	3,709,519	14,798,677
Financial liabilities						
Due to banks	-	-	-	-	540,212	540,212
Term borrowings	-	-	-	-	918,250	918,250
Customer deposits	39,173	-	-	-	10,299,407	10,338,580
Other liabilities	-	-	-	-	1,016,003	1,016,003
Total financial liabilities	39,173	-	-	-	12,773,872	12,813,045

2010	At fair value through profit or loss	At fair value through equity	Held-to-maturity	Loans and advances	Other amortised cost	Carrying amount
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Financial 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 financial assets	**41,621**	**348,263**	**288,478**	**8,716,694**	**3,403,002**	**12,798,058**
Financial 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 financial liabilities	**73,195**	**-**	**-**	**-**	**10,965,370**	**11,038,565**

Notes (continued)

6. Financial assets and liabilities (continued)

6.2 Fair value measurement – fair value hierarchy:

2011	Level 1	Level 2	Level 3
	AED'000	AED'000	AED'000
On balance sheet items			
Investments			
- Debt securities	**218,931**	**-**	**-**
- Other investments	**524**	**37,766**	**-**
Customer deposits	**-**	**39,173**	**-**
Off balance sheet items - derivatives			
Forward foreign exchange contracts	**-**	**3,809,314**	**-**
Currency options	**-**	**562,736**	**-**
Interest rate swaps	**-**	**613,315**	**-**
Interest rate future options	**-**	**367,300**	**-**

2010	Level 1	Level 2	Level 3
	AED'000	AED'000	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	-
Interest rate future options	-	-	-

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

Notes (continued)

7. Cash and balances with UAE Central Bank

	2011 AED'000	2010 AED'000
Cash on hand	**72,074**	75,866
Certificates of deposit (CDs) with Central Bank of the UAE (note 7.1)	**1,525,000**	1,900,000
Other balances with UAE Central Bank	**506,766**	226,500
	2,103,840	**2,202,366**

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

8. Due from banks

	2011 AED'000	2010 AED'000
By geographical area		
Within UAE	**413,961**	56,988
GCC countries	**77,833**	61,903
Others	**122,297**	74,085
	614,091	**192,976**

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

	2011 AED'000	2010 AED'000
AED	**334,399**	32,637
USD	**178,514**	29,867
EURO	**53,931**	93,790
GBP	**20,424**	4,822
Others	**26,823**	31,860
	614,091	**192,976**

Notes (continued)

9. Loans and advances

9.1 Loans and advances by type:

	2011 AED'000	2010 AED'000
Overdrafts	1,220,654	1,281,624
Term loans	6,961,523	5,635,922
Loans against trust receipts	1,578,965	1,130,484
Bills discounted	765,735	805,877
Bills drawn under letters of credit	630,601	520,852
	11,157,478	9,374,759
Allowance for impairment losses (note 10)	(652,218)	(658,065)
Net loans and advances	10,505,260	8,716,694

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.

	2011 AED'000	2010 AED'000
Contingent liabilities:		
- Letters of credit covering movement of goods	1,060,071	1,181,675
- Financial guarantees and other direct credit substitutes	391,897	331,695
- Bid bonds, performance bonds and other transaction related contingencies	3,558,013	3,505,655
	5,009,981	5,019,025

	2011 AED'000	2010 AED'000
Commitments:		
- Undrawn commitments – credit related	8,301,885	7,633,211
- Others	22,955	14,475

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	2011 AED'000	2010 AED'000
Balance at 1 January	658,065	479,222
Provided during the year	226,927	238,955
Released during the year	(113,598)	(33,910)
Net allowance for impairment losses	113,329	205,045
Written-off during the year	(119,176)	(26,202)
Balance at 31 December	652,218	658,065

11. Investments

	2011 AED'000	2010 AED'000
Investments at fair value through profit or loss (FVPL) (note 11.1)	37,766	41,621
Available-for-sale (AFS)		
Debt securities (note 11.2)	218,931	347,573
Other investments	524	690
	219,455	348,263
Held-to-maturity (HTM)		
Debt securities (note 11.2)	326,677	288,478
	583,898	678,362

11.1 This includes various international funds and funds with no fixed maturities. 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.

11.2 Debt securities represent the Group's investments in bonds and notes. These include floating rate securities amounting to **AED 490 million** (2010: AED 585 million). These securities are quoted on internationally recognised platforms of Reuter and Bloomberg and are liquid in normal market conditions.

Notes (continued)

11. Investments (continued)

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

	2011 AED'000	2010 AED'000
Government	88,317	87,010
Banks and financial institutions	387,531	433,102
Others	108,050	158,250
	583,898	678,362

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

2011	Debt securities AED'000	Other investments AED'000	Total AED'000
AA-	96,932	-	96,932
A+	156,856	-	156,856
A	209,884	-	209,884
A-	12,176	-	12,176
BBB+	7,279	-	7,279
BB+	22,018	-	22,018
BB	-	524	524
Unrated	40,463	37,766	78,229
	545,608	38,290	583,898

2010	Debt securities AED'000	Other investments AED'000	Total AED'000
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-	43,580	-	43,580
BB	-	690	690
Unrated	40,606	41,621	82,227
	636,051	42,311	678,362

Notes (continued)

11. Investments (continued)

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

	2011 AED'000	2010 AED'000
Within UAE	**449,877**	528,929
GCC Countries	**7,279**	57,360
Others	**126,742**	92,073
	583,898	**678,362**

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

	2011 AED'000	2010 AED'000
AED	**445,627**	485,079
USD	**68,658**	142,833
EURO	**69,613**	33,622
GBP	**-**	16,828
	583,898	**678,362**

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 reclassified 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 reclassified 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 reclassified, the impact would be as follows:

	2011 AED'000	2010 AED'000
After reclassification		
Unrealised fair value gain / (loss) recognized in cumulative changes in fair values	**-**	**12,000**

Notes (continued)

12. Property and equipment

	Freehold land	Buildings & leasehold improvements	Motor vehicles, furniture, EDP & other equipment	Total
	AED'000	AED'000	AED'000	AED'000
Cost				
At 1 January 2010	**14,066**	**100,531**	**43,583**	**158,180**
Additions	-	3,730	3,000	6,730
Disposals	-	-	(91)	(91)
At 31 December 2010	**14,066**	**104,261**	**46,492**	**164,819**
At 1 January 2011	**14,066**	**104,261**	**46,492**	**164,819**
Additions	**-**	**4,032**	**3,348**	**7,380**
Disposals	**-**	**-**	**(580)**	**(580)**
At 31 December 2011	**14,066**	**108,293**	**49,260**	**171,619**
Depreciation				
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**
At 1 January 2011	**-**	**40,134**	**38,456**	**78,590**
Charge for the year	**-**	**5,409**	**5,970**	**11,379**
On disposals	**-**	**-**	**(580)**	**(580)**
At 31 December 2011	**-**	**45,543**	**43,846**	**89,389**
Net book value				
At 31 December 2011	**14,066**	**62,750**	**5,414**	**82,230**
At 31 December 2010	**14,066**	**64,127**	**8,036**	**86,229**

The buildings in Fujairah, Dibba, Masafi, Qidfa 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 (2010: AED 1 each).

Notes (continued)

13. Intangible assets

	2011	2010
	AED'000	AED'000
Cost		
At 1 January	26,854	26,854
Additions	-	-
At 31 December	**26,854**	**26,854**
Amortization		
At 1 January	17,844	12,695
Charge for the year	5,149	5,149
At 31 December	**22,993**	**17,844**
Net book value	**3,861**	**9,010**

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

14. Capital work-in-progress

	2011	2010
	AED'000	AED'000
Premises and equipments (note 14.1)	53	1,165
Intangible assets (note 14.2)	4,767	844
	4,820	2,009

14.1 Premises and equipment costs were incurred in respect of the Group's buildings in Dubai and Fujairah for facilities management. (2010: Premises and equipment costs were incurred in respect of refurbishment of the Group's building in Sharjah).

14.2 The cost of intangible assets is in respect of the purchase of software and directly attributable costs relating to the implementation of Credit Automated Work Flow System and Internet Banking. (2010: 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

	2011	2010
	AED'000	AED'000
Accrued interest	65,941	72,908
Prepayments and deposits	8,900	7,022
Customer liabilities for acceptances	900,012	918,407
Others	40,511	30,630
	1,015,364	1,028,967

Notes (continued)

16. Due to banks and term borrowings

	2011 AED'000	2010 AED'000
By type:		
Club term loan facility (note 16.1)	**863,155**	-
Syndicated borrowing (note 16.2)	**-**	761,185
Bilateral borrowings (note 16.3)	**55,095**	146,920
	918,250	**908,105**
Short-term borrowings	**540,212**	446,457
	1,458,462	**1,354,562**
By geographical area:		
Within UAE	**197,109**	98,258
GCC Countries	**7,349**	2
Others	**1,254,004**	1,256,302
	1,458,462	**1,354,562**

16.1 On 24 June 2011, the Group arranged a club term loan facility of **AED 863.2 million** (US$ 235 million) through a syndicate of banks. The facility carries a floating rate which is the aggregate of Margin plus LIBOR and is repayable in full on 24 June 2013. 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; to maintain a minimum tangible net worth of US$ 425 million; and to maintain its ratio of impaired loans to total funded gross loans, which shall not be greater than ten (10%) percent at any time, subject to the exclusion of certain facilities as stipulated in the agreement. The respective conditions stipulated above have been complied with, as at the reporting date.

16.2 The proceeds of the Club term loan facility were utilized to settle the syndicated term loan facility comprising of US$ 190 million and Euro 13 million arranged on 31 July 2008.

16.3 During 2010, 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

	2011 AED'000	2010 AED'000
By type		
Demand and margin deposits	**2,117,244**	1,680,503
Saving deposits	**33,309**	38,103
Fixed term and notice deposits (note 17.1 & 17.2)	**8,188,027**	6,938,985
	10,338,580	**8,657,591**
By geographical area:		
Within UAE	**9,804,409**	8,144,332
Others	**534,171**	513,259
	10,338,580	**8,657,591**

Notes (continued)

17. Customer deposits (continued)

17.1 The Group received deposits aggregating to AED 643 million in 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.

17.2 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

	2011	2010
	AED'000	AED'000
Accrued interest	32,854	47,723
Employee terminal and other long term benefits	23,525	20,182
Accrued expenses	45,274	29,297
Directors' attendance fees	2,200	2,200
Liabilities under acceptances	900,012	918,407
Others	51,270	39,112
	1,055,135	1,056,921

19. Shareholders' equity

19.1 Share capital

	2011	2010
	AED'000	AED'000
Authorised, issued and fully paid:		
1,100,000,000 shares of AED 1 each (2010: 1,100,000,000 shares of AED 1 each)	1,100,000	1,100,000

The Board of Directors proposed a cash dividend of **10%** (2010: 6.2%) of the share capital for the year ended December 31, 2011.

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.

Notes (continued)

20. Interest income

	2011 AED'000	2010 AED'000
Loans and advances	633,356	571,883
Due from banks including Central Bank CDs	12,365	17,477
Investments	18,992	21,396
	664,713	610,756

21. Interest expense

	2011 AED'000	2010 AED'000
Due to banks including term borrowings	27,872	19,523
Customer deposits	210,307	231,127
	238,179	250,650

22. Net fees and commission income

	2011 AED'000	2010 AED'000
Fees and commission income		
Letters of credit	58,151	58,034
Letters of guarantee	36,931	38,576
Lending fees	58,191	50,609
Asset management and investment services	157	531
Commission on transfers	12,371	12,094
Others	1,044	708
Total fees and commission income	166,845	160,552
Fees and commission expense		
Brokerage expense	253	241
Card related charges	3,030	2,083
Other commission	-	13
Total fees and commission expense	3,283	2,337
Net fees and commission income	163,562	158,215

Notes (continued)

23. Other operating income

	2011 AED'000	2010 AED'000
Rental income	**3,940**	2,026
Rebates	**3,168**	3,078
Other miscellaneous income	**1,071**	2,241
	8,179	**7,345**

24. Income from investments

	2011 AED'000	2010 AED'000
Realised / unrealised gains	**2,452**	15,606
Dividend income	**9**	52
	2,461	**15,658**

25. Employee benefits expense

Employee benefits expense includes employee bonus of **AED 21,065 thousand** (2010: AED 13,798 thousand). The number of employees at 31 December 2011 was **576** (including **500** relating to the Bank) of which **202** (relating to the Bank) were UAE nationals (2010: 539 (including 508 relating to the Bank) of which 189 (relating to the Bank) were UAE nationals).

26. Earnings per share

The calculation of earnings per share is based on earnings of **AED 280,925 thousand** (2010: AED 170,871 thousand) divided by the weighted average number of shares of **1,100,000 thousand** (2010: 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:

	2011 AED'000	2010 AED'000
Cash on hand	**72,074**	75,866
Balances with Central Bank of UAE	**2,031,766**	2,126,500
Due from banks with less than three months maturity	**564,091**	192,976
	2,667,931	2,395,342
Due to banks with less than three months maturity	**(540,212)**	(388,522)
	2,127,719	**2,006,820**

Notes (continued)

28. Related parties

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

	31 December 2011 AED'000	Average balance during 2011 AED'000	31 December 2010 AED'000	Average balance during 2010 AED'000
Statement of financial position items				
Loans and advances	**431,174**	**485,919**	463,903	385,759
Customer deposits	**2,320,971**	**2,191,438**	1,923,423	1,890,388
Letters of credit	**69,261**	**68,328**	76,037	139,085
Financial guarantees and other direct credit substitutes	**16,653**	**16,796**	18,601	19,349
Transaction related contingencies	**108,631**	**125,842**	132,093	120,072
Statement of income items				
Interest income	**26,621**		25,096	
Interest expense	**66,872**		67,049	
Other income	**6,090**		6,866	
Key management compensation				
Salaries and other short-term benefits	**14,298**		12,990	
Employee terminal and other long-term benefits	**319**		295	
Directors' attendance fees	**2,200**		2,200	

No provisions for impairment have been recognized in respect of loans given to related parties (2010: Nil).

The loans given to related parties amounting to **AED 431.174 million** (2010: AED 463.903 million) have been secured against collateral amounting to **AED 77.5 million** (2010: AED 76.5 million).

Notes (continued)

29. Segmental reporting

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

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

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, Asset and Liability Management (ALM) and others

The segment undertakes the Group's asset and liability 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 Asset and Liability Committee. The Group's capital and investment in subsidiary is recognised under this segment.

The Group has central shared services which include Operations, Risk Management, Human Resources, Finance, Information Technology, Product, Legal and Internal Audit. The shared services cost is allocated to business segments based on transaction and relevant drivers.

Notes (continued)

29. Segmental reporting (continued)

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

2011	Wholesale banking AED'000	Consumer banking AED'000	Treasury, ALM & others AED'000	Consolidated AED'000
Segment revenue	579,533	58,626	12,592	650,751
Segment operating cost	(163,848)	(86,413)	(6,236)	(256,497)
Impairment losses	(110,180)	(3,149)	-	(113,329)
Profit / (loss)	305,505	(30,936)	6,356	280,925
Segment assets	10,957,666	536,068	3,419,630	14,913,364
Segment liabilities	9,773,531	630,778	2,447,868	12,852,177
Capital expenditure	-	-	7,380	7,380

2010	Wholesale banking AED'000	Consumer banking AED'000	Treasury, ALM & others AED'000	Consolidated AED'000
Segment revenue	497,779	56,583	29,299	**583,661**
Segment operating cost	(132,151)	(70,766)	(4,828)	**(207,745)**
Impairment losses	(182,406)	(22,639)	-	**(205,045)**
Profit / (loss)	**183,222**	**(36,822)**	**24,471**	**170,871**
Segment assets	9,147,411	588,236	3,180,966	**12,916,613**
Segment liabilities	8,474,948	391,931	2,202,195	**11,069,074**
Capital expenditure	-	-	6,730	**6,730**

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	2011 AED'000	2010 AED'000
Interest income on loans and advances		
Overdrafts	78,067	77,962
Term loans	341,750	300,659
Loans against trust receipts	106,641	90,085
Bills discounted	55,899	56,357
Bills drawn under letters of credit	50,999	46,820
	633,356	571,883
Fees and commission income		
Letters of credit	58,151	58,034
Letters of guarantee	36,931	38,576
Lending fees	58,191	50,609
Asset management and investment services	157	531
Commission on transfers	12,371	12,094
Others	1,044	708
	166,845	160,552

30. Comparative figures

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