2013

ANNUAL REPORT

بنك الفجيرة الوطني
National Bank of Fujairah

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

2013
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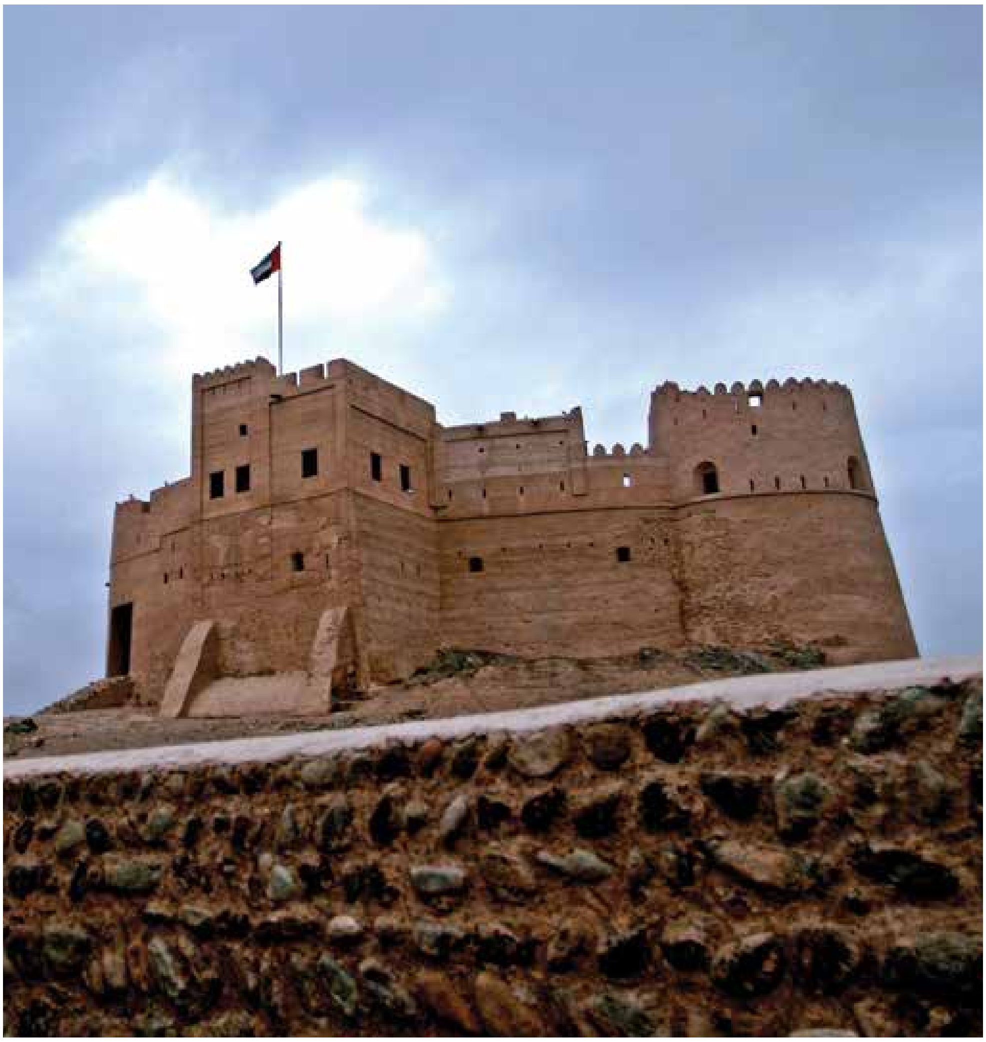

Fujairah Fort

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.

The Bank for Business in the UAE, the Pride of Fujairah

Incorporated in 1982, the National Bank of Fujairah has a long established reputation for excellence in the areas of corporate and commercial banking, trade finance and treasury. More recently, we have expanded our range of services to include comprehensive personal banking options.

NBF's commitment to the economic development of the UAE and home emirate of Fujairah is evident through our support of industries ranging from oil and shipping to services, manufacturing, construction, education and healthcare. The Bank's firm financial footing is also well-recognised in the capital markets, where we are the partner-of-choice for leading global counterparties in regional syndications.

With our solid track record, strong cultural heritage, deep market insight and unwavering focus on service and innovation, we seek to develop lasting relationships with our customers as we help them leverage growth opportunities in the ever-changing marketplace.

Our Vision

As a bank born and bred in the UAE, we at NBF celebrate our cultural heritage by playing a proactive role in the development of the local community.

We believe in cultivating rewarding relationships with our customers by providing them with the very best in financial services, innovation and service delivery.

Similarly, we continuously strive towards the creation of a stimulating environment that allows our people to pursue their own personal and professional development.

Our Network

Head Office

Hamad Bin Abdullah Street
PO Box 887, Fujairah
Tel +971 9 222 4518
Fax +971 9 222 4516

Branch Locations

Fujairah

Fujairah
Hamad Bin Abdullah Street
PO Box 887
Tel +971 9 222 4513
Fax +971 9 222 9470

Dibba
Sheikh Mohammed Bin Hamad Street
PO Box 11700
Tel +971 9 244 3788
Fax +971 9 244 3785

Masafi
NBF Building
PO Box 11208
Tel +971 9 256 3999
Fax +971 9 256 3339

Qidfah
NBF Building
PO Box 12002
Tel +971 9 236 0449
Fax +971 9 236 0494

Tawian
NBF Building, Dibba Road
PO Box 30098
Tel +971 7 258 4388
Fax +971 7 258 4355

Fujairah City Centre
G012A, Fujairah City Centre
PO Box 887
Tel +971 9 223 6392
Fax +971 9 223 7550

Dubai

Bur Dubai
Al Fujairah Building
Khalid Bin Waleed Street
PO Box 2979
Tel +971 4 397 1700
Fax +971 4 397 9100

Deira
Omar Bin Khattab Street
Fish round about
PO Box 2979
Tel +971 4 603 5700
Fax +971 4 221 6831

Jebel Ali
NBF Building
Next to Etisalat
PO Box 17676
Tel +971 4 803 0300
Fax +971 4 881 0939

Abu Dhabi

Abu Dhabi
Al Ferdous Tower
Al Salam Street
PO Box 786
Tel +971 2 612 5300
Fax +971 2 672 8362

Mussafah
Rashid Al Mazroui Building
Bank Street, Mussafah Industrial Area
PO Box 786
Tel + 971 2 555 4414
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Al Ain
Sheikh Falah Bin Zayed Al Nahyan
Building, near clock intersection
Main Road
PO Box 88108
Tel + 971 3 764 8142
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Ajman

Ajman
Al Shorafa Tower
Opposite to R Holding offices
Sheikh Khalifa Bin Zayed Street
PO Box 7622
Tel +971 6 731 8904
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Chairman's Report

Chairman's Report

On behalf of the Board of Directors, I am pleased to present the Annual Report of National Bank of Fujairah PSC and its subsidiaries for the year ended 31 December 2013.

Record profit achieved through an unwavering focus on core business, service quality and prudent risk management

2013 proved to be a momentous year for National Bank of Fujairah. The bank recorded its highest ever profit of AED 393.1 million, surpassing its previous benchmark of AED 323.8 million. Through this achievement, the bank has not only demonstrated itself capable of accomplishing the principal medium term strategic objectives set out in 2010, but has also laid out a solid foundation for the next phase of its growth journey.

The bank outperformed the industry average for a fourth year running, registering a strong net profit growth of 28.6% on top of the AED 305.8 million achieved in 2012. The loan book grew by 17.5% while our deposit base expanded by 24.6%. Although our operating expenses increased by 15.7% to AED 324.0 million due to the ongoing investment in NBF's operational and business platforms, the cost to income ratio improved from 36.9% to 36.6%, reflecting the bank's focus on overall efficiency. Buoyed by strong growth in its core business, NBF's operating income also grew by 16.5% to AED 884.7 million.

To ensure sustainable growth, the bank continues to prudently provision for possible loan losses, with overall provision coverage improving from 79.7% in 2012 to 118.4% in 2013. Net impairment losses for the year were AED 167.6 million compared to AED 173.7 million in 2012, an improvement of 3.5%.

Alongside the improvement in operating performance, the bank also initiated the process of restructuring the size and nature of its long term funding and quality of capital. The bank repaid in full the funds received from the Ministry of Finance as part of its support for the banking sector as a whole during the financial crisis. This repayment was 3 years ahead of the originally agreed repayment date. We also took steps to strengthen our Tier 1 capital through an issue of Perpetual Notes of AED 500 million to provide the capacity for further growth and put the bank well ahead of the expected regulatory changes. Finally, the capital strengthening process was completed through a successful refinancing of the bank's Tier 2 capital of AED 400 million that extended the contractual maturity until 2023. These changes have resulted in an improved Tier 1 ratio of 14.4% (2012: 12.3%) and a more cost effective capital adequacy ratio of 17.8% (2012: 19.2%). Liquidity levels have also remained solid, with advances-to-deposits ratio of 84.0% (2012: 82.8%) and liquid assets ratio of 21.8% (2012: 16.4%).

The bank has been investing in its operating platform to better its service offerings to the customers. For instance, it has rolled out its NBF Direct internet banking service to personal and corporate banking customers and introduced a number of new functionalities to its ATM and CDM network. A number of automation and process efficiency initiatives have also been introduced to enhance customer service.

In line with continuing efforts to enhance its suite of services, the bank has developed a Sharia' compliant platform with the intention of launching Islamic products over the course of 2014. NBF has also established trade processing operations in Hong Kong, NBF Trade Services (HKG) Limited, focused on supporting clients who do business in Asia, while NBF Capital Limited, another subsidiary located in Dubai International Financial Centre, was launched to offer corporate advisory services alongside the bank's traditional lending business.

NBF continues to receive market recognition for its achievements. The bank was the recipient of the "Best Domestic Commercial Bank" at the Banker Middle East Industry Awards (BME) for a second year in a row. This award came shortly after our hat trick at the BME Product Awards, where we swept the 'Best Treasury Management,' 'Best Foreign Exchange Service' and 'Best SME Trade Finance Offering' trophies. Such endorsements reaffirm the strong client relationships and business partnerships that the bank is privileged to have cultivated in its 30 years of operations. We are humbled by the trust and confidence placed in the bank and look forward to partnering with our valued clients for greater success.

In view of the bank's record performance I, on behalf of the Board of Directors, am pleased to recommend a 25% increase in dividends and propose a distribution of profits, in the form of cash dividends, of 12.5% (2012: 10%) of the paid-up capital.

A committed partner to UAE's growth and economic diversification

We continue to play a key role in the development of the economies of the UAE and our home emirate of Fujairah. As NBF progresses towards its vision of becoming the business partner of choice of the UAE and the pride of Fujairah, an unwavering focus on service excellence and client relationships remains instrumental to our success.

The UAE is the world's eighth largest oil producer and the Arab world's second largest economy. Its success hinges on the maintenance of an open economy, with minimal restrictions on private sector activities, international trade and capital movements. Despite the impact of the recent global economic downturn, the country's economy has proven to be remarkably resilient.

The highly anticipated Expo 2020 win by Dubai, coupled with the upgrade of UAE listed equities to emerging market status, will further boost an economy that is already on an upward trajectory, spurred on by huge non-oil sector investments and the booming trade, services and tourism industries.

With such exciting developments afoot, we believe that NBF is well-positioned to capitalise on new opportunities arising from a resurgent market to strengthen its core business, exceed customer expectations and improve shareholder returns. The bank remains committed to the growth of the UAE economy under the visionary and dynamic leadership 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 express my gratitude to His Highness Sheikh Hamad Bin Mohammed Al Sharqi, member of the Supreme Council and Ruler of Fujairah, for his staunch support and for being an inspiration to the bank.

I would also like to thank my fellow directors, management and staff at NBF for their commitment and hard work.

Finally, I would like to express my gratitude to the bank's customers for their unwavering support over the course of NBF's remarkable journey.

Saleh Bin Mohamed Bin Hamad Al Sharqi

Directors' Report

Directors' Report

Making our mark in the UAE

It is an exciting time for the United Arab Emirates. As it enters its 43rd year of nationhood, the UAE has effectively leveraged its strategic position along global trading routes and safe haven status within the Middle East to transform into a global hub for commerce and finance. Historic developments, from Dubai's successful bid as host city for the World Expo to greater dialogue between Iran and the West, are poised to significantly impact the local and regional economies, with the Dubai Expo alone expected to generate roughly 277,000 jobs and add AED 140 billion to GDP.

As a bank that draws inspiration from the country's founding fathers, National Bank of Fujairah stands ready to support the UAE as it embarks on the next leg of its transformative journey. To do so, it will continue to engage key stakeholders actively – clients, the business fraternity, the community as well as staff – in pursuit of common goals.

Operating environment

In its recent ratings report, Moody's changed the outlook of the UAE banking system from "negative" to "stable" reflecting the continued improvement in its operating environment, particularly in core economic sectors such as trade, transport and tourism; as well as the ongoing recovery of the local real estate market, most notably in the residential and prime commercial segments.

As a result, problem loan levels are expected to decline and profitability increase. In addition, banks are expected to continue to maintain high liquidity and capital buffers, which have been built-up since the onset of global financial crisis. Despite this broad-based recovery in the local economy, exposures to large corporate restructurings and government-related issuers (GRIs) are expected to continue posing asset quality risks.

Macro-economic indicators reflect the gradually improving trend:

Key Statistics (UAE)	2014F	2013F	2012	2011	2010	2009	2008
Nominal GDP ($ billions)	381.6	369.4	358.9	342.0	283.9	259.7	314.5
Population (millions)	5.9	5.7	5.5	5.4	5.2	5.1	4.8
Real GDP (% change)	3.7	3.6	4.4	3.9	1.3	-4.8	5.3
Inflation (CPI,% change)	2.5	2.0	0.7	0.9	0.9	1.6	12.3

Source: Moody's Investors Service

Fujairah: Enjoying significant growth

With its ongoing infrastructural development, expertise in the oil and gas sector and strategic location outside the Strait of Hormuz, Fujairah is well-positioned to build on its reputation as a global oil bunkering hub. In January 2014, Royal Vopak announced its seventh phase of expansion at Vopak Horizon Fujairah Limited, which will add 478,000 cubic meters (cbm) of storage capacity. The expansion will feature five storage tanks for crude oil and includes pipeline connection to the new VLCC jetty in the Port of Fujairah, raising the total storage capacity at Vopak Horizon Fujairah to over 2.6 million cbm. This will mark the entry of the first crude oil tanks in the Middle East for independent storage purposes and will greatly enhance Fujairah's storage capacity for crude oil and oil products.

Fujairah's reputation as the world's second largest fuel bunkering hub was sealed with the $3.3 billion crude pipeline completed by the Government of Abu Dhabi for onward shipment to overseas buyers. The Dolphin Energy pipeline, completed in 2007, is the first multinational gas grid in the Gulf, and links Fujairah to the biggest gas field in the world, Qatar's North Field. These developments, coupled with Fujairah's strategic food storage initiative, its planned link to the GCC rail network and construction of a second large scale oil refinery, provide significant impetus to the emirate's oil and petrochemical trading, refining, storage and other maritime industry-related activities.

Directors' Report *(continued)*

Other sectors have also experienced healthy growth, with the tourism industry, for example, growing by 8%. Work on flagship infrastructural projects such as the 'Fujairah 1' Independent Water and Power Plant continues apace, with a AED 734 million ($200 million) expansion project launched in June, which is scheduled to boost the plant's seawater desalination capacity by 30 million imperial gallons per day by 2015. Fujairah 1 will be one of the world's largest operating hybrid desalination plants, and is a joint venture between the Abu Dhabi Water and Electricity Authority, Abu Dhabi-based global energy company TAQA and Singapore's Sembcorp Industries.

Emirates LNG will build liquefied natural gas (LNG) project in Fujairah, which will go towards enhancing energy supply to power stations and industries.

Such positive economic indicators and infrastructure-based investment bodes well for Fujairah's future, and NBF is proud and well poised to play a part in the emirate's growth journey.

Financial Results

The Bank

NBF's remarkable performance underscores its focus on long term sustainable results and customer service. As NBF progresses towards becoming the UAE's bank for business and the pride of Fujairah, customer support will continue to be instrumental to our ongoing success.

2013 has seen NBF outperforming the industry in terms of growth for a fourth year running on the back of strong core business performance. Net profit grew by 28.6 per cent to mark the bank's highest profit ever of AED 393.1 million, up from AED 305.8 million from the previous year. Operating profit was AED 560.7 million in 2013, up 16.9 per cent from AED 479.5 million in the previous year.

Operating income grew by 16.5 per cent to AED 884.7 million, compared to AED 759.5 million in 2012, reflecting growing business volumes and robust asset and liability management. Net interest income grew by 15.3 per cent to AED 582.0 million, compared to AED 504.9 million in 2012. Non-interest income rose to AED 302.6 million, 18.9 per cent higher than the AED 254.6 million in 2012, showing an increase primarily in trade business and credit growth. Exchange income, including derivatives income, grew by 12.3 per cent to AED 62.7 million. A gain on investment income of AED 6.5 million was also recorded in 2013, compared to AED 3.2 million for the corresponding period of 2012.

Operating expenses increased by 15.7 per cent to AED 324.0 million, a reflection of the bank's ongoing commitment towards investing in new growth initiatives and its operating platform. The cost to income ratio improved to 36.6 per cent from 36.9 per cent in 2012, driven by strong focus on productivity, a disciplined approach to cost control and the benefits of investments in technology made over the last few years.

The bank's strong operating performance helped it improve provision coverage for ongoing non-performing exposures. The loan loss charge for the year was AED 167.6 million compared to AED 173.7 million in 2012. NBF's non-performing loans and advances (NPL) ratio was reduced to 4.6 per cent from 7.6 per cent in 2012. The improvement in NPL ratio was a result of strong remedial management effort. During the year, recoveries from NPL amounted to AED 102 million (2012: AED 101 million) and write-offs amounted to AED 144.5 million (2012: 35.2 million). Total provision coverage improved to 118.4 per cent in 2013 from 79.7 per cent in 2012, while specific provision coverage improved to 55.8 per cent from 51.3 per cent over the same period.

The growth in lending and deposits of 17.5 per cent and 24.6 per cent respectively reflects the strength of the bank's customer relationships and its commitment to the development of the economy of the UAE. Total assets grew 22.3 per cent to AED 21.5 billion from AED 17.5 billion at the end of 2012. The return on average equity was 14.8 per cent (2012: 14.1 per cent) and return on average assets was 2.02 per cent (2012: 1.9 per cent).

Directors' Report *(continued)*

Segment Performance

Corporate and Institutional Banking

NBF's dedication to relationship management and personalised customer experience was evident in the positive results from the bank's customer satisfaction survey, an annual satisfaction benchmarking exercise conducted by an independent research agency featuring in-depth interviews with 500 clients across the business spectrum. During the year, NBF's cutting edge online banking facility has been successfully made available to customers for their convenience and better service.

Corporate and Institutional segments

NBF's Corporate and Institutional segments comprise corporate and financial institution businesses and represents 61.4 per cent of the Bank's operating income. The segment recorded a strong growth of 20.5 per cent in operating income to AED 543.1 million, up from AED 450.9 million in 2012. Assets at AED 11.9 billion were 12.9 per cent higher than 2012's AED 10.6 billion and liabilities at 13.7 billion were 32.2% higher than 2012's AED 10.4 billion.

Business Banking segment

NBF's "Best Domestic Commercial Bank" award achieved for the second time in a row at the Banker Middle East Industry Awards (BME) was a highlight for the segment in 2013. Similarly, the bank was also recognised at the BME Product Awards, where it swept the 'Best SME Trade Finance Offering' trophy. Such awards reaffirm the strong client relationships and business partnerships that the bank is privileged to have cultivated over the years. The Business Banking segment represents 24.8 per cent of the bank's operating income and recorded a strong growth of 10.4 per cent to AED 219.2 million, up from AED 198.6 million in 2012. Segment assets at AED 2.2 billion were 20.3 per cent higher than 2012's AED 1.8 billion and segment liabilities at AED 1.9 billion saw a strong growth of 33.2% over 2012's AED 1.4 billion.

Retail Banking

As part of the bank's efforts to expand retail business across the UAE and enhance its contribution, a full suite of retail banking products and services has now been introduced. Our 'NBF Direct' internet banking service has been rolled out, while new offsite ATMs and CDMs were deployed and a number of new functionalities added. Retail banking operating profit turned positive to reach AED 1.1 million in 2013 compared to the 2012 operating loss of AED 6.6 million. Operating income grew by 26.3% to AED 68.4 million in 2013 while cost increased by 10.8% to AED 67.3 million in 2013. Segment assets grew by 58.8% to AED 1.2 billion. 2013 saw a net loss of AED 3.4 million compared to 2012 profit of AED 15.6 million arising from a one-off release in provision in 2012 amounting to AED 31.4 million. Retail banking sales and services are undergoing further enhancement to continue this very positive trend and increase our overall market share in the coming years.

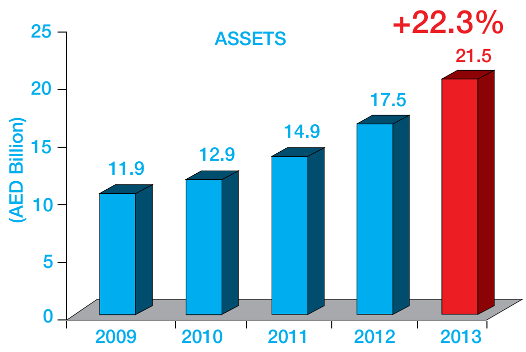
Treasury and Asset and Liability Management (ALM)

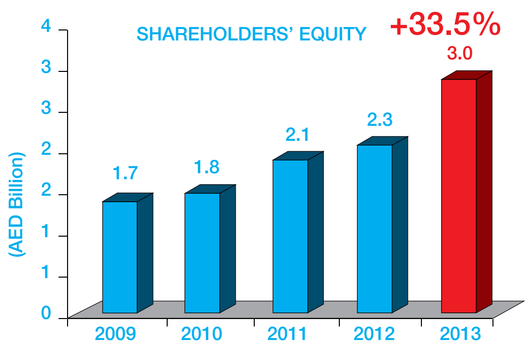
Our treasury business won 'Best Treasury Management' and 'Best Foreign Exchange Service' at the Banker Middle East Product Awards, reaffirming the ongoing success of this segment. The business saw a growth in foreign exchange and derivatives income of 12.3 per cent to AED 62.7 million (2012: 55.8 million). Sophisticated derivative transactions undertaken by the bank underscores the technical competence of NBF's treasury and its ability to offer the most complex products to its customers to help them manage their financial risks.

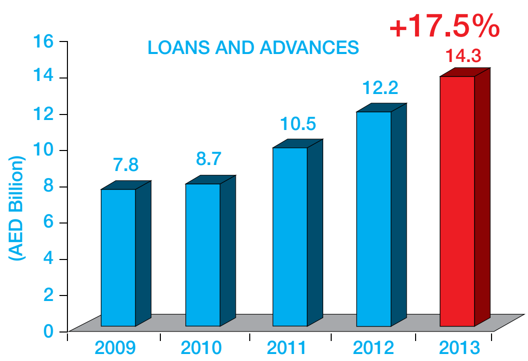
NBF's enhanced focus on asset and liability management during the year also resulted in a strong net interest growth of 15.3 per cent.

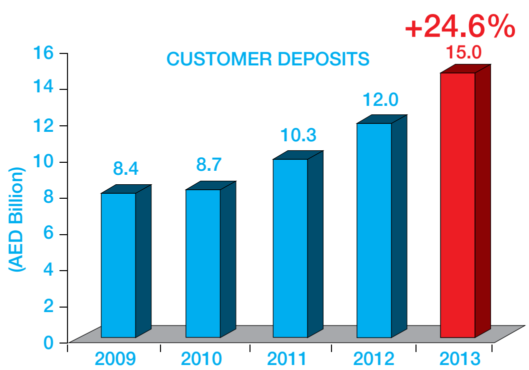
Directors' Report *(continued)*

NBF's Five Year Performance Scorecard









NBF's consistently higher than industry average growth rates is a reflection of its unwavering focus on core business, service quality and prudent risk management.

Assets:

21.5 b

2012: 17.5 b

Shareholders' equity:

3.0 b

2012: 2.3 b

Loans and advances:

14.3 b

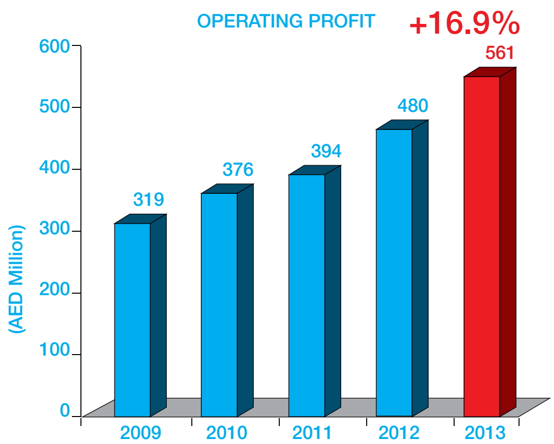
2012: 12.2 b

Customer deposits:

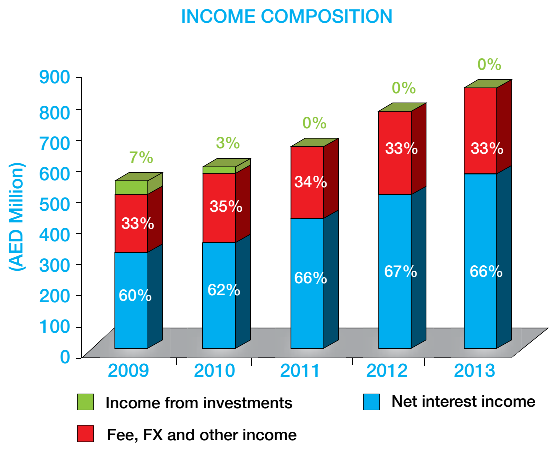
15.0 b

2012: 12.0 b

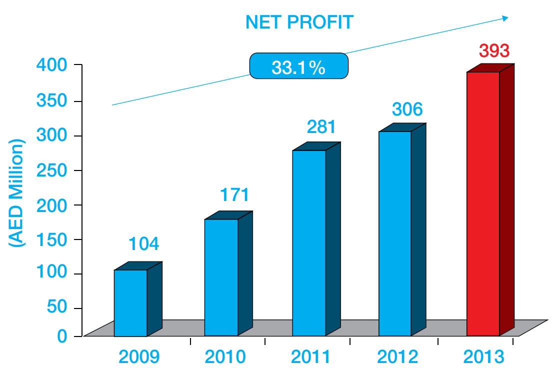
Directors' Report *(continued)*



NBF's track record for operating profit has been improving year on year on the back of impressive business performance and improved execution.



The quality of earnings has also been significantly enhanced by a growing share of stable, core business income. With a sharper focus on asset and liability management, the bank's net interest and fee income share stabilized at 2/3 and 1/3 respectively.



Our net profit on the back of annual average growth rate of 33.1% since 2009 now results in a world class ROAE of 14.8%.

Directors' Report *(continued)*

Operational Highlights

NBF's record financial performance has been underpinned by strong operational achievements:

- NBF Capital Limited, a fully owned subsidiary of NBF was established at Dubai International Financial Centre (DIFC) to provide advisory services alongside traditional banking business. The Company commenced operations in May 2013 and has witnessed an extremely encouraging start.
- The bank obtained the approval from Central Bank of the UAE to offer *Sharia'* compliant products through a window called "NBF Islamic". The bank appointed Amanie Advisors to assist in the implementation and a *Sharia'* Board has been appointed. In January 2014, the bank successfully implemented the core banking module for NBF Islamic and soft launched a "Qard Hasan" Islamic current account. 2014 will see launch of more Islamic banking products for our retail and corporate customers.
- NBF was recognised by Commerzbank for operational excellence in straight through processing of commercial payments for a third time in a row.
- The branch network has grown to 14 and new branches have also been planned for 2014. The bank's entire network is now equipped with touch screen ATMs and offer wide range of services such as cash withdrawal, credit card payment, transfer and utilities bill payment. The machines also offer cash and cheque deposit services in selected locations. The number of offsite ATMs/ CDMs have increased to 9.
- The results of the bank's third customer satisfaction survey show a high level of satisfaction and identify NBF's competitors as larger local and multinational banks from a service and business perspective. Our consistent awards in core areas of business banking, treasury and trade finance speak volumes of the trust and confidence placed in the bank by our customers. Nonetheless, we are committed to enhance our service levels and relationship management on an ongoing basis to make banking an even more exceptional experience for our customers.
- The bank's fourth employee satisfaction survey achieved a 100 per cent response rate. NBF's staff satisfaction scores remain robust and continue to rival those of high-performing organisations across the GCC banking sector and leading global employers across a variety of disciplines, with employees displaying optimism about NBF's future growth plans.
- NBF is implementing a Customer Relationship Management (CRM) system to provide a holistic view of its customers across the bank so as to service their needs in a more cohesive and prompter manner. The first phase is expected to be launched in early 2014.
- As part of the bank's ongoing focus on enhancing productivity, a number of processes have been automated and re-organised to improve processing time for customer transactions. Vendor management process, fixed assets administration and reconciliation processes have been automated end to end.
- After automating the bank's corporate credit process, NBF has initiated the automation of its retail lending process, from origination to disbursement, with a view to improving the quality of credit decisions and processing time for customers. This new phase of automation will be integrated to the Etihad Credit Bureau initiative at the earliest opportunity to ensure a consistent level of reporting and cohesive processing.
- The bank remains committed to the development of the human capital of the UAE. Its emiratisation ratio has improved from 40.7 per cent in 2012 to 41.1 per cent in 2013, which is well above the industry average. NBF's management trainee program (MTP) has been further enhanced to allow for separate class room training sessions, which began with its fourth batch of management trainees in Q4 2013. As for NBF's existing Emirati staff, a national development program has been unveiled to further support them in their personal development and help them become a more engaged and

effective work force for the bank. The program includes psychometric assessments and individual feedback sessions with professional trainers so as to enable Emirati staff to optimise their performance in a multicultural environment. NBF continues to run a well-received employee wellbeing program in conjunction with AXA ICAS. In its second year, the programme's key feature is a professional and confidential counselling service that is available to staff and their families round the clock and free of charge. It is the first of its kind for any local bank in the UAE, and underscores NBF's progressive approach towards staff development and wellbeing.

Market Leadership

NBF takes pride in positioning itself at the forefront of industry developments and is an advocate of best practices in its key business areas.

A member of the UAE interbank rate setting panel as well as the country's chapter of the International Chamber of Commerce (ICC UAE), the bank is privileged to not only win accolades from Banker Middle East for excellence in treasury, trade finance and commercial banking for a second year in a row, but is a regular recipient of Commerzbank's Straight Through Processing (STP) awards, which acknowledge excellence in the delivery of commercial payments and financial institution transfers. Similarly, Cash Management Matters bestowed NBF with its first Tajara Benchmark Status in recognition of its strengths in corporate banking and trade finance.

NBF is also an active participant of key industry seminars and regularly organises trade workshops apprising clients of the latest business developments. It has featured at top level gatherings such as the Middle East Banking Forum, organised by the UAE Banks Federation in conjunction with Financial Times and The Banker, and the ICC UAE Trade Finance conference. When Dubai hosted Sibos for the first time last September, NBF participated as an exhibiting sponsor, thereby raising its profile internationally whilst deepening its relationships with global counterparties.

In acknowledgement of the role customers play in its ongoing success, NBF featured four longtime clients in its first-ever branding campaign: Brands for Less; Taj Mahal; Gulf Star Cooling Services and Royal Printing Press. Featuring the company owners in creatively-rendered visionary sequences, the advertisements outlined NBF's role in their ongoing success, underscoring the strong client relationships that NBF has nurtured over the years.

Community Relations

NBF has long believed in the importance of giving back to the community and since the formation of its Corporate Social Responsibility (CSR) Committee in 2011, has adopted a comprehensive approach towards championing environment friendly business practices and community efforts.

Following a similar arrangement in 2012, NBF pledged further financial support to Angel Appeal, a charity initiative that provides relief to seafarers anchored off the coasts of Fujairah. A strong advocate of empowerment through education, NBF partnered Fujairah Higher Colleges of Technology in a laptop donation programme for students in 2012, and in a similar show of support, made a financial contribution to the Fujairah Welfare Association this year that would go towards helping underprivileged students within the emirate.

Our staff also rallied behind ongoing donation drives in support of the Dubai Blood Donation Centre as well as NBF's first tie-up with Al Shifa Eye Hospital, in which used eyeglasses were collected for the visually impaired.

Staff Engagement

Technology may provide a competitive edge, but it is people that form the heart and soul of banking.

At NBF, we believe in maximising the potential of our people by providing an environment that is conducive to growth and inclusivity. Not only does our ongoing focus on staff engagement and talent development reaffirm NBF's belief in its people and the roles they play in the local economy, it motivates and empowers staff to do the right thing on behalf of the bank and its customers.

Directors' Report *(continued)*

Apart from the bank's ongoing efforts at cultivating local talent through its management trainee and national development programmes, another noteworthy learning initiative that was introduced last year was an 18-to-24 month advanced development programme conducted by Fitch Learning, affiliated to Fitch Ratings, in which a third of the bank's employees, Emiratis and expatriates alike, underwent training to enhance their credit risk management skills. This is the first time the bank has introduced a specialised training exercise on such a scale, hence reaffirming the bank's commitment to service excellence and staff development.

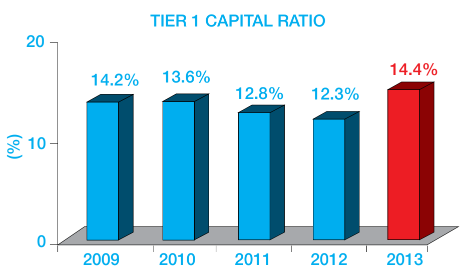
While NBF has put in place a formal approach towards staff recognition in line with market practices, it has also introduced something more "fun" in recent years to engender a deeper sense of belonging within the organisation. The NBF "Pride" campaign, initially designed to promote the bank's strategic vision and values through a photography showcase of exemplary employees, has not only generated much buzz at the workplace, not least amongst those who have been featured, but it has brought staff closer and made them prouder to be associated with the bank. The next iteration of the NBF Pride Campaign, featuring a greater cross-section of staff, is scheduled to launch in January 2014.

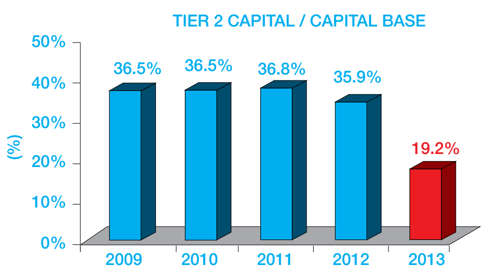
Risk Management

Risk management and corporate governance underpinned by transparency and fair business practices lies at the heart of everything we do, and are a key pre-requisite for good quality earnings, consistent results and shareholder confidence.

During the year, NBF further strengthened its risk management and corporate governance by appointing an independent professional member to the NBF Board Audit Committee and NBF Board Risk Committee. The bank also initiated a more progressive approach towards investor relations as part of its growth journey.

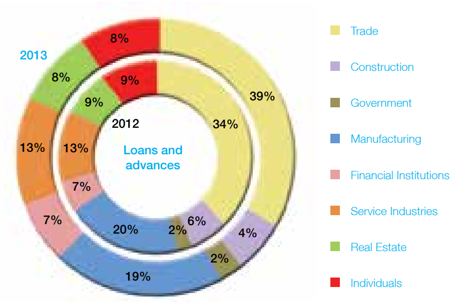
- The Bank's financial stability is underpinned by its strong liquidity and capital adequacy ratios. International credit rating agency Capital Intelligence has in its last report improved NBF's financial strength outlook from 'stable' to 'positive.' The Bank's Long Term Foreign Currency Rating (FCR) has been maintained at 'A-' since 2008, reflecting its prudent and proactive risk management practices and sound business model.
- The Bank continues to be solidly capitalised, as seen in its healthy capital adequacy ratio of 17.8 per cent and Tier 1 capital ratio of 14.4 per cent, both of which positions NBF strongly to meet evolving regulatory requirements. During the year, the bank's capital level and quality have been strengthened in line with its three-year strategic plan, which included measures to keep NBF's capital structure in line with its growth strategy and risk appetite. The bank's Tier 1 ratio is now at the highest level seen over the last five years and Tier 2 capital now represents less than 20% of the capital base. The bank prepaid its Ministry of Finance's subordinated debt of AED 642.6 million ahead of the stipulated deadline, and made its debut issue of Tier 1 perpetual notes of AED 500 million.

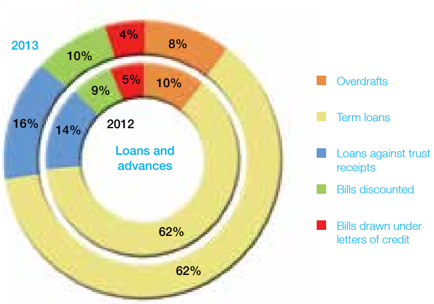




Directors’ Report *(continued)*

- The Bank has consistently looked to expand its customer base and reduce the systemic credit concentration that exists. Exposure to its top 20 customers has notably improved, reducing from 32.2 per cent in 2009, to 24.4 per cent in 2013.
- The Bank continuously monitors and manages its concentration risk from multiple perspectives, as evident from the current breadth of products, customer segments and sectors:





- NBF has also significantly improved its liquidity risk profile over the last three years. The bank’s balance sheet is well-diversified and its liquidity is of high quality; its advances-to-deposits ratio was 84.0 per cent (2012: 82.8 per cent) and liquid asset ratio was 21.8 per cent (2012: 16.4 per cent). At the same time, the bank has improved the duration of its liabilities. It has also implemented mark-to-market transfer pricing which has resulted in a more accurate reflection of market cost in the measurement of performance and risk-adjusted returns.
- The bank maintains prudent market risk limits and its trades are executed predominantly to support customer activities. NBF’s investment portfolio is held with the principal objective of liquidity management in mind and comprises mostly of debt securities, with 92.9 per cent (2012: 88.1 per cent) of the debt securities portfolio rated “BBB+” and above.
- In order to strengthen its risk and control framework, NBF has established an independent treasury middle office function to strengthen control and oversight while supporting the growing number of treasury-related business activities. Projects are being undertaken by the bank to comply with the Etihad Credit Bureau and Foreign Account Tax Compliance Act (FATCA) requirements. Progress is also underway for the automation of the retail credit lending process to enhance process efficiencies.
- The bank is fully committed to protecting the UAE financial system from money laundering and terrorist financing. It has strengthened its anti-money laundering policy, procedures and system in line with the latest recommendations from Financial Action Task Force (FATF), the international anti-money laundering regulatory body. Annual learning programs have also been implemented to enable staff to stay at the vanguard of the bank’s compliance efforts. Further, the bank has enhanced its engagement with the UAE Regulatory Authorities to ensure effective compliance.

The NBF Board and management are confident that the bank is well-positioned to continue its growth journey in the coming years. This can be achieved through an unwavering focus on enhancing the bank’s customer service and product proposition, adopting sound asset and liability management, embracing market best practices and practicing prudent risk management and good governance.

Easa Saleh Al Gurg, KCVO, CBE

Corporate Governance Report

Corporate Governance Report

The NBF Board and the management are committed to complying with the highest corporate governance standards and international best practices.

The Board of Directors' primary responsibility is to provide effective governance over the Bank's affairs for the benefit of its shareholders, and to balance the interests of its diverse constituencies, including its regulators, customers, employees, suppliers and the local communities in which it operates.

The Board plays a key role in the approval and oversight of the organisation's strategy, directional policies, risk appetites, senior appointments and supervision and remuneration of senior executives. The Bank has clearly defined the responsibilities of the Board of Directors, its corporate governance structure and delegated authorities so as to enable the effective and efficient implementation of all activities.

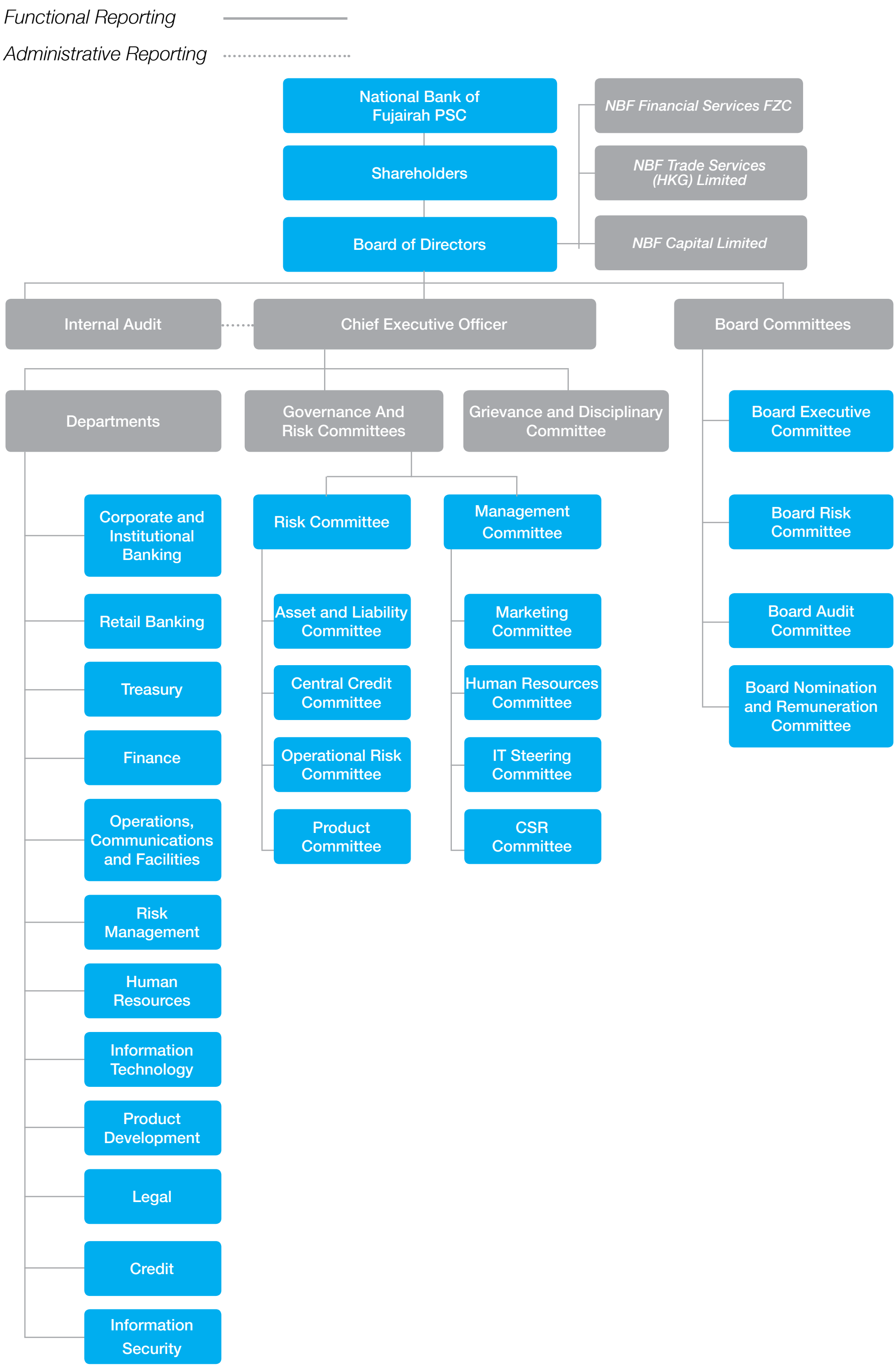
The Bank's corporate governance structure not only ensures that high levels of transparency and accountability are maintained, but also provides an appropriate functional independency and control environment from which to carry out its business activities. Also in place is a code of conduct and whistle blowing policy that encourages communication, transparency, issue escalation and fair business practices.

The Bank's formal disclosure policy is in place and note two in our annual consolidated financial statements detail NBF's compliance with all applicable laws and regulations. The annual consolidated financial statements are available on the Bank's website. For accounting policies, please refer to note three of the consolidated financial statements. Note four in our consolidated financial statements explains our financial risk management practices and can be referred to for further information on NBF's governance and risk management framework.

Corporate Governance Report *(continued)*

Organisation

The diagram below illustrates the high level organisation chart of the Bank. Management Committee and Risk Committee oversee and provide strategic direction to other committees. They also make recommendations to the Board and Board Committees.



Corporate Governance Report *(continued)*

Shareholders

NBF's shareholders consist of:

Department of Industry and Economy - Government of Fujairah	40.11%
Easa Saleh Al Gurg Company LLC	20.00%
Investment Corporation of Dubai - Government of Dubai	9.78%
Al Fujairah Investment Company	5.22%
Citizens of the United Arab Emirates	24.89%

2013: During the year, 12,148,756 shares representing 1.10% of the Bank's shares were traded.
(2012: 6,142,185 shares representing 0.56% of the Bank's shares were traded).

The investor relations and external communications are managed through the Bank's Finance and Corporate Communications departments respectively

Finance Department
Telephone: +971 9 2029210
Facsimile: +971 9 2229858
E-mail: NBF-investorrelations@nbf.ae

Corporate Communications Department
Telephone: +971 4 3971700
Facsimile: +971 4 3975385

Website: www.nbf.ae and refer to the investor relations section for further details.

Corporate Governance Report *(continued)*

The Board of Directors

The Board has adopted a rolling agenda to ensure that its responsibilities are carried out on a periodic basis. In addition, the Board continues to focus on improving engagement and effectiveness by reviewing the Bank's governance structures, processes and information flow to and from the Board. Committees such as the Board Executive Committee, Board Risk Committee, Nomination and Remuneration Committee and Board Audit Committee which are established to assist the Board in carrying out its responsibilities.

The Board also regularly reviews the financial performance of the Bank and its individual business areas. It is also focused on setting the Bank's risk appetite, policies, enterprise governance, risk and control framework and three-year business strategy.

Appointment, retirement and re-election

All directors are required to seek re-election by shareholders every three years. The Board of Directors comprises seven members (2012: 8 members) who were re-appointed on 27 March 2011 for a term of three years to fulfill its duties and responsibilities. The Chairman and all Directors are Non-Executive Directors. In 2013, no new Directors were appointed to the Bank. One director resigned and filling in the vacancy will be considered along with the full Board re-election due in March 2014. The formation of the Board of Directors is governed by the Federal Law No. 8 of 1984 (as amended).

All the directors declare their interests and directorships on an annual basis. Their dealings in the Bank's securities are also on full disclosure and at arm's length basis.

Details of the Board members' current terms of office and their external appointments are:

Board of Directors and their external appointments	**NBF, "the Bank"**
His Highness Sheikh Saleh Bin Mohamed Bin Hamad Al Sharqi	Chairman
• *Chairman of Department of Industry & Economy, Government of Fujairah*	
• *Chairman of Fujairah Port Authority*	
• *Chairman of Fujairah Petroleum Company*	
• *Chairman of Fujairah National Group*	
His Excellency Easa Saleh Al Gurg, KCVO, CBE	Deputy Chairman
• *Chairman of Easa Saleh Al Gurg Group*	
• *Chairman of Al Gurg Fosroc LLC*	
• *Chairman of Arabian Explosives Company LLC*	
• *Chairman of Al Gurg Unilever LLC*	
• *Board Member of Siemens LLC*	
• *Member of the Board of Trustees – The Oxford Centre for Islamic Studies, UK*	
Dr. Sulaiman Mousa Al Jassim	Member
• *Former Vice President of Zayed University*	
• *Board Member in Al Fujairah National Insurance Company*	
• *Chairman of Al Jassim Trading Group*	
• *Chairman of Al Jassim Marble and Tile Factory*	

Corporate Governance Report *(continued)*

Mr. Hussain Mirza Al Sayegh	Member

- *Deputy Chairman of Oilfields Supply Center*
- *Deputy Chairman of Al Nasr Leisure land*
- *Director of Emirates National Oil Company*
- *Director of Emirates National Bank of Dubai (ENBD)*

Mr. Saif Sultan Al Salami	Member

- *Managing Director of Fujairah National Group*
- *Board Member of Al Fujairah National Insurance Company*
- *Managing Director of Fujairah Investment Company*

Mr. Naser Ali Mohamed Khammas	Member

- *Managing Director of Fujairah Cement Industries*
- *Chairman Al-Ahli Group*

Mr. Mohamed Obaid Bin Majed Al Aleeli	Member

- *Director General of Department of Industry & Economy, Government of Fujairah*
- *Chairman of Fujairah Building Industries*

Directors' interests in the Bank's shares:

Name (Board of Directors)	Shareholding at 1 Jan 2013	Shareholding at 31 Dec 2013	Change
Sheikh Saleh Bin Mohamed Bin Hamad Al Sharqi	-	-	-
Easa Saleh Al Gurg, KCVO, CBE	-	-	-
Sulaiman Mousa Al Jassim	1,050,896	1,050,896	-
Hussain Mirza Al Sayegh	-	-	-
Saif Sultan Al Salami	-	-	-
Mohamed Obaid Bin Majed Al Aleeli	267,845	267,845	-
Naser Ali Mohamed Khammas	23,983	23,983	-

Corporate Governance Report *(continued)*

Board Committees

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 the Board Committees to enhance the oversight mechanism in order to discharge its responsibilities effectively. Each Committee has a formal Charter approved by the Board of Directors. Similarly, note four in our consolidated financial statements may be referred for further information on Board Committees and Governance and Risk Committees.

In 2013, the Board appointed Mr. T N Sekhar as an independent professional member to the Board Risk Committee and Board Audit Committee to further strengthen these processes by engaging an external independent expert.

In 2013, the Board of Directors met regularly and Directors received information about the activities of the Board Committees, Governance and Risk Committees, and developments in the Bank's business. The members and chairman of the Board's Committees are reviewed on a regular basis to ensure suitability and compliance with requirements. The table 'Board Committees' membership and meetings' below provides details of membership and meetings of the Board and Board Committees in 2013.

Board Committees' membership and meetings:

Name	Expiration of current term of office	Board	Board Executive Committee	Board Risk Committee	Board Audit Committee	Board Nomination & Remuneration Committee
Sheikh Saleh Bin Mohamed Bin Hamad Al Sharqi	2014	C				C
Easa Saleh Al Gurg, KCVO, CBE	2014	M	C		C	M
Sulaiman Mousa Al Jassim	2014	M	M		M	
Hussain Mirza Al Sayegh	2014	M	M		M	
Saif Sultan Al Salami	2014	M	M	C	M	M
Mohamed Obaid Bin Majed Al Aleeli	2014	M	M	M	M	
Naser Ali Mohamed Khammas	2014	M	M			
Sekhar T N	*			M	M	
Vince Cook	CEO		M	M		
Adnan Anwar	CFO			M		
Prasant Sarkar	CRO			M		
Alan Maitland Smith	HOIA				M	
Total no. of meetings		*8*	*-*	*4*	*5*	*2*
Approvals by circulation		*3*	*26*	*-*	*2*	*-*

C : Chairman

M : Member

CEO : Chief Executive Officer

CFO : Chief Financial Officer

CRO : Chief Risk Officer

HOIA : Head of Internal Audit

* Independent Professional Member

Corporate Governance Report *(continued)*

Board of Directors – Remuneration and interests in the Bank's shares

The remuneration of the Board members consists only of the directors' attendance fee, which is a fixed amount for the year and paid annually after the Annual General Meeting. For 2013, the fee was AED 2.0 million, which was charged to the statement of income, and is 0.51% of Net Profit attributed to shareholders of the Bank.

Board member remuneration paid during 2013 for year 2012	Director fees (AED per annum)
Chairman	400,000
Deputy Chairman	400,000
Director and Board Secretary	200,000 *(Per Person)*

Management

Vince Cook	Chief Executive Officer
Adnan Anwar	Chief Financial Officer
Balaji Krishnamurthy	Chief Operations Officer
Prasant Sarkar	Chief Risk Officer
Vikram Pradhan	Head of Corporate & Institutional Banking
Sharif Mohd. Rafei	Head of Retail Banking and Fujairah Region
Mark Domenic Zanelli	Head of Treasury
Abdulla Aleter	Head of Human Resources
Das P B	Senior Executive Officer - NBF Capital Limited

External Auditors

PricewaterhouseCoopers (PWC) were appointed external auditors for the Bank and its subsidiaries by the shareholders at the Annual General Meeting (AGM) held on 20 March 2013. The fee for external audit work for the audit of the Bank and its subsidiaries for the year ended 31 December 2013 was AED 619,479 (plus out-of-pocket expenses).

In addition, the fee for other services rendered amounted to AED 20,000. All non-audit work is pre-approved by the Board Audit Committee and / or the Board.

PricewaterhouseCoopers,
Emaar Square, Building 4 Level 8
P.O. Box 11987, Dubai, United Arab Emirates
Telephone: 04-3043100
Facsimile: 04-3304100

Independent Auditor's Report

Independent Auditor's Report

Independent auditor's report to the shareholders and directors of 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 subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2013, the consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards 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 the auditors' 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, the auditor considers 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 accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2013, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal Requirements

As required by the UAE Federal Law No. (8) of 1984, as amended in respect of the Bank, we report that:

(i) we have obtained all the information we considered necessary for the purpose of our audit;

(ii) the financial statements of the Bank comply, in all material respects, with the applicable provisions of the UAE Federal Law No. (8) of 1984, as amended, and the Articles of Association of the Bank;

(iii) the Bank has maintained proper books of account and its financial statements are in agreement therewith;

(iv) the Bank's financial information included in the Chairman's report and Directors' report is consistent with the books of account of the Bank; and

(v) nothing has come to our attention, which causes us to believe that the Bank has breached any of the applicable provisions of the UAE Federal Law No. (8) of 1984, as amended, or of its Articles of Association which would materially affect its activities or its financial position as at 31 December 2013.

Further, as required by the UAE Union Law No. (10) of 1980, as amended, we report that we have obtained all the information and explanations we considered necessary for the purpose of our audit.

PricewaterhouseCoopers
23 January 2014

Paul Suddaby
Registered Auditor Number 309
Dubai, United Arab Emirates

Group Financial Statements

Consolidated statement of financial position

As at 31 December 2013

	Note	2013 AED'000	2012 AED'000
Assets			
Cash and balances with the UAE Central Bank	6	4,007,712	2,406,987
Due from banks and financial institutions	7	1,298,943	1,022,441
Loans and advances	8	14,324,406	12,196,008
Investments	10	568,514	778,832
Property and equipment and capital work-in-progress	11	85,765	90,514
Intangible assets	12	22,551	12,993
Other assets	13	1,147,508	1,036,841
Total assets		21,455,399	**17,544,616**
Liabilities			
Due to banks	14	599,168	617,079
Customer deposits	15	14,997,123	12,040,102
Term borrowings	14	1,630,455	1,553,551
Other liabilities	16	1,199,119	1,065,053
Total liabilities		18,425,865	**15,275,785**
Shareholders' equity			
Share capital	17	1,100,000	1,100,000
Statutory reserve	17	353,647	314,119
Special reserve	17	248,647	209,119
Available-for-sale revaluation reserve		(1,864)	3,396
Proposed dividends	17	137,500	110,000
Retained earnings		691,604	532,197
Tier 1 capital notes	18	500,000	-
Total shareholders' equity		3,029,534	**2,268,831**
Total liabilities and shareholders' equity		21,455,399	**17,544,616**

These consolidated financial statements were approved and authorized for issue by the Board of Directors on 23 January 2014 and are signed on their behalf by:

Saleh Bin Mohamed Bin Hamad Al Sharqi
Chairman

Easa Saleh Al Gurg, KCVO, CBE
Deputy Chairman

The notes on pages 29 to 82 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 22.

Consolidated statement of income

For the year ended 31 December 2013

	Note	2013 AED'000	2012 AED'000
Interest income	*19*	838,684	767,888
Interest expense	*20*	(256,680)	(262,995)
Net interest income		582,004	**504,893**
Net fees and commission income	*21*	223,092	181,517
Foreign exchange and derivatives income		62,713	55,829
Income from investments	*22*	6,453	3,178
Other operating income	*23*	10,388	14,065
Operating income		884,650	**759,482**
Operating expenses			
Employee benefits expense	*24*	(236,990)	(211,636)
Depreciation and amortization	*11, 12*	(14,640)	(13,486)
Other operating expenses		(72,329)	(54,846)
Total operating expenses		(323,959)	**(279,968)**
Operating profit		560,691	**479,514**
Net impairment losses	*8*	(167,571)	(173,707)
Net profit for the year		393,120	**305,807**
Earnings per share (basic and diluted)	*25*	AED 0.36	**AED 0.28**

Appropriations have been reflected in consolidated statement of changes in equity.
The notes on pages 29 to 82 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 22.

Consolidated statement of comprehensive income

For the year ended 31 December 2013

	2013 AED'000	2012 AED'000
Net profit for the year	393,120	305,807
Other comprehensive income:		
Change in available-for-sale investments:		
Net fair value gains on disposal of available-for-sale investments	(5,569)	(2,582)
Net changes in fair value of available-for-sale investments	400	9,511
Others	(91)	4,908
Net change in available-for-sale-investments	(5,260)	11,837
Total comprehensive income for the year	387,860	317,644

The notes on pages 29 to 82 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 22.

Consolidated statement of cash flows

For the year ended 31 December 2013

Operating activities	*Note*	2013 AED'000	**2012 AED'000**
Net profit for the year		393,120	**305,807**
Adjustments for :			
Depreciation and amortization		14,640	13,486
Gain on disposal of property and equipment		(64)	-
Net impairment losses		167,571	173,707
Net fair value gains on disposal of investments		(6,151)	(3,746)
Net change in fair value of investments at fair value through profit and loss		(302)	568
Operating profit before working capital changes		568,814	**489,822**
Change in statutory reserve with the UAE Central Bank		(148,998)	(35,135)
Change in due from banks		(50,000)	50,000
Change in loans and advances		(2,295,969)	(1,864,455)
Change in other assets		(110,667)	(21,477)
Change in due to banks		71,522	64,836
Change in customer deposits		2,957,021	2,101,522
Change in other liabilities		134,066	9,918
Net cash generated from operating activities		1,125,789	**795,031**
Investing activities			
Purchase of property and equipment, intangible assets and capital work-in-progress		(19,449)	(26,082)
Proceeds from sale of property and equipment		64	-
Purchase of investments		(650,439)	(477,588)
Proceeds from sale of investments		861,950	297,669
Net cash generated from / (used in) investing activities		192,126	**(206,001)**
Financing activities			
Change in term borrowings		76,904	235,301
Cash dividends		(110,000)	(110,000)
Proceeds from issue of Tier 1 capital notes		500,000	-
Tier 1 capital notes coupon paid		(17,157)	-
Net cash generated from financing activities		449,747	**125,301**
Net change in cash and cash equivalents		1,767,662	**714,331**
Cash and cash equivalents at beginning of the year		2,479,073	1,764,742
Cash and cash equivalents at end of the year	*27*	4,246,735	**2,479,073**

The notes on pages 29 to 82 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 22.

Consolidated statement of changes in equity

For the year ended 31 December 2013

	Share capital	Statutory reserve	Special reserve	Retained earnings	Available--for-sale revaluation reserve	Proposed dividends	Tier 1 capital notes	Total
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
At 1 January 2012	1,100,000	283,539	178,539	397,550	(8,441)	110,000	-	2,061,187
Total comprehensive income for the year	-	-	-	305,807	11,837	-	-	317,644
Proposed dividends	-	-	-	(110,000)	-	110,000	-	-
Transfer to reserves	-	30,580	30,580	(61,160)	-	-	-	-
2011 cash dividends paid	-	-	-	-	-	(110,000)	-	(110,000)
At 31 December 2012	**1,100,000**	**314,119**	**209,119**	**532,197**	**3,396**	**110,000**	**-**	**2,268,831**
At 1 January 2013	1,100,000	314,119	209,119	532,197	3,396	110,000	-	2,268,831
Total comprehensive income for the year	-	-	-	393,120	(5,260)	-	-	387,860
Issue of Tier 1 capital notes (note 18)	-	-	-	-	-	-	500,000	500,000
Tier 1 capital notes coupon paid (note 18)	-	-	-	(17,157)	-	-	-	(17,157)
Proposed dividends	-	-	-	(137,500)	-	137,500	-	-
Transfer to reserves	-	39,528	39,528	(79,056)	-	-	-	-
2012 cash dividends paid	-	-	-	-	-	(110,000)	-	(110,000)
At 31 December 2013	1,100,000	353,647	248,647	691,604	(1,864)	137,500	500,000	3,029,534

The notes on pages 29 to 82 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 22.

Notes to the consolidated financial statements

For the year ended 31 December 2013

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 UAE 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 fourteen branches in Fujairah, Abu Dhabi, Dubai, Sharjah, Dibba, Jebel Ali, Musaffah, Masafi, Qidfah, Deira, Ajman, Tawian, Al-Ain and Fujairah City Centre.

The Bank has three fully owned subsidiary companies:

- NBF Financial Services FZC was established in December 2004 with limited liability status in the Fujairah Free Trade Zone to provide support services to the Bank.
- NBF Capital Limited is registered in the Dubai International Financial Centre (DIFC) as a company limited by shares under DIFC laws and regulations and regulated by the Dubai Financial Services Authority (DFSA). The Company was established on 3 April 2013 and commenced operations on 12 May 2013. The principal business activities of the company are arranging credit or deals in investments and advising on financial products or credit.
- NBF Trade Services (HKG) Limited is registered in Hong Kong as a company limited by shares governed and regulated under the Hong Kong Companies Ordinance. The Company was established on 10 May 2013. The principal business activity of the company is the provision of trade processing services.

The consolidated financial statements comprise the Bank and its subsidiaries (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 (IFRS), the rules of the UAE Central Bank and its Basel II Pillar 3 guidelines and the listing requirements of the 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.

Notes to the consolidated financial statements *(continued)*

2. Disclosure policy *(continued)*

(b) Frequency and medium of disclosure

The condensed consolidated interim financial information is prepared and presented on a quarterly basis while complete consolidated financial statements are prepared and presented on an annual basis in compliance with the requirements of IFRS, Basel II Pillar 3 and other guidelines from the UAE Central Bank. Disclosures of material non-public financial information are made by the Finance Department of the Group through the following mediums:

- Sending quarterly reviewed and annual audited consolidated financial statements, along with Management Discussion Analysis or Directors' report and any other price sensitive information to ADX and SCA;
- Hosting quarterly and annual consolidated financial statements on the Group's website; and
- Publication of annual report.

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

3. Summary of significant accounting policies

(a) Basis of preparation

The consolidated financial statements have been prepared in accordance with IFRS 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 UAE 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.

Standards that are effective for the Group's accounting period beginning on 1 January 2013

The following applicable new standards and amendments to existing standards have been published and are effective for the Group's accounting periods beginning on 1 January 2013.

- Amendment to IAS 1, 'Financial statement presentation' regarding other comprehensive income (effective 1 July 2012).
- IFRS - 10 'Consolidated financial statements' (effective 1 January 2013).
- IAS - 27 (revised 2011) 'Separate financial statements' (effective 1 January 2013).
- IFRS - 13 'Fair value measurement' (effective 1 January 2013).
- IAS - 19, 'Employees Benefits' (effective 1 January 2013).
- Amendment to IFRS 7, 'Financial Instruments' (effective 1 January 2013).

Management has assessed the impact of the above new standards and amendments to existing standards and has concluded that there is no significant impact from these standards and amendments on the Group's consolidated financial statements.

Notes to the consolidated financial statements *(continued)*

3. Summary of significant accounting policies *(continued)*

(a) Basis of preparation *(continued)*

The following applicable new standards have been issued but are not effective for the Group's accounting period beginning on 1 January 2013 and have not been early adopted by the Group:

IFRS - 9, 'Financial instruments' the published elements of the standard are available for immediate application but the mandatory effective date has not been published. IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of International Accounting Standard (IAS) 39 – 'Financial Instruments: Recognition and Measurement' that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch.

The Group will consider the impact of the amendments / changes to IFRS 9 when completed by the IASB and intends to adopt IFRS 9 no later than the accounting period beginning on the effective date, when published.

Amendments to IAS 36, 'Impairment of assets', on the recoverable amount disclosures for non-financial assets. This amendment removed certain disclosures of the recoverable amount of cash generating units (CGUs). The amendment is not mandatory for the Group until 1 January 2014.

There are no other new standards and amendments to published standards or IFRIC interpretations that have been issued but are not effective for the first time for the Group's financial year beginning on 1 January 2013 that would be expected to have a material impact on the consolidated financial statements of the Group.

(b) Basis of measurement

The consolidated financial statements are prepared under the historical cost convention as modified by the revaluation of the following financial assets:

- 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 the United Arab Emirates Dirham ("AED") which is the functional currency of the Group.

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

Notes to the consolidated financial statements *(continued)*

3. Summary of significant accounting policies *(continued)*

(d) Basis of consolidation

Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. The Group also assesses existence of control where it does not have more than 50 per cent of the voting power but is able to govern the financial and operating policies by virtue of de-facto control.

De-facto control may arise in circumstances where the size of the Group's voting rights relative to the size and dispersion of holdings of other shareholders give the Group the power to govern the financial and operating policies.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases. The financial statements of the subsidiaries are included in the consolidated financial statements from the date the control commences until the date that control ceases.

Transactions eliminated on consolidation

Inter-company transactions, balances, income and expenses on transactions between Group companies are eliminated. Profits and losses resulting from intercompany transactions are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(e) Financial instruments

Classification

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

Financial assets are categorized as follows:

Financial assets at fair value through profit or loss (FVTPL): 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 receivables are non-derivative financial assets with fixed and determinable payments that are not quoted in an active market.

Notes to the consolidated financial statements *(continued)*

3. Summary of significant accounting policies *(continued)*

(e) Financial instruments *(continued)*

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

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

Initial recognition

Regular purchases and sales of financial assets are recognized on the trade-date, the date on which the Group commits to purchase or sell the asset. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the consolidated statement of income. Loans and advances are recognized when cash is advanced to the borrowers.

De-recognition

Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are subsequently carried at amortized cost using the effective interest method. 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.

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.

Notes to the consolidated financial statements *(continued)*

3. **Summary of significant accounting policies** *(continued)*

(e) **Financial instruments** *(continued)*

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 consolidated statement of financial position for an instrument with similar terms and conditions.

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

The fair value of derivatives that are not exchange traded is estimated at the amount that the Group would receive or pay to terminate the contract at the date of consolidated 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.

Notes to the consolidated financial statements *(continued)*

3. Summary of significant accounting policies *(continued)*

(e) Financial instruments *(continued)*

Fair value hierarchy *(continued)*

Pursuant to disclosure requirements of IFRS 7 Financial Instruments: Disclosures, the Group has disclosed the relevant information under note 5.2.

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 consolidated 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 consolidated 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 consolidated statement of income over the remaining life of the held-to-maturity investments using the effective interest rate method.

Impairment

Financial assets are reviewed at each reporting date to determine whether there is objective evidence of impairment. If any such evidence exists, the asset's recoverable amount is estimated. Impairment loss is the difference between the net carrying value of an asset and its recoverable amount. Any such impairment loss is recognised in the consolidated 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 consolidated 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 consolidated statement of income, and is removed from the consolidated statement of other comprehensive income and recognised in the consolidated statement of income.

3. **Summary of significant accounting policies** *(continued)*

(e) **Financial instruments** *(continued)*

Impairment *(continued)*

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 recognized in consolidated statement of income, the impairment loss is reversed, with the amount of the reversal recognized in consolidated statement of income.

However, impairment losses recognized in the consolidated statement of income on equity instruments are not reversed through the consolidated statement of income because subsequent increase in fair value is recognized in fair value reserve.

(f) **Derivatives**

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 measured at fair value. Fair values are generally obtained by reference to quoted market prices, discounted cash flow models and pricing models, as appropriate.

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.

Derivatives may be embedded in another contractual arrangement (a "host contract"). The Group accounts for such embedded derivatives at fair value 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 to the host contract.

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 consolidated 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 consolidated statement of income, along with changes in the fair value of the assets and liabilities 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 the hedging reserve in other comprehensive income. Any gain or loss in fair value relating to an ineffective portion is recognized immediately in the consolidated statement of income.

Notes to the consolidated financial statements *(continued)*

3. Summary of significant accounting policies *(continued)*

(g) 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. 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 4. In particular, considerable management's judgment is required in the following:

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

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

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

Available for sale investments

The Group exercises judgment to consider impairment on the available-for-sale investments. This includes determination of whether any decline in the fair value below cost of equity instruments is significant or prolonged. In making this judgment, the Group evaluates among other factors, the normal volatility in market price. In addition, the Group considers impairment to be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance or changes in technology.

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.

(h) Due from banks and financial institutions

Amounts due from banks and financial institutions are initially recognized at fair value and measured subsequently at amortised cost using the effective interest method. Impairment of amounts due from banks and financial institutions is assessed as outlined in the accounting policy on financial instruments.

3. Summary of significant accounting policies *(continued)*

(i) Property and equipment, capital work-in-progress 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. Depreciation is charged to the consolidated 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 recognized in the consolidated statement of 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 the depreciation method are re-assessed at each reporting date.

Capital work-in-progress is stated at cost and is transferred to the appropriate asset category when it is brought into use and is depreciated in accordance with the Group's accounting policy.

(j) Intangible assets

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

Amortisation is recognised in the consolidated 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.

(k) Government grants

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

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

Due to banks, term borrowings and customer 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 consolidated statement of income. Amortised cost is calculated by taking into account any discount or premium on settlement.

(m) 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

Notes to the consolidated financial statements *(continued)*

3. Summary of significant accounting policies *(continued)*

(m) Provisions *(continued)*

flows at a rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability.

(n) 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. Guarantees are recognized at their fair value.

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).

(o) 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 the UAE pension and social security law and no further liability exists.

(p) Interest income and expense

Interest income and expense for all interest bearing financial instruments are recognised in the consolidated 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 unless re-priced.

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.

(q) 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.

Notes to the consolidated financial statements *(continued)*

3. Summary of significant accounting policies *(continued)*

(r) 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 recognized in the consolidated statement of income.

(s) Dividend income

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

(t) Cash and cash equivalents

For the purposes of the consolidated statement of cash flow, cash and cash equivalents comprise cash on hand and balances with the UAE Central Bank (excluding statutory reserve) and other balances due from and due to banks maturing within three months. Cash and cash equivalents are carried at amortised cost in the consolidated statement of financial position.

(u) 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 consolidated 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 recognized in the consolidated statement of income.

(v) 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 4, 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.

(w) Offsetting

Financial assets and liabilities are offset and the net amount is reported in the consolidated 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 IFRS / IAS, or when gains and losses arise from a group of similar transactions such as in the Group's trading activity.

Notes to the consolidated financial statements *(continued)*

3. Summary of significant accounting policies *(continued)*

(x) 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.

(y) 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 carrying amount is recognised in the consolidated statement of income.

(z) 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 consolidated statement of income on a straight-line basis over the term of the lease.

4. 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 enhances its risk management environment as a continuous process and significant progress has been made towards the implementation of the Basel II IRB approach and regulatory guidelines are awaited to complete the process for use in capital calculations. Work is also in progress for complying with Basel III requirements as they become applicable. The Group is committed to the implementation of best practices and governance standards. The roles and responsibilities of existing governance committees have been explained in note 4 (b).

(b) Governance and risk management framework

This note presents broad information about the Group's objectives, policies and processes for identifying, measuring, reporting and mitigating the above mentioned risks and the Group's management of capital. This note also covers enhanced disclosures relating to Pillar 3 (Market Discipline) of Basel II. The Board of Directors has overall responsibility for the establishment and oversight of the Group's enterprise risk management framework. The Board sets the overall risk appetite and strategy in consultation with the senior management and approves all principal governance committee charters, 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.

Notes to the consolidated financial statements *(continued)*

4. **Financial risk management** *(continued)*

(b) **Governance and risk management framework** *(continued)*

Board Executive Committee: consists of six members of the Board and the Chief Executive Officer (CEO), 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, an independent professional member, CEO, Chief Risk Officer (CRO) and Chief Financial Officer (CFO) 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 include, but not limited 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 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 UAE Central Bank;
- 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: consists of five Board members, an independent professional member and the Head of Internal Audit. 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 any reports issued by the regulatory authorities and makes 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;
- 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 all Internal Audit reports concerning any investigation or significant fraud that occurs at the Group.

Notes to the consolidated financial statements *(continued)*

4. Financial risk management *(continued)*

(b) Governance and risk management framework *(continued)*

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), Risk Committee (RC), Marketing Committee (MC), Human Resources Committee (HRC), Corporate Social Responsibility Committee (CSRC), IT Steering Committee (ITSC), 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 regularly for the effective and efficient discharge of their responsibilities. 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 (MANCOM), steered by the CEO, 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, ITSC, CSRC.

The Risk Committee (RC) steered by the CEO is responsible to develop and recommend to the Board through 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 has 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.

Notes to the consolidated financial statements *(continued)*

4. **Financial risk management** *(continued)*

(b) **Governance and risk management framework** *(continued)*

The Asset and Liability Committee (ALCO) steered by the CFO 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 (CCC) steered by the Head of Credit is responsible for credit decisions for the Group's lending portfolio, setting country and other high level Group risk limits, oversee portfolio reviews with particular focus on quality, dealing with impaired assets and 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 for reviews of credit risk policies, enhancement of credit risk reporting and processing.

The Operational Risk Committee (ORC) steered by the Head of Operational Risk and Compliance 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 Plan (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 (PC) steered by the CRO is responsible to review and approve all risks, designs, pricing, financials, product 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 (MC) steered by the CEO 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.

The Human Resources Committee (HRC) steered by the CEO 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.

Notes to the consolidated financial statements *(continued)*

4. **Financial risk management** *(continued)*

(b) **Governance and risk management framework** *(continued)*

The IT Steering Committee (ITSC) steered by the CEO 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 (CSRC) 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 (GDC) 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 to assess adequacy of internal controls and meeting of compliance requirements, operational risk management, credit review and middle office activities for market and liquidity risks.

The Group follows the Board approved whistle blowing policy where staff can independently raise matters to the CEO, the Head of Internal Audit or the Board Secretary. The Group through the GDC comprising Head of Internal Audit, Head of Human Resources and Head of Legal, and reporting to the CEO promotes 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 Audit Committee, with administrative reporting line to the CEO. 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 amounts due from 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 retail banking and a range of products and services are available to customers across the UAE.

4. Financial risk management *(continued)*

(c) Credit risk *(continued)*

Management of credit risk

An independent Credit Department is responsible for review, recommending and approving underwriting proposals and together with Risk Management Division is responsible for managing credit risk and formulation of credit policies in line with strategic objectives, risk appetite, business growth, regulatory requirements and risk management standards. An independent loan review function is responsible for loan review, on a post facto 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 risk 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 UAE Central Bank for any planned exposure to single counterparty / group, keeping in view the regulatory capital base, in accordance with the regulations of monitoring of large exposure limits issued by the UAE Central Bank.

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 to the consolidated financial statements *(continued)*

4. Financial risk management *(continued)*

(c) Credit 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 from loans and advances at 31 December 2013 and 2012 is shown below:

	Loans and advances							
2013	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded)	Past due but not impaired	
							Upto 90 days	Above 90 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Trade	5,885,664	1,456,217	7,341,881	131,227	103,296	46,188	55,979	-
Construction	629,250	3,280,379	3,909,629	75,876	20,695	2,183	26,539	-
Government	216,942	227	217,169	-	-	-	20	-
Manufacturing	2,920,009	842,293	3,762,302	55,720	48,892	10,586	47,076	-
Financial institutions	1,034,669	113,306	1,147,975	91,908	46,021	53,443	-	-
Service industries	1,970,710	174,164	2,144,874	195,217	100,247	4,253	4,189	-
Real estate	1,212,679	-	1,212,679	19,708	11,855	-	951	-
Individuals	1,269,532	66,200	1,335,732	119,010	53,135	27,843	22,854	-
Gross amount	15,139,455	5,932,786	21,072,241	688,666	384,141	144,496	157,608	-

	Loans and advances							
2012	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded)	Past due but not impaired	
							Upto 90 days	Above 90 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Trade	4,423,504	1,377,053	5,800,557	65,616	62,038	18,633	21,206	-
Construction	769,235	2,934,448	3,703,683	11,182	6,386	-	26,203	-
Government	303,242	5,107	308,349	-	-	-	-	-
Manufacturing	2,572,067	559,604	3,131,671	154,633	129,744	6,892	23,584	-
Financial institutions	894,717	88,087	982,804	237,739	96,677	-	380	-
Service industries	1,640,548	222,044	1,862,592	329,585	97,775	1,038	2,523	-
Real estate	1,203,986	-	1,203,986	18,840	13,566	-	681	-
Individuals	1,179,393	16,254	1,195,647	174,163	102,439	8,678	1,704	-
Gross amount	**12,986,692**	**5,202,597**	**18,189,289**	**991,758**	**508,625**	**35,241**	**76,281**	**-**

Notes to the consolidated financial statements *(continued)*

4. **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 2013 and 2012 is shown below:

2013	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded)	Past due but not impaired	
							Upto 90 days	Above 90 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Within UAE	14,715,654	5,865,082	20,580,736	595,846	337,993	91,052	156,018	-
GCC countries	202,875	22,326	225,201	91,775	45,887	53,444	-	-
Others	220,926	45,378	266,304	1,045	261	-	1,590	-
Total	15,139,455	5,932,786	21,072,241	688,666	384,141	144,496	157,608	-

2012	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded)	Past due but not impaired	
							Upto 90 days	Above 90 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Within UAE	12,566,027	5,166,021	17,732,048	828,019	421,961	35,241	75,901	-
GCC countries	188,493	7,016	195,509	163,739	86,664	-	-	-
Others	232,172	29,560	261,732	-	-	-	380	-
Total	**12,986,692**	**5,202,597**	**18,189,289**	**991,758**	**508,625**	**35,241**	**76,281**	**-**

Currency wise analysis

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

	2013			2012		
	Funded	Unfunded	Gross exposure	Funded	Unfunded	Gross exposure
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
AED	12,619,841	4,085,875	16,705,716	10,907,147	3,666,769	14,573,916
USD	1,993,400	1,571,504	3,564,904	1,603,611	1,300,704	2,904,315
EUR	46,250	196,425	242,675	35,381	137,929	173,310
GBP	3,070	12,100	15,170	-	5,530	5,530
XAU	395,024	-	395,024	382,789	-	382,789
Others	81,870	66,882	148,752	57,764	91,665	149,429
TOTAL	15,139,455	5,932,786	21,072,241	**12,986,692**	**5,202,597**	**18,189,289**

Notes to the consolidated financial statements *(continued)*

4. 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 monitored and quantified as part of the Group's Credit 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 and financial institutions.

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 a periodic basis in accordance with the respective credit policies. An estimate of fair value of collateral and other security enhancements held against the loan portfolio is shown below:

Notes to the consolidated financial statements *(continued)*

4. **Financial risk management** *(continued)*

(c) **Credit risk** *(continued)*

Risk mitigation, collateral and credit enhancements *(continued)*

Particulars	Loans and Advances		Collaterals	
	2013	2012	2013	2012
	AED'000	AED'000	AED'000	AED'000
Individually impaired				
Pledged deposits	30,679	24,932	5,583	3,602
Debt / Equity securities	83,258	121,056	78,141	88,092
Property	125,593	152,225	105,496	133,959
Others	449,136	693,545	20,000	20,000
Gross amount	688,666	991,758	209,220	245,653
Impairment loss	(384,141)	(508,625)	-	-
Carrying amount	304,525	483,133	209,220	245,653
Past due but not impaired				
Pledged deposits	83,187	42,650	16,487	10,541
Debt / Equity securities	-	233	-	233
Property	12,306	14,599	7,668	11,383
Others	62,115	18,799	-	-
Gross amount	157,608	76,281	24,155	22,157
Impairment loss	-	-	-	-
Carrying amount	157,608	76,281	24,155	22,157
Neither past due nor impaired				
Pledged deposits	5,330,616	3,932,073	1,278,583	973,409
Debt / Equity securities	73,604	145,859	73,604	77,274
Property	2,111,490	1,752,993	1,661,762	1,380,417
Others	6,777,471	6,087,728	-	-
Gross amount	14,293,181	11,918,653	3,013,949	2,431,100
Collective impairment provision	(430,908)	(282,059)	-	-
Carrying amount	13,862,273	11,636,594	3,013,949	2,431,100
Total	14,324,406	12,196,008	3,247,324	2,698,910
Renegotiated exposure	1,125,022	1,077,859	322,929	370,695
Contingent liabilities				
Pledged deposits	3,498,740	2,673,349	420,527	385,671
Others	2,434,046	2,529,248	140,723	131,768
Total	5,932,786	5,202,597	561,250	517,439

Notes to the consolidated financial statements *(continued)*

4. Financial risk management *(continued)*

(c) Credit risk *(continued)*

Past due but not impaired portfolio ageing is as follows:

	2013	2012
	AED'000	AED'000
Less than 1 month	106,691	50,635
1 month to 3 months	50,917	25,646
Total	157,608	76,281

Credit quality

The credit quality of the loans and advances portfolio is managed by the Group using internal credit ratings comprising 22 grades. 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 UAE 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	2013	2012
	AED'000	AED'000
Neither past due nor impaired / Past due but not impaired (RR 1-19)		
Grades 1-18: Performing or normal	13,724,828	11,338,673
Grade 19: Other Loans Especially Mentioned (OLEM)	725,961	656,261
	14,450,789	11,994,934
Individually impaired (RR 20-22)		
Grade 20: Sub-standard	73,999	358,141
Grade 21: Doubtful	292,882	208,196
Grade 22: Loss	321,785	425,421
	688,666	991,758
Total	15,139,455	12,986,692

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.

4. Financial risk management *(continued)*

(c) Credit risk *(continued)*

Loans with renegotiated terms

Loans with renegotiated terms are loans that have been rescheduled / restructured due to deterioration in the borrower's financial position and where the Group has made concessions that it would not otherwise consider. These loans are not delinquent; however, impairment is recognized in accordance with IAS 39 to represent the benefits foregone by the Group. The impairment recognized will be gradually unwound to the consolidated statement of income in a manner that corresponds to the performance of the account in line with the restructuring terms.

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 risk limits. All liquidity risk management policies and procedures are subject to review and approval by ALCO, RC, Board Risk Committee and the Board.

The Group maintains a portfolio of short-term liquid assets, largely made up of cash and balances with the UAE Central Bank representing **18.68%** (2012: 13.72%) of total assets. Short-term liquid assets also include investment grade marketable securities, 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. **16.70%** (2012: 13.46%) of the Group's deposits are pledged.

Notes to the consolidated financial statements *(continued)*

4. Financial risk management *(continued)*

(d) Liquidity risk *(continued)*

The Group uses advances to stable resources ratio of 1:1 as stipulated by the UAE Central Bank as one of the key risk indicators and monitors this on a regular basis. The Group uses more prudent internal advances to stable resources ratio measure of 0.925:1 as a trigger point for action planning.

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 of NBF Issuer Credit Rating 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 UAE Central Bank include certificates of deposit which are readily convertible into cash under repurchase arrangements with the UAE Central Bank. Investments include available-for-sale investments which can be redeemed before their contractual maturity.

Notes to the consolidated financial statements *(continued)*

4. **Financial risk management** *(continued)*

(d) **Liquidity risk** *(continued)*

At 31 December 2013	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 the UAE Central Bank	2,158,950	301,292	501,673	1,050,890	-	-	4,012,805
Due from banks and financial institutions	1,000,589	247,477	50,647	-	-	-	1,298,713
Loans and advances	2,898,644	3,346,553	2,112,855	1,137,508	4,370,470	1,787,623	15,653,653
Investments	35,359	1,963	32,825	4,781	516,631	19,868	611,427
Other assets	383,404	429,244	148,799	55,395	8,916	-	1,025,758
Total financial assets	6,476,946	4,326,529	2,846,799	2,248,574	4,896,017	1,807,491	22,602,356
At 31 December 2013							
Due to banks	265,371	197,754	16,375	120,789	-	-	600,289
Customer deposits	4,830,789	3,284,831	3,520,295	2,371,489	1,244,285	70	15,251,759
Term borrowings	864,727	5,070	6,363	195,839	260,458	494,196	1,826,653
Other liabilities	449,688	429,244	148,804	56,098	9,058	-	1,092,892
Total financial liabilities	6,410,575	3,916,899	3,691,837	2,744,215	1,513,801	494,266	18,771,593
On Balance Sheet Gap	66,371	409,630	(845,038)	(495,641)	3,382,216	1,313,225	
Cumulative Gap	66,371	476,001	(369,037)	(864,678)	2,517,538	3,830,763	
At 31 December 2012							
Financial Assets	4,969,269	3,822,559	2,387,782	1,472,668	4,313,698	1,681,125	18,647,101
Financial Liabilities	4,964,212	3,559,778	1,548,937	1,978,652	2,238,533	1,461,712	15,751,824
On Balance Sheet Gap	**5,057**	**262,781**	**838,845**	**(505,984)**	**2,075,165**	**219,413**	
Cumulative Gap	**5,057**	**267,838**	**1,106,683**	**600,699**	**2,675,864**	**2,895,277**	

The table below incorporates guarantees, letters of credit and notional amounts of derivative financial instruments, entered into by the Group, outstanding at the date of consolidated 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.

Notes to the consolidated financial statements *(continued)*

4. Financial risk management *(continued)*

(d) Liquidity risk *(continued)*

At 31 December 2013	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
Guarantees	4,613,706	-	-	-	-	-	4,613,706
Letters of credit	197,215	766,573	265,010	81,510	8,772	-	1,319,080
Forward foreign exchange contracts	1,426,905	1,276,392	625,424	220,412	-	-	3,549,133
Currency options	-	54,226	679,027	1,800,041	-	-	2,533,294
Interest rate derivatives	1,010	9,182	2,667	22,482	820,069	623,868	1,479,278
Commodity derivatives	-	24,831	1,948	56,306	-	-	83,085
	6,238,836	2,131,204	1,574,076	2,180,751	828,841	623,868	13,577,576
At 31 December 2012							
Guarantees	4,027,299	-	-	-	-	-	4,027,299
Letters of credit	173,981	597,552	282,497	116,015	5,253	-	1,175,298
Forward foreign exchange contracts	1,064,266	425,592	672,481	113,751	69,569	-	2,345,659
Currency options	-	-	-	1,821,021	-	-	1,821,021
Interest rate derivatives	9,347	12,437	12,294	24,588	656,938	-	715,604
Commodity derivatives	-	-	-	363,077	-	-	363,077
	5,274,893	**1,035,581**	**967,272**	**2,438,452**	**731,760**	**-**	**10,447,958**

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

	2013			2012		
	Positive fair value	Negative fair value	Net	Positive fair value	Negative fair value	Net
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Derivatives						
Forward foreign exchange contracts	13,894	12,936	958	13,683	11,580	2,103
Currency options	17,613	17,613	-	3,003	3,003	-
Interest rate derivatives	10,287	9,910	377	14,127	16,213	(2,086)
Commodity derivatives	502	304	198	1,625	1,625	-
	42,296	40,763	1,533	**32,438**	**32,421**	**17**

Notes to the consolidated financial statements *(continued)*

4. 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 15% 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 2013 and 2012:

	Assumed level of change %	Impact on net income and equity 2013 AED '000	Impact on net income and equity 2012 AED '000
Investments carried at fair value through the income statement			
Reference benchmarks:			
Fair value of managed funds	10%	**1,146**	2,768

	Assumed level of change %	Impact on equity 2013 AED '000	Impact on equity 2012 AED '000
Available for sale investments			
Reference benchmarks:			
Quoted debt securities	10%	**46,031**	40,984
Investments in listed equity	10%	**94**	63

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.

Notes to the consolidated financial statements *(continued)*

4. Financial risk management *(continued)*

(e) Market risk *(continued)*

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			
2013 (AED in 000's)	**224,390**	**865**	**6,198**
2012 (AED in 000's)	91,252	(1,459)	4,945
Assumed change in exchange rates	5%	5%	5%
Impact on exchange income from increase in exchange rates:			
2013 (AED in 000's)	**11,220**	**43**	**310**
2012 (AED in 000's)	4,563	(73)	247
Impact on exchange income from decrease in exchange rates:			
2013 (AED in 000's)	**(11,220)**	**(43)**	**(310)**
2012 (AED in 000's)	(4,563)	73	(247)

At 31 December 2013, the impact on exchange income due to change in exchange rate by 5% is **±18.5%** (2012: ±8.5%). Excluding the impact of US$ open position, the impact is **±0.6%** (2012: ±0.3%).

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 long term financial assets and liabilities are priced on a floating rate basis, which tracks the changes in market interest rates. Retail personal loans are priced on a fixed rate basis and constitute **4.72%** (2012: 4.89%) of the total loan portfolio. The pricing of these loans reflect the fixed rate nature of the product and are generally priced at a higher spread.

Notes to the consolidated financial statements *(continued)*

4. Financial risk management *(continued)*

(e) Market risk *(continued)*

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

Currency	**AED**	**USD**	**EUR**	**Others**	**Total**
Assumed change in interest rates	±200 bps	±200 bps	±200 bps	±200 bps	±200 bps
Impact on net interest income from increase in interest rates:					
2013 (AED in 000's)	**33,625**	**9,217**	**1,552**	**837**	**45,231**
2012 (AED in 000's)	35,000	-	-	2,000	37,000
Impact on net interest income from decrease in interest rates:					
2013 (AED in 000's)	**(95,763)**	**(8,037)**	**(447)**	**(4,795)**	**(109,042)**
2012 (AED in 000's)	(42,000)	-	-	(2,000)	(44,000)

The results of the shift analysis are reviewed monthly by ALCO, which along 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 an action plan is agreed. At 31 December 2013, the impact of 200 bps shift analysis on net interest is **+7.8% / -18.7%** (2012: +7.3% / -8.7%) and regulatory capital is **+1.4% / -3.3%** (2012: +1.2% / -1.4%).

Notes to the consolidated financial statements *(continued)*

4. 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 2013	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 the UAE Central Bank	250,000	300,000	500,000	1,050,000	-	-	1,907,712	4,007,712
Due from banks and financial institutions	1,042,360	73,460	50,000	-	-	-	133,123	1,298,943
Loans and advances	5,023,167	5,436,103	2,127,328	281,020	947,462	633,769	(124,443)	14,324,406
Investments	97,314	146,442	-	-	292,862	19,278	12,618	568,514
Other assets	-	-	-	-	-	-	1,108,112	1,108,112
Total financial assets	6,412,841	5,956,005	2,677,328	1,331,020	1,240,324	653,047	3,037,122	21,307,687
Due to banks	232,471	197,578	16,358	120,000	-	-	32,761	599,168
Customer deposits	1,907,467	2,995,750	3,528,978	2,279,670	1,077,522	70	3,207,666	14,997,123
Term borrowings	1,138,630	400,000	91,825	-	-	-	-	1,630,455
Other liabilities	-	-	-	-	-	-	1,144,852	1,144,852
Total financial liabilities	3,278,568	3,593,328	3,637,161	2,399,670	1,077,522	70	4,385,279	18,371,598
Interest rate sensitivity gap								
On-balance Sheet	3,134,273	2,362,677	(959,833)	(1,068,650)	162,802	652,977	(1,348,157)	
Off-balance Sheet	118,637	17,807	439,095	352,789	550,950	-	6,165,512	
Cumulative	3,252,910	5,633,394	5,112,656	4,396,795	5,110,547	5,763,524	10,580,879	
At 31 December 2012								
Cumulative interest rate sensitivity gap	1,626,249	4,047,215	5,203,118	4,033,640	4,814,584	4,010,958	7,428,324	

Interest rate yields

The average earning on placements and balances with banks was **0.48%** (*2012:* 0.51%), on loans and advances was **5.68%** (*2012:* 5.98%) and on investments was **1.98%** (*2012:* 2.41%). The average cost of customer deposits was **1.51%** (*2012:* 1.94%) and of due to banks and term borrowings was **2.72%** (*2012:* 2.43%).

Notes to the consolidated financial statements *(continued)*

4. 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 risk and internal control assessments and 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 RC, Board Risk Committee and the Board.

(g) Management of capital

The Group's lead regulator, the UAE Central Bank, sets and monitors regulatory capital requirements. The requirements of capital for subsidiaries, NBF Financial Services FZC, NBF Capital Limited and NBF Trade Services (HKG) Limited, are determined by the Free Zone Authority of Fujairah, DFSA and Hong Kong Companies Registry respectively.

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; and
- 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 subsidiaries 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 UAE Central Bank dated 17 November 2009. The UAE Central Bank introduced the implementation of Basel II with Standardized Approach which the Group follows while at the same time developing risk management measurement tools and robust practices to become Basel II Foundation Internal Rating Based Approach (FIRB) compliant bank. The UAE Central Bank places considerable emphasis on the Internal Capital Adequacy Assessment Planning (ICAAP) and the Group has developed economic capital model to comply with the UAE Central Bank requirements.

Notes to the consolidated financial statements *(continued)*

4. Financial risk management *(continued)*

(g) Management of capital *(continued)*

The Group's regulatory capital adequacy ratio is set by the UAE 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 ratio 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 sub-ordinated 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 December 2013 AED'000	31 December 2012 AED'000
Tier 1 Capital		
Share capital	1,100,000	1,100,000
Statutory reserve	314,119	283,539
Special reserve	209,119	178,539
Retained earnings	515,040	397,550
Tier 1 notes	500,000	-
Total Tier 1	2,638,278	**1,959,628**
Tier 2 Capital		
Available-for-sale revaluation reserve	(1,864)	3,396
Subordinated facilities (note 14.3 & 15.1)	400,000	914,083
Collective impairment provision	229,756	178,583
Total Tier 2	627,892	**1,096,062**
Deductions from Tier 1 and Tier 2 Capital		
Investments in unconsolidated subsidiaries	-	-
Total capital base (a)	3,266,170	**3,055,690**

Notes to the consolidated financial statements *(continued)*

4. Financial risk management *(continued)*

(g) Management of capital *(continued)*

Risk weighted assets

	31 December 2013 Risk-weighted equivalent AED'000	31 December 2012 Risk-weighted equivalent AED'000
Credit risk	17,553,189	15,169,519
Market risk	5,592	3,628
Operational risk	821,706	728,918
Total risk weighted assets (b)	18,380,487	15,902,065
Capital adequacy ratio (a) / (b) - %	17.77	19.22

The Group has prepared an ICAAP document and submitted to the UAE Central Bank for the years ended December 2011 and December 2012. The Group's ICAAP report includes assessment and review of the following keeping in mind a forward-looking approach:

- 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 and 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 2013 was 16.09% (2012: 17.73%).

Risk weights for credit risk

The Group has a diversified funded and unfunded credit portfolio. The exposures are classified as per the 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.

Notes to the consolidated financial statements *(continued)*

4. Financial risk management *(continued)*

(g) Management of capital *(continued)*

Risk weights for credit risk *(continued)*

Claims on other foreign non-commercial PSE are treated one grade less favourable than its sovereign. Claims on commercial PSE are treated as claims on corporate.

Claims on multilateral development banks (MDBs)

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

Claims on banks

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

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 to the consolidated financial statements *(continued)*

4. Financial risk management *(continued)*

(g) Management of capital *(continued)*

***Risk weights for credit risk** (continued)*

Credit risk and risk weights

2013 (AED'000)	On balance sheet	Off balance sheet	Credit risk mitigation (CRM)			Risk-weighted assets
	Gross outstanding	Net exposure after CCF	Exposure before CRM	CRM	After CRM	
Claims on sovereigns	4,143,170	45	4,143,215	-	4,143,215	-
Claims on public sector entities	1,146,415	32,860	1,179,275	186,658	992,617	992,617
Claims on banks	2,539,722	59,302	2,599,024	-	2,599,024	791,317
Claims on corporates	10,047,935	4,227,077	14,275,012	1,382,306	12,892,706	12,892,706
Regulatory retail exposures	1,202,877	63,490	1,266,367	53,676	1,212,691	1,212,691
Residential retail portfolio	669,950	-	669,950	12,937	657,013	657,013
Commercial real estate	492,808	-	492,808	-	492,808	492,808
Past due exposures	868,802	17,461	321,986	54,719	267,267	267,366
Higher-risk categories	12,391	-	12,391	-	12,391	18,587
Other exposures	369,627	-	369,627	-	369,627	228,084
Total	21,493,697	4,400,235	25,329,655	1,690,296	23,639,359	17,553,189

2012 (AED'000)	On balance sheet	Off balance sheet	Credit risk mitigation (CRM)			Risk-weighted assets
	Gross Outstanding	Net exposure after CCF	Exposure before CRM	CRM	After CRM	
Claims on sovereigns	2,714,488	1,021	2,715,509	-	2,715,509	-
Claims on public sector entities	928,502	43,595	972,097	140,572	831,525	831,525
Claims on banks	2,081,748	56,581	2,138,329	-	2,138,329	692,391
Claims on corporates	8,264,342	3,746,274	12,010,616	1,175,406	10,835,210	10,835,210
Regulatory retail exposures	966,398	11,351	977,749	26,501	951,248	951,248
Residential retail portfolio	567,987	-	567,987	10,346	557,641	557,641
Commercial real estate	622,825	-	622,825	-	622,825	622,825
Past due exposures	1,167,091	18,825	513,801	54,761	459,040	459,139
Higher-risk categories	28,311	-	28,311	-	28,311	42,467
Other exposures	277,553	-	277,553	-	277,553	177,073
Total	**17,619,245**	**3,877,647**	**20,824,777**	**1,407,586**	**19,417,191**	**15,169,519**

Notes to the consolidated financial statements *(continued)*

4. 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 uses Credit Risk Mitigation techniques (CRM) whereby 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:

	2013 AED'000	2012 AED'000
Interest rate risk		
- Specific interest rate risk	-	-
- General interest rate risk	-	-
Equity position risk	-	-
Foreign exchange risk	671	435
Option risk	-	-
Total market risk capital charge	671	435
Market risk – risk weighted assets	5,592	**3,628**

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** (2012: 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 to the consolidated financial statements *(continued)*

5. Financial assets and liabilities

5.1 Classification

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

2013	At fair value through profit or loss AED'000	At fair value through equity AED'000	Held-to-maturity AED'000	Loans and advances AED'000	Other amortised cost AED'000	Carrying amount AED'000
Financial assets						
Cash and balances with the UAE Central Bank	-	-	-	-	4,007,712	4,007,712
Due from banks and financial institutions	-	-	-	-	1,298,943	1,298,943
Loans and advances	-	-	-	14,324,406	-	14,324,406
Investments – at fair value	11,455	461,242	-	-	-	472,697
Investments – at cost	-	-	95,817	-	-	95,817
Other assets	-	-	-	-	1,108,112	1,108,112
Total financial assets	11,455	461,242	95,817	14,324,406	6,414,767	21,307,687
Financial liabilities						
Due to banks	-	-	-	-	599,168	599,168
Customer deposits	1,010	-	-	-	14,996,113	14,997,123
Term borrowings	-	-	-	-	1,630,455	1,630,455
Other liabilities	-	-	-	-	1,144,852	1,144,852
Total financial liabilities	1,010	-	-	-	18,370,588	18,371,598

2012	At fair value through profit or loss AED'000	At fair value through equity AED'000	Held-to-maturity AED'000	Loans and advances AED'000	Other amortised cost AED'000	Carrying amount AED'000
Financial assets						
Cash and balances with the UAE Central Bank	-	-	-	-	2,406,987	2,406,987
Due from banks and financial institutions	-	-	-	-	1,022,441	1,022,441
Loans and advances	-	-	-	12,196,008	-	12,196,008
Investments – at fair value	27,682	410,464	-	-	-	438,146
Investments – at cost	-	-	340,686	-	-	340,686
Other assets	-	-	-	-	1,010,256	1,010,256
Total financial assets	**27,682**	**410,464**	**340,686**	**12,196,008**	**4,439,684**	**17,414,524**
Financial liabilities						
Due to banks	-	-	-	-	617,079	617,079
Customer deposits	9,489	-	-	-	12,030,613	12,040,102
Term borrowings	-	-	-	-	1,553,551	1,553,551
Other liabilities	-	-	-	-	1,020,829	1,020,829
Total financial liabilities	**9,489**	**-**	**-**	**-**	**15,222,072**	**15,231,561**

Notes to the consolidated financial statements *(continued)*

5. Financial assets and liabilities *(continued)*

5.2 Fair value measurement – fair value hierarchy:

2013	Notional AED'000	Level 1 AED'000	Level 2 AED'000	Level 3 AED'000
Notional – On balance sheet				
Investments				
Debt securities		460,305	-	-
Other investments		937	11,455	-
Customer deposits		-	1,010	-
Net fair values				
Forward foreign exchange contracts	3,549,133	-	958	-
Currency options	2,533,294	-	-	-
Interest rate derivatives	1,479,278	-	377	-
Commodity derivatives	83,085	-	198	-

2012	Notional AED'000	Level 1 AED'000	Level 2 AED'000	Level 3 AED'000
Notional – On balance sheet				
Investments				
Debt securities		409,835	-	-
Other investments		629	27,682	-
Customer deposits		-	9,489	-
Net fair values				
Forward foreign exchange contracts	2,345,659	-	2,103	-
Currency options	1,821,021	-	-	-
Interest rate derivatives	715,604	-	(2,086)	-
Commodity derivatives	363,077	-	-	-

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 to the consolidated financial statements *(continued)*

6. Cash and balances with the UAE Central Bank

	2013 AED'000	2012 AED'000
Cash on hand	141,543	100,480
Certificates of deposit (CDs) with the UAE Central Bank	2,100,000	1,525,000
Other balances with the UAE Central Bank (note 6.1)	1,766,169	781,507
	4,007,712	2,406,987

6.1 Other balances with the UAE Central Bank include regulatory cash reserve deposits of AED 547.1 million (2012: AED 398.1 million).

7. Due from banks and financial institutions

	2013 AED'000	2012 AED'000
7.1 ***By type***		
Placements	1,165,820	921,067
Current accounts	133,123	101,374
	1,298,943	1,022,441
7.2 ***By geographical area***		
Within UAE	912,487	662,246
GCC countries	52,084	79,187
Others	334,372	281,008
	1,298,943	1,022,441
7.3 ***The currency wise analysis is set out below:***		
AED	647,536	558,185
USD	452,114	321,376
EUR	67,333	49,501
GBP	3,517	28,942
XAU	51,325	4,684
Others	77,118	59,753
	1,298,943	1,022,441

Notes to the consolidated financial statements *(continued)*

8. Loans and advances

	2013 AED'000	2012 AED'000
8.1 Loans and advances by type:		
Overdrafts	1,229,256	1,317,162
Term loans	9,373,600	8,110,586
Loans against trust receipts	2,386,904	1,852,710
Bills discounted	1,573,126	1,101,314
Bills drawn under letters of credit	576,569	604,920
	15,139,455	12,986,692
Allowance for impairment losses (note 8.2)	(815,049)	(790,684)
Net loans and advances	14,324,406	12,196,008

8.2. Allowance for impairment losses on loans and advances

	2013 AED'000	2012 AED'000
Balance at 1 January	790,684	652,218
Net allowances for impairment losses	167,571	173,707
Written-off during the year	(144,496)	(35,241)
Written-back during the year	1,290	-
Balance at 31 December	815,049	790,684

9. 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 consolidated statement of financial position.

	2013 AED'000	2012 AED'000
Contingent liabilities:		
- Letters of credit covering movement of goods	1,319,080	1,175,298
- Financial guarantees and other direct credit substitutes	640,937	477,809
- Bid bonds, performance bonds and other transaction related contingencies	3,972,769	3,549,490
	5,932,786	5,202,597

Notes to the consolidated financial statements *(continued)*

9. Contingent liabilities and commitments *(continued)*

	2013 AED'000	2012 AED'000
Commitments:		
- Undrawn commitments – credit related	11,791,758	11,076,002
- Others	25,820	31,158
	11,817,578	11,107,160
	17,750,364	16,309,757

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

10. Investments

	2013 AED'000	2012 AED'000
Investments at fair value through profit or loss (FVTPL) (note 10.1)	11,455	27,682
Available-for-sale (AFS)		
Debt securities (note 10.2)	460,305	409,835
Other investments	937	629
	461,242	410,464
Held-to-maturity (HTM)		
Debt securities (note 10.2)	95,817	340,686
	568,514	778,832

10.1 Investments at FVTPL include various funds whose fair values are based on the net asset values provided by the fund managers.

10.2 Debt securities aggregating **AED 556.1 million** (2012: AED 750.5 million) represent the Group's investments in bonds and notes which are quoted on recognized exchanges and prices are available on internationally recognized platforms of Reuters and Bloomberg and are liquid in normal market conditions. The debt securities portfolio includes floating rate securities amounting to **AED 243.8 million** (2012: AED 581.6 million).

Notes to the consolidated financial statements *(continued)*

10. Investments *(continued)*

10.3 The dispersion of the investment portfolio is set out below:

	2013 AED'000	2012 AED'000
Goverment	62,014	104,565
Banks and financial institutions	494,108	593,013
Others	12,392	81,254
	568,514	778,832

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

2013	Debt securities AED'000	Other investments AED'000	Total AED'000
AA+	54,510	-	54,510
AA-	123,130	-	123,130
A+	47,266	-	47,266
A	167,555	-	167,555
A-	72,336	-	72,336
BBB+	51,984	-	51,984
BBB	29,110	-	29,110
BBB-	-	937	937
Unrated	10,231	11,455	21,686
	556,122	12,392	568,514

2012	Debt securities AED'000	Other investments AED'000	Total AED'000
AA	14,909	-	14,909
AA-	18,682	-	18,682
A+	47,851	-	47,851
A	386,500	-	386,500
A-	24,360	-	24,360
BBB+	168,532	-	168,532
BBB	26,735	-	26,735
BBB-	12,497	629	13,126
Unrated	50,455	27,682	78,137
	750,521	28,311	778,832

Notes to the consolidated financial statements *(continued)*

10. Investments *(continued)*

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

	2013	2012
	AED'000	AED'000
Within UAE	100,823	493,756
GCC Countries	-	14,909
Others	467,691	270,167
	568,514	778,832

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

	2013	2012
	AED'000	AED'000
AED	10,009	451,556
USD	467,473	215,973
EUR	60,587	111,303
GBP	30,445	-
	568,514	778,832

Notes to the consolidated financial statements *(continued)*

11. Property and equipment and capital work-in-progress

AED'000	Freehold land	Buildings & leasehold improvements	Motor vehicles, furniture, EDP & other equipment	Total
Cost				
At 1 January 2012	**14,066**	**108,293**	**49,260**	**171,619**
Additions	-	5,677	4,551	10,228
Disposals	-	-	-	-
At 31 December 2012	**14,066**	**113,970**	**53,811**	**181,847**
At 1 January 2013	14,066	113,970	53,811	181,847
Additions	-	1,602	7,949	9,551
Disposals	-	-	(239)	(239)
At 31 December 2013	14,066	115,572	61,521	191,159
Depreciation				
At 1 January 2012	**-**	**45,543**	**43,846**	**89,389**
Charge for the year	-	6,525	2,034	8,559
On disposals	-	-	-	-
At 31 December 2012	**-**	**52,068**	**45,880**	**97,948**
At 1 January 2013	-	52,068	45,880	97,948
Charge for the year	-	5,553	4,229	9,782
On disposals	-	-	(224)	(224)
At 31 December 2013	-	57,621	49,885	107,506
Net book value				
At 31 December 2013	14,066	57,951	11,636	83,653
At 31 December 2012	**14,066**	**61,902**	**7,931**	**83,899**

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 (2012: AED 1 each).

11.1 Capital work-in-progress

	2013 AED'000	2012 AED'000
Premises and equipment (note 11.2)	246	1,322
Intangible assets (note 11.3)	1,866	5,293
	2,112	**6,615**

Notes to the consolidated financial statements *(continued)*

11. Property and equipment and capital work-in-progress *(continued)*

11.2 Premises and equipment costs were incurred in respect of the Group's Fujairah Free Zone building and other premises. (2012: Premises and equipment costs were incurred in respect of the Group's ATM enhancement and credit card infrastructure projects).

11.3 The cost of intangible assets is in respect of the purchase of software and directly attributable costs relating to implementation of Islamic Banking, Customer Relationship Management Project, Credit Card Infrastructure Project, Retail Lending Automation Project and SIEM Project. (2012: The cost of intangible assets is in respect of the purchase of software and directly attributable costs relating to the implementation of Internet Banking).

12. Intangible assets

	2013 AED'000	2012 AED'000
Cost		
At 1 January	40,913	26,854
Additions	13,713	14,059
At 31 December	54,626	**40,913**
Amortization		
At 1 January	27,920	22,993
Charge for the year	4,155	4,927
At 31 December	32,075	**27,920**
Net book value	22,551	**12,993**

The cost of intangible assets comprises the cost of the Group's version upgrade of the 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. It also includes purchase of software and directly attributable costs relating to the implementation of Credit Automated Work Flow System, Human Resources System and Internet Banking and other software purchases. The cost is being amortised over the estimated useful life of 5 years.

13. Other assets

	2013 AED'000	2012 AED'000
Accrued interest	82,354	88,584
Prepayments and deposits	14,290	10,404
Customer liabilities for acceptances	956,887	879,544
Others	93,977	58,309
	1,147,508	**1,036,841**

Notes to the consolidated financial statements *(continued)*

14. Due to banks and term borrowings

	2013 AED'000	2012 AED'000
By type:		
Club term loan facility (note 14.1)	863,155	863,155
Bilateral borrowings (note 14.2)	367,300	290,396
Sub-ordinated debt (note 14.3)	400,000	400,000
	1,630,455	**1,553,551**
Short-term borrowings (note 14.4)	599,168	617,079
	2,229,623	**2,170,630**
By geographical area:		
Within UAE	120,412	353,135
GCC Countries	275,475	183,650
Others	1,833,736	1,633,845
	2,229,623	**2,170,630**

14.1 On 24 June 2011, the Group arranged a club term loan facility of **AED 863.2 million** (USD 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 12 June 2014. In December 2013, the Group gave notice for prepayment of the club term loan facility on 15 January 2014.

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 USD 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.

14.2 During 2013, the Group has arranged two term loan facilities through banks, amounting to **AED 275.48 million.** The facilities carry interest rate which is the aggregate of margin and LIBOR. As per the terms of the agreements, one facility extends to 1 year and the other to 2 years after the disbursement date.

During 2012, the Group arranged three term loan facilities through banks, amounting to AED 290.4 million, of which, two facilities amounting to AED 91.8 million and AED 106.7 million have been repaid during 2013. The facilities carry interest rate which is the aggregate of margin and LIBOR. As per the terms of the agreement of the existing facility, the facility extends to 2 years after the disbursement date.

14.3 On 27 November 2013, 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. As per the terms of the facility, the full principal amount of the facility is to be repaid on 27 November 2023. The UAE Central Bank has approved the facility to be considered as Tier 2 capital for regulatory purposes.

In August 2013, the Group repaid its AED 400 million term subordinated loan facility arranged with a finance company on 19 August 2008, in full on the call date of 19 August 2013 and ahead of its original maturity date of 19 August 2018. The facility carried interest rate which is the aggregate of margin and EIBOR, payable quarterly commencing from 19 November 2008. The UAE Central Bank approved the facility to be considered as Tier 2 capital for regulatory purposes.

Notes to the consolidated financial statements *(continued)*

14. Due to banks and term borrowings *(continued)*

14.4 Short-term borrowings include gold related borrowing amounting to **AED 393.2 million** (2012: AED 317.6 million) which is used to finance gold loans extended to customers on a matched basis.

15. Customer deposits

	2013	2012
	AED'000	AED'000
By type:		
Demand and margin deposits	3,274,281	2,749,291
Saving deposits	103,287	52,289
Fixed term and notice deposits	11,619,555	8,595,918
Subordinated debt (note 15.1)	-	642,604
	14,997,123	12,040,102
By geographical area:		
Within UAE	14,739,883	11,833,520
Others	257,240	206,582
	14,997,123	12,040,102

15.1 In March 2013, the Group repaid its AED 643 million subordinated loan to the UAE Ministry of Finance in full and ahead of its original maturity date of 2016, having received all necessary approvals from the UAE Central Bank and the UAE Ministry of Finance.

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

16. Other liabilities

	2013	2012
	AED'000	AED'000
Accrued interest	51,960	60,960
Employee terminal and other long term benefits	31,377	26,820
Accrued expenses	68,068	53,691
Directors' attendance fees	2,000	2,200
Liabilities under acceptances	956,887	879,544
Others	88,827	41,838
	1,199,119	1,065,053

Notes to the consolidated financial statements *(continued)*

17. Shareholders' equity

17.1 Share capital

	2013 AED'000	2012 AED'000
Authorised, issued and fully paid:		
1,100,000,000 shares of AED 1 each (2012: 1,100,000,000 shares of AED 1 each)	**1,100,000**	**1,100,000**

The Board of Directors proposed a cash dividend of **12.5%** (2012: 10%) of the share capital for the year ended 31 December 2013.

17.2 *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.

18. Tier 1 capital notes

In March 2013, the Bank issued Tier 1 capital notes with a principal amount of AED 500 million (the "Capital Notes"). Issuance of these Capital Notes was approved by the Bank's Extra Ordinary General Meeting (EGM) in March 2013. The UAE Central Bank has also approved the facility to be considered as Tier 1 capital for regulatory purposes. These Capital Notes bear interest at a fixed rate payable semi-annually in arrears. The Capital Notes are non-cumulative perpetual securities for which there is no fixed redemption date, and are callable subject to certain conditions. The Bank may, at its sole discretion, elect not to make an interest / coupon payment.

19. Interest income

	2013 AED'000	2012 AED'000
Loans and advances	815,572	741,567
Due from banks including the UAE Central Bank CDs	10,586	10,733
Investments	12,526	15,588
	838,684	**767,888**

20. Interest expense

	2013 AED'000	2012 AED'000
Due to banks including term borrowings	36,100	31,885
Customer deposits	220,580	231,110
	256,680	**262,995**

Notes to the consolidated financial statements *(continued)*

21. Net fees and commission income

	2013 AED'000	2012 AED'000
Fees and commission income		
Letters of credit	71,750	61,288
Letters of guarantee	41,203	40,591
Lending fees	95,190	66,453
Asset management and investment services	31	102
Commission on transfers	18,024	15,746
Others	3,081	925
Total fees and commission income	229,279	185,105
Fees and commission expense		
Brokerage expense	495	246
Card related charges	5,551	3,342
Other charges	141	-
Total fees and commission expense	6,187	3,588
Net fees and commission income	223,092	181,517

22. Income from investments

	2013 AED'000	2012 AED'000
Net fair value gains on investments	6,453	3,165
Dividend income	-	13
	6,453	3,178

23. Other operating income

	2013 AED'000	2012 AED'000
Rental income	1,279	1,270
Rebates	3,747	3,187
Other miscellaneous income	5,362	9,608
	10,388	14,065

24. Employee benefits expense

Employee benefits expense includes employee bonus of AED 35.8 million (2012: AED 27.5 million). The number of employees at 31 December 2013 was 668 (including 555 relating to the Bank) of which 228 (relating to the Bank) were UAE nationals (2012: 607 (including 513 relating to the Bank) of which 209 (relating to the Bank) were UAE nationals).

Notes to the consolidated financial statements *(continued)*

25. Earnings per share

The calculation of earnings per share is based on earnings of **AED 393.1 million** (2012: AED 305.8 million) divided by the weighted average number of shares of **1,100 million** (2012: 1,100 million shares) outstanding during the year.

26. 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 2013 AED'000	Average balance during 2013 AED'000	31 December 2012 AED'000	Average balance during 2012 AED'000
Statement of financial position items				
Loans and advances	1,038,366	889,762	983,722	920,627
Customer deposits	4,072,921	3,457,115	3,338,793	3,144,598
Investments	19,221	32,388	40,446	40,236
Letters of credit	87,751	94,105	58,985	65,201
Financial guarantees and other direct credit substitutes	17,177	15,568	13,565	17,798
Transaction related contingencies	291,550	281,064	277,779	253,300
Acceptances	60,966	63,990	82,459	57,172
Tier 1 capital notes	500,000	386,301	-	-
Statement of income items				
Interest income	36,249		40,320	
Interest expense	85,683		86,763	
Other income	9,818		7,546	
Key management compensation				
Salaries and other short-term benefits	17,782		13,672	
Employee terminal benefits	526		403	
Directors' attendance fees	2,000		2,200	

Notes to the consolidated financial statements *(continued)*

26. Related parties *(continued)*

No provisions for impairment have been recognized in respect of loans given to related parties (2012: Nil).

The loans given to related parties amounting to **AED 1,038.4 million** (2012: AED 983.7 million) have been secured against collateral amounting to **AED 780.0 million** (2012: AED 171.4 million).

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:

	2013	2012
	AED'000	AED'000
Cash on hand	141,543	100,480
Balances with the UAE Central Bank (note 27.1)	3,319,059	1,908,395
Due from banks with less than three months maturity	1,248,943	1,022,441
	4,709,545	3,031,316
Due to banks with less than three months maturity	(462,810)	(552,243)
	4,246,735	2,479,073

27.1 Balances with the UAE Central Bank include certificates of deposit. In accordance with UAE Central Bank regulations on issuance of Central Bank certificates of deposit, the Bank can enter into repurchase agreements in order to obtain short term liquidity.

28. 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:

Corporate and Institutional banking

Corporate and Institutional segments

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

Notes to the consolidated financial statements *(continued)*

28. Segmental reporting *(continued)*

Business banking segment

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

Retail 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 subsidiaries is recognised under this segment.

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

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

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Notes to the consolidated financial statements *(continued)*

28. Segmental reporting *(continued)*

2013 – AED'000	Corporate and Institutional segments	Business banking segment	Retail banking	Treasury, ALM and others	Consolidated
Segment revenue	543,081	219,190	68,426	53,953	884,650
Segment operating cost	(153,026)	(89,014)	(67,292)	(14,627)	(323,959)
Segment operating profit / (loss)	390,055	130,176	1,134	39,326	560,691
Net impairment losses	(134,767)	(28,315)	(4,489)	-	(167,571)
Net profit / (loss)	255,288	101,861	(3,355)	39,326	393,120
Segment assets	11,954,424	2,217,669	1,245,076	6,038,230	21,455,399
Segment liabilities	13,747,369	1,858,687	975,828	1,843,981	18,425,865
Capital expenditure	-	-	-	19,385	19,385

2012 – AED'000	Corporate and Institutional segments	Business banking segment	Retail banking	Treasury, ALM and others	Consolidated
Segment revenue	450,859	198,605	54,188	55,830	**759,482**
Segment operating cost	(138,407)	(73,062)	(60,752)	(7,747)	**(279,968)**
Segment operating profit / (loss)	**312,452**	**125,543**	**(6,564)**	**48,083**	**479,514**
Net impairment losses	(158,219)	(37,613)	22,125	-	**(173,707)**
Net profit / (loss)	**154,233**	**87,930**	**15,561**	**48,083**	**305,807**
Segment assets	10,590,190	1,843,457	784,002	4,326,967	**17,544,616**
Segment liabilities	10,401,628	1,395,210	992,165	2,486,782	**15,275,785**
Capital expenditure	-	-	-	26,082	**26,082**