Arab Banking Corporation (B.S.C.)

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2008

ERNST & YOUNG

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ARAB BANKING CORPORATION (B.S.C.)

We have audited the accompanying consolidated financial statements of Arab Banking Corporation B.S.C. [the Bank] and its subsidiaries [the Group] which comprise the consolidated balance sheet as at 31 December 2008 and the consolidated statements of income, cash flows and changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Board of Directors' Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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 financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the 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 financial statements in order to design audit procedures that are appropriate for 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 the Board of Directors as well as evaluating the overall presentation of the financial statements.

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

Ernst & Young

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ARAB BANKING CORPORATION (B.S.C.) [continued]

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of 31 December 2008 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Regulatory Matters

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements, and the contents of the Directors' report relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank have occurred during the year ended 31 December 2008 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position and that the Bank has complied with the terms of its banking license.

Ernst & Young

26 February 2009
Manama, Kingdom of Bahrain

CONSOLIDATED BALANCE SHEET
31 December 2008

All figures in US $ Million

	Note	***2008***	*2007*
ASSETS			
Liquid funds		**823**	335
Trading securities	4	**126**	747
Placements with banks and other financial institutions		**4,017**	5,268
Non-trading securities	5,7 & 8	**10,623**	12,890
Loans and advances	6 & 8	**11,931**	12,329
Investments in associates		**5**	32
Interest receivable		**256**	392
Other assets	9	**591**	621
Premises and equipment		**114**	130
TOTAL ASSETS		**28,486**	32,744
LIABILITIES			
Deposits from customers		**10,728**	10,791
Deposits from banks and other financial institutions		**6,210**	8,811
Certificates of deposit		**38**	1,063
Securities sold under repurchase agreements		**5,814**	6,202
Interest payable		**213**	341
Taxation	10	**31**	73
Other liabilities	11	**866**	727
TERM NOTES, BONDS AND OTHER TERM FINANCING	12	**2,498**	2,579
Total liabilities		**26,398**	30,587
EQUITY	13		
Share capital		**2,000**	1,000
Reserves		**135**	218
Retained earnings		**(342)**	649
EQUITY ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**1,793**	1,867
Minority interests		**295**	290
Total equity		**2,088**	2,157
TOTAL LIABILITIES AND EQUITY		**28,486**	32,744

These consolidated financial statements were authorised for issue by the Board of Directors on 26th February 2009 and signed on their behalf by the Chairman and President & Chief Executive.

Mohammed Layas
Chairman

Hassan Ali Juma
President & Chief Executive

The attached notes 1 to 29 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME

Year ended 31 December 2008

All figures in US $ Million

	Note	***2008***	*2007*
OPERATING INCOME			
Interest income	14	**1,816**	1,689
Interest expense	15	**(1,385)**	(1,391)
Net interest income		**431**	298
Other operating income	16	**176**	393
Total operating income		**607**	691
Impairment provisions - net	8	**(1,055)**	(230)
NET OPERATING (LOSS) INCOME AFTER PROVISIONS		**(448)**	461
OPERATING EXPENSES			
Staff		**235**	181
Premises and equipment		**29**	24
Other		**88**	70
Total operating expenses		**352**	275
(LOSS) PROFIT BEFORE TAXATION		**(800)**	186
Taxation on foreign operations	10	**(36)**	(37)
(LOSS) PROFIT FOR THE YEAR		**(836)**	149
Income attributable to minority interests		**(44)**	(24)
(LOSS) PROFIT ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**(880)**	125
BASIC AND DILUTED (LOSS) EARNINGS PER SHARE (EXPRESSED IN US $)	28	**(0.57)**	0.13

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2008

All figures in US $ Million

	Note	***2008***	*2007*
OPERATING ACTIVITIES			
(Loss) profit attributable to the shareholders of the parent		**(880)**	125
Items not involving cash flow:			
Impairment provisions - net	8	**1,055**	230
Depreciation		**13**	10
Items considered separately:			
Gains/ losses on non-trading securities - net	16	**20**	(15)
Changes in operating assets and liabilities:			
Trading securities		**598**	14
Placements with banks and other financial institutions		**751**	(1,027)
Loans and advances		**(965)**	(3,296)
Other assets		**41**	(379)
Deposits from customers		**535**	3,102
Deposits from banks and other financial institutions		**(1,684)**	358
Securities sold under repurchase agreements		**(384)**	5,349
Other liabilities		**154**	611
Other non-cash movements		**194**	(90)
Net cash (used in) from operating activities		**(552)**	4,992
INVESTING ACTIVITIES			
Purchase of non-trading securities		**(800)**	(7,447)
Sale and redemption of non-trading securities		**1,936**	1,998
Purchase of premises and equipment		**(39)**	(15)
Sale of premises and equipment		**6**	7
Controlling interest in an associate	17	**(6)**	-
Net cash from (used in) investing activities		**1,097**	(5,457)
FINANCING ACTIVITIES			
Increase in share capital - rights issue	13	**1,110**	-
Redemption of certificates of deposit - net		**(1,039)**	(35)
(Repayment) issue of term notes, bonds and other term financing - net		**(58)**	150
Issue of subordinated debt		**-**	500
Cash dividend paid		**-**	(100)
Net cash from financing activities		**13**	515
Increase in liquid funds		**558**	50
Effect of exchange rate changes on liquid funds		**(70)**	11
Liquid funds at beginning of the year		**335**	274
Liquid funds at end of the year		**823**	335

The attached notes 1 to 29 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2008

All figures in US $ Million

	Equity attributable to shareholders of the parent							*Minority interests*	*Total equity*
	Share capital	*Share premium*	*Statutory reserve*	*General reserve*	*Retained earnings**	*Cumulative changes in fair values*	*Total*		
Balance at the end of the year 2006	1,000	-	296	150	612	10	2,068	50	2,118
Foreign exchange translation adjustments	-	-	-	-	25	-	25	5	30
Cumulative changes in fair values and other	-	-	-	-	-	(251)	(251)	-	(251)
Net income recognised directly in equity	-	-	-	-	25	(251)	(226)	5	(221)
Profit for the year – 2007	-	-	-	-	125	-	125	24	149
Total recognised income and expense for the year	-	-	-	-	150	(251)	(101)	29	(72)
Transfers during the year	-	-	13	-	(13)	-	-	-	-
Dividend paid - 2006	-	-	-	-	(100)	-	(100)	-	(100)
Dilution in a subsidiary	-	-	-	-	-	-	-	211	211
Balance at the end of the year 2007	1,000	-	309	150	649	(241)	1,867	290	2,157
Foreign exchange translation adjustments	-	-	-	-	(111)	-	(111)	(66)	(177)
Cumulative changes in fair values and other	-	-	-	-	-	(193)	(193)	-	(193)
Net income recognised directly in equity	-	-	-	-	(111)	(193)	(304)	(66)	(370)
Loss for the year – 2008	-	-	-	-	(880)	-	(880)	44	(836)
Total recognised income and expense for the year	-	-	-	-	(991)	(193)	(1,184)	(22)	(1,206)
Issue of share capital (note 13)	1,000	110		-	-	-	1,110	-	1,110
Controlling interest in an associate (note 17)	-	-	-	-	-	-	-	27	27
Balance at the end of the year 2008	**2,000**	**110**	**309**	**150**	**(342)**	**(434)**	**1,793**	**295**	**2,088**

* Retained earnings include loss of US$ 81 million (2007: gain of US$ 30 million) representing net unrealised gains / losses on translation of investments in foreign subsidiaries into US dollars and non-distributable reserves arising from consolidation of subsidiaries amounting to US$ 389 million (2007: US$ 275 million).

The attached notes 1 to 29 form part of these consolidated financial statements.

1 INCORPORATION AND ACTIVITIES

The parent bank, Arab Banking Corporation (B.S.C.), [the Bank] is incorporated in the Kingdom of Bahrain by an Amiri decree and operates under a wholesale banking licence issued by the Central Bank of Bahrain.

The Bank's registered office is at ABC Tower, Diplomatic Area, P.O. Box 5698, Manama, Kingdom of Bahrain and is listed on Bahrain Stock Exchange.

2 SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance
The consolidated financial statements of Arab Banking Corporation (B.S.C.) and its subsidiaries [the Group] are prepared in accordance with International Financial Reporting Standards [IFRS] and the relevant provisions of the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law.

The following is a summary of the significant accounting policies which are consistent with those used in the previous year:

Accounting convention
These consolidated financial statements are prepared under the historical cost convention, as modified by the measurement at fair value of derivatives, trading and available-for-sale financial assets. In addition, as more fully discussed below, assets and liabilities that are hedged items in fair value hedges, and are otherwise carried at cost, are adjusted to record changes in fair values attributable to the risk being hedged.

The accounting policies are consistent with those used in the previous year except for amendments to IAS 39 and IFRS 7, Reclassification of Financial Assets, which were issued on 13 October 2008 and applicable from 1 July 2008. As a result, additional disclosures have been made under note 7 providing information about the reclassification of available-for-sale securities to other non-trading securities.

The consolidated financial statements have been presented in United States Dollars, rounded to the nearest million unless otherwise stated, which is the functional currency of the Group.

Future changes in accounting policies

IFRS 8 Operating Segments
The application of IFRS 8 which will be effective for the year ending 31 December 2009 will result in amended and additional disclosures relating to operating segments.

IAS 1 Presentation of Financial Statements (Revised)
The application of IAS 1 (Revised), which will be effective for the year ending 31 December 2009, will result in amendments to the presentation of the consolidated financial statements.

Management does not expect these standards will have a significant impact on the Group's financial statements when implemented.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Consolidation
The consolidated financial statements comprise the financial statements of the Group as at and for the year ended 31 December each year. The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies. All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in full.

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group.

Acquisition of minority interests and partial/deemed disposals of subsidiaries are accounted for using the parent entity extension method, whereby:

a) the difference between the consideration and the book value of the share of net assets is recognised as goodwill;
b) in the case of partial disposals, the difference between the proceeds received and the book value of the share of net assets sold is recognised as profit or loss in the consolidated statement of income; and
c) in the case of deemed partial disposals resulting from a capital increase, the difference between the book value of the share of net assets in the subsidiary after and before the capital increase is recognised as profit or loss in the consolidated statement of income.

Minority interests represent the portion of profit or loss and net assets not owned, directly or indirectly, by the Group and are presented separately in the statement of income and within equity in the consolidated balance sheet, separately from consolidated equity attributable to the shareholders of the Bank.

Liquid funds
Liquid funds comprise of cash, nostro balances and balances with central banks.

Trading securities
Trading securities are initially recorded at fair value. Gains and losses arising from changes in fair values are included in the consolidated statement of income in the period in which they arise. Interest earned and dividends received are included in interest income and other operating income respectively.

Placements with banks and other financial institutions
Placements with banks and other financial institutions are stated at amortised cost net of any amounts written off and provision for impairment. The carrying values of such assets which are being effectively hedged for changes in fair value are adjusted to the extent of the changes in fair value being hedged, with the resultant changes being recognised in the consolidated statement of income.

Non-trading securities
These are classified as follows:

- Held to maturity
- Available-for-sale
- Other non-trading securities

All non-trading securities are initially recognised at cost, being the fair value of the consideration given including incremental acquisition charges associated with the security.

Held to maturity
Securities which have fixed or determinable payments, fixed maturities and are intended to be held to maturity, are subsequently measured at amortised cost, less provision for impairment in value.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Non-trading securities (continued)

Available-for-sale
Available-for-sale financial investments are those which are designated as such or do not qualify to be classified as fair value through statement of income, held to maturity or loans and advances. They include equity instruments, investments in mutual funds and other debt instruments.

After initial recognition, these are remeasured at fair value, unless fair value cannot be reliably determined in which case they are measured at cost less impairment. That portion of any fair value changes relating to an effective hedging relationship is recognised directly in the consolidated statement of income. Fair value changes which are not part of an effective hedging relationship, are reported as a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as "cumulative changes in fair values" within equity, is included in consolidated statement of income for the period.

Other non-trading securities
Other non-trading securities are financial assets with fixed or determinable payments and fixed maturities that are not quoted in the active market. These instruments are not being held with the intent of sale in the near term. These investments are valued at fair value as at 1 July 2008, in accordance with the amendments to IAS 39 'Reclassification of Financial Assets'. Through the effective interest method, the new cost is amortised to the security's expected recoverable amount over the expected remaining life.

Derecognition of financial assets and financial liabilities
A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where the rights to receive cash flows from the asset have expired, or the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a ‘pass-through’ arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Loans and advances
Loans and advances are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. After initial measurement, the loans and advances are subsequantly measured at amortised cost using the effective interest rate method, adjusted for effective fair value hedge less any amounts written off and provision for impairment. The losses arising from impairment of such loans and advances are recognised in the consolidated statement of income in 'Impairment provisions - net' and in an impairment allowance account in the consolidated balance sheet. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an intergral part of the effective interest rate. The amortisation is 'Interest income' in the consolidated statement of income.

In relation to loans and advances which are part of an effective hedging relationship any gain or loss arising from a change in fair value is recognised directly in the consolidated statement of income. The carrying values of loans and advances which are being effectively hedged for changes in fair value are adjusted to the extent of the changes in fair value being hedged.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments in associates
Investments in associates are accounted for by the equity method. Associates are enterprises in which the Group exercises significant influence but not control, normally where it holds 20% to 50% of the voting power.

Premises and equipment
Premises and equipment are stated at cost, less accumulated depreciation and provision for impairment in value, if any.

Freehold land is not depreciated. Depreciation on other premises and equipment is provided on a straight-line basis over their estimated useful lives.

Impairment and uncollectability of financial assets
An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset or group of financial assets may be impaired. If such evidence exists, an impairment loss is recognised in the consolidated statement of income.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

In addition to the provision for specific impaired loans and advances, collective provisions are made to cover impairment against specific group of assets where there is a measurable decrease in estimated future cash flows.

Impairment is determined as follows:

(a) for assets carried at amortised cost, impairment is based on the present value of estimated future cash flows discounted at the original effective interest rate;
(b) for assets carried at fair value, impairment is the difference between cost and fair value; and
(c) for assets carried at cost, impairment is based on the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

The Group uses the provision account to record impairment except for equity and similar investments which are written down with future increases in their fair value being recognised directly in equity.

Deposits
All money market and customer deposits are carried at amortised cost. An adjustment is made to these, if part of an effective fair value hedging strategy, to adjust the value of the deposit for the fair value being hedged with the resultant changes being recognised in the consolidated statement of income.

Repurchase and resale agreements
Assets sold with a simultaneous commitment to repurchase at a specified future date ('repos') are not derecognised. The counterparty liability for amounts received under these agreements are shown as sale of securities under repurchase agreement in the balance sheet. The difference between sale and repurchase price is treated as interest expense using effective yield method. Assets purchased with a corresponding commitment to resell at a specified future date ('reverse repos') are not recognised in the balance sheet, as the Group does not obtain control over the assets. Amounts paid under these agreements are included in placements with banks and other financial institutions or loans and advances, as appropriate. The difference between purchase and resale price is treated as interest income using effective yield method.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Provisions
Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event and the costs to settle the obligation are both probable and able to be reliably measured.

Financial guarantees
In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the consolidated financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the consolidated statement of income in 'Impairment provision'. The premium received is recognised in the consolidated statement of income in 'Other income' on a straight line basis over the life of the guarantee.

Employee pension and other end of service benefits
Costs relating to employee pension and other end of service benefits are generally accrued in accordance with actuarial valuations based on prevailing regulations applicable in each location.

Recognition of income and expenses
For all financial instruments measured at amortised cost and interest bearing financial instruments classified as available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense. Other fee income and expense are recognised when earned or incurred.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Where the Group enters into an interest rate swap to change interest from fixed to floating (or vice versa) the amount of interest income or expense is adjusted by the net interest on the swap.

Fair values
The fair value for financial instruments traded in active markets at the balance sheet date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

For externally managed funds, the fair value is determined by reference to the Net Asset Values provided by the fund administrators.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Significant accounting judgments and estimates

Judgements
In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect in the amounts recognised in the consolidated financial statements:

Classification of securities and loans and advances
Upon acquisition of a security, management decides whether it should be classified as held to maturity, held for trading or available-for-sale.

The Group classifies securities investments as trading if they are acquired primarily for the purpose of making short term profit.

Securities which are eligible for reclassification per IAS 39 amendments and the Group has an intention and ability to hold for a foreseeable future are reclassified as other non-trading securities.

Securities which are not held with the intent of sale in the near term and are eligible per IAS 39 amendments are reclassified as other non-trading securities.

Loans and advances are classified depending on management's intent.

For those deemed to be held to maturity the Group ensures that the requirements of IAS 39 are met and in particular the Group has the intention and ability to hold these to maturity.

Estimation uncertainty
The key assumptions concerning the future and other key sources of estimation at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment losses on financial assets
On a quarterly basis the Group assesses whether a provision for impairment should be recorded in the consolidated statement of income. In particular, considerable judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes in such provisions.

Impairment against specific groups of financial assets
In addition to specific provisions against individually significant loans and advances and securities, the Group also makes a provision to cover impairment against specific group of financial assets where there is a measurable decrease in estimated future cash flows. This provision is based on any deterioration in the internal grade of the financial assets since it was granted. The amount of provision is based on historical loss pattern for loans within each grading and is adjusted to reflect current economic changes.

The internal grading process takes into consideration factors such as collateral held, deterioration in country risk, industry, technological obsolescence as well as identified structural weakness or deterioration in cash flows.

Taxation on foreign operations
There is no tax on corporate income in the Kingdom of Bahrain. Taxation on foreign operations is provided for in accordance with the fiscal regulations applicable in each location. No provision is made for any liability that may arise in the event of distribution of the reserves of subsidiaries. A substantial portion of such reserves is required to be retained to meet local regulatory requirements.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign currencies
Monetary assets and liabilities in foreign currencies are translated into functional currencies at the rates of exchange ruling at the balance sheet date. Any gains or losses are taken to the consolidated statement of income.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

The assets and liabilities of foreign operations are translated at rates of exchange ruling at the balance sheet date. Income and expense items are translated at average exchange rates for the period. Foreign exchange translation gains and losses arising from translating the financial statements of subsidiaries into functional currency, being US dollars are recorded directly in equity under retained earnings.

Trade and settlement date accounting
All "regular way" purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset.

Derivatives and hedge accounting
The Group enters into derivative instruments including forwards, futures, forward rate agreements, swaps and options in the foreign exchange, interest rate and capital markets. These are stated at fair value. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the consolidated balance sheet.

Changes in the fair values of derivatives held for trading activities or to offset other trading positions or do not qualify for hedge accounting are included in other operating income in the consolidated statement of income.

For the purposes of hedge accounting, hedges are classified into three categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; (b) cash flow hedges which hedge the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction; and (c) net investment hedges which hedge the exposure to net investment in foreign operation.

Changes in the fair value of derivatives that are designated, and qualify, as fair value hedges and that prove to be highly effective in relation to the hedged risk, are included in other operating income along with the corresponding changes in the fair value of the hedged assets or liabilities which are attributable to the risk being hedged.

Changes in the fair value of derivatives that are designated, and qualify, as cash flow hedges and that prove to be highly effective in relation to the hedged risk are recognised in a separate component of equity, and the ineffective portion recognised in the consolidated statement of income. The gains or losses on cash flow hedges recognised initially in equity are transferred to the consolidated statement of income in the period in which the hedged transaction impacts the income. Where the hedged transaction results in the recognition of an asset or a liability the associated gain or loss that had been initially recognised in equity is included in the initial measurement of the cost of the related asset or liability.

Change in fair value of derivative or non-derivatives that are designated and qualify, as net investment hedges and that prove to be highly effective in relation to the hedged risk are accounted for in a way similar to cash flow hedges.

Hedge accounting is discontinued when the derivative hedging instrument either expires or is sold, terminated or exercised, no longer qualifies for hedge accounting or is revoked. Upon such discontinuance:

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivatives and hedge accounting (continued)

- in the case of fair value hedges of interest-bearing financial instruments any adjustment to the carrying amount relating to the hedged risk is amortised in the consolidated statement of income over the remaining term to maturity.

- in the case of cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. When such transaction occurs the gain or loss retained in equity is recognised in the consolidated statement of income or included in the initial measurement of the cost of the related asset or liability, as appropriate. Where the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of income.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through the income statement. These embedded derivatives are measured at fair value with the changes in fair value recognised in the consolidated statement of income.

Fiduciary assets
Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and, accordingly, are not included in the consolidated balance sheet.

Offsetting
Financial assets and financial liabilities are only offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and the Group intends to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with the master netting agreements, and the related assets and liabilities are presented gross in the balance sheet.

Term notes, bonds and other term financing
Issued financial instruments (or their components) are classified as liabilities under 'Term notes, bonds and other term financing', where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder.

After initial measurement, the term notes, bonds and other term financing are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.

All figures in US$ Million

3 CLASSIFICATION OF FINANCIAL INSTRUMENTS

As at 31 December 2008, financial instruments have been classified for the purpose of measurement under International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* as follows:

	Held for trading	*Available-for-sale*	*Financial assets at amortised cost/ Loans and receivables*	*Total*
ASSETS				
Liquid funds	**-**	**-**	**823**	**823**
Trading securities	**126**	**-**	**-**	**126**
Placements with banks and other financial institutions	**-**	**-**	**4,017**	**4,017**
Non-trading securities	**-**	**6,504**	**4,119**	**10,623**
Loans and advances	**-**	**-**	**11,931**	**11,931**
Interest receivable and other assets	**-**	**-**	**847**	**847**
	126	**6,504**	**21,737**	**28,367**

	Held for trading	*Available-for-sale*	*Financial liabilities at amortised cost*	*Total*
LIABILITIES				
Deposits from customers	**-**	**-**	**10,728**	**10,728**
Deposits from banks and other financial institutions	**-**	**-**	**6,210**	**6,210**
Certificates of deposit	**-**	**-**	**38**	**38**
Securities sold under repurchase agreements	**-**	**-**	**5,814**	**5,814**
Interest payable and other liabilities	**-**	**-**	**1,079**	**1,079**
TERM NOTES, BONDS AND OTHER TERM FINANCING	**-**	**-**	**2,498**	**2,498**
	-	**-**	**26,367**	**26,367**

In 2008, the Bank has reclassified available-for-sale securities of US$ 4,087 million to other non-trading securities, effective 1 July 2008. Refer note 7 for details.

All figures in US$ Million

3 CLASSIFICATION OF FINANCIAL INSTRUMENTS (continued)

As at 31 December 2007, financial instruments have been classified for the purpose of measurement under International Accounting Standard 39 Financial Instruments: Recognition and Measurement as follows:

	Held for trading	*Available-for-sale*	*Financial assets at amortised cost/ Loans and receivables*	*Total*
ASSETS				
Liquid funds	-	-	335	335
Trading securities	747	-	-	747
Placements with banks and other financial institutions	-	-	5,268	5,268
Non-trading securities	-	12,883	7	12,890
Loans and advances	-	-	12,329	12,329
Interest receivable and other assets	-	-	1,013	1,013
	747	12,883	18,952	32,582

	Held for trading	*Available-for-sale*	*Financial liabilities at amortised cost*	*Total*
LIABILITIES				
Deposits from customers	-	-	10,791	10,791
Deposits from banks and other financial institutions	-	-	8,811	8,811
Certificates of deposit	-	-	1,063	1,063
Securities sold under repurchase agreements	-	-	6,202	6,202
Interest payable and other liabilities	-	-	1,068	1,068
TERM NOTES, BONDS AND OTHER TERM FINANCING	-	-	2,579	2,579
	-	-	30,514	30,514

All figures in US$ Million

4 TRADING SECURITIES

	2008	2007
Externally managed funds	**31**	723
Debt securities	**81**	14
Equities	**14**	10
	126	747

Externally managed funds represent investments in hedge funds (fund of funds) managed by internationally renowned asset managers. In 2007, the group gave notice to the fund managers of the externally managed funds to exit the fund. US$ 31 million (2007: nil) represents amount due from externally managed funds at year end.

5 NON-TRADING SECURITIES

	2008			2007		
	Quoted	***Unquoted***	***Total***	*Quoted*	*Unquoted*	*Total*
Available-for-sale						
Debt securities	**6,585**	**991**	**7,576**	12,161	950	13,111
Equity securities *	**25**	**81**	**106**	20	70	90
Held to maturity						
Debt securities	**-**	**32**	**32**	-	7	7
Other non-trading securities carried at amortised cost **	**4,087**	**-**	**4,087**	-	-	-
	10,697	**1,104**	**11,801**	12,181	1,027	13,208
Provision against non-trading securities	**(161)**	**(1,017)**	**(1,178)**	-	(318)	(318)
	10,536	**87**	**10,623**	12,181	709	12,890

* Included in the above are unquoted equity securities of US$ 55 million (2007: US$ 51 million) carried at cost. This is due to the unpredictable nature of future cash flows and lack of suitable alternative methods to arrive at a reliable fair value. There is no market for these investments and the Group intends to hold them for the long term.

All other available-for-sale securities and non-trading securities have been valued using observable market inputs.

**As explained in note 7, the Group has identified assets, eligible under the amendment to IAS 39, for which it has a clear intent to hold for the foreseeable future and are no longer quoted in an active market. The assets were reclassified with retrospective effect as on 1 July 2008 in accordance with the amendment to IAS 39 and are reflected as other non-trading securities carried at amortised cost.

Provisions against non-trading securities are primarily on structured investment vehicles, collateralized debt obligations and for failed banks on account of market dislocations, mainly in North America and Europe.

The ratings distribution of non-trading securities is given below:

	2008	2007
AAA rated debt securities	**5,826**	7,609
AA to A rated debt securities	**3,253**	3,301
Other investment grade debt securities	**687**	743
Other non-investment grade debt securities	**1,620**	1,060
Unrated debt securities	**309**	405
Equity securities	**106**	90
	11,801	13,208
Provisions against non-trading securities	**(1,178)**	(318)
	10,623	12,890

All figures in US$ Million

5 NON-TRADING SECURITIES (continued)

The movements in provisions against non-trading securities during the year were as follows:

	2008	2007
At 1 January	**318**	20
Charge for the year	**899**	299
Write-offs	**(28)**	(1)
Foreign exchange translation and other adjustments	**(11)**	-
At 31 December	**1,178**	318

Gross amount of non-trading securities individually determined to be impaired before deducting any individually assessed impairment losses was US$ 1,254 million (2007: US$ 720 million). Interest income received during the year on impaired securities was US$ 9 million (2007: nil).

6 LOANS AND ADVANCES

	2008	2007
i) By industrial sector		
Financial services	**3,828**	4,294
Other services	**3,052**	3,166
Manufacturing	**2,990**	2,677
Construction	**660**	787
Mining and quarrying	**283**	478
Trade	**472**	483
Consumer	**192**	152
Government	**265**	303
Other	**616**	308
	12,358	12,648
Loan loss provisions	**(427)**	(319)
	11,931	12,329

	2008	2007
ii) Provisions by industrial sector		
Financial services	**81**	45
Other services	**30**	16
Manufacturing	**47**	28
Construction	**3**	1
Trade	**32**	49
Consumer	**5**	4
Government	**62**	60
Other	**167**	116
	427	319

The movements in loan loss provisions during the year were as follows:

	2008	2007
At 1 January	**319**	381
Charge for the year	**167**	17
Write backs / recoveries	**(11)**	(86)
Write-offs	**(21)**	(6)
Foreign exchange translation and other adjustments	**(27)**	13
At 31 December	**427**	319

All figures in US$ Million

6 LOANS AND ADVANCES (continued)

Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance amounted to US$ 235 million (2007: US$ 162 million).

At 31 December 2008, interest in suspense on past due loans amounted to US$ 194 million (2007: US$ 212 million).

The fair value of collateral that the Group holds relating to loans individually determined to be impaired at 31 December 2008 amounts to US$ 25 million (2007: US$ 5 million). The collateral consists of cash and letters of guarantees from banks. For a more detailed description see 'Collateral and other credit enhancements' under note 21.

7 RECLASSIFICATION OF FINANCIAL ASSETS

In October 2008, the International Accounting Standards Board [IASB] issued amendments to IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures" titled "Reclassification of Financial Assets". The amendments to IAS 39 permit reclassification of financial assets from the available-for-sale category to the other non-trading securities category in certain circumstances.

The amendments to IFRS 7 introduce additional disclosure requirements if an entity has reclassified financial assets in accordance with the IAS 39 amendments. The amendments are effective retrospective from 1 July 2008.

Per the amendments to IAS 39 and IFRS 7, "Reclassification of Financial Assets", the Group reclassified certain available-for-sale securities assets to other non-trading securities carried at amortised cost. The Group identified assets, eligible under the amendments, for which it had a clear intent to hold for the foreseeable future. The assets were reclassified with retrospective effect as on 1 July 2008. The significant market dislocations witnessed in the financial sector in 2008 is considered as a rare event.

Financial assets reclassified into other non-trading securities carried at amortised cost from available-for-sale category are as follows:

	2008
As at the effective date of reclassification of 1 July 2008	
Carrying value and fair value	4,477
Fair value losses recognised in the cumulative changes in fair value reserve upto the date of reclassification	215
As at 31 December 2008	
Carrying value	4,087
Fair value	3,662
Additional fair value losses that would have been recognised in the cumulative changes in fair value reserve had the other non-trading securities had not been reclassified	425

Out of the above reclassified available-for-sale financial assets US$ 316 million have been hedged for changes in fair value, which arise because of the change in interest rate. The Group earns an effective interest rate of 1% to 9% on these investments and the carrying values reflect the cash flows expected to be recovered as at the date of reclassification.

All figures in US$ Million

8 IMPAIRMENT PROVISIONS - NET

During the year the Group has made the following provisions for impairment - net:

	2008	*2007*
Non-trading securities (note 5)	**(899)**	(299)
Loans and advances (note 6)	**(156)**	69
	(1,055)	(230)

9 OTHER ASSETS

	2008	*2007*
Positive fair value of derivatives (note 18)	**244**	139
Securities sold awaiting value	**55**	165
Margin dealing accounts	**51**	90
Bank owned life insurance	**28**	27
Staff loans	**23**	21
Assets acquired on debt settlement	**15**	16
Others	**175**	163
	591	621

The negative fair value of derivatives amounting to US$ 299 million (2007: US$ 151 million) is included in other liabilities (note 11). Details of derivatives are given in note 18.

10 TAXATION ON FOREIGN OPERATIONS

	2008	*2007*
Consolidated balance sheet		
Current tax liability	**28**	71
Deferred tax liability	**3**	2
	31	73
Consolidated statement of income		
Current tax on foreign operations	**53**	61
Deferred tax on foreign operations	**(17)**	(24)
	36	37
Analysis of tax charge		
At Bahrain (income tax rate of nil)	**-**	-
On profits of subsidiaries operating in other jurisdictions	**36**	37
Income tax expense reported in the consolidated statement of income	**36**	37

In view of the operations of the Group being subject to various tax jurisdictions and regulations, it is not practical to provide a reconciliation between the accounting and taxable profits together with the details of effective tax rates.

All figures in US$ Million

11 OTHER LIABILITIES

	2008	2007
Negative fair value of derivatives (note 18)	**299**	151
Cash export and credit assignment payables	**131**	116
Margin deposits including cash collateral	**73**	50
Employee related payables	**58**	40
Cheques for collection	**30**	11
Deferred income	**19**	20
Non-corporate tax payable	**9**	15
Securities purchased awaiting value	**-**	138
Accrued charges and other payables	**247**	186
	866	727

The positive fair value of derivatives amounting to US$ 244 million (2007: US$ 139 million) is included in other assets (note 9). Details of derivatives are given in note 18.

12 TERM NOTES, BONDS AND OTHER TERM FINANCING

In the ordinary course of business, the Bank and certain subsidiaries raise term financing through various capital markets at commercial rates.

Total obligations outstanding at 31 December 2008

	Parent bank	*Subsidiaries*	*Total*
Aggregate maturities			
2009	**-**	**59**	**59**
2010	**384**	**-**	**384**
2011	**300**	**200**	**500**
2012	**1,000**	**-**	**1,000**
2014	**55**	**-**	**55**
2017	**500**	**-**	**500**
	2,239	**259**	**2,498**
Total obligations outstanding at 31 December 2007	2,291	288	2,579

All obligations bear floating rates of interest.

The Group has not repurchased its own debt in 2008 (2007: US$ 15 million).

In 2007, the Bank raised US$ 500 million of subordinated debt under its US$ 2,500,000,000 Euro Medium Term Deposit Note Programme.

13 EQUITY

a) Share capital

	2008	2007
Authorised – 2,500 million shares of US$ 1 each (2007: 1,500 million shares of US$ 1 each)	**2,500**	1,500
Issued, subscribed and fully paid – 2,000 million shares of US$ 1 each (2007: 1,000 million shares of US$ 1 each)	**2,000**	1,000

All figures in US$ Million

13 EQUITY (continued)

Rights issue

The Board of Directors at its meeting held on 25 March 2008 resolved to increase the authorised, issued and paid up capital of the Bank.

The authorised share capital of the Bank was increased from US$ 1,500 million to US$ 2,500 million and the issued share capital from US$ 1,000 million to US$ 2,000 million through a priority rights offering of 1,000 million shares (nominal value US$ 1 per share) to existing shareholders. These shares were issued at a premium of US$ 0.11 per share and the allotment was completed on 18 June 2008.

The Board of Directors have not recommended a dividend relating to the year ended 31 December 2008 (2007: Nil).

b) Statutory reserve

As required by the Articles of Association of the Bank and the Bahrain Commercial Companies Law, 10% of the profit of the previous years was transferred to the statutory reserve. No such transfer has been made during the current year since the Bank has incurred losses during the year. Such annual transfers will cease when the reserve totals 50% of the paid up share capital. The reserve is not available for distribution but can be utilised as security for purpose of a distribution in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

c) General reserve

The general reserve underlines the shareholders' commitment to enhance the strong equity base of the Bank. There are no restrictions on the distribution of this reserve.

d) Cumulative changes in fair values

	2008	*2007*
Balance at beginning of year	**(241)**	10
Transferred to consolidated statement of income on impairment	**171**	2
Transferred to consolidated statement of income on disposal	**2**	-
Net movement in fair value during the year	**(386)**	(253)
Amortisation of fair value short-fall on reclassified securities	**20**	-
Balance at end of year	**(434)**	(241)

14 INTEREST INCOME

	2008	*2007*
Loans and advances	**1,083**	862
Securities	**502**	578
Placements with banks and other financial institutions	**200**	221
Others	**31**	28
	1,816	1,689

All figures in US$ Million

15 INTEREST EXPENSE

	2008	*2007*
Deposits from banks and other financial institutions	**934**	862
Deposits from customers	**314**	304
Term notes, bonds and other term financing	**97**	147
Subordinated debt	**22**	20
Certificates of deposit	**17**	52
Others	**1**	6
	1,385	1,391

16 OTHER OPERATING INCOME

	2008	*2007*
Fee and commission income	**192**	192
Fee and commission expense	**(50)**	(56)
(Losses) gains on non-trading securities - net	**(20)**	15
Gains on dealing in foreign currencies - net	**26**	7
Gains on dealing in derivatives - net	**17**	18
(Losses) gains less losses on trading securities - net	**(32)**	54
Profit on dilution in a subsidiary (Banco ABC Brasil S.A.)	**-**	94
Other – net	**43**	69
	176	393

Included in the fee and commission income is US$ 11 million (2007: US$ 10 million) with respect to fee income relating to trust and other fiduciary activities.

17 SUBSIDIARIES AND ASSOCIATES

The principal subsidiaries, all of which have 31 December as their year end, are as follows:

	Country of incorporation	*Interest % of Arab Banking Corporation (B.S.C.)*	
		2008	*2007*
ABC International Bank plc	United Kingdom	**100**	100
ABC Islamic Bank (E.C.)	Bahrain	**100**	100
Arab Banking Corporation (ABC) - Jordan	Jordan	**87**	87
Banco ABC Brasil S.A.	Brazil	**56**	56
ABC Algeria	Algeria	**70**	70
Arab Banking Corporation - Egypt [S.A.E.]	Egypt	**98**	98
ABC Tunisie	Tunisia	**100**	100
Arab Financial Services B.S.C. (c)	Bahrain	**54.6**	45.7

In May 2008, the Group increased its shareholding in Arab Financial Services Company B.S.C. (c) [AFS] to 54.6% from 45.7% held previously, resulting in the Group acquiring a controlling interest in AFS at book value.

The financial statements of AFS have been consolidated in the financial statements of the Group from the date control was transferred to the Group.

The details of assets, liabilities, income and expenses of AFS have not been disclosed as these are not material to the consolidated financial statements.

The profit from AFS since acquisition has not been disclosed seperately as these are not material to the Group's consolidated statement of income.

All figures in US$ Million

18 DERIVATIVES AND HEDGING

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments.

The table below shows the positive and negative fair values of derivative financial instruments. The notional amount is that of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at year end and are not indicative of either market or credit risk.

	2008			*2007*		
	Positive fair value	***Negative fair value***	***Notional amount***	*Positive fair value*	*Negative fair value*	*Notional amount*
Derivatives held for trading						
Interest rate swaps	**120**	**95**	**2,692**	57	45	3,970
Currency swaps	**21**	**5**	**165**	4	-	194
Forward foreign exchange contracts	**39**	**13**	**2,907**	51	49	4,923
Options	**37**	**69**	**2,647**	21	29	4,488
Futures	**26**	**73**	**2,507**	6	11	1,107
	243	**255**	**10,918**	139	134	14,682
Derivatives held as hedges						
Interest rate swaps	**1**	**42**	**913**	-	16	3,973
Currency swaps	**-**	**2**	**27**	-	1	29
Forward foreign exchange contracts	**-**	**-**	**491**	-	-	540
Options	**-**	**-**	**1,500**	-	-	2,500
	1	**44**	**2,931**	-	17	7,042
	244	**299**	**13,849**	139	151	21,724
Risk weighted equivalents (credit and market risk)			**1,006**			975

Derivatives are carried at fair value using valuation techniques based on observable market inputs.

Derivatives held as hedges include:

a) Fair value hedges which are predominantly used to hedge fair value changes arising from interest rate fluctuations in loans and advances, placements, deposits and available-for-sale debt securities.

   For the year ended 31 December 2008, the Bank recognised a net loss of US$ 53 million (2007: loss of US$ 1 million), on hedging instruments. The total gain on hedged items attributable to the hedged risk amounted to US $ 55 million. (2007: gain of US$ 1 million).

b) Net investment hedges comprise forward foreign exchange contracts of US$ 256 million (2007: US$ 153 million). As at 31 December 2008, the fair value of the forward foreign exchange contracts was immaterial.

   In addition to the forward foreign exchange contracts, the Group uses deposits which are accounted for as hedges of net investment in foreign operation. As at 31 December 2008, the Bank had deposits amounting to US$ 202 million (2007: US$ 387 million) which were designated as net investment hedges.

18 DERIVATIVES AND HEDGING (continued)

Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and interest rate futures are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. Forward rate agreements are effectively tailor-made interest rate futures which fix a forward rate of interest on a notional loan, for an agreed period of time starting on a specified future date.

Swaps are contractual agreements between two parties to exchange interest or foreign currency amounts based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency. For cross-currency swaps, notional amounts are exchanged in different currencies. For cross-currency interest rate swaps, notional amounts and fixed and floating interest payments are exchanged in different currencies.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

Derivative related credit risk

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favorable to the Group. The majority of the Group's derivative contracts are entered into with other financial institutions and there is no significant concentration of credit risk in respect of contracts with positive fair value with any individual counterparty at the balance sheet date.

Derivatives held or issued for trading purposes

Most of the Group's derivative trading activities relate to sales, positioning and arbitrage. Sales activities involve offering products to customers. Positioning involves managing market risk positions with the expectation of profiting from favorable movements in prices, rates or indices. Arbitrage involves identifying and profiting from price differentials between markets or products. Also included under this heading are any derivatives which do not meet IAS 39 hedging requirements.

Derivatives held or issued for hedging purposes

The Group has adopted a comprehensive system for the measurement and management of risk. Part of the risk management process involves managing the Group's exposure to fluctuations in foreign exchange rates (currency risk) and interest rates through asset and liability management activities. It is the Group's policy to reduce its exposure to currency and interest rate risks to acceptable levels as determined by the Board of Directors. The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on an ongoing basis and hedging strategies used to ensure positions are maintained within established limits. The Board has established levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Interest rate gaps are reviewed on an ongoing basis and hedging strategies used to reduce the interest rate gaps to within the limits established by the Board.

As part of its asset and liability management the Group uses derivatives for hedging purposes in order to reduce its exposure to currency and interest rate risks. This is achieved by hedging specific financial instrument, forecasted transactions as well as strategic hedging against overall balance sheet exposures. For interest rate risk this is carried out by monitoring the duration of assets and liabilities using simulations to estimate the level of interest rate risk and entering into interest rate swaps and futures to hedge a proportion of the interest rate exposure, where appropriate. Since strategic hedging does not qualify for special hedge accounting related derivatives are accounted for as trading instruments.

All figures in US$ Million

18 DERIVATIVES AND HEDGING (continued)

Derivatives held or issued for hedging purposes (continued)

The Group uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks. In addition, the Group uses interest rate swaps and interest rate futures to hedge against the interest rate risk arising from specifically identified loans and securities bearing fixed interest rates. In all such cases the hedging relationship and objective, including details of the hedged item and hedging instrument, are formally documented and the transactions are accounted for as hedges.

19 CREDIT COMMITMENTS AND CONTINGENT ITEMS

Credit commitments and contingent items include commitments to extend credit, standby letters of credit, acceptances and guarantees, which are structured to meet the various requirements of customers.

At the balance sheet date, the principal outstanding and the risk weighted equivalents were as follows:

	2008	*2007*
Short-term self-liquidating trade and transaction-related contingent items	**6,036**	4,078
Direct credit substitutes, guarantees and acceptances	**1,351**	1,125
Forward asset purchase commitments	**-**	200
Undrawn loans and other commitments	**1,401**	2,822
	8,788	8,225
Risk weighted equivalents	**3,321**	2,891

The table below shows the contractual expiry by maturity of the Group's contingent liabilities and commitments:

	2008	*2007*
On demand	**1,478**	1,141
1 - 6 months	**1,867**	2,190
6 - 12 months	**1,666**	1,626
1 - 5 years	**3,352**	2,806
Over 5 years	**425**	462
	8,788	8,225

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

All figures in US$ Million

20 SIGNIFICANT NET FOREIGN CURRENCY EXPOSURES

Significant net foreign currency exposures, arising mainly from investments in subsidiaries, are as follows:

	2008		*2007*	
Long (short)	***Currency***	***US$ equivalent***	*Currency*	*US$ equivalent*
Brazilian Real	**64**	**27**	208	117
Egyptian Pound	**640**	**116**	269	49
Jordanian Dinar	**78**	**110**	67	94
Pound Sterling	**29**	**42**	19	38
Saudi Riyal	**59**	**16**	542	145
Algerian Dinar	**2,911**	**41**	2,470	37

21 RISK MANAGEMENT

Introduction

Risk is inherent in the Group's activities and is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. The Group is exposed to credit risk, liquidity risk, operational and market risk, legal risk and strategic risk as well as other forms of risk inherent in its financial operations.

Over the last few years the Group has invested heavily into developing a comprehensive and robust risk management infrastructure. This includes risk identification processes under credit, market and operational risk spectrums, risk measurement models and rating systems as well as a strong business process to monitor and control these risks.

Risk management structure

Executive Management is responsible for implementing the Group's Risk Strategy/Appetite and Policy Guidelines set by the Board Risk Committee (BRC), including the identification and evaluation on a continuous basis of all significant risks to the business and the design and implementation of appropriate internal controls to minimise them. This is done through the following board committee, senior management committees and the Credit & Risk Group in Head Office.

Within the broader governance infrastructure, the Board committees carry the main responsibility of best practice management and risk oversight. At this level, the BRC oversees the definition of risk appetite, risk tolerance standards, and risk process standards to be kept in place. The BRC is also responsible to coordinate with other Board Committees for monitoring compliance with the requirements of the regulatory authorities in the various countries in which the Group operates.

The Group Audit Committee is responsible to the Board for ensuring that the Group maintains an effective system of financial, accounting and risk management controls and for monitoring compliance with the requirements of the regulatory authorities in the various countries in which the Group operates.

The Group's Head Office Credit Committee (HOCC) is responsible for credit decisions at the higher levels of Group's lending portfolio, setting country and other high level Group limits, dealing with impaired assets and general credit policy matters.

Each subsidiary is responsible for managing its own risks and has its own Subsidiary Board Risk Committee, Credit Committee and (in the case of major subsidiaries) Asset and Liability Committee (ALCO), or equivalent, with responsibilities generally analogous to the Group committees.

All figures in US$ Million

21 RISK MANAGEMENT (continued)

The ALCO is chiefly responsible for defining long-term strategic plans and short-term tactical initiatives for directing asset and liability allocation prudently for the achievement of the Group's strategic goals. ALCO 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/reward guidelines approved by the BRC. The above management structure, supported by teams or risk and credit analysts, as well as the IT systems provide a coherent infrastructure to carry credit and risk functions in a seamless manner.

The Operational Risk Management Committee (ORCO) is responsible for defining long-term strategic plans and short-term tactical initiatives for operational risk. It also has the overall responsibility to monitor and prudently manage exposure to operational risks including strategic and reputation risks.

Risk measurement and reporting system

Risk mitigation
As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions.

The risk profile is assessed before entering into hedge transactions, which are authorised by the appropriate level of seniority within the Group. The effectiveness of hedges is monitored monthly by the Group. In situations of ineffectiveness, the Group will enter into a new hedge relationship to mitigate risk on a continuous basis.

The Group actively uses collateral to reduce its credit risk (see below for details).

Excessive risk concentration
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 concentrations of risk, the Group policies and procedures include specific guidelines to focus on country and counter party limits and maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Credit risk
Credit risk is the risk that the Group will incur a loss because its customers, clients and counterparties failed to discharge their contractual obligations. The Group manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentration, and by monitoring exposures in relation to such limits.

The first level of protection against undue credit risk is through country, industry and other risk threshold limits, together with customer and customer group credit limits, set by the BRC and the HOCC and allocated between the Bank and its banking subsidiaries. Credit exposure to individual customers or customer groups is then controlled through a tiered hierarchy of delegated approval authorities based on the risk rating of the customer under the Group's internal credit rating system. Where unsecured facilities sought are considered to be beyond prudential limits, Group policies require collateral to mitigate the credit risk in the form of cash, securities, legal charges over the customer's assets or third-party guarantees. The Group also employs Risk Adjusted Return on Capital (RAROC) as a measure to evaluate the risk/reward relationship at the transaction approval stage. RAROC analysis is also conducted on a portfolio basis, aggregated for each business segment, business unit and for the whole Group.

All figures in US$ Million

21 RISK MANAGEMENT (continued)

Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including credit commitments and contingent items. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Gross maximum exposure	
	2008	*2007*
Liquid funds	**704**	245
Trading debt securities	**81**	14
Placement with banks and other financial institutions	**4,017**	5,268
Non-trading debt securities	**10,543**	12,819
Loans and advances	**11,931**	12,329
Other credit exposures	**847**	1,013
	28,123	31,688
Credit commitment and contingent items	**8,788**	8,225
Total	**36,911**	39,913

Where financial instruments are recorded at fair value the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

For more detail on the maximum exposure to credit risk for each class of financial instrument, references should be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown below.

Risk concentration of the maximum exposure to credit risk

The Group's assets (before taking into account any collateral held or other credit enhancements), liabilities and equity and commitments and contingencies can be analysed by the following geographical regions:

	Assets		*Liabilities and equity*		*Credit commitment and contingent items*	
	2008	*2007*	***2008***	*2007*	***2008***	*2007*
Western Europe	**4,577**	5,988	**2,421**	3,941	**1,467**	1,494
Arab World	**12,034**	12,265	**18,196**	21,986	**4,800**	4,437
Asia	**691**	815	**363**	704	**135**	183
North America	**7,549**	10,010	**5,300**	4,132	**1,194**	1,188
Latin America	**3,010**	2,961	**2,142**	1,926	**674**	677
Other	**625**	705	**64**	55	**518**	246
Total	**28,486**	32,744	**28,486**	32,744	**8,788**	8,225

All figures in US$ Million

21 RISK MANAGEMENT (continued)

Risk concentration of the maximum exposure to credit risk (continued)

An industry sector analysis of the Group's financial assets, before and after taking into account collateral held or other credit enhancements, is as follows:

	Gross maximum exposure 2008	***Net maximum exposure 2008***	*Gross maximum exposure 2007*	*Net maximum exposure 2007*
Financial services	**11,601**	**9,077**	14,373	12,319
Other services	**3,760**	**3,570**	3,830	3,545
Manufacturing	**2,987**	**2,755**	2,780	2,447
Construction	**719**	**608**	845	682
Mining and quarrying	**297**	**289**	500	500
Trade	**454**	**339**	447	425
Government	**7,483**	**7,465**	8,423	8,309
Other	**822**	**696**	490	182
Total	**28,123**	**24,799**	31,688	28,409

An industry sector analysis of the Group's credit commitments and contingent items, before and after taking into account collateral held or other credit enhancements, is as follows:

	Gross maximum exposure 2008	***Net maximum exposure 2008***	*Gross maximum exposure 2007*	*Net maximum exposure 2007*
Financial services	**4,563**	**4,132**	3,411	3,240
Other services	**629**	**605**	1,487	1,475
Manufacturing	**2,176**	**2,162**	2,226	2,174
Construction	**572**	**571**	539	515
Mining and quarrying	**212**	**212**	147	147
Trade	**442**	**442**	371	370
Government	**166**	**164**	16	15
Other	**28**	**28**	28	28
Total	**8,788**	**8,316**	8,225	7,964

All figures in US$ Million

21 RISK MANAGEMENT (continued)

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group using internal credit ratings. The table below shows the credit quality by class of financial asset, based on the Group's credit rating system.

31 December 2008	***Neither past due nor impaired***			***Past due***	
	High grade	***Standard grade***	***Sub-standard grade***	***or individually impaired***	***Total***
Liquid funds	**704**	**-**	**-**	**-**	**704**
Trading securities	**81**	**-**	**-**	**-**	**81**
Placements with banks and other financial institutions	**2,983**	**1,027**	**7**	**-**	**4,017**
Non-trading debt securities	**9,758**	**719**	**-**	**66**	**10,543**
Loans and advances	**6,746**	**5,113**	**-**	**72**	**11,931**
Other credit exposures	**772**	**75**	**-**	**-**	**847**
	21,044	**6,934**	**7**	**138**	**28,123**

31 December 2007	*Neither past due nor impaired*			*Past due*	
	High grade	*Standard grade*	*Sub-standard grade*	*or individually impaired*	*Total*
Liquid funds	245	-	-	-	245
Trading securities	14	-	-	-	14
Placements with banks and other financial institutions	4,044	1,224	-	-	5,268
Non-trading debt securities	11,713	672	14	420	12,819
Loans and advances	6,046	6,273	-	10	12,329
Other credit exposures	924	89	-	-	1,013
	22,986	8,258	14	430	31,688

As at 31 December 2008 and 2007, the total amount of past due but not impaired assets was immaterial.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio through risk rating system. This facilitated focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating is supported by a variety of financial analytics, combined with the processed market information to provide the main inputs for the measurement of counterparty credit risk. All internal ratings are tailored to the various categories and are derived in accordance with Bank's credit policy. The attributable risk ratings are assessed and updated regularly. Each risk rating class has grades equivalent to Moody's, S&P and Fitch rating agencies.

Carrying amount per class of financial assets whose terms have been renegotiated as at year end

	2008	*2007*
Loans and advances	**48**	57

All figures in US$ Million

21 RISK MANAGEMENT (continued)

Collateral and other credit enhancements

The amount and type of collateral depends on an assessment of the credit risk of the counterparty. The types of collateral mainly includes cash and guarantees from banks.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses. The Group also makes use of master netting agreements with counterparties.

Settlement risk

Settlement risk is the risk of loss due to the failure of a counterparty to honour its obligations to deliver cash, securities or other assets as contractually agreed. For certain types of transactions, the Group mitigates this risk through a settlement agent to ensure that a trade is settled only when both parties fulfill their settlement obligations. Settlement approvals form a part of credit approval and limit monitoring procedure.

Market risk

Market risk is the risk that the Group's earnings or capital, or its ability to support business strategy, will be impacted by the change in market rates or prices related to interest rates, equity prices, credit spreads, foreign exchange rates, and commodity prices.

The Group has established risk management policies and limits within which exposure to market risk is monitored, measured and controlled by the RMD with strategic oversight exercised by ALCO. The RMD's Market Risk Management (MRM) unit is responsible for developing and implementing market risk policy and risk measuring/monitoring methodology and for reviewing all new trading products and product limits prior to ALCO approval. MRM's core responsibility is to measure and report market risk against limits throughout the Group.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. The Group is exposed to interest rate risk as a result of mismatches of interest rate re-pricing of assets and liabilities. The most prominent market risk factor for the Bank is interest rates. This risk is minimized as the Bank rate sensitive assets and liabilities are mostly floating rate, where the duration risk is lower. In general, the Bank uses matched currency funding and translates fixed rate instruments to floating rate to better manage the duration in the asset book.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Group's consolidated statement of income.

The sensitivity of the consolidated statement of income is the effect of the assumed changes in interest rates on the net interest income for one year, based on financial assets and financial liabilities held at 31 December 2008, including the effect of hedging instruments. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets, including the effect of any associated hedges and swaps. Substantially all the available-for-sale non trading securities held by the Group are floating rate assets. Hence, the sensitivity to changes in equity due to interest rate changes is insignificant.

	Increase in basis points 2008	*Sensitivity statement of income 2008*	*Decrease in basis points 2008*	*Sensitivity statement of income 2008*
USD	**25**	**33**	**25**	**(33)**
Euro	**25**	**-**	**25**	**-**
GBP	**25**	**1**	**25**	**(1)**
Others	**25**	**(2)**	**25**	**2**

All figures in US$ Million

21 RISK MANAGEMENT (continued)

Interest rate risk (continued)

	Increase in basis points 2007	***Sensitivity statement of income 2007***	***Decrease in basis points 2007***	***Sensitivity statement of income 2007***
USD	25	4	25	(4)
Euro	25	1	25	(1)
GBP	25	(4)	25	4
Others	25	5	25	(5)

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

The table below indicates the currencies to which the Group had significant exposure at 31 December 2008 on its monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the US$, with all other variables held constant on the consolidated statement of income (due to the fair value of currency sensitive trading and non-trading monetary assets and liabilities) and equity (due to the change in fair value of currency swaps and forward foreign exchange contracts used as cash flow hedges) and the effect of impact of foreign currency movements on the structured positions of the Bank in its subsidiaries. A negative amount in the table reflects a potential net reduction in the consolidated statement of income or equity, while a positive amount reflects a potential net increase.

Currency	***Change in currency rate in % 2008***	***Effect on profit before tax 2008***	***Effect on equity 2008***	*Effect on profit before tax 2007*	*Effect on equity 2007*
Brazilian Real	**+/- 5%**	**-**	**+/-1**	+/-5	+/-7
GBP	**+/- 5%**	**-**	**+/-3**	-	+/-2
Egyptian Pound	**+/- 5%**	**-**	**+/-6**	-	+/-3
Jordanian Dinar	**+/- 5%**	**-**	**+/-5**	-	+/-4
Algerian Dinar	**+/- 5%**	**-**	**+/-2**	-	+/-2
Saudi Riyal	**+/- 5%**	**+/-8**	**-**	+/-11	-

Equity price risk

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The non-trading equity price risk exposure arises from the Bank's securities portfolio.

The effect on equity (as a result of a change in the fair value of trading equity instruments and equity instruments held as available for sale) due to a reasonably possible change in equity indices or the NAVs, with all other variables held constant, is as follows:

	% Change in equity price 2008	***Effect on statement of income/ equity 2008***	*% Change in equity price 2007*	*Effect on statement of income/ equity 2007*
Trading securities				
Change in NAVs of fund of funds in North America and Europe	**+/- 5%**	**+/-2**	+/- 5%	+/-36
Other equities	**+/- 5%**	**+/-1**	+/- 5%	-
Available-for-sale equities	**+/- 5%**	**+/-4**	+/- 5%	+/-4

All figures in US$ Million

21 RISK MANAGEMENT (continued)

Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes or systems or from external events. Operational risk is inherent in all business activities and can never be eliminated entirely; however shareholder value can be preserved and enhanced by managing, mitigating and, in some cases, insuring against operational risk. To achieve this goal the Operational Risk Management Unit has developed an operational risk framework, which includes identification, measurement, management, and monitoring and risk control/mitigation elements. A variety of underlying processes are being deployed across the Group including risk and control self-assessments, Key Risk Indicators (KRI), event management, new product review and approval processes and business contingency plans.

The Group intends to make operational risk transparent throughout the enterprise, to which end processes are being developed to provide for regular reporting of relevant operational risk management information to business management, senior management, the ORCO, the BRC and the Board of Directors generally.

Group policy dictates that the operational functions of booking, recording and monitoring of transactions are carried out by staff that are independent of the individuals initiating the transactions. Each business line – including Operations, Information Technology, Human Resources, Legal & Compliance and Financial Control - is further responsible for employing the aforementioned framework processes and control programmes to manage its operational risk within the guidelines established by the Group's policy and procedures. To ensure that all operational risks to which the Group is exposed are adequately managed, support functions are also involved in the identification, measurement, management, monitoring and control/mitigation of operational risk, as appropriate.

All figures in US$ Million

21 RISK MANAGEMENT (continued)

The maturity analysis of assets and liabilities analysed according to when they are expected to be recovered or settled or when they could be realised.

At 31 December 2008	Within 1 month	1 -3 months	3 - 6 months	6 - 12 months	Total within 12 months	1 - 5 years	5-10 years	10 - 20 years	Over 20 years	Undated	Total over 12 months	Total
ASSETS												
Liquid funds	588	18	85	132	823	-	-	-	-	-	-	823
Trading securities	8	-	38	80	126	-	-	-	-	-	-	126
Placements with banks and other financial institutions	3,607	400	9	1	4,017	-	-	-	-	-	-	4,017
Non-trading securities	7,824	29	557	177	8,587	1,227	608	121	-	80	2,036	10,623
Loans and advances	1,664	1,646	2,104	1,344	6,758	3,324	1,161	674	14	-	5,173	11,931
Others	-	-	-	-	-	-	-	-	-	966	966	966
Total assets	13,691	2,093	2,793	1,734	20,311	4,551	1,769	795	14	1,046	8,175	28,486
LIABILITIES, MINORITY INTERESTS AND EQUITY												
Deposits from customers	3,788	3,700	909	284	8,681	2,044	3	-	-	-	2,047	10,728
Deposits from banks and other financial institutions	3,120	1,298	1,243	247	5,908	301	1	-	-	-	302	6,210
Certificates of deposit	4	-	34	-	38	-	-	-	-	-	-	38
Securities sold under repurchase agreement	3,600	1,661	-	553	5,814	-	-	-	-	-	-	5,814
Term notes, bonds and other term financing	-	59	-	-	59	1,884	555	-	-	-	2,439	2,498
Others	-	-	-	-	-	-	-	-	-	1,110	1,110	1,110
Shareholders' equity and minority interests	-	-	-	-	-	-	-	-	-	2,088	2,088	2,088
Total liabilities, shareholders' equity and minority interests	10,512	6,718	2,186	1,084	20,500	4,229	559	-	-	3,198	7,986	28,486
Net liquidity gap	3,179	(4,625)	607	650	(189)	322	1,210	795	14	(2,152)	189	-
Cumulative net liquidity gap	3,179	(1,446)	(839)	(189)		133	1,343	2,138	2,152	-		

Within 1 month are primarily liquid securities that can be sold under repurchase agreements. Deposits are continuously replaced with other new deposits or rollover from the same or different counterparties, based on available lines of credit.

All figures in US$ Million

21 RISK MANAGEMENT (continued)

At 31 December 2007	*Within 1 month*	*1 -3 months*	*3 - 6 months*	*6 - 12 months*	*Total within 12 months*	*1 - 5 years*	*5-10 years*	*10 - 20 years*	*Over 20 years*	*Undated*	*Total over 12 months*	*Total*
ASSETS												
Liquid funds	335	-	-	-	335	-	-	-	-	-	-	335
Trading securities	16	-	731	-	747	-	-	-	-	-	-	747
Placements with banks and other financial institutions	4,346	653	47	222	5,268	-	-	-	-	-	-	5,268
Non-trading securities	9,813	30	776	109	10,728	1,048	465	638	11	-	2,162	12,890
Loans and advances	1,380	2,707	1,517	1,244	6,848	3,501	1,336	630	14	-	5,481	12,329
Others	-	-	392	-	392	-	-	-	-	783	783	1,175
Total assets	15,890	3,390	3,463	1,575	24,318	4,549	1,801	1,268	25	783	8,426	32,744
LIABILITIES, MINORITY INTERESTS AND EQUITY												
Deposits from customers	3,893	2,713	637	255	7,498	3,259	34	-	-	-	3,293	10,791
Deposits from banks and other financial institutions	4,813	2,796	491	356	8,456	350	5	-	-	-	355	8,811
Certificates of deposit	3	1	1,059	-	1,063	-	-	-	-	-	-	1,063
Securities sold under repurchase agreement	3,972	2,114	116		6,202							6,202
Term notes, bonds and other term financing	-	80	58	-	138	1,884	557	-	-	-	2,441	2,579
Others	-	-	414	-	414	-	-	-	-	727	727	1,141
Shareholders' equity and minority interests	-	-	-	-	-	-	-	-	-	2,157	2,157	2,157
Total liabilities, shareholders' equity and minority interests	12,681	7,704	2,775	611	23,771	5,493	596	-	-	2,884	8,973	32,744
Net liquidity gap	3,209	(4,314)	688	964	547	(944)	1,205	1,268	25	(2,101)	(547)	-
Cumulative net liquidity gap	3,209	(1,105)	(417)	547		(397)	808	2,076	2,101	-		

All figures in US$ Million

21 RISK MANAGEMENT (continued)

Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

Group maintains liquid assets at prudential levels to ensure that cash can quickly be made available to honor all its obligations, even under adverse conditions. The Group is generally in a position of excess liquidity, its principal sources of liquidity being its deposit base, liquidity derived from its operations and inter-bank borrowings. The Minimum Liquidity Guideline (MLG) is used to manage and monitor daily liquidity. The MLG represents the minimum number of days the Bank can survive the combined outflow of all deposits and contractual drawdowns, under market value driven encashability scenarios.

In addition, the internal liquidity/maturity profile is generated to summarize the actual liquidity gaps versus the revised gaps based on internal assumptions.

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2008 based on contractual undiscounted repayment obligations. See the previous table for the expected maturities of these liabilities. Repayments which are subjected to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

At 31 December 2008	*On demand*	*1 - 3 months*	*3 - 6 months*	*6 - 12 months*	*1 - 5 years*	*5-10 years*	*10 - 20 years*	*Over 20 years*	*Total*
Financial liabilities									
Deposits from customers	**4,801**	**4,336**	**1,007**	**304**	**380**	**3**	-	-	**10,831**
Deposits from banks and other financial institutions	**3,123**	**1,307**	**1,278**	**265**	**388**	**1**	-	-	**6,362**
Securities sold under repurchase agreements	**3,600**	**1,671**	-	**571**	-	-	-	-	**5,842**
Certificates of deposits	**5**	-	**34**	-	-	-	-	-	**39**
Term notes, bonds and other term financing	-	**64**	-	-	**2,156**	**706**	-	-	**2,926**
Total non-derivative undiscounted on balance sheet financial liabilities	**11,529**	**7,378**	**2,319**	**1,140**	**2,924**	**710**	**-**	**-**	**26,000**
OFF BALANCE SHEET ITEMS									
Gross settled foreign currency derivatives	**2,043**	**710**	**312**	**393**	**121**	**-**	**11**	**-**	**3,590**

All figures in US$ Million

21 RISK MANAGEMENT (continued)

At 31 December 2007	*On demand*	*1 - 3 months*	*3 - 6 months*	*6 - 12 months*	*1 - 5 years*	*5-10 years*	*10 - 20 years*	*Over 20 years*	*Total*
Financial liabilities									
Deposits from customers	6,122	3,403	1,175	293	687	34	-	-	11,714
Deposits from banks and other financial institutions	5,264	2,824	511	379	431	5	-	-	9,414
Securities sold under repurchase agreements	4,277	2,133	120	-	-	-	-	-	6,530
Certificates of deposits	63	11	1,076	-	-	-	-	-	1,150
Term notes, bonds and other term financing	141	104	99	-	2,291	760	-	-	3,395
Total non-derivative undiscounted on balance sheet financial liabilities	15,867	8,475	2,981	672	3,409	799	-	-	32,203
OFF BALANCE SHEET ITEMS									
Gross settled foreign currency derivatives	1,818	1,857	1,160	758	82	-	-	11	5,686

All figures in US$ Million

22 SEGMENTAL INFORMATION

Segmental information is presented in respect of the Group's business and geographical segments. The primary reporting format business segments, is based on the products and services provided or the type of customer serviced and reflects the manner in which financial information is evaluated by management and the Board of Directors.

For financial reporting purposes, the Group is divided into the following main business segments:

Treasury focuses primarily on diversification of funding sources and revenue streams by marketing to develop and build long-term customer relationships, and investments in capital efficient and diversified investment portfolios.

Project and structured finance offers clients and project sponsors considerable experience and proven ability in structuring, arranging, and syndicating complex transactions, and providing advisory services to clients throughout the Arab world.

Trade finance offers structured trade finance and forfaiting solutions to meet the needs of all types of customers, including government and financial institutions.

Commercial banking and corporate offers a variety of products and services for its clients through a relationship-based approach and cooperation and coordination among the Group’s product and geographic units.

Islamic banking services provides through its dedicated operations, institutional, corporate, high net worth and retail Shari'a-compliant products and services.

Retail is aimed at offering a wide range of consumer finance and wealth management products to the retail sector.

Investment banking offers advisory, capital raising and fund management services to customers.

Equity and Other comprises items which are not directly attributable to specific business segments and earnings on the Group's net free capital.

Unallocated operating expenses are reported separately.

The results reported for the business segments are based on the Group's internal financial reporting systems. The accounting policies of the segments are the same as those applied in the preparation of the Group's consolidated financial statements as set out in note 2. Transactions between segments are conducted at estimated market rates on an arm's length basis.

Secondary segment information is based upon the location of the units responsible for recording the transaction.

All figures in US$ Million

22 SEGMENTAL INFORMATION (continued)

Primary segment information	*2008*								
	Treasury	*Project and structured finance*	*Trade finance*	*Commercial banking and corporate*	*Islamic banking services*	*Retail*	*Investment banking*	*Equity and Other*	*Total*
Net interest and other income	**85**	**39**	**94**	**147**	**32**	**76**	**2**	**132**	**607**
Segment result before provision	**50**	**28**	**51**	**87**	**22**	**26**	**(8)**	**132**	**388**
Impairment provisions - net	**(899)**	**(2)**	**(1)**	**(7)**	**(3)**	**(12)**	**-**	**(131)**	**(1,055)**
Segment result	**(849)**	**26**	**50**	**80**	**19**	**14**	**(8)**	**1**	**(667)**
Unallocated operating expenses									**(133)**
Profit before taxation and minority interests									**(800)**
Segment assets employed	**15,026**	**2,802**	**2,190**	**5,426**	**1,569**	**695**	**33**	**745**	**28,486**
Segment liabilities and equity	**25,501**	**-**	**-**	**-**	**-**	**-**	**-**	**2,985**	**28,486**

All figures in US$ Million

22 SEGMENTAL INFORMATION (continued)

Primary segment information

	2007								
	Treasury	*Project and structured finance*	*Trade finance*	*Commercial banking and corporate*	*Islamic banking services*	*Retail*	*Investment banking*	*Equity and Other*	*Total*
Net interest and other income	78	40	78	112	87	44	4	248	691
Segment result before provision	45	26	59	55	74	9	(5)	251	514
(Impairment provisions) - net	(299)	3		21	(1)	(3)	-	49	(230)
Segment result	(254)	29	59	76	73	6	(5)	300	284
Unallocated operating expenses									(98)
Profit before taxation and minority interests									186
Segment assets employed	18,765	2,521	2,472	5,554	1,620	568	178	1,066	32,744
Segment liabilities and equity	29,787	-	-	-	-	-	-	2,957	32,744

All figures in US$ Million

22 SEGMENTAL INFORMATION (continued)

Secondary segment information

	2008			2007		
	Arab World	*Europe and Americas*	*Total*	*Arab World*	*Europe and Americas*	*Total*
Segment profit before taxation and minority interests	**(888)**	**88**	**(800)**	73	113	186
Segment assets	**21,195**	**7,291**	**28,486**	25,226	7,518	32,744

23 REPURCHASE AND RESALE AGREEMENTS

Proceeds from assets sold under repurchase agreements at the year-end amounted to US$ 5,814 million (2007: US$ 6,202 million). The carrying value of securities sold under repurchase agreements at the year-end amounted to US$ 6,756 million (2007: US$ 8,546 million).

Amounts paid for assets purchased under resale agreements at the year-end amounted to US$ 271 million (2007: US$ 114 million) and relate to customer product and treasury activities. The market value of the securities purchased under resale agreements at the year-end amounted to US$ 272 million (2007: US$ 114 million).

24 TRANSACTIONS WITH RELATED PARTIES

Related parties represent associated companies, major shareholders, directors and key management personnel of the Group and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Group's management.

The year end balances in respect of related parties included in the consolidated financial statements are as follows:

	Major shareholders	*Directors*	*Associates*	*2008*	*2007*
Loans and advances	**-**	**-**	**-**	**-**	1
Deposits from customers	**1,882**	**1**	**-**	**1,883**	2,287

The expenses in respect of related parties included in the consolidated financial statements are as follows:

	2008	2007
Interest expense	**9**	18

Compensation of the key management personnel is as follows:

	2008	*2007*
Short term employee benefits	**18**	9
Post employment benefits	**10**	2
	28	11

All figures in US$ Million

25 FIDUCIARY ASSETS

Funds under management at the year-end amounted to US$ 5,324 million (2007: US$ 4,115 million). These assets are held in a fiduciary capacity and are not included in the consolidated balance sheet.

26 FAIR VALUE OF FINANCIAL INSTRUMENTS

"Fair value" is the amount at which an asset could be exchanged or a liability settled in a transaction between knowledgeable, willing parties in an arm's length transaction. Underlying the definition of fair value is the presumption that the Group is a going concern without any intention or requirement to curtail materially the scale of its operation.

The carrying values of financial instruments are not significantly different from the fair values.

27 ASSETS PLEDGED AS SECURITY

At the balance sheet date, in addition to the items mentioned in note 23, assets amounting to US$ 313 million (2007: US$ 125 million) have been pledged as security for borrowings and other banking operations.

28 BASIC AND DILUTED EARNINGS

Basic earnings per share is calculated by dividing the profit for the year by the weighted average number of shares during the year. No figures for diluted earnings per share have been presented, as the Bank has not issued any capital based instruments which would have any impact on earnings per share, when exercised.

The Group's earnings for the year are as follows:

	2008	*2007*
(Loss) Profit for the year	**(880)**	125
Weighted average number of shares outstanding during the year (millions)	**1,538**	1,000
Basic and diluted (loss) earnings per share (US$)	**(0.57)**	0.13

All figures in US$ Million

29 CAPITAL ADEQUACY

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

The risk asset ratio calculations for the year ended 2008 are based on standardised measurement methodology and in accordance with the CBB Basel II guidelines. The previous year's computations were carried out in accordance with Basel I guidelines.

		Basel II 2008	*Basel I 2007*
CAPITAL BASE			
Tier 1 capital		**2,509**	2,268
Tier 2 capital		**650**	738
Total capital base	[a]	**3,159**	3,006
RISK WEIGHTED EXPOSURES			
Credit risk weighted assets and off balance sheet items		**17,625**	18,462
Market risk weighted assets and off balance sheet items		**882**	2,431
Operational risk weighted assets		**1,030**	-
Total risk weighted assets	[b]	**19,537**	20,893
Risk asset ratio	[a/b*100]	**16.2%**	14.4%
Minimum Requirement		**12.0%**	12.0%

Regulatory capital consists of Tier 1 capital, which comprises share capital, retained earnings, statutory reserve, general reserve, minority interests, foreign currency translation adjustments in equity and Tier 2 capital, which includes subordinated long term debt and collective provisions.

The Group has complied with all the requirements as set by the Central Bank of Bahrain.