

**Arab Banking Corporation (B.S.C.)**

**CONSOLIDATED FINANCIAL STATEMENTS**

**31 DECEMBER 2012**

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

### **Report on the consolidated financial statements**

We have audited the accompanying consolidated financial statements of Arab Banking Corporation (B.S.C.) [the Bank] and its subsidiaries [together 'the Group'] which comprise the consolidated statement of financial position as at 31 December 2012 and the consolidated statements of income, comprehensive income, cash flows and changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory information.

#### *Board of Directors' responsibility for the consolidated financial statements*

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

#### *Auditors' responsibility*

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

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

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

**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 2012, its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

**Report on other regulatory requirements**

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 1), we report that:

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; and
- b) the financial information contained in the Report of the Board of Directors is consistent with the consolidated financial statements.

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2012 that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests.

A stylized, handwritten signature of 'Ernst & Young' in black ink.

4 February 2013  
Manama, Kingdom of Bahrain

Arab Banking Corporation (B.S.C.)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 December 2012


All figures in US\$ Million

	Note	2012	2011
<b>ASSETS</b>			
Liquid funds	6	1,532	1,399
Trading securities		64	64
Placements with banks and other financial institutions		4,334	4,305
Securities bought under repurchase agreements	26	578	215
Non-trading securities	7	4,005	6,050
Loans and advances	9	12,860	11,985
Interest receivable		364	349
Other assets	11	674	527
Premises and equipment		116	121
<b>TOTAL ASSETS</b>		<b>24,527</b>	<b>25,015</b>
<b>LIABILITIES</b>			
Deposits from customers		12,029	11,526
Deposits from banks and other financial institutions		5,142	4,273
Certificates of deposit		35	30
Securities sold under repurchase agreements	26	419	2,907
Interest payable		245	225
Taxation	12	119	126
Other liabilities	13	534	461
TERM NOTES, BONDS AND OTHER TERM FINANCING	14	1,782	1,448
<b>Total liabilities</b>		<b>20,305</b>	<b>20,996</b>
<b>EQUITY</b>			
Share capital	15	3,110	3,110
Reserves		686	488
<b>EQUITY ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT</b>		<b>3,796</b>	<b>3,598</b>
Non-controlling interests		426	421
<b>Total equity</b>		<b>4,222</b>	<b>4,019</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>24,527</b>	<b>25,015</b>

The consolidated financial statements were authorised for issue by the Board of Directors on 4 February 2013 and signed on their behalf by the Chairman and the President & Chief Executive.



Saddek El Kaber  
Chairman



Hassan Ali Juma  
President & Chief Executive

Arab Banking Corporation (B.S.C.)

CONSOLIDATED STATEMENT OF INCOME

Year ended 31 December 2012

*All figures in US\$ Million*

	Note	2012	2011
<b>OPERATING INCOME</b>			
Interest and similar income	16	1,061	1,118
Interest and similar expense	17	(540)	(610)
<b>Net interest income</b>		<b>521</b>	508
Other operating income	18	295	310
<b>Total operating income</b>		<b>816</b>	818
Impairment provisions - net	10	(62)	(28)
<b>NET OPERATING INCOME AFTER PROVISIONS</b>		<b>754</b>	790
<b>OPERATING EXPENSES</b>			
Staff		279	291
Premises and equipment		37	36
Other		87	87
<b>Total operating expenses</b>		<b>403</b>	414
<b>PROFIT BEFORE TAXATION</b>		<b>351</b>	376
Taxation on foreign operations	12	(88)	(106)
<b>PROFIT FOR THE YEAR</b>		<b>263</b>	270
Income attributable to non-controlling interests		(58)	(66)
<b>PROFIT ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT</b>		<b>205</b>	204
<b>BASIC AND DILUTED EARNINGS PER SHARE (EXPRESSED IN US\$)</b>			
	31	<b>0.07</b>	0.07



Saddek El Kaber  
Chairman



Hassan Ali Juma  
President & Chief Executive

# Arab Banking Corporation (B.S.C.)

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2012

*All figures in US\$ Million*

	<i>Note</i>	<b>2012</b>	<b>2011</b>
<b>PROFIT FOR THE YEAR</b>		<b>263</b>	<b>270</b>
<b>Other comprehensive income</b>			
Net fair value movements during the year after impairment effect	15	<b>33</b>	7
Amortisation of fair value shortfall on reclassified securities	15	<b>15</b>	22
Unrealised loss on exchange translation in foreign subsidiaries		<b>(87)</b>	(104)
<b>Total other comprehensive loss for the year</b>		<b>(39)</b>	<b>(75)</b>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<b>224</b>	<b>195</b>
Comprehensive income attributable to non-controlling interests		<b>(26)</b>	(19)
<b>Comprehensive income attributable to shareholders of the parent</b>		<b>198</b>	<b>176</b>

# Arab Banking Corporation (B.S.C.)

## CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2012

*All figures in US\$ Million*

	<i>Note</i>	<b>2012</b>	<b>2011</b>
<b>OPERATING ACTIVITIES</b>			
Profit for the year		<b>263</b>	270
Adjustments for:			
Impairment provisions - net	10	<b>62</b>	28
Depreciation and amortisation		<b>13</b>	14
Amortisation of fair value shortfall on reclassified securities	15	<b>15</b>	22
Gain on disposal of non-trading securities - net	18	<b>(6)</b>	(11)
Gain on repurchase of term notes, bonds and other term financing	14	-	(15)
Changes in operating assets and liabilities:			
Treasury bills and other eligible bills		<b>145</b>	(332)
Trading securities		<b>(4)</b>	(6)
Placements with banks and other financial institutions		<b>(20)</b>	1,971
Securities bought under repurchase agreements		<b>(397)</b>	31
Loans and advances		<b>(1,179)</b>	(395)
Interest receivable and other assets		<b>(199)</b>	(317)
Deposits from customers		<b>630</b>	679
Deposits from banks and other financial institutions		<b>988</b>	(1,795)
Securities sold under repurchase agreements		<b>(2,488)</b>	(812)
Interest payable and other liabilities		<b>115</b>	12
Other non-cash movements		<b>(124)</b>	103
Net cash used in operating activities		<b>(2,186)</b>	(553)
<b>INVESTING ACTIVITIES</b>			
Purchase of non-trading securities		<b>(887)</b>	(650)
Sale and redemption of non-trading securities		<b>3,066</b>	2,607
Purchase of premises and equipment		<b>(11)</b>	(14)
Sale of premises and equipment		<b>1</b>	2
Additional investment in a subsidiary		-	(16)
Net cash from investing activities		<b>2,169</b>	1,929
<b>FINANCING ACTIVITIES</b>			
Issue (redemption) of certificates of deposit - net		<b>6</b>	(10)
Issue of term notes, bonds and other term financing		<b>1,084</b>	-
Repayment of term notes, bonds and other term financing		<b>(781)</b>	(525)
Repurchase of term notes, bonds and other term financing	14	<b>(6)</b>	(208)
Dividend paid to non-controlling interests		<b>(21)</b>	(19)
Net cash from (used in) financing activities		<b>282</b>	(762)
Net change in liquid funds		<b>265</b>	614
Effect of exchange rate changes on liquid funds		<b>13</b>	(32)
Cash and cash equivalents at beginning of the year		<b>965</b>	383
<b>CASH AND CASH EQUIVALENTS AT END OF THE YEAR</b>	<b>6</b>	<b>1,243</b>	<b>965</b>

The attached notes 1 to 32 form part of these consolidated financial statements

Arab Banking Corporation (B.S.C.)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2012

All figures in US\$ Million

	Equity attributable to the shareholders of the parent						Total	Non-controlling interests	Total equity
	Share capital	Statutory reserve	General reserve	Retained earnings*	Foreign exchange translation adjustments	Cumulative changes in fair value			
At 31 December 2010	3,110	335	150	(22)	(20)	(125)	3,428	432	3,860
Profit for the year	-	-	-	204	-	-	204	66	270
Other comprehensive income for the year	-	-	-	-	(57)	29	(28)	(47)	(75)
Total comprehensive income for the year	-	-	-	204	(57)	29	176	19	195
Transfers during the year	-	20	-	(20)	-	-	-	-	-
Other equity movements in subsidiaries	-	-	-	(6)	-	-	(6)	(30)	(36)
At 31 December 2011	3,110	355	150	156	(77)	(96)	3,598	421	4,019
Profit for the year	-	-	-	205	-	-	205	58	263
Other comprehensive income for the year	-	-	-	-	(55)	48	(7)	(32)	(39)
Total comprehensive income for the year	-	-	-	205	(55)	48	198	26	224
Transfers during the year	-	21	-	(21)	-	-	-	-	-
Other equity movements in subsidiaries	-	-	-	-	-	-	-	(21)	(21)
<b>At 31 December 2012</b>	<b>3,110</b>	<b>376</b>	<b>150</b>	<b>340</b>	<b>(132)</b>	<b>(48)</b>	<b>3,796</b>	<b>426</b>	<b>4,222</b>

\* Retained earnings include non-distributable reserves arising from consolidation of subsidiaries amounting to US\$ 406 million (2011: US\$ 402 million).



# Arab Banking Corporation (B.S.C.)

---

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

### 1 INCORPORATION AND ACTIVITIES

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 is a Bahraini Shareholding Company with limited liability and is listed on the Bahrain Bourse. The Central Bank of Libya is the ultimate parent of the Bank and its subsidiaries (together 'the Group').

The Bank's registered office is at ABC Tower, Diplomatic Area, P.O. Box 5698, Manama, Kingdom of Bahrain. The Bank is registered under commercial registration number 10299 issued by the Ministry of Industry and Commerce, Kingdom of Bahrain.

The Bank together with its subsidiaries provides trade finance, treasury, project and structured finance, corporate banking and financial institutions, syndications and as well as Islamic banking products. Retail banking services are only provided in the MENA region.

### 2 BASIS OF PREPARATION

#### 2.1 Statement of compliance

The consolidated financial statements of the Bank and its subsidiaries [together 'the Group'] have been prepared in accordance with International Financial Reporting Standards [IFRS] issued by the International Accounting Standards Board [IASB] and the relevant provisions of the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law and the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives.

#### 2.2 Accounting convention

The 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 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.

#### 2.3 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries 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.

Losses within a subsidiary are attributed to the non-controlling interest even if that results in a deficit balance. A change in the ownership interest of a subsidiary without a loss of control is accounted for as an equity transaction.

Non-controlling 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 consolidated statement of income and within equity in the consolidated statement of financial position, separately from consolidated equity attributable to the shareholders of the Bank.

### 3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS

#### 3.1 Standards effective for the year

The accounting policies adopted are consistent with those used in the previous financial year, except for the impact of the following amendments to IFRS effective as of 1 January 2012:

- IAS 12 Income Taxes (Amendment) – Deferred Taxes: Recovery of Underlying Assets
- IFRS 1 First-Time Adoption of International Financial Reporting Standards (Amendment) – Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters
- IFRS 7 Financial Instruments : Disclosures – Enhanced Derecognition Disclosure Requirements

The adoption of the above amendments did not have any material impact on the Group's financial position, performance or disclosures.

#### 3.2 Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

- **IAS 1 *Presentation of Items of Other Comprehensive Income – Amendments to IAS 1***  
The amendments to IAS 1 change the grouping of items presented in other comprehensive income. Items that could be reclassified (or 'recycled') to profit or loss at a future point in time would be presented separately from items that will never be reclassified (for example, net gain on hedge of net investment, exchange differences on translation of foreign operations, net movement on cash flow hedges and net loss or gain on available-for-sale financial assets). The amendment affects presentation only and has no impact on the Group's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.
- **IAS 19 *Employee Benefits (Revised)***  
The IASB has issued numerous amendments to IAS 19. These range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording. The amended standard will impact the net benefit expense as the expected return on plan assets will be calculated using the same interest rate as applied for the purpose of discounting the benefit obligation. The amendment becomes effective for annual periods beginning on or after 1 January 2013.
- **IFRS 7 Disclosures — *Offsetting Financial Assets and Financial Liabilities* — Amendments to IFRS 7**  
These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with IAS 32 Financial Instruments: Presentation. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. These amendments will not impact the Group's financial position or performance and become effective for annual periods beginning on or after 1 January 2013.

**3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)**

**3.2 Standards issued but not yet effective (continued)**

- **IFRS 9 *Financial Instruments: Classification and Measurement***  
IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but Amendments to IFRS 9 Mandatory Effective Date of IFRS 9 and Transition Disclosures, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but will not have an impact on classification and measurement of financial liabilities. The Group will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued.
- **IFRS 10 *Consolidated Financial Statements, IAS 27 *Separate Financial Statements****  
IFRS 10 replaces the portion of IAS 27 Consolidated and Separate Financial Statements that addresses the accounting for consolidated financial statements. It also addresses the issues raised in SIC-12 Consolidation — Special Purpose Entities. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgement to determine which entities are controlled and therefore are required to be consolidated by a parent, compared with the requirements that were in IAS 27. Based on the preliminary analyses performed, IFRS 10 is not expected to have any impact on the accounting for the currently held investments of the Group. This standard becomes effective for annual periods beginning on or after 1 January 2013.
- **IFRS 12 *Disclosure of Interests in Other Entities***  
IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required, but the standard has no impact on the Group's financial position or performance. This standard becomes effective for annual periods beginning on or after 1 January 2013.
- **IFRS 13 *Fair Value Measurement***  
IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Group is currently assessing the impact that this standard will have on the financial position and performance, but based on the preliminary analyses, no material impact is expected. This standard becomes effective for annual periods beginning on or after 1 January 2013.

The following standards and interpretations not expected to have an impact on the Group's financial position, performance, and/or disclosures:

- **IAS 28 *Investments in Associates and Joint Ventures (as revised in 2011)*** - The revised standard becomes effective for annual periods beginning on or after 1 January 2013.
- **IAS 32 *Offsetting Financial Assets and Financial Liabilities — Amendments to IAS 32*** - These amendments become effective for annual periods beginning on or after 1 January 2014.
- **IFRS 1 *Government Loans – Amendments to IFRS 1*** - The amendment is effective for annual periods beginning on or after 1 January 2013.
- **IFRS 11 *Joint Arrangements*** - This standard becomes effective for annual periods beginning on or after 1 January 2013, and is to be applied retrospectively for joint arrangements held at the date of initial application.

**3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)**

**3.2 Standards issued but not yet effective (continued)**

*Annual Improvements May 2012*

These improvements will not have an impact on the Group, but include:

- IFRS 1 First-time Adoption of International Financial Reporting Standards
- IAS 1 Presentation of Financial Statements
- IAS 16 Property Plant and Equipment
- IAS 32 Financial Instruments, Presentation
- IAS 34 Interim Financial Reporting

These improvements are effective for annual periods beginning on or after 1 January 2013.

**4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Liquid funds**

Liquid funds comprise of cash, nostro balances, balances with central banks and treasury bills and other eligible bills. Liquid funds are initially measured at their fair value and subsequently remeasured at amortised cost.

**Cash and cash equivalents**

Cash and cash equivalents referred to in the consolidated statement of cash flows comprise of cash and non restricted balances with central banks, deposits with banks and financial institutions and treasury bills with original maturities of three months or less.

**Trading securities**

Trading securities are initially recorded at fair value. Subsequent to initial measurement, 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 and similar income' and 'other operating income' respectively, in the consolidated statement of income.

**Placements with banks and other financial institutions**

Placements with banks and other financial institutions are initially measured at fair value and subsequently remeasured 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. After initial measurement, these are remeasured at amortised cost, less provision for impairment in value.

**4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Non-trading securities (continued)**

*Available-for-sale*

Available-for-sale investments include equity and debt securities. Equity investments classified as available-for-sale are those which are neither classified as held for trading nor designated at fair value through profit or loss. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions.

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 under fair value movements during the year in the consolidated statement of comprehensive income 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 year.

*Other non-trading securities*

Other non-trading securities are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an 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.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

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, loans and advances are subsequently measured at amortised cost using the effective interest rate method, adjusted for effective fair value hedges 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 statement of financial position. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is recognised as 'interest and similar income' in the consolidated statement of income.

**4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Loans and advances (continued)**

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.

**Investments in associates**

Investments in associates are accounted for under 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 statement of financial position 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.

*Financial assets carried at amortised cost and loans and receivables*

For financial assets carried at amortised cost (such as amounts due from banks, loans and advances and held-to-maturity investments), the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the consolidated statement of income. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of 'interest and similar income'. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group.

If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to 'impairment provisions - net'.

**4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Impairment and uncollectability of financial assets (continued)**

*Financial assets carried at amortised cost and loans and receivables (continued)*

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. If the Group has reclassified trading assets to loans and advances, the discount rate for measuring any impairment loss is the new effective interest rate determined at the reclassification date. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal credit grading system, that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

*Available-for-sale financial assets*

For available-for-sale financial assets, the Group assesses at each statement of financial position date whether there is an objective evidence that an investment is impaired.

In the case of debt instruments classified as available-for-sale, the Group assesses individually whether there is objective evidence of impairment based on the same criteria as financial assets carried at amortised cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that asset previously recognised in the consolidated statement of income. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of 'interest and similar income'. If, in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to a credit event occurring after the impairment loss was recognised in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

In the case of equity investments classified as available-for-sale, objective evidence would also include a 'significant' or 'prolonged' decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated statement of income is removed from equity and recognised in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income. Increases in the fair value after impairment are recognised directly in equity.

**4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Deposits**

All money market and customer deposits are initially measured at fair value and subsequently remeasured 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 reverse repurchase 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 consolidated statement of financial position. The difference between sale and repurchase price is treated as interest expense using the effective yield method. Assets purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognised in the consolidated statement of financial position, as the Group does not obtain control over the assets. The difference between purchase and resale price is treated as interest income using the effective yield method.

**Provisions**

Provisions are recognised when the bank has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expense relating to any provision is presented in the consolidated statement of income net of any reimbursement.

**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 provisions - net'. 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 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.



**4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Recognition of income and expenses (continued)**

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.

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan. When it is unlikely that a loan will be drawn down, the loan commitment fees are recognised over the commitment period on a straight line basis.

Fees arising from negotiating or participating in the negotiation of a transaction for a third party, such as the arrangement of the acquisition of shares or other securities are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

**Fair values**

The fair value for financial instruments traded in active markets at the statement of financial position 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.

**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.

**Foreign currencies**

*Transactions and balances*

Transactions in foreign currencies are initially recorded at the spot rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities in foreign currencies are translated into the Group's functional currency at the rates of exchange ruling at the date of the statement of financial position. 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.

*Group companies*

As at the reporting date, the assets and liabilities of foreign operations are translated into the Bank's functional currency at rates of exchange ruling at the date of the statement of financial position. Income and expense items are translated at average exchange rates for the year. Exchange differences arising on translation are recorded in the consolidated statement of comprehensive income under unrealised gain (loss) on exchange translation in foreign subsidiaries. On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation is recognised in profit or loss.

**4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**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 statement of financial position.

Changes in the fair values of derivatives held for trading activities or to offset other trading positions or which 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 a net investment in a foreign operation.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objectives and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the Group will assess the effectiveness of changes in the hedging instrument’s fair value in offsetting the exposure to changes in the hedged item’s fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

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 the statement of comprehensive income 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.

Changes in fair value of derivatives 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.

**4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Derivatives and hedge accounting (continued)**

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:

- 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 consolidated statement of income. 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 statement of financial position.

**Offsetting**

Financial assets and financial liabilities are only offset and the net amount reported in the statement of financial position 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 master netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

**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.

Term notes, bonds and other term financing are initially measured at fair value plus transaction costs. 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.

**Significant accounting judgments, estimates and assumptions**

In the process of applying the Group's accounting policies, management has exercised judgment and estimates in determining the amounts recognised in the financial statements. The most significant uses of judgment and estimates are as follows:

*Going concern*

The Bank's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future. Furthermore, the management is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

**4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Significant accounting judgments, estimates and assumptions (continued)**

*Fair value of financial instruments*

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but if this is not available, judgment is required to establish fair values.

*Impairment losses on loans and advances*

The Group reviews its individually significant loans and advances at each statement of financial position date to assess whether an impairment loss should be recorded in the consolidated statement of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risks and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups).

The Group's 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.

The impairment loss on loans and advances is disclosed in more detail in note 9.

*Impairment losses on available-for-sale investments*

The Group reviews its debt securities classified as available-for-sale investments at each statement of financial position date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and advances.

The Group also records impairment charges on available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is 'significant' or 'prolonged' requires judgment. In making this judgment, the Group evaluates, among other factors, historical share price movements and duration and extent to which the fair value of an investment is less than its cost.

Arab Banking Corporation (B.S.C.)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

**5 CLASSIFICATION OF FINANCIAL INSTRUMENTS**

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

<b>At 31 December 2012</b>	<i>Held for trading</i>	<i>Available-for-sale</i>	<i>Amortised cost/ Loans and receivables</i>	<i>Total</i>
<b>ASSETS</b>				
Liquid funds	-	-	1,532	1,532
Trading securities	64	-	-	64
Placements with banks and other financial institutions	-	-	4,334	4,334
Securities bought under repurchase agreements	-	-	578	578
Non-trading securities *	-	2,527	1,478	4,005
Loans and advances	-	-	12,860	12,860
Interest receivable and other assets	-	-	1,016	1,016
	<u>64</u>	<u>2,527</u>	<u>21,798</u>	<u>24,389</u>
	<i>Held for trading</i>	<i>Available-for-sale</i>	<i>Amortised cost</i>	<i>Total</i>
<b>LIABILITIES</b>				
Deposits from customers	-	-	12,029	12,029
Deposits from banks and other financial institutions	-	-	5,142	5,142
Certificates of deposit	-	-	35	35
Securities sold under repurchase agreements	-	-	419	419
Interest payable, taxation and other liabilities	-	-	898	898
TERM NOTES, BONDS AND OTHER TERM FINANCING	-	-	1,782	1,782
	<u>-</u>	<u>-</u>	<u>20,305</u>	<u>20,305</u>

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 5 CLASSIFICATION OF FINANCIAL INSTRUMENTS (continued)

At 31 December 2011	<i>Held for trading</i>	<i>Available-for-sale</i>	<i>Amortised cost/ Loans and receivables</i>	<i>Total</i>
<b>ASSETS</b>				
Liquid funds	-	-	1,399	1,399
Trading securities	64	-	-	64
Placements with banks and other financial institutions	-	-	4,305	4,305
Securities bought under repurchase agreements	-	-	215	215
Non-trading securities *	-	4,049	2,001	6,050
Loans and advances	-	46	11,939	11,985
Interest receivable and other assets	-	-	855	855
	<u>64</u>	<u>4,095</u>	<u>20,714</u>	<u>24,873</u>
	<i>Held for trading</i>	<i>Available-for-sale</i>	<i>Amortised cost</i>	<i>Total</i>
<b>LIABILITIES</b>				
Deposits from customers	-	-	11,526	11,526
Deposits from banks and other financial institutions	-	-	4,273	4,273
Certificates of deposit	-	-	30	30
Securities sold under repurchase agreements	-	-	2,907	2,907
Interest payable, taxation and other liabilities	-	-	812	812
<b>TERM NOTES, BONDS AND OTHER</b>				
TERM FINANCING	-	-	1,448	1,448
	<u>-</u>	<u>-</u>	<u>20,996</u>	<u>20,996</u>

\* Included in the above are other non-trading securities amounting to US\$ 1,416 million (2011: US\$ 1,997 million) which were reclassified effective 1 July 2008. Refer note 8 for details.

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

	<b>2012</b>	<b>2011</b>
<b>6 LIQUID FUNDS</b>		
Cash on hand and floats	<b>31</b>	37
Balances due from banks	<b>528</b>	182
Deposits with central banks	<b>349</b>	435
Treasury bills and other eligible bills with original maturities of three months or less	<b>335</b>	311
<b>Cash and cash equivalents</b>	<b>1,243</b>	965
Treasury bills and other eligible bills with original maturities of more than three months	<b>289</b>	434
	<b>1,532</b>	1,399

### 7 NON-TRADING SECURITIES

	<i>2012</i>			<i>2011</i>		
	<i>Quoted</i>	<i>Unquoted*</i>	<i>Total</i>	<i>Quoted</i>	<i>Unquoted*</i>	<i>Total</i>
<b>Available-for-sale</b>						
Debt securities	<b>1,688</b>	<b>1,121</b>	<b>2,809</b>	1,420	2,918	4,338
Equity securities	<b>23</b>	<b>63</b>	<b>86</b>	23	67	90
<b>Held to maturity</b>						
Debt securities	-	7	7	-	4	4
<b>Other non-trading securities carried at amortised cost **</b>	<b>1,471</b>	-	<b>1,471</b>	1,997	-	1,997
	<b>3,182</b>	<b>1,191</b>	<b>4,373</b>	3,440	2,989	6,429
Provision against non-trading securities	<b>(31)</b>	<b>(337)</b>	<b>(368)</b>	(40)	(339)	(379)
	<b>3,151</b>	<b>854</b>	<b>4,005</b>	3,400	2,650	6,050

\* Includes unquoted equity securities carried at cost amounting to US\$ 38 million (2011: US\$ 39 million) net of provisions. 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 other non-trading securities have been valued using observable market inputs.

\*\* As explained in note 8, the Group has identified assets, eligible under the 2008 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.

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 7 NON-TRADING SECURITIES (continued)

Provisions against non-trading securities are primarily due to the impact on collateralized debt obligations (mainly in North America and Europe) which were fully provisioned in 2008.

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

	<b>2012</b>	<b>2011</b>
AAA rated debt securities	<b>907</b>	2,650
AA to A rated debt securities	<b>801</b>	884
Other investment grade debt securities	<b>1,681</b>	1,942
Other non-investment grade debt securities	<b>643</b>	579
Unrated debt securities	<b>255</b>	284
Equity securities	<b>86</b>	90
	<b>4,373</b>	6,429
Provisions against non-trading securities	<b>(368)</b>	(379)
	<b>4,005</b>	6,050

The movement in provisions against non-trading securities during the year is as follows:

	<b>2012</b>	<b>2011</b>
At 1 January	<b>379</b>	515
Charge for the year	<b>3</b>	13
Write backs / recoveries	<b>(11)</b>	(30)
Write-offs	<b>(9)</b>	(130)
Foreign exchange translation and	<b>6</b>	11
At 31 December	<b>368</b>	379

The gross amount of non-trading securities individually determined to be impaired, before deducting any individually assessed impairment losses amounts to US\$ 407 million (2011: US\$ 427 million). Interest income received during the year on impaired securities amounts to US\$ 1 million (2011: US\$ 2 million).

### 8 RECLASSIFICATION OF FINANCIAL ASSETS

In October 2008, the 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 permitted 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 introduced additional disclosure requirements if an entity had reclassified financial assets in accordance with the IAS 39 amendments. The amendments were effective retrospectively to 1 July 2008.

Per the amendments to IAS 39 and IFRS 7, "Reclassification of Financial Assets", the Group reclassified certain available-for-sale securities 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.



**8 RECLASSIFICATION OF FINANCIAL ASSETS (continued)**

The carrying values and fair values of the assets reclassified are as follows:

	<b>2012</b>	<b>2011</b>
Carrying value	<b>1,416</b>	1,997
Fair value	<b>1,432</b>	1,878

Fair value gains that would have been recognised in other comprehensive income for the year ended 31 December 2012 had the other non-trading securities not been reclassified amounts to US\$ 135 million (2011: fair value losses of US\$ 46 million).

The Group earns an effective interest rate of 1% to 9% (2011: 1% to 9%) on these investments and the carrying values reflect the cash flows expected to be recovered as of year end. Reclassified available-for-sale financial assets at cost include US\$ 123 million (2011: US\$ 176 million) which have been hedged for changes in fair value, on account of changes in interest rates.

**9 LOANS AND ADVANCES**

	<b>2012</b>	<b>2011</b>
<i><b>i) By industrial sector</b></i>		
Financial services	<b>3,266</b>	3,010
Other services	<b>2,639</b>	2,813
Manufacturing	<b>4,156</b>	3,952
Construction	<b>945</b>	642
Mining and quarrying	<b>671</b>	676
Personal	<b>191</b>	200
Trade	<b>621</b>	338
Agriculture, fishing and forestry	<b>436</b>	475
Consumer	<b>405</b>	331
Government	<b>120</b>	135
	<b>13,450</b>	12,572
Loan loss provisions	<b>(590)</b>	(587)
	<b>12,860</b>	11,985

	<b>2012</b>	<b>2011</b>
<i><b>ii) Loan loss provisions by industrial sector</b></i>		
Financial services	<b>190</b>	184
Other services	<b>21</b>	19
Manufacturing	<b>46</b>	58
Construction	<b>4</b>	4
Mining and quarrying	<b>12</b>	2
Personal	<b>3</b>	2
Trade	<b>52</b>	46
Agriculture, fishing and forestry	<b>3</b>	2
Consumer	<b>12</b>	11
Government	<b>63</b>	64
Collective impairment	<b>184</b>	195
	<b>590</b>	587

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 9 LOANS AND ADVANCES (continued)

The movement in loan loss provisions during the year is as follows:

	<i>Specific impairment</i>		<i>Collective impairment</i>	
	<i>2012</i>	<i>2011</i>	<i>2012</i>	<i>2011</i>
At 1 January	<b>392</b>	399	<b>195</b>	169
Charge for the year	<b>96</b>	49	-	22
Write backs / recoveries	<b>(19)</b>	(26)	<b>(7)</b>	-
Write-offs	<b>(47)</b>	(35)	<b>(4)</b>	-
Foreign exchange translation and other adjustments	<b>(16)</b>	5	-	4
At 31 December	<b>406</b>	392	<b>184</b>	195

The gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance amounts to US\$ 430 million (2011: US\$ 437 million).

The fair value of tangible collateral that the Group holds relating to loans individually determined to be impaired at 31 December 2012 amounts to US\$ 24 million (2011: US\$ 21 million).

At 31 December 2012, interest in suspense on past due loans amounts to US\$ 231 million (2011: US\$ 217 million).

### 10 IMPAIRMENT PROVISIONS - NET

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

	<i>2012</i>	<i>2011</i>
Non-trading securities (note 7)	<b>8</b>	17
Loans and advances (note 9)	<b>(70)</b>	(45)
	<b>(62)</b>	(28)

### 11 OTHER ASSETS

	<i>2012</i>	<i>2011</i>
Positive fair value of derivatives (note 20)	<b>226</b>	186
Bank owned life insurance	<b>34</b>	32
Staff loans	<b>26</b>	22
Investments in associates	<b>22</b>	21
Assets acquired on debt settlement	<b>20</b>	12
Margin dealing accounts	<b>17</b>	14
Others	<b>329</b>	240
	<b>674</b>	527

The negative fair value of derivatives amounting to US\$ 101 million (2011: US\$ 118 million) is included in other liabilities (note 13). Details of derivatives are given in note 20.

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 12 TAXATION ON FOREIGN OPERATIONS

	<i>2012</i>	<i>2011</i>
<b>Consolidated statement of financial position</b>		
Current tax liability	<b>87</b>	109
Deferred tax liability	<b>32</b>	17
	<b>119</b>	126
<b>Consolidated statement of income</b>		
Current tax on foreign operations	<b>101</b>	114
Deferred tax on foreign operations	<b>(13)</b>	(8)
	<b>88</b>	106
<b>Analysis of tax charge</b>		
At Bahrain (income tax rate of nil)	-	-
On profits of subsidiaries operating in other jurisdictions	<b>88</b>	106
Income tax expense reported in the consolidated statement of income	<b>88</b>	106

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 the effective tax rates.

### 13 OTHER LIABILITIES

	<i>2012</i>	<i>2011</i>
Negative fair value of derivatives (note 20)	<b>101</b>	118
Employee related payables	<b>77</b>	76
Margin deposits including cash collateral	<b>76</b>	28
Cheques for collection	<b>51</b>	37
Deferred income	<b>29</b>	21
Securities purchased awaiting value	<b>15</b>	-
Non-corporate tax payable	<b>8</b>	7
Accrued charges and other payables	<b>177</b>	174
	<b>534</b>	461

The positive fair value of derivatives amounting to US\$ 226 million (2011: US\$ 186 million) is included in other assets (note 11). Details of derivatives are given in note 20.

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 14 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 2012

	Currency	Rate of Interest	Parent bank	Subsidiaries	Total
<b>Aggregate maturities</b>					
2017	US\$	<i>Libor + 2.25%</i>	<b>1,000</b>	-	<b>1,000</b>
2017 *	US\$	<i>Libor + 1.35%</i>	<b>371</b>	-	<b>371</b>
2020 *	BRL	<i>7.88</i>	-	<b>411</b>	<b>411</b>
			<b>1,371</b>	<b>411</b>	<b>1,782</b>
Total obligations outstanding at 31 December 2011			1,159	289	1,448

\* Subordinated

Parent bank's obligations bear a floating rate of interest whereas the subsidiary's obligations bear a fixed rate of interest.

During the year ended 31 December 2012, the Bank repurchased a portion of its term loan borrowings with a nominal value of US\$ 5 million (2011: US\$ 169 million). The repurchase did not result in any gain or loss (2011: US\$ 7 million gain included in the consolidated statement of income in "other operating income").

In addition, during the year ended 31 December 2012, the Bank also repurchased a portion of its subordinated liabilities with a nominal value of US\$ 1 million (2011: US\$ 39 million). The repurchase did not result in any gain or loss (2011: US\$ 8 million gain included in the consolidated statement of income in "other operating income").

The Group has not had any defaults of principal, interest or other breaches with regard to any of its liabilities during the years ended 31 December 2012 and 2011.

### 15 EQUITY

#### a) Share capital

	2012	2011
Authorised – 3,500 million shares of US\$ 1 each (2011: 3,500 million shares of US\$ 1 each)	<b>3,500</b>	3,500
Issued, subscribed and fully paid – 3,110 million shares of US\$ 1 each (2011: 3,110 million shares of US\$ 1 each)	<b>3,110</b>	3,110

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 15 EQUITY (continued)

#### b) Statutory reserve

As required by the Articles of Association of the Bank and the Bahrain Commercial Companies Law, 10% of the profit for the year is transferred to the statutory reserve. Such annual transfers will cease when the reserve totals 50% of the paid up share capital. The reserve is not available except 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 after obtaining approval of the Central Bank of Bahrain.

#### d) Cumulative changes in fair value

	<i>2012</i>	<i>2011</i>
At 1 January	(96)	(125)
Transferred to consolidated statement of comprehensive income on impairment	2	12
Transferred to consolidated statement of comprehensive income on disposal	(5)	(11)
Net movement in fair value during the year	36	6
Amortisation of fair value shortfall on reclassified securities	15	22
At 31 December	<u>(48)</u>	<u>(96)</u>

### 16 INTEREST AND SIMILAR INCOME

	<i>2012</i>	<i>2011</i>
Loans and advances	725	787
Securities	209	209
Placements with banks and other financial institutions	95	97
Others	32	25
	<u>1,061</u>	<u>1,118</u>

### 17 INTEREST AND SIMILAR EXPENSE

	<i>2012</i>	<i>2011</i>
Deposits from banks and other financial institutions	329	359
Deposits from customers	162	202
Term notes, bonds and other term financing	45	38
Others	3	10
Certificates of deposit	1	1
	<u>540</u>	<u>610</u>

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 18 OTHER OPERATING INCOME

	<b>2012</b>	<b>2011</b>
Fee and commission income	<b>200</b>	199
Fee and commission expense	<b>(8)</b>	(20)
Bureau processing income	<b>34</b>	31
Gain on dealing in derivatives - net	<b>32</b>	29
Gain on dealing in foreign currencies - net	<b>16</b>	33
Gain on disposal of non-trading securities - net	<b>6</b>	11
Gain on trading securities - net	<b>3</b>	1
Gain on repurchase of subordinated debt (note 14)	-	8
Gain on repurchase of term loan (note 14)	-	7
Other – net	<b>12</b>	11
	<b>295</b>	310

Included in the fee and commission income is US\$ 11 million (2011: US\$ 11 million) of fee income relating to trust and other fiduciary activities.

### 19 SUBSIDIARIES

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

	<i>Country of incorporation</i>	<i>Interest of Arab Banking Corporation (B.S.C.)</i>	
		<b>2012</b>	<b>2011</b>
		%	%
ABC International Bank plc	United Kingdom	<b>100.0</b>	100.0
ABC Islamic Bank (E.C.)	Bahrain	<b>100.0</b>	100.0
Arab Banking Corporation (ABC) - Jordan	Jordan	<b>87.0</b>	86.7
Banco ABC Brasil S.A.	Brazil	<b>58.0</b>	57.8
ABC Algeria	Algeria	<b>88.0</b>	88.0
Arab Banking Corporation - Egypt [S.A.E.]	Egypt	<b>99.6</b>	98.4
ABC Tunisie	Tunisia	<b>100.0</b>	100.0
Arab Financial Services Company B.S.C. (c)	Bahrain	<b>54.6</b>	54.6

**20 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.

	2012			2011		
	<i>Positive fair value</i>	<i>Negative fair value</i>	<i>Notional amount</i>	<i>Positive fair value</i>	<i>Negative fair value</i>	<i>Notional amount</i>
<i>Derivatives held for trading</i>						
Interest rate swaps	68	55	1,639	70	52	2,086
Currency swaps	8	1	207	3	2	132
Forward foreign exchange contracts	37	36	3,982	54	50	3,804
Options	5	5	1,899	12	12	1,950
Futures	3	1	992	1	-	1,104
	<b>121</b>	<b>98</b>	<b>8,719</b>	<b>140</b>	<b>116</b>	<b>9,076</b>
<i>Derivatives held as hedges</i>						
Interest rate swaps	-	3	816	1	2	680
Forward foreign exchange contracts	105	-	317	45	-	549
	<b>105</b>	<b>3</b>	<b>1,133</b>	<b>46</b>	<b>2</b>	<b>1,229</b>
	<b>226</b>	<b>101</b>	<b>9,852</b>	<b>186</b>	<b>118</b>	<b>10,305</b>
Risk weighted equivalents (credit and market risk)			<b>1,591</b>			<b>1,475</b>

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, available-for-sale debt securities and subordinated loan of a subsidiary.

For the year ended 31 December 2012, the Group recognised a net loss of US\$ 78 million (2011: loss of US\$ 67 million) on hedging instruments. The total gain on hedged items attributable to the hedged risk amounted to US\$ 78 million (2011: gain of US\$ 67 million).

- b) Net investment hedges comprise forward foreign exchange contracts of US\$ nil million (2011: US\$ 181 million). As at 31 December 2012, the fair value of the forward foreign exchange contracts was nil.

In addition to the forward foreign exchange contracts, the Group uses deposits which are accounted for as hedges of net investment in foreign operations. As at 31 December 2012, the Group had deposits amounting to US\$ 620 million (2011: US\$ 382 million) which were designated as net investment hedges.

**20 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 date of the statement of financial position.

***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 of Directors.



**20 DERIVATIVES AND HEDGING (continued)**

*Derivatives held or issued for hedging purposes (continued)*

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 instruments, forecasted transactions as well as strategic hedging against overall statement of financial position 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.

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.

**21 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 statement of financial position date, the principal outstanding and the risk weighted equivalents were as follows:

	<i>2012</i>	<i>2011</i>
Short-term self-liquidating trade and transaction-related contingent items	<b>4,985</b>	4,570
Direct credit substitutes, guarantees and acceptances	<b>3,739</b>	3,138
Undrawn loans and other commitments	<b>1,299</b>	1,086
	<b>10,023</b>	8,794
Risk weighted equivalents	<b>3,236</b>	3,291

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

	<i>2012</i>	<i>2011</i>
On demand	<b>1,020</b>	1,025
1 - 6 months	<b>3,464</b>	2,726
6 - 12 months	<b>3,179</b>	2,564
1 - 5 years	<b>2,167</b>	2,312
Over 5 years	<b>193</b>	167
	<b>10,023</b>	8,794

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

**21 CREDIT COMMITMENTS AND CONTINGENT ITEMS (continued)**

The Group is engaged in litigation in various jurisdictions. The litigation involves claims by and against the Group which have arisen in the ordinary course of business. The Directors of the Bank, after reviewing the claims pending against Group companies and based on the advice of relevant professional legal advisors, are satisfied that the outcome of these claims will not have a material adverse effect on the financial position of the Group.

**22 SIGNIFICANT NET FOREIGN CURRENCY EXPOSURES**

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

	<i>2012</i>		<i>2011</i>	
	<i>Currency</i>	<i>US\$ equivalent</i>	<i>Currency</i>	<i>US\$ equivalent</i>
<b>Long (short)</b>				
Brazilian Real	<b>1,024</b>	<b>500</b>	543	291
Jordanian Dinar	<b>145</b>	<b>204</b>	111	157
Algerian Dinar	<b>12,388</b>	<b>158</b>	11,355	149
Egyptian Pound	<b>852</b>	<b>136</b>	849	141
Pound Sterling	<b>(5)</b>	<b>(8)</b>	85	131
UAE Dirham	<b>5</b>	<b>1</b>	281	77
Saudi Riyal	<b>(366)</b>	<b>(98)</b>	(346)	(92)
Euro	<b>11</b>	<b>14</b>	(1)	(1)

**23 FAIR VALUE OF FINANCIAL INSTRUMENTS**

Fair value is an amount for which an asset could be exchanged or a liability settled between knowledgeable and willing parties in an arm's length transaction. Consequently, differences can arise between carrying values and fair value estimates.

The fair values of financial assets and financial liabilities which are not carried at fair value are not materially different from their carrying value except for the following:

	2012		2011	
	Carrying value	Fair value	Carrying value	Fair value
Other non-trading securities	1,471	1,487	1,997	1,878
Term notes, bonds and other term financing	782	726	662	561

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

**Level 1 valuation:** Directly observable quotes for the same instrument (market prices).

**Level 2 valuation:** Directly observable proxies for the same instrument accessible at valuation date (mark-to-model with market data).

**Level 3 valuation:** Derived proxies (interpolation of proxies) for similar instruments that have not been observed (mark-to-model with deduced proxies).

As at 31 December, the Group has used the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

	2012			2011		
	Level 1	Level 2	Total	Level 1	Level 2	Total
<b>Financial assets</b>						
<b>Trading securities</b>						
Debt securities	60	1	61	55	6	61
Externally managed funds	-	3	3	-	3	3
	<b>60</b>	<b>4</b>	<b>64</b>	<b>55</b>	<b>9</b>	<b>64</b>
<b>Non-trading securities</b>						
Available-for-sale						
Debt securities	1,751	726	2,477	1,524	2,474	3,998
Equity securities at fair value	12	-	12	12	-	12
	<b>1,763</b>	<b>726</b>	<b>2,489</b>	<b>1,536</b>	<b>2,474</b>	<b>4,010</b>
<b>Loans and advances - available-for-sale</b>	-	-	-	-	46	46
<b>Derivatives held for trading</b>	-	121	121	-	140	140
<b>Derivatives held as hedges</b>	-	105	105	-	46	46
<b>Financial liabilities</b>						
<b>Derivatives held for trading</b>	-	98	98	-	116	116
<b>Derivatives held as hedges</b>	-	3	3	-	2	2

**23 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)**

**Financial instruments recorded at fair value**

The description of the determination of fair value for financial instruments recorded at fair value using valuation techniques is discussed in note 4, which incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

**Transfers between level 1 and level 2**

None of the financial instruments were transferred from level 1 to level 2 during the year ended 31 December 2012 (2011: none).

**24 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 committees, 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 the 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 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.

**24 RISK MANAGEMENT (continued)**

**Risk management structure (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 counterparty 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.

**24 RISK MANAGEMENT (continued)**

**Credit risk (continued)**

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.

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

The Group's concentration of risk is managed by geographical region and by industry sector. The table below shows the maximum exposure to credit risk for the components of the statement of financial position, 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.

	<i>Gross maximum exposure</i>	
	<i>2012</i>	<i>2011</i>
Liquid funds	<b>1,501</b>	1,362
Trading debt securities	<b>61</b>	61
Placements with banks and other financial institutions	<b>4,334</b>	4,305
Securities bought under repurchase agreements	<b>578</b>	215
Non-trading debt securities	<b>3,956</b>	5,998
Loans and advances	<b>12,860</b>	11,985
Other credit exposures	<b>1,016</b>	855
	<b>24,306</b>	24,781
Credit commitment and contingent items (note 21)	<b>10,023</b>	8,794
Total	<b>34,329</b>	33,575

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.

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 24 RISK MANAGEMENT (continued)

#### 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:

	<i>Assets</i>		<i>Liabilities and equity</i>		<i>Credit commitments and contingent items</i>	
	<i>2012</i>	<i>2011</i>	<i>2012</i>	<i>2011</i>	<i>2012</i>	<i>2011</i>
Western Europe	<b>3,882</b>	3,491	<b>775</b>	1,205	<b>2,127</b>	788
Arab World	<b>9,187</b>	9,262	<b>18,107</b>	16,344	<b>3,831</b>	4,316
Asia	<b>1,054</b>	875	<b>43</b>	228	<b>316</b>	345
North America	<b>3,034</b>	4,861	<b>995</b>	2,532	<b>370</b>	319
Latin America	<b>6,383</b>	5,503	<b>4,301</b>	4,387	<b>3,092</b>	2,726
Other	<b>766</b>	789	<b>85</b>	85	<b>287</b>	300
<b>Total</b>	<b>24,306</b>	24,781	<b>24,306</b>	24,781	<b>10,023</b>	8,794

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:

	<i>Gross maximum exposure</i>		<i>Net maximum exposure</i>	
	<i>2012</i>	<i>2011</i>	<i>2012</i>	<i>2011</i>
Financial services	<b>9,535</b>	9,764	<b>8,599</b>	8,973
Other services	<b>4,530</b>	3,708	<b>4,381</b>	3,362
Manufacturing	<b>4,220</b>	4,038	<b>4,104</b>	3,643
Construction	<b>991</b>	722	<b>933</b>	668
Mining and quarrying	<b>724</b>	730	<b>717</b>	721
Agriculture, fishing and forestry	<b>444</b>	480	<b>444</b>	478
Trade	<b>582</b>	304	<b>558</b>	229
Consumer	<b>393</b>	320	<b>393</b>	320
Government	<b>2,693</b>	4,511	<b>2,679</b>	4,495
Personal	<b>194</b>	204	<b>175</b>	165
<b>Total</b>	<b>24,306</b>	24,781	<b>22,983</b>	23,054

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 24 RISK MANAGEMENT (continued)

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

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:

	<u>Gross maximum exposure</u>		<u>Net maximum exposure</u>	
	2012	2011	2012	2011
Financial services	3,964	4,306	2,094	2,795
Other services	2,700	1,301	2,694	1,294
Manufacturing	1,507	1,531	1,493	1,515
Construction	1,040	787	1,035	783
Mining and quarrying	395	389	395	389
Agriculture, fishing and forestry	14	10	14	10
Trade	296	397	294	395
Government	68	46	68	45
Other	39	27	38	26
<b>Total</b>	<b>10,023</b>	<b>8,794</b>	<b>8,125</b>	<b>7,252</b>

#### 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 2012	<u>Neither past due nor impaired</u>			<u>Past due</u>	<u>Total</u>
	<u>High grade</u>	<u>Standard grade</u>	<u>Sub-standard grade</u>	<u>or individually impaired</u>	
Liquid funds	1,501	-	-	-	1,501
Trading debt securities	61	-	-	-	61
Placements with banks and other financial institutions	3,437	897	-	-	4,334
Securities bought under repurchase agreements	578	-	-	-	578
Non-trading debt securities	3,034	903	-	19	3,956
Loans and advances	5,939	6,828	-	93	12,860
Other credit exposures	870	146	-	-	1,016
	<b>15,420</b>	<b>8,774</b>	<b>-</b>	<b>112</b>	<b>24,306</b>

31 December 2011	<u>Neither past due nor impaired</u>			<u>Past due</u>	<u>Total</u>
	<u>High grade</u>	<u>Standard grade</u>	<u>Sub-standard grade</u>	<u>or individually impaired</u>	
Liquid funds	1,362	-	-	-	1,362
Trading debt securities	61	-	-	-	61
Placements with banks and other financial institutions	2,912	1,386	7	-	4,305
Securities bought under repurchase agreements	215	-	-	-	215
Non-trading debt securities	4,592	1,380	-	26	5,998
Loans and advances	4,297	7,576	-	112	11,985
Other credit exposures	703	152	-	-	855
	<b>14,142</b>	<b>10,494</b>	<b>7</b>	<b>138</b>	<b>24,781</b>



**24 RISK MANAGEMENT (continued)**

**Credit quality per class of financial assets (continued)**

As at 31 December 2012, the total amount of past due but not impaired assets was US\$ 39 million (2011: US\$ 21 million).

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio through a risk rating system. This facilitates 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 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 the Group'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**

	<i>2012</i>	<i>2011</i>
Loans and advances	<u>234</u>	<u>231</u>

**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 fulfil 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 Risk Management Department (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.

**24 RISK MANAGEMENT (continued)**

**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 Group is interest rates. This risk is minimized as the Group's rate sensitive assets and liabilities are mostly floating rate, where the duration risk is lower. In general, the Group 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 reasonably 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, 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.

	<i>2012</i>			
	<i>Increase in basis points</i>	<i>Sensitivity statement of income</i>	<i>Decrease in basis points</i>	<i>Sensitivity statement of income</i>
<b>US Dollar</b>	<b>25</b>	<b>5</b>	<b>25</b>	<b>(5)</b>
<b>Euro</b>	<b>25</b>	<b>-</b>	<b>25</b>	<b>-</b>
<b>Pound Sterling</b>	<b>25</b>	<b>-</b>	<b>25</b>	<b>-</b>
<b>Brazilian Real</b>	<b>25</b>	<b>-</b>	<b>25</b>	<b>-</b>
<b>Others</b>	<b>25</b>	<b>1</b>	<b>25</b>	<b>(1)</b>
	<i>2011</i>			
	<i>Increase in basis points</i>	<i>Sensitivity statement of income</i>	<i>Decrease in basis points</i>	<i>Sensitivity statement of income</i>
US Dollar	25	5	25	(5)
Euro	25	-	25	-
Pound Sterling	25	-	25	-
Brazilian Real	25	2	25	(2)
Others	25	-	25	-

**24 RISK MANAGEMENT (continued)**

**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 2012 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 the impact of foreign currency movements on the structural 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	<i>Change in currency rate in % 2012</i>	<i>Effect on profit before tax 2012</i>	<i>Effect on equity 2012</i>	<i>Change in currency rate in % 2011</i>	<i>Effect on profit before tax 2011</i>	<i>Effect on equity 2011</i>
Brazilian Real	+/- 5%	-	+/-24	+/- 5%	-	+/-14
Pound Sterling	+/- 5%	-	-	+/- 5%	-	+/-7
Egyptian Pound	+/- 5%	-	+/-7	+/- 5%	-	+/-7
Jordanian Dinar	+/- 5%	+/-1	+/-7	+/- 5%	+/-1	+/-7
Algerian Dinar	+/- 5%	-	+/-8	+/- 5%	-	+/-8
Saudi Riyal	+/- 5%	+/-5	-	+/- 5%	+/-6	-
UAE Dirham	+/- 5%	-	-	+/- 5%	+/-4	-

**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 Group'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 net asset values, with all other variables held constant, is as follows:

	<i>% Change in equity price 2012</i>	<i>Effect on statement of income/ equity 2012</i>	<i>% Change in equity price 2011</i>	<i>Effect on statement of income/ equity 2011</i>
<b>Trading securities</b>	+/- 5%	-	+/- 5%	-
<b>Available-for-sale equities</b>	+/- 5%	+/-2	+/- 5%	+/-3

**24 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.

**24 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.

The Group maintains liquid assets at prudential levels to ensure that cash can quickly be made available to honour 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 Group 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 2012 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.

<b>At 31 December 2012</b>	<i>Within 1 month</i>	<i>1 - 3 months</i>	<i>3 - 6 months</i>	<i>6 - 12 months</i>	<i>1 - 5 years</i>	<i>5-10 years</i>	<i>Total</i>
<b>Financial liabilities</b>							
Deposits from customers	5,223	1,869	619	555	4,594	192	13,052
Deposits from banks and other financial institutions	2,121	1,243	846	403	743	-	5,356
Securities sold under repurchase agreements	85	21	-	317	-	-	423
Certificates of deposits	9	2	10	5	9	-	35
Term notes, bonds and other term financing	-	-	-	-	1,371	515	1,886
<b>Total non-derivative undiscounted financial on statement of financial position</b>	<b>7,438</b>	<b>3,135</b>	<b>1,475</b>	<b>1,280</b>	<b>6,717</b>	<b>707</b>	<b>20,752</b>
<b>ITEMS OFF STATEMENT OF FINANCIAL POSITION</b>							
Gross settled foreign currency derivatives	2,372	1,015	265	404	148	317	4,521
Guarantees	3,567	-	-	-	-	-	3,567

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million***24 RISK MANAGEMENT (continued)****Liquidity risk (continued)**

At 31 December 2011	<i>Within 1 month</i>	<i>1 - 3 months</i>	<i>3 - 6 months</i>	<i>6 - 12 months</i>	<i>1 - 5 years</i>	<i>5-10 years</i>	<i>Total</i>
Financial liabilities							
Deposits from customers	5,783	2,669	1,338	680	1,208	172	11,850
Deposits from banks and other financial institutions	1,981	876	665	618	209	5	4,354
Securities sold under repurchase agreements	245	1,996	114	362	205	-	2,922
Certificates of deposits	4	2	10	5	9	-	30
Term notes, bonds and other term financing	-	-	789	-	-	709	1,498
Total non-derivative undiscounted financial liabilities on statement of financial position	<u>8,013</u>	<u>5,543</u>	<u>2,916</u>	<u>1,665</u>	<u>1,631</u>	<u>886</u>	<u>20,654</u>
ITEMS OFF STATEMENT OF FINANCIAL POSITION							
Gross settled foreign currency derivatives	1,767	1,356	802	133	83	345	4,486
Guarantees	2,996	-	-	-	-	-	2,996

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

All figures in US\$ Million

**24 RISK MANAGEMENT (continued)****Liquidity risk (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 2012	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
<b>ASSETS</b>												
Liquid funds	1,026	321	62	123	1,532	-	-	-	-	-	-	1,532
Trading securities	3	-	8	-	11	10	11	32	-	-	53	64
Placements with banks and other financial institutions	2,904	563	565	300	4,332	1	-	-	-	1	2	4,334
Securities bought under repurchase agreements	578	-	-	-	578	-	-	-	-	-	-	578
Non-trading securities	2,105	125	573	411	3,214	724	17	1	-	49	791	4,005
Loans and advances	1,238	1,806	1,885	2,097	7,026	4,879	851	93	11	-	5,834	12,860
Others	9	16	23	80	128	97	5	-	-	924	1,026	1,154
<b>Total assets</b>	<b>7,863</b>	<b>2,831</b>	<b>3,116</b>	<b>3,011</b>	<b>16,821</b>	<b>5,711</b>	<b>884</b>	<b>126</b>	<b>11</b>	<b>974</b>	<b>7,706</b>	<b>24,527</b>
<b>LIABILITIES, SHAREHOLDERS' EQUITY AND NON-CONTROLLING INTERESTS</b>												
Deposits from customers	5,267	1,803	577	388	8,035	3,485	132	-	-	377	3,994	12,029
Deposits from banks and other financial institutions	2,119	1,236	832	382	4,569	568	-	-	-	5	573	5,142
Certificates of deposit	9	2	10	5	26	9	-	-	-	-	9	35
Securities sold under repurchase agreements	85	20	-	314	419	-	-	-	-	-	-	419
Term notes, bonds and other term financing	-	-	-	-	-	1,371	411	-	-	-	1,782	1,782
Others	38	25	26	18	107	43	2	-	-	746	791	898
Shareholders' equity and non-controlling interests	-	-	-	-	-	-	-	-	-	4,222	4,222	4,222
<b>Total liabilities, shareholders' equity and non-controlling interests</b>	<b>7,518</b>	<b>3,086</b>	<b>1,445</b>	<b>1,107</b>	<b>13,156</b>	<b>5,476</b>	<b>545</b>	<b>-</b>	<b>-</b>	<b>5,350</b>	<b>11,371</b>	<b>24,527</b>
Net liquidity gap	345	(255)	1,671	1,904	3,665	235	339	126	11	(4,376)	-	-
Cumulative net liquidity gap	345	90	1,761	3,665		3,900	4,239	4,365	4,376	-		

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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

All figures in US\$ Million

## 24 RISK MANAGEMENT (continued)

## Liquidity risk (continued)

At 31 December 2011	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
<b>ASSETS</b>												
Liquid funds	1,399	-	-	-	1,399	-	-	-	-	-	-	1,399
Trading securities	3	61	-	-	64	-	-	-	-	-	-	64
Placements with banks and other financial institutions	3,378	512	415	-	4,305	-	-	-	-	-	-	4,305
Securities bought under repurchase agreements	215	-	-	-	215	-	-	-	-	-	-	215
Non-trading securities	4,054	108	478	257	4,897	1,090	61	2	-	-	1,153	6,050
Loans and advances	1,114	1,584	1,612	1,907	6,217	4,452	1,265	48	3	-	5,768	11,985
Others	10	17	12	29	68	159	9	-	-	761	929	997
<b>Total assets</b>	<b>10,173</b>	<b>2,282</b>	<b>2,517</b>	<b>2,193</b>	<b>17,165</b>	<b>5,701</b>	<b>1,335</b>	<b>50</b>	<b>3</b>	<b>761</b>	<b>7,850</b>	<b>25,015</b>
<b>LIABILITIES, SHAREHOLDERS' EQUITY AND NON-CONTROLLING INTERESTS</b>												
Deposits from customers	4,492	1,374	609	651	7,126	4,279	121	-	-	-	4,400	11,526
Deposits from banks and other financial institutions	1,979	870	654	602	4,105	163	3	-	-	2	168	4,273
Certificates of deposit	5	2	10	5	22	8	-	-	-	-	8	30
Securities sold under repurchase agreement	245	1,992	111	359	2,707	200	-	-	-	-	200	2,907
Term notes, bonds and other term financing	-	-	786	-	786	-	662	-	-	-	662	1,448
Others	-	-	-	-	-	-	-	-	-	812	812	812
Shareholders' equity and non-controlling interests	-	-	-	-	-	-	-	-	-	4,019	4,019	4,019
<b>Total liabilities, shareholders' equity and non-controlling interests</b>	<b>6,721</b>	<b>4,238</b>	<b>2,170</b>	<b>1,617</b>	<b>14,746</b>	<b>4,650</b>	<b>786</b>	<b>-</b>	<b>-</b>	<b>4,833</b>	<b>10,269</b>	<b>25,015</b>
<b>Net liquidity gap</b>	<b>3,452</b>	<b>(1,956)</b>	<b>347</b>	<b>576</b>	<b>2,419</b>	<b>1,051</b>	<b>549</b>	<b>50</b>	<b>3</b>	<b>(4,072)</b>	<b>-</b>	<b>-</b>
<b>Cumulative net liquidity gap</b>	<b>3,452</b>	<b>1,496</b>	<b>1,843</b>	<b>2,419</b>		<b>3,470</b>	<b>4,019</b>	<b>4,069</b>	<b>4,072</b>	<b>-</b>		



# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 25 OPERATING SEGMENTS

For management purposes, the Group is organised into five operating segments which are based on business units and their activities. The Group has accordingly been structured to place its activities under the distinct divisions which are as follows:

- **MENA subsidiaries** cover retail, corporate and treasury activities of subsidiaries in North Africa and Levant;
- **International wholesale banking** encompasses corporate and structured finance, trade finance, Islamic banking services and syndications;
- **Group treasury** comprises treasury activities of Bahrain Head Office, New York and London;
- **ABC Brasil** primarily reflects the commercial banking and treasury activities of the Brazilian subsidiary Banco ABC Brasil S.A., focusing on the corporate and middle market segments in Brazil; and
- **Other** includes activities of Arab Financial Services B.S.C. (c).

	2012					Total
	<i>MENA subsidiaries</i>	<i>International wholesale banking</i>	<i>Group treasury</i>	<i>ABC Brasil</i>	<i>Other</i>	
Net interest income	112	98	73	235	3	521
Other operating income	47	88	23	110	27	295
<b>Total operating income</b>	<b>159</b>	<b>186</b>	<b>96</b>	<b>345</b>	<b>30</b>	<b>816</b>
Profit before impairment provisions	76	130	79	219	4	508
Impairment (provisions) write-back - net	(10)	(12)	10	(43)	(7)	(62)
Profit before taxation and unallocated operating expenses	66	118	89	176	(3)	446
Taxation on foreign operations	(23)	(8)	(2)	(55)	-	(88)
Unallocated operating expenses						(95)
<b>Profit for the year</b>						<b>263</b>
Segment assets employed	3,135	7,818	7,341	6,189	44	24,527
	2011					
	<i>MENA subsidiaries</i>	<i>International wholesale banking</i>	<i>Group treasury</i>	<i>ABC Brasil</i>	<i>Other</i>	Total
Net interest income	92	71	57	282	6	508
Other operating income	50	88	41	108	23	310
<b>Total operating income</b>	<b>142</b>	<b>159</b>	<b>98</b>	<b>390</b>	<b>29</b>	<b>818</b>
Profit before impairment provisions	63	107	80	247	3	500
Impairment (provisions) write-back - net	(5)	(9)	14	(30)	2	(28)
Profit before taxation and unallocated operating expenses	58	98	94	217	5	472
Taxation on foreign operations	(21)	(5)	(1)	(79)	-	(106)
Unallocated operating expenses	-	-	-	-	-	(96)
<b>Profit for the year</b>						<b>270</b>
Segment assets employed	2,653	7,488	9,279	5,540	55	25,015

**25 OPERATING SEGMENTS (continued)**

**Geographical information**

The Group operates in six geographic markets: Middle East and North Africa, Western Europe, Asia, North America, Latin America and others. The following table show the external total operating income of the major units within the Group, based on the country of domicile of the entity for the years ended 31 December 2012 and 2011:

			<i>Banco ABC Brasil</i>	<i>Other</i>	<i>Total</i>
<b>2012</b>	<i>Bahrain</i>	<i>ABCIB</i>			
<b>Total operating income</b>	<b>145</b>	<b>114</b>	<b>345</b>	<b>212</b>	<b>816</b>
<b>2011</b>					
<b>Total operating income</b>	<b>122</b>	<b>95</b>	<b>390</b>	<b>211</b>	<b>818</b>

There were no revenues derived from transactions with a single external customer that amounted to 10% or more of the Group's revenue (2011: same).

Non-current assets consist of premises and equipment and are not material to the Group.

**26 REPURCHASE AND RESALE AGREEMENTS**

Proceeds from assets sold under repurchase agreements at the year end amounted to US\$ 419 million (2011: US\$ 2,907 million). The carrying value of securities sold under repurchase agreements at the year end amounted to US\$ 464 million (2011: US\$ 3,261 million).

Amounts paid for assets purchased under resale agreements at the year end amounted to US\$ 578 million (2011: US\$ 215 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\$ 603 million (2011: US\$ 215 million).

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 27 TRANSACTIONS WITH RELATED PARTIES

Related parties represent the ultimate parent, major shareholders, associates, 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:

	<i>Ultimate parent</i>	<i>Major shareholder</i>	<i>Directors</i>	<i>2012</i>	<i>2011</i>
Deposits from customers	2,353	290	4	2,647	3,770
Term notes, bonds and other term financing	665	335	-	1,000	-
Short-term self-liquidating trade and transaction-related contingent items	1,339	-	-	1,339	906

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

	<i>2012</i>	<i>2011</i>
Commission income	6	5
Interest expense	24	17

Compensation of the key management personnel is as follows:

	<i>2012</i>	<i>2011</i>
Short term employee benefits	20	24
Post employment benefits	6	4
	<u>26</u>	<u>28</u>

### 28 FIDUCIARY ASSETS

Funds under management at the year end amounted to US\$ 13,949 million (2011: US\$ 12,384 million). These assets are held in a fiduciary capacity and are not included in the consolidated statement of financial position.

### 29 ISLAMIC DEPOSITS AND ASSETS

Deposits from customers and banks and financial institutions include Islamic deposits of US\$ 257 million (2011: US\$ 291 million). Loans and advances and non-trading securities include Islamic assets of US\$ 870 million (2011: US\$ 764 million) and US\$ 229 million (2011: US\$ 265 million).

### 30 ASSETS PLEDGED AS SECURITY

At the statement of financial position date, in addition to the items mentioned in note 26, assets amounting to US\$ 297 million (2011: US\$ 142 million) have been pledged as security for borrowings and other banking operations.

# Arab Banking Corporation (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

*All figures in US\$ Million*

### 31 BASIC AND DILUTED EARNINGS PER SHARE

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:

	<b>2012</b>	<b>2011</b>
Profit attributable to the shareholders of the parent	<b>205</b>	204
Weighted average number of shares outstanding during the year (millions)	<b>3,110</b>	3,110
Basic and diluted earnings per share (US\$)	<b>0.07</b>	0.07

### 32 CAPITAL ADEQUACY

The primary objectives of the Group's capital management policies 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 as at 31 December are based on standardised measurement methodology and in accordance with the CBB Basel II guidelines.

<b>CAPITAL BASE</b>		<b>2012</b>	<b>2011</b>
Tier 1 capital		<b>4,050</b>	3,898
Tier 2 capital		<b>1,085</b>	1,049
Total capital base	[a]	<b>5,135</b>	4,947

### RISK WEIGHTED EXPOSURES

Credit risk weighted assets and off balance sheet items		<b>18,889</b>	17,667
Market risk weighted assets and off balance sheet items		<b>1,441</b>	1,350
Operational risk weighted assets		<b>1,450</b>	1,313
Total risk weighted assets	[b]	<b>21,780</b>	20,330
Risk asset ratio	[a/b*100]	<b>23.6%</b>	24.3%
Minimum requirement		<b>12.0%</b>	12.0%

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

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