Annual Report 2006

Arab Banking Corporation Group

Registered Address

Arab Banking Corporation Group
ABC Tower, Diplomatic Area
PO Box 5698, Manama
Kingdom of Bahrain

(Commercial Registration Number 10299)

www.arabbanking.com

المؤسسة العربية المصرفية (ش.م.ب)
ARAB BANKING CORPORATION (B.S.C.)

Contents

Annual Report 2006

ABC's vision is to be the premier and most innovative international Arab financial group.

ABC's mission is to consistently generate increasing value for its shareholders, specialise in Arab-related activities across the world, invest in international financial institutions that diversify revenues, offer innovative and high quality services to its customers and attract and retain high quality employees by providing rewarding careers.

The Board of Directors

Mr. Mohammed Husain Layas EC* RC*

Chairman • Libyan
B.A. Accounting and Business Management, University of Benghazi, Libya; Diploma of the Institute of Economic Development, Washington, U.S.A.

Managing Director of Libyan Investment Corporation; Deputy Chairman and former Director of British Arab Commercial Bank, London, U.K.; Banque Intercontinentale Arabe, Paris, France and Arab International Bank, Cairo, Egypt. Mr. Layas joined the Board of Arab Banking Corporation (B.S.C.) in 2001 with over 35 years' experience in international banking.

Mr. Khalifa Mohammed Al-Kindi EC + GC*

Deputy Chairman • U.A.E. citizen
B.Sc. in Economics, East Michigan University, U.S.A.

Managing Director, Abu Dhabi Investment Council; Chairman, National Bank of Abu Dhabi and a Director of Abu Dhabi Aviation. Mr. Al-Kindi is also a Director of ABC International Bank plc, U.K. He has been a Director of Arab Banking Corporation (B.S.C.) since 1992 and has over 25 years' experience as an investment banker as well as holding a number of directorships in various public corporations.

Mr. Hilal Mishari Al-Mutairi EC +

Deputy Chairman • Kuwaiti
B.Sc. in Economics, Alexandria University, Egypt.

First Vice Chairman, Kuwait Chamber of Commerce & Industry. Director of Kuwait Investment Authority. Past offices include Minister of Trade and Industry of Kuwait; General Manager of Kuwait Investment Company and of Kuwait Clearing Company.
Mr. Al-Mutairi is also a Director of ABC International Bank plc, U.K. He has been a Director of Arab Banking Corporation (B.S.C.) since 2001 and has more than 35 years of commercial and financial industry experience.

Mr. Mohamed Abdel Salam Shokri EC GC NC

Director • Libyan
Masters Degree in Accounting Science, Oklahoma City University, U.S.A.

Deputy Governor, Central Bank of Libya. Past offices include Deputy Chief Executive, General Manager of British Arab Commercial Bank, London, UK.; Chairman and General Manager of Gumhouria Bank, Libya; Deputy General Manager and Director of Libyan Arab Tunisian Bank; Chairman of the Libyan Banks Association and Director of a number of other banks and financial institutions across the region. Mr. Shokri has been a Director of Arab Banking Corporation (B.S.C.) since April, 2006 and has over 30 years' experience as a banker.

Mr. Abdallah Saud Al Humaidhi EC GC NC*

Director • Kuwaiti
M.S. American University of Beirut.

Chairman and Managing Director, Commercial Facilities Company, Kuwait and Member of the Board and the Executive Committee of Kuwait Investment Authority. Mr. Al Humaidhi is also a Member of the Board of Kuwait Chamber of Commerce & Industry and Director of Arab Banking Corporation – Egypt (S.A.E.). He has been a Director of Arab Banking Corporation (B.S.C.) since 2001 and has over 20 years' experience in the banking and investment sectors.

Dr. Anwar Ali Al-Mudhaf AC RC

Director • Kuwaiti
M.B.A. and Ph.D. in Finance, Peter F. Drucker Graduate School of Management, Claremont Graduate University, California, U.S.A.

Dr. Al-Mudhaf is currently the Chairman & CEO of Al-Razzi Holding Company; the General Manager of Kuwait Health Insurance Company; a Director of the Board of Credit One Company Kuwait; a Director of the Board of Governors in the Oxford Institute for Energy Studies and Chairman of Banco ABC Brasil. He is also a lecturer in corporate finance; investment management and financial institutions at Kuwait University. Dr. Al-Mudhaf has formerly served as an advisor to the Finance and Economic Affairs Committee at Kuwait's Parliament and Director of Al-Ahli Bank of Kuwait. Dr. Al-Mudhaf joined Arab Banking Corporation (B.S.C.)'s Board in December 1999 and has over 15 years' experience in banking and finance.

Dr. Saleh Lamin El-Arbah ** AC

Director • Libyan
B.A. in Economics, University of Benghazi, Libya; M.B.A. University of Hartford, U.S.A.; Ph.D. in Economics, Academy of Science, Hungary.

Director of Accounting at the Central Bank of Libya; former Undersecretary of the Ministry of Planning, Economy and Commerce, Libya. Also a Director of Arab Banking Corporation - Tunisie. Dr. El-Arbah has been a Director of Arab Banking Corporation (B.S.C.) since 1996 and has over 30 years' experience in central government. Dr. El-Arbah previously held a chair in Macroeconomics from the University of Gharian (Libya).

Mr. Eissa Mohammed Al Suwaidi EC AC*

Director • U.A.E. citizen
B.Sc. in Economics, Northeastern University of Boston, U.S.A.

Executive Director of Abu Dhabi Investment Authority and Director of Abu Dhabi National Oil Company For Distribution (ADNOC-FOD), International Petroleum Investment Company, Abu Dhabi Fund for Development and National Bank of Abu Dhabi. Also Vice Chairman of Arab Banking Corporation - Egypt (S.A.E.). He has been a Director of Arab Banking Corporation (B.S.C.) since 1995, with over 20 years in investment banking.

Mr. Mubarak Rashid Al-Mansouri NC RC

Director • U.A.E. citizen
B.Sc. in Finance, M.B.A. University of West Florida, U.S.A.

Director General, Abu Dhabi Retirement Pensions and Benefits Fund, Abu Dhabi; Director of Arab International Bank, Egypt; also Director of Arab Banking Corporation (Jordan). Mr. Al-Mansouri has been a Director of Arab Banking Corporation (B.S.C.) since 1997 and has more than 15 years' experience in investment and commercial banking.

Mr. Hassan Ali Juma AC RC

Director • Bahraini
Fellow of the Chartered Institute of Management Accountants (FCIMA), U.K.

Managing Director of National Bank of Bahrain; former Chairman of Bahrain Telecommunications Company. Also Director of ABC International Bank plc, U.K. Mr. Juma has been a Director of Arab Banking Corporation (B.S.C.) since 1994. He has more than 25 years' experience as a commercial banker.

Dr. Saleh Helwan Al Humaidan NC

Director • Saudi
Ph.D. in Agricultural Economics, Oklahoma State University, U.S.A.

General Manager, Arab Investment Company, Riyadh; Member of the Boards of Saudi International Petrochemical Company, Jubail and Saudi Investment Fund, London, U.K.; Chairman, Saudi Moroccan Development Investment Company, Casablanca. Dr. Humaidan is also the Deputy Chairman of Arab Banking Corporation (Jordan).
He has over 25 years of experience in the economic and investment fields gained through his work at the Saudi Arabian Ministry of Planning, the Saudi Development Fund, and the Arab Investment Company. Dr. Humaidan joined Arab Banking Corporation (B.S.C.) as a Director in 2001.

Mr. Yousef Abdelmaula EC GC

Director • Libyan
M.B.A. Hartford University, U.S.A.

Mr. Abdelmaula is the Executive Director of the Libyan Foreign Investment Board. He serves also as Director on the boards of Libyan Foreign Bank and Arab Banking Corporation (Jordan). Mr Abdelmaula has more than 20 years of banking experience.

Dr. Khaled S. Kawan

Secretary to the Board & Legal Counsel • Libyan
Ph.D. (Doctorat D'Etat) in Banking Laws, University of Paris (Sorbonne), France.

Secretary to Arab Banking Corporation (B.S.C.)'s Board of Directors since July 1992, Dr. Kawan joined ABC in June 1991, having previously spent some time with a prime French Law firm in Paris.
He was made Legal Counsel and Head of Legal & Compliance in March 2004. Dr. Kawan also represents ABC as a Director on the boards of Arab Banking Corporation – Egypt (S.A.E.) and Arab Banking Corporation (Jordan).

EC Member of the Executive Committee
AC Member of the Audit Committee
GC Member of the Corporate Governance Committee
RC Member of the Risk Committee
NC Member of the Nomination & Compensation Committee

* Chairman
\+ Deputy Chairman

** Dr. Saleh Lamin El-Arbah passed away after a short illness on 30 December 2006.

Directors' Report

We are pleased to report that ABC's corporate revolution continued to produce positive results in 2006.

Mr Mohammed Layas, Chairman

(All figures stated in US dollars)

The dramatic switch in 2004 from a geographical-based organisation structure to one founded on product lines, combined with the establishment of dedicated marketing teams with clear global responsibilities, has achieved the desired effect of stimulating greater cooperation between all the Group's operating units and product groups, as the delivery of the right product to meet each customer's needs becomes its paramount driver.

We have maintained our policy of cautious asset growth aimed at leveraging the balance sheet and generating stable revenues to replace earnings from the two major non-core subsidiaries sold in 2004. The Group increased its loans and advances portfolio by 26% during the year, taking particular advantage of the economic expansion in the Gulf area driven by the increase in hydrocarbon prices and general infrastructure development. This, together with increases in the Group's holdings of marketable securities and its inter-bank placements, produced a 38% increase in total operating income. The increase in operating expenses was less than proportionate, at 24%. Further recoveries of historical loan loss provisions fully offset the additional portfolio provisions made, resulting in a 57% surge in net profit, exceeding $200 million for the first time in ABC's history.

The new organisational structure has ably supported an increase in the Group's business turnover. At the same time as marketing and product delivery teams were refocused, the introduction of an institutionalised, conservative credit culture, assisted by uniformly applied credit policies and rating techniques throughout the organisation, together with a new performance-geared executive motivation system, has ensured a continuous improvement of asset quality. This is amply demonstrated by the steady decline in the ratio of non-performing loans to gross loans, from 5.1% in 2004 to 3.6% in 2005 and now to 2.0%, and in the ratio of loan loss provisions to non-performing loans, which rose from 141% in 2004 to 155% in 2005 and has now achieved a very healthy 208%.

The international banking community and the various credit rating agencies have recognised the Group's achievement over recent years. We were gratified that ABC's long term counterparty rating was upgraded – the second rating increase in two years – to BBB+ by both S&P and Fitch Ratings, in recognition of our progress to date and putting us on track for our aim of achieving A- status in the near future.

The high regard in which ABC is held in the market ensured the success of its 2005 initiative to meet its future funding needs under its innovative $2.5 billion Euro Medium Term Deposit Note (EMTDN) Programme. Under this programme it successfully completed the issue of a 5-year floating rate note issue, raising $300 million, priced at the equivalent of a rating of A. 2006 also saw the successful closure of ABC International Bank plc's 5-year term loan facility, which was oversubscribed in the London market and increased from an initial $150 million to $200 million as a result. The proportion of the Group's funding from CDs, Bonds and Term Finance has consequently reached 14.8% of total liabilities compared with 10.6% at the end of 2005, helping to ensure greater funding stability for the future.

The synergistic benefits that have accrued from the new operational framework put in place via the combination of organisational and product-based matrix management, together with the refinement of its performance-based corporate culture, have set the scene for the next stage in ABC's evolution, as it prepares to shift gears in pursuance of its plan to produce reliable and rising returns to its shareholders. Over the next three years the Group will focus on developing five major sources of business income - treasury, wholesale commercial banking (including project and structured finance, trade finance and forfaiting, and loan syndications), Islamic finance, investment banking and retail/SME banking, which will form the pillars of its future operating strategy. It aims to increase revenues and returns particularly from the Islamic Financial Services, Investment Banking and Retail Banking product groups, in order to achieve a more balanced and diversified business spread with the capacity to deliver a wide range of products to an equally diversified customer base.

The Investment Banking Division, which was formed early in 2006, became operational towards the end of the year and is now set to make its contribution both to the services offered by the Group and its revenues.

The Group also continued to make progress towards full Basel II compliance as it commenced implementation of the necessary software and systems to achieve the automated analytical and internal risk assessment capabilities required to meet the requirements under the Foundation Internal Ratings Based Approach under Basel II. This target is one of several software initiatives requiring a substantial investment over the 5-year period 2003-8.

Looking ahead, therefore, we expect to see the Group developing as a multi-faceted organisation with the capability of offering customers active in, or doing business with, the Arab world a wide array of products spanning the full range of banking services. Through continuous product development aimed at meeting the needs of our customers, a first class delivery service and good risk management, we aim to fulfil our mission of generating increasing shareholder value.

Finally, as always, I should like on behalf of the Board to thank all the Group's management and staff for their continued support and invaluable contribution to making 2006 one of the most successful years in ABC Group's history. We would also wish to record our thanks to all the regulatory authorities with which the Group deals worldwide, and especially to the Central Bank of Bahrain, for their invaluable guidance and wise counsel.

Mohammed Layas
Chairman

Note: In compliance with the Central Bank of Bahrain Circular No. BMA/751/93, EDBC/782/93 and ODG/407/03 set out below are the interests of Directors and Senior Managers in the shares of Arab Banking Corporation (B.S.C.) and the distribution of shareholding for the year ended 31 December 2006.

	31/12/2006	1/1/2006*
Directors' Shares	**96,700**	9,670
Senior Managers' Shares	**35,510**	532
Total	**132,210**	10,202

Directors' remuneration, allowances and expenses for attendance at Board meetings for 2006 amounted to US$2,246,000 (2005: US$ 1,524,000).

	2006			2005		
% of shares held	**No. of shares**	**No. of shareholders**	**% of total outstanding shares**	No. of shares*	No. of shareholders	% of total outstanding shares
Less than 1%	**58,371,800**	**1,333**	**6**	8,407,479	1,328	8
1% up to less than 5%	**125,909,170**	**7**	**13**	10,021,134	5	10
5% up to less than 10%	**-**	**-**	**-**	-	-	-
10% up to less than 20%	**-**	**-**	**-**	-	-	-
20% up to less than 50%	**815,719,030**	**3**	**82**	81,571,387	3	82
50% and above	**-**	**-**	**-**	-	-	-
Total	**1,000,000,000**	**1,343**	**100**	100,000,000	1,336	100

* The nominal value per share of US$10.00 was reduced to US$1.00 in June 2006 following a share split.

Global Network
2006 Highlights

The ABC Group

ABC Parent (ABC BSC)

	US$ millions
Total Assets	17,251
Total Loans and Advances	4,846
Total Deposits	13,271
Shareholders' Funds	2,068

ABC Group

	US$ millions
Total Assets	22,402
Total Loans and Advances	8,622
Total Deposits	17,652
Shareholders' Funds	2,068

Arab World Division

Arab Banking Corporation – Algeria

	US$ millions
Total Assets	341
Total Loans and Advances	91
Total Deposits	266
Shareholders' Funds	38
Number of Branches	5

ABC Islamic Bank (E.C.)

	US$ millions
Total Assets	817
Total Loans and Advances	486
Total Deposits	706
Shareholders' Funds	103
Number of Branches	-

Arab Banking Corporation (Jordan)

	US$ millions
Total Assets	730
Total Loans and Advances	292
Total Deposits	573
Shareholders' Funds	92
Number of Branches	13

Arab Banking Corporation – Egypt (S.A.E.)

	US$ millions
Total Assets	447
Total Loans and Advances	182
Total Deposits	327
Shareholders' Funds	102
Number of Branches	13

Arab Banking Corporation – Tunisie, S.A.

	US$ millions
Total Assets	133
Total Loans and Advances	39
Total Deposits	107
Shareholders' Funds	12
Number of Branches	3

Other Subsidiaries

ABC International Bank plc

	US$ millions
Total Assets	3,484
Total Loans and Advances	1,414
Total Deposits	2,405
Shareholders' Funds	547
Number of Branches	4

Banco ABC Brasil S.A.

	US$ millions
Total Assets	1,516
Total Loans and Advances	1,056
Total Deposits	1,177
Shareholders' Funds	158
Number of Branches	4

Financial Highlights

		2006	2005	2004	2003 Restated **	2002 Restated ***
Earnings (US$ million)	Net interest income	**249**	193	152	158	464
	Other operating income	**235**	159	153	259	257
	Total operating income	**484**	352	305	417	721
	Profit before provisions, tax and minority interests	**222**	141	106	203	230
	Writeback/(Provisions for credit losses)	**-**	14	10	(74)	(204)
	Profit before tax and minority interests	**222**	155	116	87	26
	Net profit (loss) for the year from continuing operations	**202**	129	109	71	(41)
	Net profit for the year from discontinued operations	**-**	-	470	49	-
Financial Position (US$ million)	Total assets	**22,402**	17,588	14,922	30,068	28,915
	Loans and advances	**8,622**	6,833	6,012	15,921	14,981
	Placements with banks and other financial institutions	**4,160**	3,264	4,305	6,651	6,802
	Trading securities	**757**	593	184	86	373
	Non Trading securities	**7,828**	6,003	3,617	5,204	4,632
	Shareholders' funds	**2,068**	1,926	1,852	1,585	1,371
Ratios (%)	*Profitability*					
	Cost: Income ratio (costs as % of gross operating income)	**54**	60	65	51	68
	Net profit (loss) as % of average shareholders' funds	**10.2**	6.8	30.1	7.9	(2.8)
	Net profit (loss) as % of average assets	**0.94**	0.81	4.07	0.83	(0.15)
	Dividend cover (times)	**2.0**	1.8	1.9	1.8	-
	Capital					
	Risk weighted assets (US$ million)	**14,107**	10,476	8,249	18,051	19,015
	Capital base (US$ million)	**2,225**	2,089	1,974	2,661	2,495
	Risk asset ratio - Tier 1	**13.5**	17.6	15.7	12.0	11.5
	Risk asset ratio - Total	**15.8**	19.9	23.9	14.7	13.1
	Average shareholders' funds as % of average total assets	**8.7**	11.9	13.5	10.5	5.2
	Loans and advances as a multiple of shareholders' funds (times)	**4.2**	3.5	3.2	10.0	10.9
	Total debt as a multiple of shareholders' funds (times)	**9.8**	8.1	7.0	17.6	19.8
	Term financing as multiple of shareholders' funds (times)	**0.93**	0.82	0.99	1.17	1.59
	Assets					
	Loans and advances as % of total assets	**38.5**	38.9	40.3	52.9	51.8
	Securities as % of total assets	**38.3**	37.5	25.5	17.6	17.3
	Non-accrual loans as % of gross loans	**2.0**	3.6	5.1	4.5	4.9
	Loans loss provisions as % of non-accrual loans	**208.2**	154.6	141.4	102.0	94.7
	Loan loss provisions as % of gross loans	**4.2**	5.6	7.2	4.6	4.6
	Liquidity					
	Liquid assets ratio	**58.1**	57.8	56.4	42.1	43.1
	Deposits to loans cover (times)	**2.0**	2.0	1.8	1.6	1.5
Share Information	Basic Earnings per share - Profit for the year	* **$0.20**	$0.13	$0.58	$0.12	($0.04)
	- Profit from continuing operations	* **$0.20**	$0.13	$0.11	$0.07	-
	Dividends per share - Cash	* **$0.10**	$0.07	$0.29	$0.07	-
	- Stock			0.062 shares		
	Net asset value per share	* **$2.07**	$1.93	$1.85	$1.68	$1.46
Capitalisation (US$ million)	Authorised	**1,500**	1,500	1,500	1,500	1,500
	Issued, Subscribed and fully paid-up	**1,000**	1,000	1,000	1,000	1,000

* At an extraordinary general meeting of the shareholders of the Bank held on 7 June 2006, it was resolved to change the nominal value of the shares of the Bank from US$ 10 per share to US$ 1 per share. The number of shares have been amended to reflect this change for all the years.

** Figures for 2003 restated to exclude amounts relating to the discontinued operations where required.

*** Figures for 2002 restated following revisions to International Accounting Standard 39.

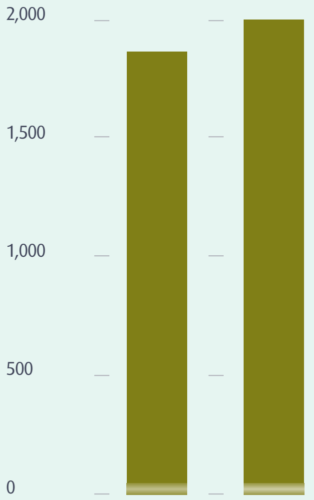
Principal shareholders
Kuwait Investment Authority (Kuwait)
Central Bank of Libya (Libya)
Abu Dhabi Investment Authority (Abu Dhabi)
Individual and Institutional Investors

Registered address
Arab Banking Corporation (B.S.C.)
ABC Tower, Diplomatic Area
P.O. Box 5698, Manama
Kingdom of Bahrain

Publicly quoted company listed on Bahrain Stock Exchange.
(Commercial Registration Number 10299)

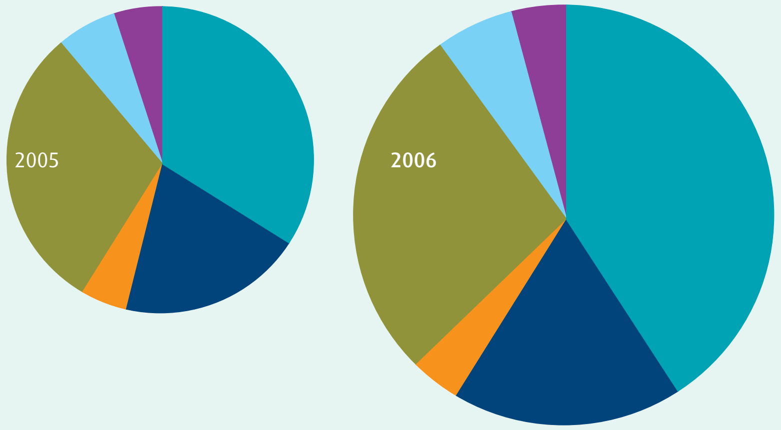
Financial Strength

Shareholders' Funds
($ million)



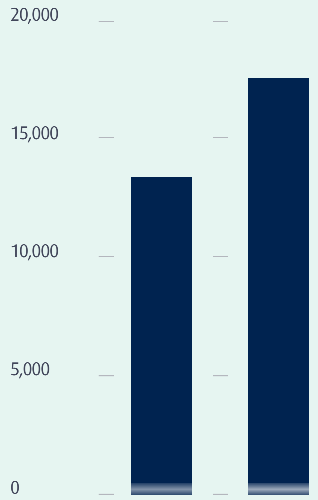
2005	**2006**
1,926	**2,068**

Assets Breakdown
Percentage



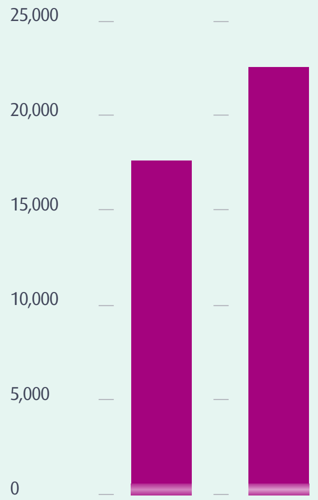
	Arab World	Western Europe	Asia	North America	Latin America	Others
2005	34%	20%	5%	30%	6%	5%
2006	**41%**	**18%**	**4%**	**27%**	**6%**	**4%**

Deposits
($ million)



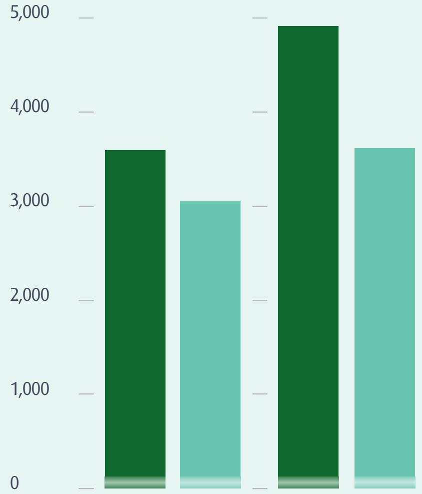
2005	**2006**
13,491	**17,652**

Total Assets
($ million)

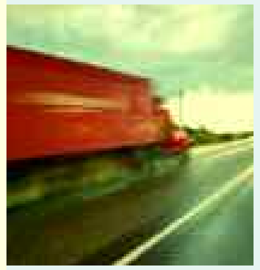


2005	**2006**
17,588	**22,402**

Short and Long Term Loans
($ million)



	2005	**2006**
Short term Loans	3,723	**4,886**
Long term Loans	3,110	**3,736**
	6,833	**8,622**



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$1.2 billion

for the acquisition and expansion of the existing Hidd power and water facilities in Bahrain

$425 million >>

joint mandate obtained for an *ijara sukuk* from Dar Al Arkan

The President & Chief Executive's Review of Operations

In 2006 ABC Group's total assets increased by 27% to $22.4 billion, with the addition of $1.79 billion of good quality assets to its loans and advances portfolio.

Ghazi M. Abdul-Jawad, President & Chief Executive

(All figures stated in US dollars unless otherwise indicated)

World economic growth maintained its buoyant pace during 2006, recording its highest annual rate for 30 years. In a tribute to globalisation, both developing and developed countries shared in the largesse as global growth showed signs of becoming increasingly broad based. China led the way with a 10.7% growth rate, followed by India with 8.7%. The EU's economic recovery, which began the year somewhat tentatively on account of higher energy costs and lower world demand, strengthened later supported by domestic demand, finishing the year with an estimated 2.8% overall growth rate. The United States' economy bounced back strongly from the sharp slowdown in 2005 in the wake of Hurricane Katrina, expanding by an estimated 3.4%, although consumer spending slowed towards the end of the year.

In the Arab world, producers continued to benefit from strong oil and gas prices while those economies primarily dependent on agriculture and tourism also did well amid signs of increasing inter-Arab tourism and trade. The sharp rise over recent years in the rate of infrastructure and inward investment was maintained in most countries in the Middle East and North Africa (MENA) region, the GCC area providing the most striking example, while continuing progress towards economic reforms in Egypt, Algeria and Tunisia also bore considerable fruit.

That ABC should find itself with room to grow, after the disposal of its two major non-core subsidiaries in 2004 with the resultant impact on both its asset base and its leverage, at just this time of rapid economic expansion in the region and recovery in Europe, has indeed been fortuitous. In 2006 the Group's total assets increased by 27% to $22.4 billion, with the addition of $1.79 billion of good quality assets to its loans and advances portfolio along with a similar expansion in its more liquid inter-bank placements and securities holdings. The 38% increase in its total operating income – the product of a 29% increase in net interest margin on the back of the asset expansion and higher interest rates, and a near 48% increase in other income – was an impressive result in light of the need for swift replacement of earning assets following the sale of Banco Atlántico and International Bank of Asia.

The 24% rise in operating expenses, particularly those relating to staff costs, was not surprising considering the hiring of additional product and specialist staff, recently introduced performance-related reward system and retention packages and start-up costs of the Group's new Investment Banking Division. Nevertheless, our cost: expenses ratio, which stood at 65% at the end of 2004 and which has been progressively reduced to the present 54%, continues to decline.

Total non-performing loans were again reduced in 2006, through a combination of negotiated settlements, gradual workout recoveries and secondary market asset sales, and now stand at only 2% of gross loans. By increasing both our specific provisions and those on our unencumbered portfolio, we have achieved a loan loss provisions to non-performing loans ratio now exceeding 200%.

Progress in managing or disposing of weak assets and improving the provision coverage, combined with the systematic improvement in the Group's asset quality – the loans and advances portfolio quality now stands at the equivalent of an A- rating – and of its profitability, should, we believe, soon be reflected in our long term credit rating. Indeed, as the Chairman has pointed out, ABC's recent successful 5-year FRN issue was priced by the market at the equivalent of an A rating. The advanced risk management software to be implemented over the next two years, designed amongst other things to help us to meet Basel II standards of asset categorisation, will also help us to maintain the quality of our assets. Meanwhile we will continue to concentrate on building up reliable and consistent revenue streams from our main business lines, providing our customers with the highest quality of service and meeting their evolving needs through imaginative and innovative solutions, while simultaneously expanding our customer base.

In regard to the overall marketing function, under the Group's matrix management system respective responsibilities for product and relationship building have been segregated, with a clear distinction between the two functions. This structure has resulted in more client-focused and productive marketing and product delivery, increased efficiency and improved cross-selling capabilities and synergies throughout the organisation.

ABC built on its capability of advising on, arranging and underwriting entire transactions under a single roof. Deals closed in 2006 included a $153 million financing for United Stainless Steel Company in Bahrain, with several similar transactions in the pipeline due to be booked in 2007.

Product Groups

Treasury

Group Treasury's primary role continues to be that of central co-ordinator of ABC Group's funding and liquidity management. As part of its funding activity in 2006 Group Treasury raised $300 million through a 5-year floating rate note (FRN) issue, under its $2.5 billion Euro Medium Term Deposit Notes Programme. The Programme not only provides ABC with the flexibility to launch further such issues, but also enables it to enter into bilateral transactions and private placements in any currency, over any period. Meanwhile, ABC International Bank plc (ABCIB) successfully closed a $200 million 5-year term facility arranged in London.

Group Treasury directs the core Hubs of Bahrain and London, as well as the treasury offices of the ABC branches in New York and Tunis and the various subsidiaries, in their efforts to focus on business growth and revenue diversification. The Bahrain Hub provides support to the Arab world subsidiaries in their marketing and product development for the benefit of their clients, while the London Hub concentrates on further building banking and corporate customer relationships in Europe, North Africa, the Levant and Turkey.

Treasury's FX and Derivatives trading activities, along with its $8 billion proprietary portfolio activities related to its investments in predominantly investment grade securities, have played an important part in diversifying ABC Group's revenues mix. Proprietary trading and investment activities are coordinated in an effort to increase and build customer related business and revenues, through a wide array of products including money markets, Islamic *murabaha*, foreign exchange, structured products and interest rate and currency derivatives. Treasury offers Islamic banks Shari'a-compliant structures enabling them to place funds overnight on a similar basis to money market deposits.

The Portfolio Management unit manages institutional discretionary and non-discretionary portfolios in the areas of fixed income, equities and structured products. The mandates are managed actively against benchmarks and the unit has built a solid reputation over the years for performance and service quality. The Bahrain Hub manages Treasury Group's significant proprietary portfolios across a well-diversified range of asset classes including bonds, FRNs, Collateralised Mortgage Obligations (CMO), Collateralised Debt Obligations (CDO), asset-backed securities, emerging market debt, hedge funds and equities. The London Hub provides mainly customer-related activities, whilst also managing proprietary investment portfolios on behalf of ABCIB alongside foreign exchange and bond trading.

In a year of record profits for Treasury, it continues to be a major contributor to the overall profitability of ABC Group. Group Treasury's mission is to make ABC Group the pre-eminent Arab financial institution for the trading and distribution of all treasury and capital market products within the Arab world, and the premier global provider of currency and capital markets expertise relating to the Arab world. Its immediate focus will be on generating more customer-related business by direct marketing to both corporate and institutional clients.

Project & Structured Finance

Headquartered in Bahrain, P&SF maintains the largest dedicated project and structured finance team in the Arab world, offering the full range of advisory, structuring and arranging services to its regional and international client base. The group also maintains specialist teams in London and Paris to enable it to cover the MENA region more effectively.

2006 was another stellar year for project finance in the MENA region and ABC played a significant role in many of the very large transactions seen. Successful deals included a $2.5 billion debt financing for the Greater Equate project consisting of a world scale ethane cracker, an ethyl benzene unit and a polyethylene plant, $1.2 billion for the acquisition and expansion of the existing Hidd power and water facilities in Bahrain and $8.6 billion for the development of an integrated refinery and petrochemical complex at Rabigh in Saudi Arabia.

ABC also built on its capability of advising on, arranging and underwriting entire transactions under a single roof. Deals closed in 2006 included a $153 million financing for United Stainless Steel Company in Bahrain, with several similar transactions in the pipeline due to be booked in 2007.

P&SF continued to develop its asset finance expertise, concluding several aviation and shipping transactions during the year, including a $160 million term debt facility for Aviation Lease and Finance Company to part finance five Boeing 737-800 aircraft leased to Turkish Airlines. It also expanded the scope of its financial advisory services, with teams supporting one of the bidders for the Disi Conveyance Water System in Jordan, one of the bidding consortia for the Enfidha and Monastir airport concessions in Tunisia and the Saudi Kayan project in Saudi Arabia. ABC meanwhile signed a landmark Memorandum of Understanding with National Oil Corporation of Libya during 2006 to provide assistance and advisory services in relation to certain NOC projects.

Although economic growth is likely to continue in the MENA region, the financing arena remains very competitive. P&SF has therefore maintained its central objective of lead-arranging mandates - where yields can be enhanced through subsequent sell-down and there are often opportunities to gain ancillary business - as well as advisory and arranging opportunities in North Africa and the Levant, where ABC's branch and representative office network gives it a natural advantage and enhanced ability to play a leading role.

The President & Chief Executive's Review of Operations

Trade Finance

Trade Finance group's activities centre around the two Hubs in London and Bahrain. Taking full advantage of the favourable operating environment arising from strong regional trade flows and buoyant market liquidity, the Trade Finance units expanded both their origination and asset distribution activities during the year.

In addition to growing its client base through more intensive and coordinated marketing activities, the group has also deepened existing relationships, as long-standing customers have increasingly availed themselves of its specialist, niche ability to provide imaginative, tailor-made trade solutions whilst accommodating MENA region risks. The group has established a strong and dynamic client base, ranging from SMEs to global leaders in their fields and spanning business sectors as diverse as primary commodities and high-tech telecommunications equipment.

Building upon its existing and diversified range of traditional trade finance products, Trade Finance was particularly active in developing its trade receivables discounting facilities, including hybrid structures involving corporate and credit insurance elements. From an initial focus on the telecommunications sector, the group has been at the forefront of specialised, bespoke receivables discounting product development. Underpinned by ABC Group's matrix management approach, the experience gained in ABCIB London in spearheading the imaginative structuring of facilities has provided a valuable product template for ABC Group as a whole, whilst the heightened synergy that has developed between the London and Bahrain Hubs has been amply demonstrated by the Bahrain unit's success in distributing the new assets created in London to investors within the MENA region. The group anticipates that more capital goods exporters will take up this highly versatile product.

The Bahrain unit has likewise continued to develop its client base – both corporate and correspondent bank customers – originating over $150 million of primary business in 2006. Its available for sale and held-for-investment portfolios now exceed $600 million and continue to grow apace, with a noteworthy contribution from the Singapore representative office, which now concentrates on directing Far East trade finance business to the Bahrain office.

Islamic Financial Services

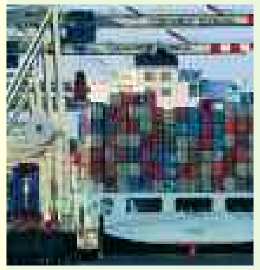
The market for Islamic banking products continued to surge during 2006, presenting a challenge to ABC to maintain its leadership position in product and business development.

During the year much attention was paid to Islamic project finance in the MENA region, and ABC Islamic Bank – frequently working with Project & Structured Finance – was prominent as adviser and arranger in several GCC-based transactions. The corporate market in the Gulf was similarly buoyant as leading companies in Kuwait, Saudi Arabia and the UAE accessed the growing pool of Islamic liabilities seeking productive outlets, and again ABC Islamic Bank displayed its regional leadership credentials in the *sukuk* and syndicated Islamic financing markets.

In the UK, the distribution network for ABCIB's Islamic 'mortgages', marketed under its unique *alburaq* brand, expanded steadily and asset volumes rose five-fold while the transaction pipeline was strong at over £250 million. The *Al Bait UK Property Fund*, for which ABCIB's Islamic Asset Management unit acts as Property Investment Manager and which holds a £50 million diversified portfolio of UK assets, performed well. Alongside its real estate activities, IAM has also built up an impressive track record in producing attractive returns from equipment leasing for itself and its investors, and 2006 saw a continuation of healthy end of lease gains.

In addition to its Shari'a-compliant banking, project financing and investment business lines, ABC Group provides treasury and hedging solutions to its Islamic banking counterparties. 2006 witnessed growth in commodities *murabaha* flows – which still represent the largest proportion of short term assets held by Islamic banks – as well as an increase in liquid placements in the unique *ABC Clearing Company* managed by ABC Islamic Bank.

Looking ahead, a Shari'a-compliant money market fund is planned for launch out of Bahrain in the first half of 2007. A new real estate fund will also be brought to market by ABCIB, focusing on 'value added' investments in the US commercial and industrial sectors. Islamic Financial Services' long-term ambition is to be able to offer a comprehensive range of investment instruments and products across the maturity and risk spectrum, complementing the trade, asset-backed and project-related commercial banking products which are the mainstay of ABC's Islamic banking activity, together with the more recently developed *sukuk* and capital market business lines.



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$350 million

joint mandate for an *ijara sukuk* issue for Sharjah Electricity and Water

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$2.5 billion

financing for Greater Equate petrochemical units, Kuwait

$160 million >>

term debt facility for Aviation Lease and Finance Company to part finance five Boeing 737-800 aircraft leased to Turkish Airlines

The President & Chief Executive's Review of Operations

During 2006 the MENA region debt market maintained its remarkable pace of growth. High levels of liquidity - particularly in the GCC area - drove major new investments in infrastructure, petrochemical and other energy related projects, not to mention substantial corporate investment.

Retail Banking & SME

2006 marked another year of expanding retail banking activities throughout ABC Group.

ABC Algeria got its new retail banking arm off to a good start with an instantly successful car loan product, following careful preparation and pre-marketing with car dealers. ABC Jordan launched a series of innovative campaigns providing incentives for customers to take out personal loans, credit cards and car loans, which proved to be attractive and contributed greatly to the expansion of its retail assets portfolio. On the liabilities side, ABC Egypt introduced a new CD product to add to its retail services range.

ABC Algeria completed preparations for inaugurating three more retail branches, due for opening in early 2007. ABC Egypt added one branch to its network and prepared to open two more in 2007, while ABC Jordan also opened a new branch. On the technology front, ABC Jordan launched SMS banking and implemented the outsourcing of its ATM network processing and maintenance to *EuroNet*. ABC Egypt will complete a similar exercise in 2007.

A Retail Credit unit was meanwhile established at Head Office in Bahrain, under the aegis of Credit & Risk Group, tasked with sharpening the focus on ABC Group's growing retail activities and ensuring the maintenance of quality portfolios. A policy and process review was subsequently carried out, utilising the services of an external specialist consultant.

Syndications

During 2006 the MENA region debt market maintained its remarkable pace of growth. High levels of liquidity - particularly in the GCC area - drove major new investments in infrastructure, petrochemical and other energy related projects, not to mention substantial corporate investment. The growing use of Islamic financing products featured prominently amongst the many innovative financing methods accessed by borrowers during the year.

Against this background, the Syndications team enjoyed yet another record year in terms of mandates achieved and fee income booked, with 15 syndicated transactions being successfully closed, in most cases with oversubscription. Notable was the MTC Kuwait Islamic *murabaha* financing, which raised $1.2 billion, and the Union National Bank term loan at the end of the year which was increased from $450 million to $1 billion after heavy oversubscription. Sole mandates included a $75 million term loan for International Finance Company of Kuwait and the highly successful $153 million project finance for United Stainless Steel Company, Bahrain. Joint mandates were also achieved for Aref Investment Group S.A.K., Kuwait in respect of its *murabaha* financing, launched at $100 million but subsequently increased to $200 million, and a $60 million term loan facility for Alliance Housing Bank in Oman.

Outside the Gulf area, Syndications worked as joint arranger for the very successful €350 million refinancing for Orascom Telecom Tunisie, in addition to a $60 million syndicated term loan for Capital Bank of Jordan and a $200 million term loan for Kuveyt Turk of Turkey.

In 2006 Syndications also commenced secondary trading of loan assets, adding a new fee-based revenue stream to its considerable earning power.

The year closed very positively, with sole mandates awarded by Gulf Industrial Investment Company ($555 million) and Hashoo Group for its $150 million hotel, commercial and retail project in Libya, and joint mandates obtained for *ijara sukuks* from Sharjah Electricity & Water ($350 million) and Dar Al Arkan ($425 million) and from Bahrain Telecommunications Company for its debut $300 million syndicated term loan facility.

Corporate & Institutional Banking

Falling margins over time led to a reconsideration of the role of the previous Government & Financial Institutions group and the decision to dedicate more personnel to the corporate sector. Corporate & Institutional Banking now oversees ABC's relationships in the region in both the government and financial institutions sector and the corporate sector, offering both general corporate banking and correspondent banking products.

2006 was significant in terms of both the level and composition of business achieved. Business turnover attained an historic high, 24% up on 2005, with most of the growth in the corporate sector. Business booked was spread among different commercial and industrial sectors while, geographically, growth was concentrated in the GCC countries.

Bilateral relationships with leading corporates are being developed with the aim of building a broad multi-product based client base. CIB's intention is to push ahead with this strategy, while continuing to pursue business with established relationships in the G&FI sector, particularly in the GCC area, Tunisia and Egypt and selected targets in other MENA region countries where ABC has a presence.

Investment Banking

In 2006 ABC Group established a full service investment banking and fund management business, ABC Investment Banking. The new product group will offer world class advisory, capital raising and fund management services within, from and to the MENA region. Its objective is to become the leading intermediary for clients seeking investment banking advice and services in the region.

The group has established four divisions, Corporate Finance, Equities, Debt Capital Markets and Placement & Fund Raising Group, and is in the process of establishing a Cayman Islands registered fund management business, ABC Capital Partners. The divisions will offer the following services within the MENA region:

Corporate Finance - Traditional merger and acquisition transactions, corporate advisory services and advice related to capital raising. Corporate Finance will also provide industry expertise.

Equities – Regional institutional brokerage services offering primary (Initial Public Offerings and other public issues) and secondary market trading, equity derivatives, margin trading and private placements.

Debt Capital Markets – Floating rate notes, bank subordinated and hybrid capital, fixed rate bonds, acquisition and leveraged finance and securitisation.

Placement & Fund Raising Group – Fund management services and products, including fund raising for both proprietary and third party alternative asset funds.

With the MENA region currently enjoying unprecedented macro-economic and financial market growth, favourable global capital market conditions and repatriation of capital, ABC Investment Banking is well positioned to develop the pre-eminent regional investment banking and fund management business. It will provide first class advisory and capital raising capabilities whilst giving Middle East investors access to a broad range of local and international investment products.

In its foundation year, ABC Investment Banking has recruited a high calibre team of professionals with broad international experience. Further key personnel will be employed as its platform is built out. The ABC Investment Banking brand will be launched in 2007.

Banking Group

ABC's New York Branch, which relocated to new premises in October, has been busy rebuilding its business following the shift in emphasis towards trade and structured finance and commercial lending focused on the Arab world. Balance sheet growth was above budgeted levels, while on the off-balance sheet side the branch issued over $1 billion of documentary letters of credit on behalf of US companies through the new ABC Iraq Branch in Baghdad, in respect of oil liftings from SOMO, the State hydrocarbon agency. ABC New York continues to support its engineering, construction and oil and gas clients' bonding requirements through the issue of standby letters of credit for major projects in the Middle East.

ABC's Iraq Branch formally commenced business in September 2005, providing trade finance, inward and outward remittances and advisory services to multinational corporates. The branch had a satisfactory first year of operation, especially as regards the volume of documentary credits issued on behalf of the Trade Bank of Iraq and trade related activities routed to various ABC units.

Arab Banking Corporation - Egypt (S.A.E.)

Egypt's structural reform process accelerated in 2006. As the mood of cautious optimism grew with easier availability of foreign currency and the appreciation of the Egyptian pound, the positive effect on the business environment was evidenced by increased exports and a record 6.8% GDP growth in the fiscal year to June 2006. Foreign exchange reserves at the Central Bank reached $26 billion. Inflation, however, reversed its recent downward trend as consumer demand increased, compelling the Central Bank to increase key overnight deposit and lending intervention rates.

ABC Egypt responded positively to this environment, increasing its corporate and retail loans, trade finance and treasury activity. The Corporate Banking Division expanded its participations in club deals and syndicated loan transactions, focusing on the corporate, project and equity financing sectors, often working together with ABCIB and the Project & Structured Finance team. The Division continued to grow its client base, reflected in an expansion in its loan book and diversification into a wide range of industrial and commercial sectors.

The Retail Group, meanwhile, added a new branch at the Sheraton Heliopolis residential area in Cairo to its network, which now numbers 13 branches. It continued to develop its product range, launching a new issue of Certificates of Deposit tailored for medium term savers and expanding its Bancassurance activity. The Correspondent Banking Division expanded its trade finance operations, increasing turnover by 12%. The Treasury Group, too, had a successful year, earning substantial revenues from increased foreign exchange market activity whilst also diversifying into client-driven stock market dealings.

ABC Egypt's net interest margin jumped by 31% to $13.5 million, but other income fell by 17% to $3.7 million on the back of reduced marketable securities income. Total operating income was nevertheless 16% higher than 2005 at $17.3 million. Operating expenses rose by 23% nevertheless, after accounting for loan loss and general provisions offset by enhanced credit recoveries, the bank's net profit, at $5.3 million, was 18% up on 2005.

For 2007, ABC Egypt will continue its network expansion while launching a range of new credit card and personal loan products. Its Treasury Group also plans to diversify further into the lucrative foreign banknote shipping business.

Arab Banking Corporation (Jordan)

The Jordanian economy grew by 6.0% in real terms in 2006, lower than 2005's 7.2% and 2004's 7.7%. Inflation however rose by 6.0%, partly driven by increased energy prices, amid concerns for the economy over the potential impact of oil prices on the cost of Jordan's imports and thus its trade and budget deficits.

2006 was a good year for ABC Jordan, with core business growth backing an increase in its total credit facilities portfolio to $288 million from $258 million in 2005. In addition to its trade finance and ancillary business, ABC Jordan was prominent in financing a number of domestic projects, leading to an expanded corporate portfolio, while total retail loans also grew in all categories. These achievements in turn led to a 26% increase in net interest income to $21.7 million. In spite of a slowdown in activity on the Amman Stock Exchange, resulting in lower revenues from its treasury and investment business, its total revenues of $38.2 million were only marginally short of 2005's record. Its non-performing loans were also reduced through strenuous collection efforts, producing a creditable $2.7 million in net write-backs. With reduced operating expenses the bank returned a net profit of $14.9 million, 11% below 2005's $16.7 million.

During the year ABC Jordan launched its SMS banking and Visa card projects and added MasterCard to the suite of credit cards offered to its customers. It also achieved full convergence of its ATM network with the *EuroNet* international system and inaugurated a new branch, in Khalda in the west Amman area, replacing another at Salt as it realigned its network.

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Arab Banking Corporation (Jordan) (continued)
Expectations of rising foreign direct investment flows, growth in exports and a positive outlook for the Amman Stock Exchange augur well for future growth at ABC Jordan. It plans to launch a number of initiatives early in 2007, including a new prepaid card to add to its stable of credit and debit cards, a Bancassurance pilot project and a major marketing campaign aimed at expanding the savings accounts base.

Arab Banking Corporation - Algeria
Algeria's GDP grew by an estimated 5.1% in 2006, less than 2005's 6.5% but above the 4.8% 2001-2005 average. High hydrocarbon prices fed through to surging foreign exchange reserves, which increased from $50 billion to $70 billion, and much reduced external debt, down to some $8 billion from $20 billion in 2005 and equivalent to less than 10% of GDP. As the pace of economic reform quickened, the government launched a number of development projects with a total value of over $20 billion planned for the next 3 years. Increased foreign investment into the new private banking sector meanwhile led to growing competition between public and private banks which, together with the strong liquidity in the market, put mounting pressure on margins.

Despite these pressures ABC Algeria saw its operating income rise by 35% to $25.7 million in 2006, on the back of increased interest and commission income. With its operating expenses rising by only 14% to $10.3 million, its operating profit increased by 54% to $15.4 million. After normal loan loss provisions the bank would thus have returned a healthy increase in its net profit but, unfortunately, a case involving embezzlement at one of the bank's customers required it to make a substantial provision pending a negotiated settlement.

ABC Algeria's 2004 strategic reorganisation repositioned it to focus on retail banking activities and trade finance, where it has targeted large Algerian and multinational corporates and the SME sector. The Commercial Banking Division, created in 2005, has since booked $115 million of loans and $134 million of indirect facilities. During 2006 the Retail Division finalised the establishment of 3 new branches in Algiers, one of which became operational before the year end, with the remaining two due to open for business in January 2007, bringing the bank's total network to 7 branches. The Division also launched a highly successful car loan product in the second half of the year, attracting some 1,000 customers by the year end.

In the coming year ABC Algeria, having completed the sale of a strategically unnecessary branch at Hassi Messoud in 2006, plans to open more branches in better placed locations to bring the network up to 11 branches in all. It will also be launching a series of personal loan and savings products as it expands its product range. Once the country's ATM network has been upgraded, the bank will begin installing ATMs at all its branches.

Arab Banking Corporation - Tunisia
Tunisia's economy grew by 5.8% in 2006, compared with 4.2% in 2005, as foreign direct investments and trade continued to expand. The rate of imports growth, at 13.4%, however exceeded that of exports, which only grew by 10%.

ABC Tunis, an Offshore Banking Unit (OBU) which is a full branch of ABC, and ABC Tunisie its onshore banking subsidiary, both benefited from the economic growth in similar ways. Their increased customer deposits were channelled largely towards inter-bank placements and liquid assets (although more so at the onshore subsidiary than the OBU), generating increased net interest margin. Both also earned higher non-interest revenues, although in the case of the OBU it was in the areas of documentary credit/guarantee issuance and foreign exchange operations that the major increases were seen, whereas the subsidiary, whilst benefiting from similar trade finance opportunities, also increased its loan fee and commission income. Operating income rose, by 25% to $5.5 million in the case of the OBU, and by 53% to $4.8 million at the subsidiary. However, again in both cases, new staff recruitments helped to drive up operating expenses.

Excluding the extraordinary gain in 2005 from the write-back of provisions made against ABC's guarantee of its subsidiary, following ABC Tunisie's relinquishing of the guarantee as it increased its issued capital, the OBU's net profit for the year of $3.8 million represented a turnaround from a small loss the previous year. In ABC Tunisie's case, 2005's operating loss, caused by the need to put aside loan loss provisions following the cancellation of the guarantee, was turned around into a $0.6 million net profit.

The year also saw ABC Tunisie successfully co-arranging its first medium term syndicated loan, in favour of Tunisia's first private sector mobile telephone operator. The 5-year €225 million loan comprised a Tunisian Dinar tranche, co-led by ABC Tunisie, and a Euro tranche co-led by ABCIB.

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$555 million

sole mandate awarded by Gulf Industrial Investment Company

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$300 million

sole mandate awarded from Bahrain Telecommunications Company for its syndicated term loan facility

<< $8.6 billion

development of an integrated refinery and petrochemical complex at Rabigh in Saudi Arabia

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Arab Banking Corporation - Tunisia (continued)

Throughout the year ABC Tunisie focused on improving its procedures, enhancing its credit and risk management, working out its non-performing loans and refining its regulatory and governance processes in accordance with the Central Bank's and the Group's policies. On the technology front it successfully implemented major enhancements in its transfer and automated remittance methodology, anti-money laundering filtering applications, and its trade finance systems. It also completed work on ABC Group's global banking solution *Symbols*, scheduled to go live in early 2007.

ABC Islamic Bank (E.C.)

The regional operating environment remained favourable to Islamic banking in 2006, with a continuing preference for Islamic products where available. The industry expanded by an estimated 15%, making it the fastest growing banking segment in the region.

ABC Islamic Bank, taking full advantage of the trend while focusing on self-originated and lead managed transactions to maximise fee income, delivered another successful performance on the heels of its 2005 doubling of total income and near-doubling of net income. With balance sheet footings growth of 34% following a $40 million capital injection from ABC, it produced a net income of $5.3 million, 43% up on the previous year, on the back of a 35% increase in operating income.

The bank continued to build its product base, launching in cooperation with Group Treasury two Shari'a-compliant hedging offerings, *Muwa'amah* and *Tabdeel*, aimed at customers with currency and profit rate exposures. These industry-first products were well received in the marketplace. It is also developing a method of hedging the price of commodity purchases by its manufacturing clients, to be rolled out in 2007.

During the year it was mandated to lead manage several large corporate syndicated transactions for GCC customers, notably Al-Waha Petrochemical and Yansab, two highly successful deals attracting a broad range of regional investors. The bank was also mandated to provide debt and Shari'a advisory services in a number of large project finance transactions, working in conjunction with the Project & Structured Finance team in Bahrain, including the prestigious Saudi Kayan project in Saudi Arabia.

ABC Islamic Bank's performance in 2006 was an important step towards positioning it as the premier Islamic bank in the region, with a fast-growing reputation for innovation and service quality. Its longer term objectives remain to gain a steadily increasing share of the regional corporate market whilst expanding its position in investment and capital markets products.

ABC International Bank plc (ABCIB)

The MENA region's economic development has created many opportunities for ABCIB, accompanied however by an intensification of competition from other international banks. Despite this, ABCIB continued to build its European-MENA trade finance franchise in 2006, expanding its key relationships and its overall client base. Its success has been largely due to the imaginative use of new financing techniques - first developed to meet the specific needs of some of its European exporting customers and then rolled out as discrete product initiatives in their own right – combined with the ability to harness the new synergies offered by the ABC Group network to access the skills and/or placement power of Bahrain-based specialists.

ABCIB's Trade & Commodity Finance team expanded both its origination and asset distribution activities, recording its best ever performance at both revenue and net income levels, with contributions from all its branches and marketing offices, including the Istanbul office whose first full year of operation surpassed all expectations. The team continued to build on its traditional trade finance product range, developing innovative trade receivables discounting facilities with hybrid corporate and credit insurance structures. Its ability to provide bespoke trade finance solutions is an essential part of its continued success and maintenance of client relations, for example proving so successful in meeting the requirements of automotive exporters to the MENA region that it has become effectively the 'Middle East house bank' for several major international companies.

ABCIB's Project & Structured Finance team was however again impacted by early repayments and prepayments of its asset portfolio, with new transactions booked yet to produce significant revenues due to their inherently long lead times. Nevertheless, it won several financing mandates in Egypt (in the hydrocarbon and petrochemical areas), Jordan (water conveyance), Algeria (cement plant construction) and Tunisia (telecommunications) as well as important advisory mandates for the development and operation of a new Tunisian airport at Enfidha and the operating concession at Monastir airport.

The Islamic Asset Management team expanded its product base, launching a commercial property financing instrument aimed at putting Shari'a-compliant real estate financing on the same economic footing as conventional property loan products. The distribution network for its Islamic residential mortgage-equivalent offering was also widened as an important UK-based Islamic bank joined the two existing banking groups that presently market this product. As the year drew to a close, the number of mortgage applications received surpassed the 1,000 mark and, with some £125 million of outstanding applications in the pipeline at the beginning of 2007, the product's popularity is now well-proven. Meanwhile, the *Al Bait Property Fund* – for which ABCIB's IAM acts as Property Investment Manager and which holds a diversified portfolio of UK assets valued at over £50 million, performed well. IAM is currently arranging the sale of the Fund in order to realise for its investors the portfolio's accrued capital gains, following which it will then bring a new real estate fund to the market.

As part of the bank's strategy of maintaining a well-diversified and well-spread funding base, ABCIB's Treasury successfully raised $200 million in 2006 through a 5-year term loan, underwritten and arranged by a wide range of major banks in Europe, Asia and the Middle East, increased from the original launch figure of $150 million as a result of oversubscription.

ABCIB's loans and advances to customers, which stood at £721 million at the end of 2006, remained well diversified across a wide range of borrowers, industries and countries. The bank recorded a slight increase in its operating income to £46.3 million (2005: £45.7 million); however, as its operating expenses, at £29.7 million, were 7% below that of 2005, it ended the year with a healthy 17% increase in net profit after taxation of £18.3 million.

For 2007, ABCIB is well placed to exploit the considerable opportunities that exist in the MENA region for its key business lines. It therefore anticipates growth in all sectors, but particularly in project finance, Islamic banking services and treasury business.

Banco ABC Brasil S.A.

In spite of the elections, which normally affect market volatility and the economic variables, and the strong appreciation of the *Real* against the US Dollar in 2006, Brazilian economic performance was fairly good, with a moderate 2.7% growth in GDP and a strong trade balance surplus of $34 billion, allowing foreign exchange reserves to increase to $73.4 billion. Inflation at 3.2% was significantly under the target of 4.5%, enabling interest rates to maintain a downward trend throughout the year.

ABC Brasil's total loans, expanded by 27% to $1,056 million in 2006, and lower borrowing costs enabled the bank to generate a 45% increase in net interest margin, to $50.7 million. Total treasury revenues, at $17.5 million, were five times higher than those for 2005, while commission and other income surged to $9.4 million. The bank's total operating revenues for the year thus amounted to $77.6 million, 75% up on the previous year. Operating expenses, including incentive payments and bonuses, however also rose, by 56% to $39.3 million but, as this increase was less than that of operating revenues, after loan loss provisions and taxation ABC Brasil returned a net profit of $23.2 million or 2.5 times higher than 2005.

For 2007, ABC Brasil believes that the economy will remain resilient with inflation kept under control, allowing for further reductions in interest rates. Tax exemption measures should also help to encourage investment and induce a favourable economic performance. The bank therefore intends to continue with its current product mix and customer profile for the foreseeable future, and expects significant growth in both asset volumes and margins.

For 2007, **ABC International Bank plc, a subsidiary of the ABC Group, is well placed to exploit the considerable opportunities that exist in the MENA region for its key business lines.** It therefore anticipates growth in all sectors, but particularly in project finance, Islamic banking services and treasury business.

Credit & Risk Group

During the year ABC Group continued to implement various changes in its organisation and processes, benefiting it in terms of risk asset quality and sharply reduced non-performing loans whilst maintaining focus on the required enhancements to the risk management systems and process pursuant to compliance with the key principles of the Basel II Accord.

Credit Risk

In 2006 the Credit Risk unit of the CRG commenced the formal implementation of the *Fermat* Basel II module, for calculation of the Group's Pillar 1 capital adequacy requirements under the Standardised Approach. Concurrently, a number of other initiatives were undertaken to enhance the analytical and underwriting standards and improve internal risk assessment, with the ultimate aim of meeting the requirements under the Foundation IRB Approach of Basel II, including the training of key personnel in the use of Moody's *Financial Analyst* and Moody's *Risk Advisor* software as the adopted corporate spreading and rating tool. Various Moody's KMV products, used for the provision of default estimates, portfolio management and as an effective economic capital estimation tool, were also reviewed during the year, intended for subsequent implementation.

The budgeting and business planning process has been improved. Each business unit now prepares a Risk Profile of its Business Plan within the approved Risk Strategy determined by the Board Risk Committee (BRC), following which the BRC reviews the consolidated Group Risk Profile for the coming year, and actual performance for each quarter thereafter.

Internal enhancements were completed to the credit application processing system and the limits and exposures management system implemented in 2005. An internally developed data warehousing component and tool, within the exposure management system, has greatly facilitated multi-dimensional data extraction and reporting.

Semi-annual review of the performing assets portfolio and quarterly review of the Arab world subsidiaries' impaired assets have been streamlined. The year also saw the completion of a review by an international consultant of the Consumer Banking Policy and Process governing all consumer business undertaken by the Arab world units, whose recommendations are currently being studied with a view to implementation in the near future.

Market Risk

Following its review of treasury activities in the investment book during 2006, Market Risk Management (MRM) implemented an enhanced asset allocation model and conducted a strategic review of the overall market risk system to incorporate the asset allocation requirements. MRM also implemented enhancements to the investment and asset/liability monitoring and reporting capability.

Operational Risk

An independent Operational Risk Management (ORM) Department, with Groupwide responsibilities, was created in 2006 and an Operational Risk Management Committee established. ORM has since developed a strategy for operational risk, a framework for its management, and policies and procedures to facilitate the implementation of this framework across ABC Group. Implementation commenced in ABC and ABCIB during 2006 with presentations/training sessions at various levels of management, and is scheduled for all other subsidiaries during 2007.

Remedial Loans Unit

2006 also marked another successful performance by the Remedial Loans Unit (RLU). For the third consecutive year, significant recoveries led to net write backs of loan loss provisions, reflected in the Non-Performing Loans: Gross Loans ratio, which fell to 2.0% in 2006 from 3.6% and 5.1% in 2005 and 2004 respectively, and in the Loan Loss Provisions: Non-Performing Loans ratio, which rose to 208% from 155% and 141% in 2005 and 2004 respectively.

The President & Chief Executive's Review of Operations

Looking ahead, our advanced risk management software, cautious approach to risk management and asset quality and expanding delivery channels and product range are expected to be the **key factors in the future success of the Group and its ability to generate rising shareholder returns.**

Global Information Technology

Global Information Technology (GIT) is responsible for the Group's Information Technology (IT) strategy development and implementation and IT operations of the Group. GIT also maintains the Group's IT application services, and infrastructure. During 2006 GIT was chiefly engaged in the following projects.

Core Banking System – Wholesale

A major upgrade to the Core Banking System, driven by technical developments, provided the wholesale units with key new functionality. The Core Banking System was also extended to ABC Islamic Bank and the new ABC Iraq branch.

A project at ABCIB Milan branch commenced in 2006 to implement ABC's standardised trade finance solution and integrate it with the local regulatory reporting system. This project will be completed in 2007.

The Trade Finance solution for ABC NY was also moved to GIT's *Global Processing Hub (GPH)* as part of the Group's overall centralisation programme.

Core Banking System – Retail

Good progress was made on the standardised Retail Banking System centralised through GPH. This programme will obviate the need for separate IT operation centres in each retail unit. Following successful implementation at ABC Tunisie, ABC Egypt's system is due for similar upgrade in 2007.

Rollout to the retail units of the *Front Office System* for dealing and position keeping continued in 2006 with full implementation at ABC Egypt. 2007 will see rollout to all other retail units.

ABC Group also embarked on a global initiative to outsource *ATM Driving, Debit Card Management & EMV Readiness* programmes throughout all retail units. With rollout successfully achieved at ABC Jordan in 2006, the outsourcing programme will move to ABC Egypt and ABC Algeria in 2007, followed by ABC Tunisie in 2008.

Enterprise Credit Risk Management Systems

In addition to the rollout completion for measurement methodologies and analytics tools to all Arab World units, GIT completed key upgrades to the group limits, credit approval, and global exposure management systems.

Basel II readiness (Standardised Approach) will be achieved for Group level reporting in 2007.

Anti-Money Laundering Phase I

Phase I of the AML project, including monitoring payments and scanning of customer details, was successfully completed during 2006 for all units. Phase II of the project, which will enable units to monitor suspicious activities through pattern detection, will be launched in 2007.

Investment Banking Group

GIT established the IT infrastructure and application environment to support the start-up of ABC's new Investment Banking Group, including front office dealing, position keeping, proprietary brokerage and margin trading systems. These systems are tightly integrated with ABC's existing core banking systems. During 2007 GIT will initiate a system selection and implementation project to provide the Investment Banking Group with a state of the art Equity Trading and Order Management System.

Technical Infrastructure

GIT successfully completed an upgrade of the Group's private global network for all integrated units and Local Area Network at Head Office, resulting in superior quality service, more efficient network traffic, and enhanced redundancy. 2006 also saw the introduction of a pilot project providing further security for enterprise users, computers, and messaging.

Conclusion

ABC Group's results for 2006 provide affirmation of the success of the performance-focused yet conservative and risk aware culture that we have been implementing over the past few years. By separating the marketing and product processing functions within the Group we have been able to concentrate resources in such a way as to focus our management and staff on the essentials of the job at hand and, by associating performance of the whole Group, the units and departments and, finally, the individuals within them, with each individual's remuneration, have provided the motivation for success. Looking ahead, our advanced risk management software, cautious approach to risk management and asset quality and expanding delivery channels and product range are expected to be the key factors in the future success of the Group and its ability to generate rising shareholder returns.

Corporate Governance

Arab Banking Corporation (B.S.C.) was incorporated as a Bahrain joint stock company in 1980 by Decree in the Kingdom of Bahrain and was issued with an Offshore Banking Unit licence by the Bahrain Monetary Agency, beginning its operations with an authorised capital of US$1,000 million. By April 1981, US$750 million was fully paid up by ABC's original shareholders, the Ministry of Finance of Kuwait (whose shareholding was later transferred to the Kuwait Investment Authority), the Libyan Secretariat of Treasury (whose shareholding was later transferred to the Central Bank of Libya) and the Abu Dhabi Investment Authority. Each of the three shareholders held one-third of ABC's issued share capital until 1990. At the end of 1989 ABC's authorised capital was increased to US$1,500 million and in 1990 ABC listed its shares on the Bahrain and Paris stock exchanges and increased its paid-up capital to US$1,000 million by a public offering in Bahrain and international private placement.

On 6 September 2006, under Decree No. (64) of 2006 promulgating the Central Bank of Bahrain and Financial Institutions Law, the Central Bank of Bahrain was created to succeed and assume all the responsibilities and powers of the Bahrain Monetary Agency. Other major initiatives that took place at around the same time included the introduction of a new licensing framework for the financial services industry, with five basic licensee categories, namely conventional or Islamic bank (within which there are various subcategories), insurance, investment business and specialised licensees. Under this framework, ABC is now licensed as a conventional wholesale bank.

Board of Directors

The Board of Directors is responsible for the overall direction, supervision and control of the Group. It meets regularly (usually six times a year) to consider key aspects of the Group's affairs, strategy and operations. The shareholders appoint the Board for a specific term of three years. There are currently 12 Directors on the Board, all non-executive, with varied backgrounds and experience, who individually and collectively exercise independent and objective judgement. As a rule Directors do not have, and in 2006 no Director had at any time during the year, any direct or indirect material interest in any contract of significance with ABC or any of its subsidiaries.

Specific responsibilities have been delegated to the following **Board Committees:**

The **Executive Committee** is responsible for exercising the powers of the Board, save for those which the Board expressly reserves for itself, in the management of the business and affairs of the Group when the Board is not in service.

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 **Corporate Governance Committee** assists the Board in shaping and monitoring the Corporate Governance policies and practices of the Group and evaluating compliance with policies and procedures. The Committee also reviews and assesses the adequacy of the Group's policies and practices on corporate governance.

The **Board Risk Committee** is responsible for the continual review and approval of the Group's Risk Policies and Medium Term and Annual Risk Strategy/Appetite, within which business strategy, objectives and targets are formulated. The Committee reviews the Group's Risk Profile to ensure that it is within the Group's Risk Policies and Appetite parameters. It delegates authority to senior management to conduct day-to-day business within the prescribed policy and strategy parameters, whilst ensuring that processes and controls are adequate to manage the Group's Risk Policies and Strategy.

The **Nominations and Compensation Committee** is responsible for the formulation of the Group's executive and staff remuneration policy and senior management appointments and remuneration.

Internal Control

The Board is responsible for the establishment and review of the Group's system of internal control. In addition to minutes and reports submitted to it by the Board Risk Committee and the Group Audit Committee, identifying any significant issues relating to the adequacy of the Group's risk management policies and procedures, the Board receives reports and recommendations from its Corporate Governance Committee and its Nominations and Compensation Committee for its consideration. The Board also receives regular reports from management identifying performance against budget, major business issues and the impact of the external business and economic environment on its areas of responsibility.

Day-to-day responsibility for internal control rests with management. There is in place a process of identifying, evaluating and managing the significant risks faced by the Group, the key elements of which are explained below but can be summarised as:

- A well-defined management structure with clear authorities and delegation of responsibilities, documented procedures and authority levels to ensure that all material risks are properly assessed and controlled.
- Internal Control Policies that require management to identify major risks and monitor the effectiveness of internal procedures in controlling and reporting on them.
- Robust Compliance and Anti-Money Laundering functions.
- Group Audit, which reports to the Group Audit Committee on the effectiveness of key internal controls in relation to these major risks and carries out reviews of the efficacy of management oversight in carrying out these responsibilities as part of its regular audit of Group departments and business units.

Corporate Governance

Internal Control (continued)

- A comprehensive planning and budgeting process that delivers detailed annual financial forecasts and targets for Board approval.
- A Group Risk Management function, comprising overarching Head Office risk management committees and a dedicated risk management support group.

Compliance

In accordance with the rules of the Central Bank of Bahrain (CBB), ABC has appointed a Compliance Officer and a Money Laundering Reporting Officer (MLRO).

The role of the Compliance Officer is to act as central coordinator for the Group in respect of all matters relating to CBB regulatory reporting and other requirements. The compliance function covers areas such as corporate governance, adherence to best practices, codes of conduct and conflict of interest. Each operating entity in the Group, to the extent required by applicable law and regulation, has appointed a local compliance officer to ensure adherence to local requirements and regulatory issues.

The CBB's laws and regulations with respect to Anti-Money Laundering (AML) apply to all ABC branches and subsidiaries. The Group is committed to ensuring adherence to these regulations and to the recommendations of the Basel Committee and Financial Action Task Force which they incorporate, which are in turn reflected in ABC's own Group AML Manual which has been approved by the Board of Directors. The Group has strict Know Your Customer policies and units are precluded from establishing a new business relationship until all relevant parties to the relationship have been identified, the nature of the business they expect to conduct has been established and satisfactory evidence of identity obtained. ABC's AML policies are available on its website.

The MLRO appointed in each unit is responsible for supervising the unit's AML activities and for maintaining appropriate and effective systems, controls and records to ensure compliance with local AML regulations and the provisions of the Group AML Manual. The MLRO is also responsible for reviewing and reporting any suspicions concerning a customer or an account to that unit's regulator and senior management.

The responsibilities of the Group's MLRO include formulating, issuing and implementing the Group's AML strategies and policies on an ongoing basis, overseeing appropriate AML training to all relevant staff, supervising and coordinating the activities of the unit MLROs and reporting to the President & Chief Executive and the Board of Directors on critical money laundering issues which require the attention of senior management. The Group MLRO reports directly to the President & Chief Executive, in addition to having a direct and independent reporting line to the CBB.

Risk Management

The major risks to which the Group is exposed in conducting its business and operations, and the means and organisational structure it employs in seeking to manage them strategically in building shareholder value, are outlined below.

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 senior management committees and the Credit & Risk Group in Head Office.

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

The **Asset and Liability Committee (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 **Investment Banking Committee (IBCO)** is responsible for name clearance and review of all investment banking related deals from an operational, fiduciary and reputation risk perspective, in line with the risk/reward guidelines approved by the BRC.

The **Operational Risk Management Committee** oversees the independent Operational Risk Management function and is responsible for defining long-term strategic plans and short-term tactical initiatives to prudently manage, control and measure exposure to operational risks.

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

The **Credit & Risk Group (CRG)** has overall responsibility for centralised credit policy and procedure formulation, country risk and counterparty analysis, approval/review and exposure reporting, control and risk-related regulatory compliance, remedial loans management and the provision of analytical resources to senior management. It is also responsible for identifying market and operational risks arising from the Group's activities, recommending to the relevant central committees appropriate policies and procedures for managing exposure to such risks and establishing the systems necessary to implement effective controls.

Credit Risk

ABC Group's portfolio and credit exposures are managed in accordance with the Group Credit Policy, which applies Groupwide qualitative and quantitative guidelines, with particular emphasis on avoiding undue concentrations or aggregations of risk. ABC's banking subsidiaries are governed by specific credit policies that, whilst closely following and subject to the Group Credit Policy, may be adapted to suit local practices and regulatory requirements as well as individual units' product and sectoral needs. The Credit Risk section of the CRG's Risk Management Department (RMD) coordinates all technology development related to credit risk management and provides senior management with consolidated information on Group exposures to counterparties, countries, industries, etc.

The first level of protection against undue credit risk is through Group 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 ABC 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 ABC'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 RAROC as a measure to evaluate the risk/reward relationship at the transaction approval stage.

Day-to-day management of existing credit exposure is the responsibility of the business unit account officers who, in turn, must adhere to the detailed requirements for regular review of the customers and analysis of their financial and economic condition, under the oversight of the CRG's Head Office Credit Department in the case of customers with limits exceeding the relevant business unit's authority. Significant aggregated credit exposures are regularly reviewed by senior management, with industry/sectoral exposures being reviewed periodically. Business unit portfolios are subject to detailed semi-annual Head Office reviews, as are all customer risk ratings. Group Audit meanwhile carries out separate Risk Asset Reviews of business units to assess and provide an independent opinion on the quality of their credit exposures and adherence to credit policies and procedures.

Credit exposures found to rank below a satisfactory risk rating are segregated and more actively supervised as impaired assets under the guidance or supervision of the CRG's Remedial Loans Unit (RLU). Impaired assets are reviewed regularly by the respective business units, with progress reports submitted at least quarterly to the RLU, who in turn reports their progress to senior management and regulators. Subject to minimum loan loss provision levels mandated under the Group Credit Policy, specific provisions in respect of impaired assets are based on estimated potential loss. Unencumbered portfolio provisions are also maintained to cover unidentified possible future losses.

Market Risk

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

The Group is exposed to **Foreign Exchange Rate Risk** through both its trading portfolios and its structural positions. Foreign exchange rate risk is managed by appropriate limits and stop loss parameters determined by each subsidiary's local ALCO and approved by its Board. ABC's structural balance sheet positions, which relate to its net investment in its foreign subsidiaries, are reviewed regularly by ALCO in accordance with the Group's strategic plans and managed on a dynamic basis by Group Treasury, hedging such exposures as appropriate.

In managing the **Interest Rate Risk** resulting from the Group's trading and banking activities, the effect of interest rate movements is assessed using sensitivity analyses and other modelling techniques. There are established limits on individual business units' aggregate maximum exposures to interest rate risk and on an overall basis for the core banking units. Board approved trading limits are monitored by MRM and any exceptions brought to the attention of ALCO.

As a normal part of its treasury trading activities, the Group may also be exposed to **Equity, Debt Securities, Commodity and Volatility Risk**. This risk is also monitored by MRM against Board approved limits.

Liquidity Risk

ABC 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. It has specific policies regarding liquid assets coverage of short-term wholesale deposits and in particular the potential risk impact of withdrawals by large single depositors, ensuring that there is no reliance on any one customer or small group of customers. Maturity mismatch is also managed within internal policy limits. The maturity profile of the Group's assets, liabilities and off-balance sheet items is given in Note 15 to the Financial Statements.

Operational Risk

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. Business units have primary responsibility for identifying and managing their own operational risks. The Operational Risk Management Unit of RMD is currently introducing the framework for best practice Operational Risk measurement under Basel II stipulations.

The Group's information technology arm is continually developing and refining the Group's security software to ensure that its systems can reliably identify and intercept unauthorised access. The Group pays close attention to disaster recovery. All essential operational data required for business continuity are backed up on separate computers both within the Head Office and elsewhere in Bahrain, in addition to being downloaded hourly to the Group's servers in London.

Legal Risk

Inadequate documentation, legal and regulatory incapacity or insufficient authority of a counterparty, contract invalidity or unenforceability, are all examples of legal risk. Management of this risk is the responsibility of the Head Office Legal & Compliance Department (LCD) and is carried out through effective consultation with internal and external legal counsels, together with close monitoring of the litigation cases involving the Group. All major Group subsidiaries have their own in-house legal departments, acting under the guidance of the LCD.

Capital Management

The CBB is the lead regulator for ABC and sets and monitors its capital requirements on both a consolidated and an unconsolidated basis. Individual banking subsidiaries are regulated directly by their local banking supervisors, who set and monitor their capital adequacy requirements. The CBB requires each Bahrain-based bank or banking group to maintain a minimum ratio of total capital to risk-weighted assets of 12%, taking into account both on and off balance sheet transactions. ABC Group's capital management is aimed at maintaining an optimum level of capital to enable it to pursue strategies that build long-term shareholder value, whilst always meeting minimum regulatory ratio requirements. Details of risk weighted assets, capital base and the risk asset ratio are provided in Note 27 to the Financial Statements.

Group Financial Review

(All figures stated in US dollars)

Income Statement

In 2006, the Group's net profit for the year from continuing operations increased to $202 million from $129 million in 2005 and $109 million in 2004.

Net interest income was 29% higher than 2005, at $249 million (2005: $193 million), while non-interest income grew by 48% to $235 million (2005: $159 million). No provision for impaired assets was required as the total of write backs and recoveries equalled the total of new provisions for the year (2005: $14 million write back). Net operating income increased to $484 million, 32% higher than 2005 ($366 million).

Operating expenses increased by 24% to $262 million (2005: $211 million). Profit before taxation and minority interests was therefore $222 million, a 43% increase over 2005 ($155 million). After taxation on operations outside Bahrain of $17 million (2005: $20 million) and minority interests in subsidiaries of $3 million (2005: $6 million), the net profit for the year of $202 million was 57% higher than that for 2005.

Sources and Uses of Funds

Liquid assets, comprising trading and non-trading securities, placements and liquid funds, totalled $13,019 million (2005: $10,169 million). Non-trading securities (almost entirely 'available for sale' securities) stood at $7,828 million (2005: $6,003 million), money market placements at $4,160 million (2005: $3,264 million) and liquid funds and trading securities at $1,031 million (2005: $902 million). The loans and advances portfolio stood at $8,622 million (2005: $6,833 million) while investments in an associate, interest receivable, premises and equipment and other assets, in aggregate standing at $761 million (2005: $586 million), made up the remainder of the total assets. Placements, together with liquid funds of $274 million (2005: $309 million), represented 19.8% (2005: 20.3%) of total assets. Total liquid assets, including non-trading securities, represented 58.1% (2005: 57.8%) of total assets.

These assets were funded by deposits from customers of $7,508 million (2005: $5,310 million), deposits from banks and other financial institutions totalling $9,070 million (2005: $8,108 million), term notes, bonds and other term financings of $1,927 million (2005: $1,575 million) and certificates of deposit $1,074 million (2005: $73 million). Interest payable, taxation and other liabilities amounted to $705 million (2005: $549 million) in aggregate. Total deposits included $853 million (2005: $1,260 million) relating to sale and repurchase agreements.

Whereas in 2005 term obligations (term notes, bonds and other term financings) were divided 86:14 between the parent bank and its subsidiaries respectively, in 2006 the division was 80:20 respectively as ABC raised an additional $352 million of term debt to equal $1,927 million in total.

The total assets of the Group in 2006 amounted to $22,402 million (2005: $17,588 million). Average assets were $21,458 (2005: $15,904 million) while average liabilities, excluding shareholders' equity, amounted to $19,472 million (2005: $14,109 million).

Credit Commitments, Contingent Items and Derivatives

At the end of 2006, ABC Group's consolidated off-balance sheet items stood at $20,543 million (2005: $12,105 million). The total credit risk-weighted asset equivalent of commitments and contingent items and derivatives was $2,172 million (2005: $1,402 million). The total volume of documentary credits, acceptances and guarantees undertaken during the year was $11,357 million (2005: $7,884 million), 58% (2005: 62%) of which related to the Arab world.

The Group uses a range of derivative products for the purposes of hedging and servicing customer-related requirements, as well as for proprietary trading purposes. The total market risk-weighted equivalent of the exposures under these categories at the end of 2006 was $459 million (2005: $287 million).

No significant credit derivative trading activities were undertaken during the year.

Geographical and Maturity Distribution of the Balance Sheet

In 2006, the proportion of ABC Group's total assets in the Arab world increased substantially, from 34% to 41% as the proportion of its assets in North America fell from 30% to 27%, to Western Europe reduced from 20% to 18%, and to Asia from 5% to 4%. The proportion of liabilities to the Arab world increased from 71% to 81%, while the proportion of liabilities to Western Europe reduced from 12% to 10%, that to North America from 5% to 2% while those to Asia reduced from 4% to 2%.

(%)	Assets 2006	Assets 2005	Liabilities & Equity 2006	Liabilities & Equity 2005
Arab world	**41**	34	**81**	71
Western Europe	**18**	20	**10**	12
Asia	**4**	5	**2**	4
North America	**27**	30	**2**	5
Latin America	**6**	6	**5**	5
Others	**4**	5	**-**	3
	100	100	**100**	100

(%)	Earning Assets 2006	Earning Assets 2005	Loans & Advances 2006	Loans & Advances 2005
Arab world	**40**	35	**69**	69
Western Europe	**19**	20	**9**	7
Asia	**6**	7	**7**	8
North America	**28**	30	**2**	1
Latin America	**7**	6	**13**	12
Others	**-**	2	**-**	3
	100	100	**100**	100

An analysis of the maturity profile of earning assets shows that, at the end of 2006, 47% (2005: 48%) did not exceed one year's maturity. Loans and advances maturing within one year amounted to 58% (2005: 56%) of all loans and advances. The proportion of liabilities maturing within one year was 73% (2005: 76%) of all liabilities and equity.

(%)	Earning Assets 2006	Earning Assets 2005	Liabilities & Equity 2006	Liabilities & Equity 2005
Within 1 month	**20**	25	**44**	53
1 - 3 months	**15**	9	**21**	17
3 - 6 months	**5**	5	**4**	4
6 -12 months	**7**	9	**3**	2
Over 1 year	**49**	49	**15**	10
Undated	**4**	3	**13**	14
	100	100	**100**	100

Distribution of Credit Exposure

ABC Group's credit exposure (defined as the gross credit risk to which the Group is potentially exposed) as at 31 December 2006 is given below.

($ millions)	Funded Exposure 2006	Funded Exposure 2005	Credit Commitments & Contingent Items 2006	Credit Commitments & Contingent Items 2005	Derivatives* 2006	Derivatives* 2005
Customer type						
Banks	**11,251**	7,183	**1,860**	1,109	**106**	97
Non-banks	**5,025**	5,350	**3,343**	2,029	**38**	23
Sovereign	**5,530**	4,446	**886**	1,057	**1**	1
	21,806	16,979	**6,089**	4,195	**145**	121
Risk rating						
1 = Exceptional	**5,924**	4,914	**191**	104	**13**	3
2 = Excellent	**2,016**	1,646	**377**	154	**64**	53
3 = Superior	**4,964**	3,020	**725**	767	**37**	38
4 = Good	**2,761**	2,545	**1,030**	854	**23**	24
5 = Satisfactory	**3,405**	2,113	**2,711**	1,591	**8**	2
6 = Adequate	**2,360**	2,450	**682**	469	**-**	1
7 = Watchlist	**295**	171	**320**	223	**-**	-
8 = Special Mention	**47**	50	**3**	11	**-**	-
9 = Substandard	**25**	15	**24**	-	**-**	-
10 = Doubtful	**3**	27	**26**	22	**-**	-
11 = Loss	**6**	28	**-**	-	**-**	-
	21,806	16,979	**6,089**	4,195	**145**	121

* Derivative exposures are computed as the cost of replacing derivative contracts represented by mark-to-market values where they are positive, and an estimate for the potential change in market values reflecting the volatilities that affect them.

Group Financial Review

Classified Loans and Provisions

Non-performing loans and off-balance sheet credits are formally defined as those in default on contractual repayments of principal or payment of interest in excess of 90 days. In practice, however, all credits that give rise to reasonable doubt as to timely collection, whether or not they are in such default, are treated as non-performing. Such credits are immediately placed on non-accrual status, with all past due interest being reversed and accumulated unpaid interest thereafter excluded from income.

The total of all loans on non-accrual status as at the end of 2006 was $183 million (2005: $262 million). Aggregate provisions at the end of 2006 stood at $381 million (2005: $405 million) and constituted 208% (2005: 155%) of all non-performing loans and 4.2% (2005: 5.6%) of gross loans and advances.

An ageing analysis is given below in respect of all loans and advances on non-accrual, together with their related provisions:

($ millions)	Principal	Provisions	Net Book Value
Less than 3 months	4	2	2
3 months to 1 year	4	1	3
1 to 3 years	62	47	15
Over 3 years	113	113	-
	183	**163**	**20**

Group Capital Structure and Capital Adequacy Ratios

The Group's capital base of $2,225 million comes substantially from the shareholders' funds of $2,068 million, as was also the case in 2005 when shareholders' funds of $1,926 million formed the greater part of the capital base of $2,089 million. The consolidated capital adequacy ratio as at 31 December 2006 was 15.8% (2005:19.9%), well above the CBB's mandated minimum of 12% and the 8% guideline under the Basel Accord for international banks.

All ABC Group subsidiaries meet the capital adequacy requirements of their respective regulatory authorities.

Factors Affecting Historical or Future Performance

The Group's primary financial goal is the delivery of consistent and rising value for its shareholders through sustainable earnings and assets growth. Based on its evaluation of the following factors, management remains optimistic that the Group will continue to achieve this:

Political stability – On the whole, management believes that the Group's activities and assets are sufficiently widely diversified to provide a cushion against major losses from isolated cases of political instability. The Group has in place rigorous, regularly tested, disaster recovery procedures to face eventualities arising from political or other disruptions. The Group has no significant risk exposures outside of the Arab world, the USA and Europe.

Energy prices – Global hydrocarbon prices have a direct impact on the annual budgets and infrastructure improvements of many of the countries in the Arab world, as well as on the economies of OECD countries. High hydrocarbon prices benefit producing countries, which tend to increase demand by those countries for capital equipment and construction services needed for infrastructure-building and development projects, as well as for consumer goods; OECD-based capital exporters and project contractors likewise prosper. Lower energy prices benefit residents of developed countries, leading to an increased demand for developing countries' goods and tourism services, thus enhancing the revenues of countries able to deliver those goods and services. The Group's revenues benefit from both of these scenarios. The prognosis is for hydrocarbon prices to remain steady over the medium term, with occasional spikes.

Foreign currency values – Where ABC's subsidiaries are capitalised with currencies other than the US dollar, it is exposed to fluctuations in the values of those currencies. ABC takes all appropriate steps to hedge against such fluctuations where this is practicable or desirable.

Volatility of currency markets - Foreign exchange rate volatility can affect the Group's foreign exchange trading revenues. The Group believes that it benefits overall from currency volatility, in view of the opportunities for profitable proprietary trading thus generated.

Interest rates – Although the Group's net interest revenue can be negatively affected by interest rate changes, the impact is mainly on income from equity funds since its lending and marketable securities holdings are based predominantly on floating or short-term interest rates and therefore largely insulated from interest rate swings.

Independent Auditors' Report to the Shareholders of Arab Banking Corporation (B.S.C.)

ERNST & YOUNG

We have audited the accompanying consolidated financial statements of Arab Banking Corporation B.S.C. ['the Bank'] and its subsidiaries ['the Group'] which comprise the consolidated balance sheet as at 31 December 2006 and the consolidated statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Board of Directors' Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

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 2006 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Legal and Regulatory Matters

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements, and the contents of the Directors' report relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank have occurred during the year ended 31 December 2006 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position and that the Bank has complied with the terms of its banking licence.

Ernst & Young

6 February 2007
Manama, Kingdom of Bahrain

Consolidated Balance Sheet

31 December 2006

All figures in US$ million

	Note	2006	2005
ASSETS			
Liquid funds		**274**	309
Trading securities	3	**757**	593
Placements with banks and other financial institutions		**4,160**	3,264
Non-trading securities	4	**7,828**	6,003
Loans and advances	5	**8,622**	6,833
Investments in associates		**32**	29
Interest receivable		**264**	146
Other assets	6	**338**	282
Premises and equipment		**127**	129
TOTAL ASSETS		**22,402**	17,588
LIABILITIES			
Deposits from customers		**7,508**	5,310
Deposits from banks and other financial institutions		**9,070**	8,108
Certificates of deposit		**1,074**	73
Interest payable		**210**	109
Taxation	7	**47**	44
Other liabilities	8	**448**	396
TERM NOTES, BONDS AND OTHER TERM FINANCING	9	**1,927**	1,575
TOTAL LIABILITIES		**20,284**	15,615
EQUITY	10		
Share capital		**1,000**	1,000
Reserves		**456**	430
Retained earnings		**612**	496
EQUITY ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**2,068**	1,926
Minority interests		**50**	47
TOTAL EQUITY		**2,118**	1,973
TOTAL LIABILITIES AND EQUITY		**22,402**	17,588

These consolidated financial statements were authorised for issue by the Board of Directors on 6 February 2007 and signed on their behalf by the Chairman and President & Chief Executive.

Mohammed Layas
Chairman

Ghazi M. Abdul-Jawad
President & Chief Executive

The attached notes 1 to 27 form part of these consolidated financial statements.

Consolidated Statement of Income

Year ended 31 December 2006

All figures in US$ million

	Note	2006	2005
OPERATING INCOME			
Interest income		**1,232**	705
Interest expense		**(983)**	(512)
Net interest income		**249**	193
Other operating income	11	**235**	159
Total operating income		**484**	352
Write back of impairment provisions - net		**-**	14
NET OPERATING INCOME AFTER PROVISIONS		**484**	366
OPERATING EXPENSES			
Staff		**177**	134
Premises and equipment		**25**	23
Other		**60**	54
Total operating expenses		**262**	211
PROFIT BEFORE TAXATION		**222**	155
Taxation on foreign operations	7	**(17)**	(20)
NET PROFIT FOR THE YEAR		**205**	135
Income attributable to minority interests		**(3)**	(6)
INCOME ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**202**	129
BASIC AND DILUTED EARNINGS PER SHARE (expressed in US $)	26	**0.20**	0.13

The attached notes 1 to 27 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

Year ended 31 December 2006

All figures in US$ million

	Note	2006	2005
OPERATING ACTIVITIES			
Income attributable to the shareholders of the parent		**202**	129
Items not involving cash flow:			
Write back of impairment provisions - net		**-**	(14)
Depreciation		**12**	11
Items considered separately:			
Gains less losses on non-trading securities	11	**(1)**	(6)
Changes in operating assets and liabilities:			
Trading securities		**(162)**	(409)
Placements with banks and other financial institutions		**(744)**	925
Loans and advances		**(1,514)**	(958)
Other assets		**(158)**	(100)
Deposits from customers		**2,091**	261
Deposits from banks and other financial institutions		**695**	2,749
Other liabilities		**137**	33
Other non-cash movements		**(98)**	(10)
Net cash from operating activities		**460**	2,611
INVESTING ACTIVITIES			
Purchase of non-trading securities		**(3,345)**	(3,805)
Sale and redemption of non-trading securities		**1,556**	1,513
Purchase of premises and equipment		**(11)**	(7)
Sale of premises and equipment		**22**	2
Net cash used in investing activities		**(1,778)**	(2,297)
FINANCING ACTIVITIES			
Issue (Redemption) of certificates of deposit - net		**993**	(19)
Issue of term notes, bonds and other term financing		**512**	544
Repayment of term notes, bonds and other term financing		**(158)**	(779)
Cash dividend paid		**(70)**	(50)
Net cash from (used in) financing activities		**1,277**	(304)
(Decrease) increase in liquid funds		**(41)**	10
Effect of exchange rate changes on liquid funds		**6**	(4)
Liquid funds* at beginning of the year		**309**	303
Liquid funds* at end of the year		**274**	309

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

The attached notes 1 to 27 form part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

Year ended 31 December 2006

All figures in US$ million

	Attributable to shareholders of the parent							
	Share capital	Statutory reserve	General reserve	Retained earnings[1]	Cumulative changes in fair values	Total	Minority interests	Total equity
Balance at the end of the year 2004	1,000	263	150	424	15	1,852	40	1,892
Foreign exchange translation adjustments	-	-	-	6	-	6	1	7
Cumulative changes in fair values and other	-	-	-	-	(11)	(11)	-	(11)
Net income recognised directly in equity	-	-	-	6	(11)	(5)	1	(4)
Net profit for the year - 2005	-	-	-	129	-	129	6	135
Total recognised income and expense for the year	-	-	-	135	(11)	124	7	131
Transfers during the year	-	13	-	(13)	-	-	-	-
Dividend paid - 2004	-	-	-	(50)	-	(50)	-	(50)
Balance at the end of the year 2005	1,000	276	150	496	4	1,926	47	1,973
Foreign exchange translation adjustments	-	-	-	4	-	4	-	4
Cumulative changes in fair values and other	-	-	-	-	6	6	-	6
Net income recognised directly in equity	-	-	-	4	6	10	-	10
Net profit for the year - 2006	-	-	-	202	-	202	3	205
Total recognised income and expense for the year	-	-	-	206	6	212	3	215
Transfers during the year	-	20	-	(20)	-	-	-	-
Dividend paid - 2005	-	-	-	(70)	-	(70)	-	(70)
Balance at the end of the year 2006	**1,000**	**296**	**150**	**612**	**10**	**2,068**	**50**	**2,118**

1) Retained earnings include US$ 5 million (2005: US$ 2 million) representing net unrealised gains / losses on translation of investments in foreign subsidiaries into US dollars and non-distributable reserves amounting to US$ 148 million (2005: US$ 144 million).

The attached notes 1 to 27 form part of these consolidated financial statements.

All figures in US$ million

1. Incorporation and Activities

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

2. Significant Accounting Policies

The consolidated financial statements of Arab Banking Corporation (B.S.C.) and its subsidiaries [the Group] are prepared in accordance with International Financial Reporting Standards (IFRS) and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law. The following is a summary of the significant accounting policies which are consistent with those used in the previous year:

Accounting convention

These consolidated financial statements are prepared under the historical cost convention, as modified by the measurement at fair value of derivatives, investments carried at fair value through profit and loss, 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 which is the functional currency of the Group.

IASB Standards issued but not adopted

IFRS 7 Financial Instruments: Disclosures

The application of IFRS 7, which will be effective for the year ending 31 December 2007 will result in amended and additional disclosures realting to financial instruments and associated risks.

IAS 1 Presentation of Financial statements (Amended)

The application of IAS 1 (amended) which will be effective for the year ending 31 December 2007 will result in amended and additional disclosures relating to entity's objectives, policies and processes for managing capital.

Consolidation

These consolidated financial statements include the financial statements of the Parent Bank and its subsidiaries after adjustment for minority interests and elimination of inter-company transactions and balances. The financial statements of the subsidiaries are prepared for the same reporting year as the Parent Bank, using consistent accounting policies.

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.

Liquid funds

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

Trading securities

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

Placements with banks and other financial institutions

Placements with banks and other financial institutions are stated at 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. Resultant changes are recognised in the consolidated statement of income.

Non-trading securities

These are classified as follows:
- Held to maturity
- Available for sale

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 and fixed maturity which are intended to be held to maturity, are subsequently measured at amortised cost, less provision for impairment in value.

All figures in US$ million

Available for sale

Securities intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity, changes in interest rates or equity prices are classified as "available for sale". After initial recognition, these are normally remeasured at fair value, unless fair value cannot be reliably determined in which case they are measured at cost less impairment. That portion of any fair value changes relating to an effective hedging relationship is recognised directly in the consolidated statement of income. Fair value changes which are not part of an effective hedging relationship, are reported as a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as "cumulative changes in fair value" within equity, is included in consolidated statement of income for the period.

Loans and advances

Loans and advances quoted in an active market are classified as "held to maturity" or "available for sale" depending on management's intent.

Loans and advances that are not quoted in an active market are classified as "unquoted loans and advances".

Unquoted loans and advances and held to maturity loans and advances are stated at amortised cost, less provision for impairment.

Loans and advances classified as available for sale are stated at fair value. Unrealised gains and losses on remeasurement to fair value which are not part of an effective hedging relationship, are reported as a separate component of equity until the loan is sold, collected or otherwise disposed of, or the loan is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the consolidated statement of income for the period.

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

Premises and equipment

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

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

Impairment and uncollectability of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, an impairment loss is recognised in the consolidated statement of income. The recoverable amount is based on the net present value of anticipated future cash flows, discounted at the original interest rate.

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

Impairment is determined as follows:

(a) for assets carried at amortised cost, impairment is based on the present value of estimated future cash flows discounted at the original effective interest rate;

(b) for assets carried at fair value, impairment is the difference between cost and fair value; and

(c) for assets carried at cost, impairment is based on the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

In the case of impaired available for sale equity securities, any increase in fair value is recognised as an increase in cumulative changes in fair value directly in equity until disposed of.

Deposits

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

Repurchase and resale agreements

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

All figures in US$ million

2. Significant Accounting Policies (Continued)

Provisions

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

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.

Revenue recognition

Interest income and loan fees which are considered an integral part of the effective yield of a loan, are recognised using the effective yield method unless collectibility is in doubt. The recognition of interest income is suspended when loans become impaired, such as when overdue by more than 90 days. Other fee income and expense are recognised when earned or incurred.

Premiums and discounts on non trading securities and loans and advances (except loans and advances carried at fair value through statement of income) are amortised using the effective interest method and taken to interest income.

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

Fair values

For securities, derivatives and loans and advances traded in organised financial markets, fair value is determined by reference to quoted market prices. Bid prices are used for assets and offer prices are used for liabilities. In the case of units in mutual funds, or similar investment vehicles fair values are based on the last published bid price.

For unquoted securities fair value is determined by reference to brokers' quotes, recent transaction(s), the market value of similar securities, or based on the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics.

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount payable on demand.

The fair value of forward exchange contracts is calculated by reference to forward exchange rates with similar maturities. The fair value of unquoted derivative instruments is determined either by discounted cash flows, internal pricing models or by reference to brokers' quotes.

Significant accounting judgements and estimates

Judgements

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

Classification of investments and quoted loans and advances

Upon acquisition of an investment, management decides whether it should be classified as held to maturity, held for trading or available for sale.

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

Securities intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity, changes in interest rates or equity prices are classified as available for sale.

Quoted loans and advances are classified as "held to maturity" or "available for sale" depending on management's intent.

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

Estimation uncertainty

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

Impairment losses on financial assets

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

Impairment against specific group of financial assets

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

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

All figures in US$ million

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

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

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

Trade and settlement date accounting

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

Derivatives

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

Changes in the fair values of derivatives held for trading activities or to offset other trading positions are included in other operating income in the consolidated statement of income.

For the purposes of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (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.

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

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

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 derivative transactions, while providing effective economic hedges under the Group's asset and liability management and risk management positions, do not qualify for hedge accounting under the specific rules in IAS 39 and are therefore accounted for as derivatives held for trading and the related fair value gains and losses reported in other operating income.

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

Fiduciary assets

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

Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and the Group intends to settle on a net basis.

All figures in US$ million

3. Trading Securities

	2006	2005
Externally managed funds	**716**	584
Debt securities	**41**	8
Equities	**-**	1
	757	593

Externally managed funds represent investments in hedge funds (fund of funds) managed by internationally renowned asset managers.

4. Non-Trading Securities

	2006	2005
Available for sale		
AAA rated debt securities	**4,500**	3,961
AA to A rated debt securities	**1,965**	1,166
Other investment grade debt securities	**603**	396
Other debt securities	**690**	422
Equity securities	**53**	51
	7,811	5,996
Held to maturity - Debt securities	**17**	7
	7,828	6,003

Available for sale investments include investments of US$ 398 million (2005: US$ 340 million) of a structured finance nature which are of investment grade and are managed by international investment banks with underlying investments predominantly in AAA rated debt securities.

Included in equity securities are unquoted equity securities of US$ 37 million (2005: US$ 24 million) carried at cost. This is due to the unpredictable nature of future cash flows and lack of suitable alternative methods to arrive at a reliable fair value.

5. Loans and Advances

	2006	2005
i) By industrial sector		
Financial services	**3,982**	2,965
Other services	**2,162**	1,546
Manufacturing	**1,498**	1,678
Construction	**279**	133
Trade	**221**	324
Consumer	**121**	104
Government	**298**	276
Other	**442**	212
	9,003	7,238
Loan loss provisions	**(381)**	(405)
	8,622	6,833
ii) By classification		
Quoted loans and advances:		
Available for sale	**81**	62
Held to maturity	**5**	3
Unquoted loans and advances	**8,917**	7,173
	9,003	7,238
Loan loss provisions	**(381)**	(405)
	8,622	6,833

All figures in US$ million

5. Loans and Advances

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

	2006	2005
At 1 January	**405**	468
Charge for the year	**68**	32
Write backs/recoveries	**(68)**	(46)
Write-offs	**(54)**	(52)
Foreign exchange translation and other adjustments	**30**	3
At 31 December	**381**	405

At 31 December 2006 uncollected interest in suspense on past due loans amounted to US$ 172 million (2005: US$ 182 million).

The gross carrying value of loans placed on a non-accrual basis amounted to US$ 183 million at the year end (2005: US$ 262 million).

6. Other Assets

	2006	2005
Positive fair value of derivatives (note 13)	**62**	72
Assets acquired on debt settlement	**10**	11
Staff loans	**20**	16
Bank owned life insurance	**26**	25
Securities sold awaiting value	**37**	35
Deferred tax assets	**13**	10
Others	**170**	113
	338	282

The negative fair value of derivatives amounting to US$ 59 million (2005: US$ 77 million) is included in other liabilities (Note 8). Details of derivatives are given in Note 13.

7. Taxation on Foreign Operations

	2006	2005
Consolidated balance sheet:		
Current tax liability	**15**	11
Deferred tax liability	**32**	33
	47	44
Consolidated statement of income :		
Current tax on foreign operations	**6**	11
Deferred tax on foreign operations	**11**	9
	17	20

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

8. Other Liabilities

	2006	2005
Negative fair value of derivatives (note 13)	**59**	77
Margin deposits including cash collateral	**101**	66
Employee related payables	**64**	46
Non corporate tax payable	**11**	12
Securities purchased awaiting value	**37**	48
Cheques for collection	**22**	17
Deferred income	**28**	25
Accrued charges and other payables	**126**	105
	448	396

The positive fair value of derivatives amounting to US$ 62 million (2005: US$ 72 million) is included in other assets (Note 6). Details of derivatives are given in Note 13.

All figures in US$ million

9. Term Notes, Bonds and Other Term Financing

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

Total obligations outstanding at 31 December 2006

	Parent bank	Subsidiaries	Total
Aggregate maturities:			
2007	**300**	**178**	**478**
2008	**50**	**-**	**50**
2009	**500**	**-**	**500**
2010	**399**	**-**	**399**
2011	**300**	**200**	**500**
	1,549	**378**	**1,927**
Total obligations outstanding at 31 December 2005	1,349	226	1,575

All obligations bear floating rates of interest.

10. Equity

a) Share capital

	2006	2005
Authorised – 1,500 million shares of US$ 1 each	**1,500**	1,500
Issued, subscribed and fully paid – 1,000 million shares of US$ 1 each	**1,000**	1,000

At an Extraordinary general meeting of the shareholders of the Bank held on 7 June 2006, it was resolved to change the nominal value of the shares of the Bank from US$ 10 per share to US$ 1 per share. The number of shares have been amended to reflect this change.

b) Statutory reserve

As required by the Articles of Association of the Bank and the Bahrain Commercial Companies Law, 10% of the net 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 for distribution but can be utilised as security for purpose of a distribution in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

c) General reserve

The general reserve underlines the shareholders' commitment to enhance the strong equity base of the Bank.

11. Other Operating Income

	2006	2005
Fee and commission income	**132**	94
Fee and commission expense	**(30)**	(16)
Gains less losses on non-trading securities	**1**	6
Gains less losses on dealing in foreign currencies	**11**	11
Gains less losses on dealing in derivatives	**17**	9
Gains less losses on trading securities	**66**	27
Other – net	**38**	28
	235	159

All figures in US$ million

12. Investments in Subsidiaries and Associates

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

	Country of incorporation	Interest of Arab Banking Corporation (B.S.C.) (%)
ABC International Bank plc	United Kingdom	100
ABC Islamic Bank (E.C.)	Bahrain	100
Arab Banking Corporation (ABC) – Jordan	Jordan	87
Banco ABC Brasil S.A.	Brazil	84
ABC Algeria	Algeria	70
Arab Banking Corporation - Egypt [S.A.E.]	Egypt	98
ABC Tunisie	Tunisia	100

The principal associate is Arab Financial Services B.S.C. (c), incorporated in Bahrain, with a 46% ownership (2005: 43%).

13. Derivatives

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.

	2006			2005		
	Positive fair value	Negative fair value	Notional amount	Positive fair value	Negative fair value	Notional amount
Derivatives held for trading						
Interest rate and currency swaps	**30**	**17**	**2,968**	33	34	2,137
Forward foreign exchange contracts	**12**	**12**	**2,468**	18	12	1,585
Options	**5**	**4**	**3,020**	14	8	2,403
Futures	**14**	**9**	**736**	6	7	232
	61	**42**	**9,192**	71	61	6,357
Derivatives held as hedges						
Interest rate and currency swaps	**-**	**17**	**2,003**	1	16	1,235
Forward foreign exchange contracts	**-**	**-**	**759**	-	-	318
Options	**1**	**-**	**2,500**	-	-	-
	1	**17**	**5,262**	1	16	1,553
	62	**59**	**14,454**	72	77	7,910
Risk weighted equivalents (credit and market risk)			**479**			299

Derivatives held as hedges include:

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

b) Cash flow hedges with a notional amount of US$ 5 million (2005: US$ 5 million), comprising interest rate swaps of US$ 5 million (2005: US$ 5 million), the fair value of which is immaterial.

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.

All figures in US$ million

13. Derivatives (continued)

Derivative product types (continued)
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 favourable to the Group. The majority of the Group's derivative contracts are entered into with other financial institutions and there is no significant concentration of credit risk in respect of contracts with positive fair value with any individual counterparty at the balance sheet date.

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

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

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

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. The Group also uses interest rate swaps to hedge against the cash flow risks arising on certain floating rate loans. 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.

14. Credit Commitments and Contingent Items

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

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

	2006	2005
Short-term self-liquidating trade and transaction-related contingent items	**3,889**	2,657
Direct credit substitutes, guarantees and acceptances	**654**	498
Forward asset purchase commitments	**6**	19
Undrawn loans and other commitments	**1,540**	1,021
	6,089	4,195
Risk weighted equivalents	**2,152**	1,390

All figures in US$ million

15. Maturities of Assets, Liabilities and Off Balance Sheet Items

The maturity analysis of assets, liabilities and off balance sheet items based on remaining period to the contractual maturity date, except for Mortgage Backed Securities, Small Business Administration pools and Collateralised Debt Obligations classified as non-trading securities amounting to US$ 4,421 million (2005: US$ 3,770 million) which are based on expected repayment dates is as follows:

At 31 December 2006

	Within 1 month	1 - 3 months	3 - 6 months	6 - 12 months	1 - 5 years	5 - 10 years	10 - 20 years	Over 20 years	Undated	Total
ASSETS										
Liquid funds	274	-	-	-	-	-	-	-	-	274
Trading securities	1	-	5	-	31	-	-	1	719	757
Placements with banks and other financial institutions	2,920	1,137	72	31	-	-	-	-	-	4,160
Non-trading securities	43	15	61	678	3,094	2,766	1,118	-	53	7,828
Loans and advances	1,198	2,140	890	793	2,392	734	464	11	-	8,622
Others	-	-	-	-	-	-	-	-	761	761
Total assets	**4,436**	**3,292**	**1,028**	**1,502**	**5,517**	**3,500**	**1,582**	**12**	**1,533**	**22,402**
LIABILITIES, MINORITY INTERESTS AND EQUITY										
Deposits from customers	4,595	1,667	681	159	381	25	-	-	-	7,508
Deposits from banks and other financial institutions	5,338	3,028	257	134	291	22	-	-	-	9,070
Certificates of deposit	3	39	23	-	1,009	-	-	-	-	1,074
Term notes, bonds and other term financing	-	78	-	400	1,449	-	-	-	-	1,927
Others	-	-	-	-	-	-	-	-	705	705
Shareholders equity and minority interests	-	-	-	-	-	-	-	-	2,118	2,118
Total liabilities, shareholders equity and minority interests	**9,936**	**4,812**	**961**	**693**	**3,130**	**47**	**-**	**-**	**2,823**	**22,402**
OFF BALANCE SHEET ITEMS										
Credit commitments and contingent items	1,176	775	774	1,061	965	797	412	129	-	6,089
Foreign exchange contracts	1,850	1,396	1,907	477	49	15	-	-	-	5,694
Interest rate contracts	143	1,129	288	632	3,776	1,616	906	270	-	8,760
Total	**3,169**	**3,300**	**2,969**	**2,170**	**4,790**	**2,428**	**1,318**	**399**	**-**	**20,543**
At 31 December 2005										
Total assets	4,224	1,465	878	1,547	4,395	2,633	1,218	6	1,222	17,588
Total liabilities, minority interests and equity	9,224	3,021	767	356	1,662	36	-	-	2,522	17,588
Off balance sheet items	3,390	2,110	1,555	1,484	2,203	1,019	314	30	-	12,105

All figures in US$ million

16. 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 repricing of assets and liabilities. The Board has established levels of interest rate risk by setting interest rate sensitivity limits.

Positions are monitored on an ongoing basis and hedging strategies used to ensure positions are maintained within established limits.

The Group's interest sensitivity position based on contractual repricing arrangements or maturity whichever is earlier at **31 December 2006** has been shown in the table below:

At 31 December 2006

	Up to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	over 5 years	Non-interest bearing items	Total	Effective interest rates
Liquid funds	274	-	-	-	-	-	-	274	1.5
Trading securities	3	1	-	-	33	1	719	757	10.0
Placements with banks and other financial institutions	2,920	1,108	74	58	-	-	-	4,160	5.0
Non-trading securities	4,115	2,783	244	127	285	217	57	7,828	5.8
Loans and advances	2,822	3,233	1,515	454	534	64	-	8,622	7.1
Others	-	-	-	-	-	-	761	761	-
Total assets	10,134	7,125	1,833	639	852	282	1,537	22,402	
Deposits from customers	5,140	1,546	498	82	52	24	166	7,508	5.6
Deposits from banks and other financial institutions	5,403	3,018	356	118	155	-	18	9,068	5.4
Certificates of deposit	3	39	23	-	1,009	-	-	1,074	4.8
Others	-	-	-	-	-	-	705	705	-
TERM NOTES, BONDS AND OTHER TERM FINANCING	900	979	50	-	-	-	-	1,929	5.5
Shareholders equity and minority interests	-	-	-	-	-	-	2,118	2,118	-
Total liabilities, shareholders equity and minority interests	11,446	5,582	927	200	1,216	24	3,007	22,402	
On balance sheet gap	(1,312)	1,543	906	439	(364)	258	(1,470)	-	
Off balance sheet gap	(892)	396	192	(33)	700	(363)	-	-	
Total interest rate sensitivity gap	(2,204)	1,939	1,098	406	336	(105)	(1,470)	-	
Cumulative interest rate sensitivity gap	(2,204)	(265)	833	1,239	1,575	1,470	-	-	
At 31 December 2005									
Cumulative interest rate sensitivity gap	(224)	(209)	471	991	1,517	1,467	-	-	

17. Significant Net Foreign Currency Exposures

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

	2006 Currency	2006 US$ equivalent	2005 Currency	2005 US$ equivalent
Long (Short)				
Brazilian Real	1	1	(12)	(5)
Egyptian Pound	246	43	228	40
Jordanian Dinar	55	78	54	76
Pound Sterling	5	10	13	22
Saudi Riyal	661	176	(68)	(18)
Algerian Dinar	1,911	27	2,332	32
Hong Kong Dollar	(153)	(20)	-	-

All figures in US$ million

18. Credit Risk

Credit risk is the risk that a customer or counterparty will fail to meet a commitment, resulting in financial loss to the Group. Such risk arises from lending, trade finance, treasury and other activities undertaken by the Group. Credit risk is actively monitored in accordance with the credit policies which clearly define delegated lending authorities, policies and procedures. The management of credit risk also involves the monitoring of risk concentrations by industrial sector as well as by geographic location. For details of composition of loans and advances portfolio refer note 5.

19. Geographical Distribution of Assets, Liabilities and Off Balance Sheet Items

	2006 Assets	2006 Liabilities and equity	2006 Credit commitments and contingent items	2005 Assets	2005 Liabilities and equity	2005 Credit commitments and contingent items
Western Europe	4,117	2,214	1,388	3,439	2,156	759
Arab World	9,270	18,175	3,433	5,985	12,501	2,517
Asia	811	485	139	919	746	291
North America	6,077	339	816	5,244	810	332
Latin America	1,432	1,173	239	1,091	823	241
Other	695	16	74	910	552	55
	22,402	22,402	6,089	17,588	17,588	4,195

20. Segmental Information

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

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

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

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

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

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

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

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

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

Unallocated operating expenses are reported separately.

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

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

All figures in US$ million

20. Segmental Information (continued)

Primary segment information

2006	Treasury	Project and structured finance	Trade finance	Commercial banking and corporate	Islamic banking services	Retail	Equity and Other	Total
Net interest and other income	**127**	**31**	**100**	**64**	**18**	**28**	**116**	**484**
Segment result	**95**	**20**	**63**	**42**	**8**	**1**	**115**	**344**
Unallocated operating expenses								**(122)**
Profit before taxation and minority interests								**222**
Segment assets employed	**12,436**	**1,522**	**4,413**	**1,691**	**1,012**	**304**	**1,024**	**22,402**
Segment liabilities, minority interests and shareholders equity	**19,789**	**-**	**-**	**-**	**-**	**-**	**2,613**	**22,402**

2005	Treasury	Project and structured finance	Trade finance	Commercial banking and corporate	Islamic banking services	Retail	Equity and Other	Total
Net interest and other income	106	30	91	50	17	13	45	352
Segment result	74	15	57	37	8	1	45	237
Unallocated operating expenses								(82)
Profit before taxation and minority interests								155
Segment assets employed	9,694	1,330	3,615	1,329	755	171	694	17,588
Segment liabilities, minority interests and equity	15,175	-	-	-	-	-	2,413	17,588

Secondary segment information

	2006			2005		
	Arab World	Europe and Americas	Total	Arab World	Europe and Americas	Total
Segment profit before taxation and minority interests	**165**	**57**	**222**	120	35	155
Segment assets	**17,151**	**5,251**	**22,402**	12,845	4,743	17,588

21. Repurchase and Resale Agreements

Proceeds from assets sold under repurchase agreements at the year-end amounted to US$ 853 million (2005: US$ 1,260 million).

Amounts paid for assets purchased under resale agreements at the year-end amounted to US$ 36 million (2005: US$ 163 million) and relate to customer product and treasury activities.

All figures in US$ million

22. Transactions with Related Parties

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

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

	Major shareholders	Directors	Associates	2006	2005
Loans and advances	**28**	**-**	**-**	**28**	-
Deposits from customers	**1,112**	**1**	**6**	**1,119**	671

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

	2006	2005
Interest expense	**8**	6

Compensation of the key management personnel is as follows:

	2006	2005
Short term employee benefits	**14**	10
Post employment benefits	**3**	5
	17	15

23. Fiduciary Assets

Funds under management at the year-end amounted to US$ 3,913 million (2005: US$ 3,517 million). These assets are held in a fiduciary capacity and are not included in the consolidated balance sheet.

24. Fair Value of Financial Instruments

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

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

25. Assets Pledged as Security

At the balance sheet date, in addition to the items mentioned in Note 21, assets amounting to US$ 115 million (2005: US$ 114 million) have been pledged as security for borrowings and other banking operations.

26. Basic and Diluted Earnings and Dividend per Share

"Basic" earnings per share is calculated by dividing the net 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 and dividend per share for the year are as follows:

	2006	2005
Net profit for the year	**202**	129
Weighted average number of shares outstanding during the year (millions)	**1,000**	1,000*
Basic and diluted earnings per share (US$)	**0.20**	0.13
Dividend per share		
- Proposed cash dividend (US$)	**0.10**	0.07

* Earning per share for 2005 has been adjusted to reflect for the change in nominal value of the shares (Note 10).

A final dividend of US$ 0.10 per share (2005: US$ 0.07 per share) amounting to US$ 100 million (2005:US$ 70 million) has been proposed for approval at the Annual Ordinary General Meeting.

Notes to the Consolidated Financial Statements

31 December 2006

All figures in US$ million

27. Capital Adequacy

The risk asset ratio calculations, in accordance with the capital adequacy guidelines established for the global banking industry, are as follows:

Capital base	2006	2005
Tier 1 capital	**1,901**	1,842
Tier 2 capital	**324**	247
Total capital base	**2,225**	2,089

Risk Weighted Exposure

	Balance		Risk weighted equivalents	
	2006	2005	2006	2005
Assets				
Cash and claims on, guaranteed by or collateralised by securities of central governments and central banks of OECD countries	**4,510**	2,830	**-**	-
Claims on banks and public sector companies incorporated in OECD countries and short term claims on banks incorporated in non-OECD countries	**8,991**	8,291	**1,798**	1,658
Claims secured by mortgage of residential property	**107**	82	**54**	41
Claims on public sector entities, central governments, central banks and longer term claims on banks incorporated in non-OECD countries and all other assets, including claims on private sector entities	**8,151**	5,908	**8,151**	5,908
Off balance sheet items				
Credit commitments and contingent items (note 14)	**6,089**	4,195	**2,152**	1,390
Derivatives (note 13)	**14,454**	7,910	**20**	12
Credit risk weighted assets and off balance sheet items			**12,175**	9,009
Market risk weighted assets and off balance sheet items *			**1,932**	1,467
Total risk weighted assets			**14,107**	10,476
Risk asset ratio			**15.8%**	19.9%

* Market risk capital requirements are based on the standardised measurement methodology.

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International Directory

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