2013

ABC Islamic Bank

Annual Report

Connecting **MENA** To The World

بنك المؤسسة العربية المصرفية الإسلامي (ش.م.ب.م)

ABC Islamic Bank (E.C.)

Contents

ABC Group Network

Connecting MENA to the rest of the world

With a global network of subsidiaries, branches and representative offices across the world, Arab Banking Corporation prides itself on its global reach and local expertise. We leverage our extensive network and specialist execution capabilities to deliver value-added solutions to our clients.

The ABC Group

Our Group's success is the result of the approach taken by each and every one of our banks to conduct our global business.

Bahrain

ABC Islamic Bank (E.C.)

ABC Islamic Bank aims to provide the largest number of Shari'a-compliant products and services under one roof, seeking to meet diverse investment requirements and to fulfill the Group's strategy of sustainable growth.

Bahrain
Head Office

Arab Banking Corporation (B.S.C.)

Steadfast guidance takes us closer to our goals. Clear strategic direction, backed by solid leadership, is being rewarded by stronger relationships with our clients and financial success.

Algeria

Arab Banking Corporation – Algeria

Relentless application of our strategy is setting ABC Algeria apart. We are gaining recognition for growing our network and strengthening the quality of our offering.

Egypt

Arab Banking Corporation – Egypt

ABC Egypt has been resolute in the face of uncertainty. Intelligent navigation of the challenges we face is leading to profitable growth.

Jordan

Arab Banking Corporation – Jordan

Through its entrepreneurialism, ABC Jordan has become a respected local corporate and retail bank. Skilled pursuit of opportunities, backed by careful avoidance of risks, has fuelled growth.

Tunisia

Arab Banking Corporation – Tunisia

ABC Tunisia is building strong relationships. Productive teamwork among our employees and close collaboration with clients are providing resilience.

United Kingdom

ABC International Bank plc

Trustworthiness, consistency and reliability are three invaluable qualities for a bank. In the eyes of our clients, ABC International Bank possesses all of them, which is why they make us a preferred partner.

Brazil

Banco ABC Brasil S.A.

With great efficiency, Banco ABC Brasil offers financial solutions and a wide range of products and services to corporate customers, backed by a quick decision-making process and expertise.

Vision and Mission

Our Vision

To be the Islamic Bank of choice in the region and provide banking solutions for customers' needs.

Our Mission

Our mission is to uphold our carefully formulated Islamic principles in the quest for mutual prosperity for our clients and the Bank. In pursuit of our mission, we commit the Bank to the purest forms of Islamic banking products and services from a Shari'a perspective. We remain demonstrably independent from the conventional sector and recognise the importance of Islam's social objectives in conducting our business. We are also committed to delivering a level of service that matches, or exceeds, the market practice internationally. To do so, we seek to employ the best available human resources and technology to apply the highest professional, moral and ethical standards.

ABC Head Office in Bahrain.

Directors' Report

Dr. Khaled S. Kawan
Chairman

I am pleased to present to you, on behalf of the Board of Directors, the annual report and the consolidated financial statements of ABC Islamic Bank (E.C.) for the year ended December 31, 2013.

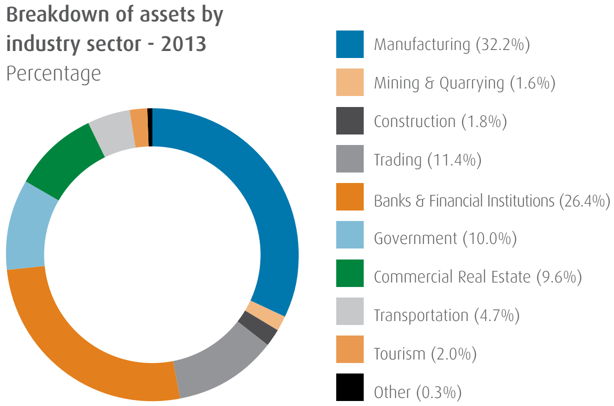
In the name of Allah, the Beneficent, the Merciful.

The financial results of the Bank for 2013 were pleasing all-round. While we managed to maintain year-end assets for 2013 at nearly the same level as 2012, net profit of $12.2 million was 48% higher than the net profit for last year. This accomplishment is due to a number of factors. Notably, run-offs of over $0.5 billion were replenished by booking assets at higher margins income. A higher volume of customer related fee income business was also recorded. Likewise, the credit portfolio was rationalized throughout the year, whereby no new provisions were required for 2013, whilst the overall risk rating of the portfolio improved by one notch while the geographic composition remained mostly unchanged. By the same token, operating expenses were held in check with the cost to income ratio improving to 30.63% in 2013 from 43.3% in 2012. Liquidity of the bank remained strong with a Capital Adequacy ratio of over 27%, which is well above the regulatory requirement of 12% and provides the bank with a robust platform for expected future growth.

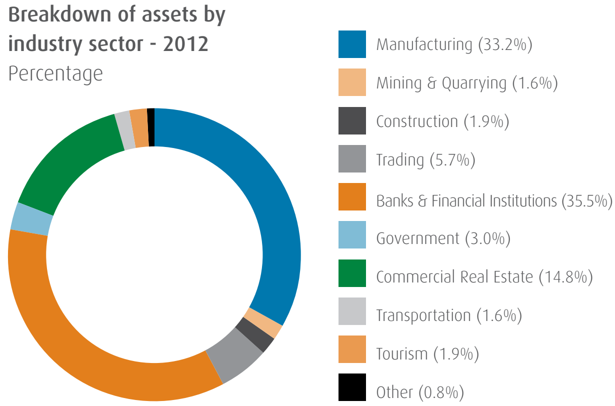
There is optimism looking at 2014 and beyond. The strategic initiatives set for ABC Islamic Bank are gaining both ground and traction. Legacy issues from the Global Economic crisis of 2008 by the Grace of Allah are behind us now. Resumed economic activity in core target markets and the promise of Islamic Banking in Arab countries holds great potential for ABC Islamic Bank. More specifically, for ABC Islamic Bank, a combination of focused improvements in service quality and coinciding of the Saudi week-end with Bahrain has resulted in a significant

(All figures stated in US dollars)

Breakdown of assets by industry sector - 2013
Percentage



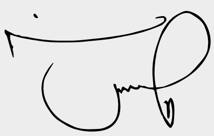
Breakdown of assets by industry sector - 2012
Percentage



up-tick in Trade Finance volumes for the Islamic Bank. Management and the operations group are now looking at improvements in customer training and automation of processes for Islamic Bank Trade Finance to consolidate this further.

We are gratified that these achievements of ABC Islamic Bank together with its future promising outlook have been vindicated by the market place. ABC Islamic Bank has been the first Islamic Bank to obtain a rating from the Islamic International Rating Agency (IIRA). This was reaffirmed in August 2013 as being unchanged from the previous year at A-/A-2 on the International scale and A+(bh)/A-1(bh) on the National scale with a stable outlook.

In closing I would like to thank the Central Bank of Bahrain for its regulatory oversight and all relevant government ministries for their friendly co-operation. I would also like to thank our customers for their continued patronage and use of our products and services and all of our staff for their dedication and hard work. Finally I would like to thank, the shareholder for its support and to express the Board's appreciation to the Shari'a Board for their direction and wisdom in Shari'a matters.



Khaled S. Kawan
Chairman

Board of Directors

Dr. Khaled S. Kawan

RC æ ⪤

Chairman

Ph.D. (Doctorat D'Etat) in Banking Laws, University of Paris (Sorbonne), France.

Dr. Kawan joined Arab Banking Corporation (B.S.C.) ("ABC") in June 1991. Dr. Kawan is the Group Chief Executive Officer of Arab Banking Corporation (B.S.C.) since October 2013. He was Group Legal Counsel until December 2009, when he was appointed Group Deputy Chief Executive. He represents ABC Group as Chairman of Arab Banking Corporation – Egypt (S.A.E.) and Arab Financial Services Company B.S.C. (c). He also acts as a Director of ABC International Bank plc.

Mr. Paul Jennings

RC æ ⪤

Deputy Chairman

Mr. Jennings joined ABC International Bank plc in September 1999 and has over 30 years banking experience principally within Trade, Commodity, Export and Structured Finance business as well as Loan Syndications and Asset Trading. Mr. Jennings developed his knowledge and expertise with major international banks namely Lloyds and Mitsubishi Bank and also within boutique/merchant banking operations namely Arbuthnot Latham, Singer & Friedlander and London Forfaiting Company. Mr. Jennings is a director of Banco ABC Brasil and is Chairman of the Northern European Committee of the IFA (International Forfaiting Association).

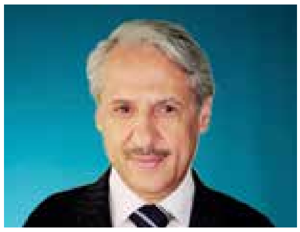
Mr. Abdulrahman Abdulla Al-Sayed

AC NCCGC § ▭

Director

MBA, University Of Dundee, UK
Certified Public Accountant (CPA)

Mr. Al-Sayed has over 14 years of experience in Islamic banking and its regulations. He is the co-founder, Chief Executive Officer and board member of Itqan Financial Services, an investment business company licensed and regulated by the Central Bank of Bahrain. Prior to that, he was the Director of Islamic Financial Institutions Supervision Directorate at the Central Bank of Bahrain between 1998 and 2008. He represented the Central Bank of Bahrain in several committees, notably, the Corporate Governance Working Group and the Capital Adequacy requirements for Sukuk, Securitizations and Real Estate Investments Working Group of the Islamic Financial Services Board, Malaysia. He also serves as a consultant/expert for the Audit Committee of Al Salam Bank – Bahrain. Mr. Al-Sayed has presented papers at various conferences and seminars and published articles on various subjects, particularly, regulations, Basel and risk management of Islamic banks.



Mr. Saleh H A Hussain

AC NCCGC § ▭

Director

MBA, Brunel University, UK

Mr. Hussain has over 35 years of banking experience. He is the chairman of the Board of Directors of Solidarity General Takaful and President of Saleh Hussain Consultancy. His other memberships include Arab Financial Services Company B.S.C. (c), Bahrain - Board member and Head of Audit Committee; Bahrain Development Bank - Board Member; Saudi Hollandi Bank, Saudi Arabia - Audit Committee member; Alkhabeer Capital, Saudi Arabia - Head of Audit Committee; and AlMajdouie Group, Saudi Arabia - Head of Audit Committee.

AC	Member of the Audit Committee
RC	Member of the Risk Committee
NCCGC	Member of the Nominations, Compensation & Corporate Governance Committee
▭	Non-executive
æ	Executive
⪤	Non-independent
§	Independent

Mr. Andrew Wilson

RC AC NCCGC æ ⋊⋉

Director

B.Sc (Hons) degree in Banking and Finance from the University of Loughborough, United Kingdom and an Associate of the Chartered Institute of Bankers

Mr. Wilson joined Arab Banking Corporation ("ABC" or the "Bank") in January 1989 initially in the Accounting, Systems and Compliance Department. He joined Group Audit in 1991 and served as a Senior Team Leader responsible for assessing the credit quality of risk assets and reviewing the operations of ABC Group branches and subsidiaries in various locations worldwide. Mr. Wilson was appointed as Head of Operations in March 2005. In addition to his responsibilities as Head of Operations of ABC Bahrain, he also served as ABC's Group Money Laundering Reporting Officer for 3 years and as a Director of ABC Securities (the Bank's brokerage company) for 2 years. Prior to joining the Bank, Mr Wilson, worked for Standard Chartered Bank, first in London and then in Qatar and Bahrain.

Mr. Naveed Khan

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Managing Director

MBA (Finance) University of the Punjab, Pakistan

Mr. Khan is Global Head of Islamic Banking at Arab Banking Corporation (B.S.C.) and has over 25 years of international banking experience in Corporate Banking, Treasury & Capital Markets, Consumer Banking and Islamic Finance. He spent his formative years in banking with Citigroup. Over a 15 year period with Citigroup, Mr. Khan moved from Karachi, where he was Citi's Corporate Banking Head to Citibank London, Budapest, New York and finally back to London where his last role was as East European Treasurer. In 1999, Mr. Khan moved to Riyadh to become Head of Islamic Banking at a Citi affiliate, Saudi American Bank. In 2004 Mr. Khan moved to ABC Islamic Bank as Managing Director. Mr. Khan was appointed as the Global Head for Islamic Banking for the ABC Group of companies in 2009 and was also appointed as a member of the Head Office Credit Committee of ABC BSC in 2011. Mr. Khan was also appointed as a member of the Head Office Asset & Liability Committee (ALCO) of ABC BSC in 2013 in addition to being voted as the Deputy Chairman of IIFM & Chairman of the Executive Committee of IIFM.

Mr. Graham Scopes

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Ex-Deputy Chairman

Mr. Scopes joined ABC in April 2001, and is currently Global Head of Corporate & Structured Finance, which comprises, ABC's Global Project & Structured Finance franchise, offering advisory and lending services, and the Corporate Banking & Financial Institutions department. This latter unit has primary responsibility for ABC's Gulf Cooperation Council ("GCC") countries client relationships and commercial banking activities. Prior to joining ABC, Mr. Scopes worked for 19 years for The Chase Manhattan Bank, based in London and Bahrain.

Mr. Luke Wells

Secretary to the Board

B.Com/LLB (Hons), University of Auckland, New Zealand

Mr. Wells joined the Legal Department of ABC in 2006. He has had previous experience working in leading law firms, including Rudd Watts & Stone (now Minter Ellison Rudd Watts) in Auckland, New Zealand and Herbert Smith in London and Moscow.

** Resigned during 2013*

Senior Management

Mr. Naveed Khan
Managing Director
MBA (Finance) University of the Punjab, Pakistan

Mr. Khan is Global Head of Islamic Banking at Arab Banking Corporation (B.S.C.) and has over 25 years of international banking experience in Corporate Banking, Treasury & Capital Markets, Consumer Banking and Islamic Finance. He spent his formative years in banking with Citigroup. Over a 15 year period with Citigroup, Mr. Khan moved from Karachi, where he was Citi's Corporate Banking Head to Citibank London, Budapest, New York and finally back to London where his last role was as East European Treasurer. In 1999, Mr. Khan moved to Riyadh to become Head of Islamic Banking at a Citi affiliate, Saudi American Bank. In 2004 Mr. Khan moved to ABC Islamic Bank as Managing Director. Mr. Khan was appointed as the Global Head for Islamic Banking for the ABC Group of companies in 2009 and was also appointed as a member of the Head Office Credit Committee of ABC BSC in 2011. Mr. Khan was also appointed as a member of the Head Office Asset & Liability Committee (ALCO) of ABC BSC in 2013 in addition to being voted as the Deputy Chairman of IIFM & Chairman of the Executive Committee of IIFM.

Mr. Hammad Hassan
Head of Marketing
MBA, Lahore University of Management Sciences, Pakistan; B.Sc. Electrical Engineering, University of Engineering & Technology, Lahore, Pakistan

Mr. Hassan has over 19 years of banking experience, split among Citigroup, its affiliate in Saudi Arabia, Samba Financial Group and ABC Islamic Bank, in the areas of Consumer Banking, Corporate Banking and Islamic Finance. He joined Citigroup in Pakistan in 1994. In 1997, Mr. Hassan moved to Samba Financial Group and worked in different areas of the corporate bank before moving to the Islamic banking group as Product and Business Development Head. In early 2005, he moved to ABC Islamic Bank as head of Marketing. In this role, he is responsible for leading the marketing and origination effort at ABC Islamic Bank covering corporate, public sector and institutional clients across GCC and MENA.

Mr. Iftikhar Ali
Head of Structuring & Capital Markets
MBA, Institute of Business Administration, Karachi; Chartered Financial Analyst (CFA) from CFA Institute, USA

Mr. Ali has 19 years of Islamic & Investment banking experience. He recently joined ABC Islamic Bank from Gulf International Bank where he was heading the Debt Capital Markets and Islamic Banking units. Previously, Mr. Ali headed the Corporate Finance team for Credit Agricole Indosuez for Pakistan before moving to Abu Dhabi Islamic Bank as part of their Structured and Project Finance team. He also has been an elected board member of the local CFA society.

Mr. Abdulkarim Ismaeel Ahmed
MLRO / Regulatory & Sharia Compliance Officer
Post Graduate Accounting Diploma, Gulf Polytechnic, Bahrain

Mr. Ahmed, has over 30 years of experience in both Islamic and conventional banking activities covering wide areas such as Fund managing, administration, operations, accounting, auditing, regulatory and Shari'a compliance through various posts held at Banco do Brazil, Banque Nationale De Paris and the ABC Group. His long years of audit experience with the Group Audit Department of ABC at various Arab and international branches and subsidiaries further exposed him to a wider range of conventional and Islamic retail/wholesale products and enhanced his awareness of the requirements and responsibilities of the positions he currently holds.

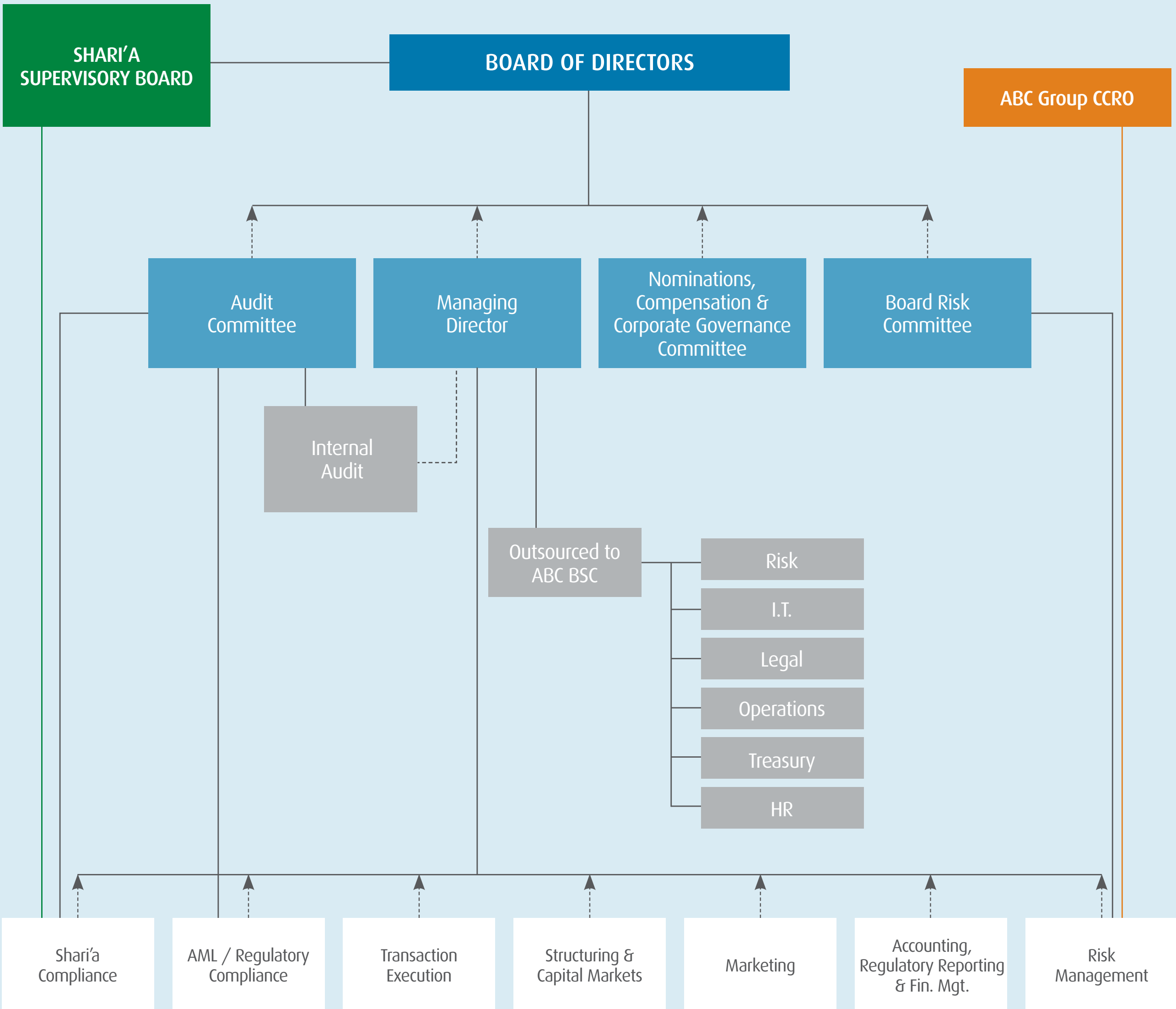
Mr. Khalid Alraee
Chief Financial Officer
B.Com, University of the Punjab, Pakistan

Mr. Alraee started his career with Peat Marwick, Mitchell & Co (merged with KPMG Fakhro), auditing banking clients, trading and shipping companies in 1984. Two years later he joined Reuters Middle East limited as the Regional Assistant Manager, Financial Control – responsible for financial reporting and accounting systems for Bahrain, Saudi Arabia, Qatar and Yemen offices. In 1992, Mr. Alraee joined the Accounting Systems & Compliance Department of ABC Investment and Services Co, which was later converted to a fully- fledged Islamic entity and consequently renamed ABC Islamic Bank.

Mr. Hisham Mouzughi
Head of Risk & Credit Support
Master of Science in Business Administration (MSBA), Boston University; MBA, Webster University; Postgraduate Diploma in Accounting & Finance, London School of Economics; Postgraduate Diploma in Islamic Banking & Insurance, Institute of Islamic Banking & Insurance, London

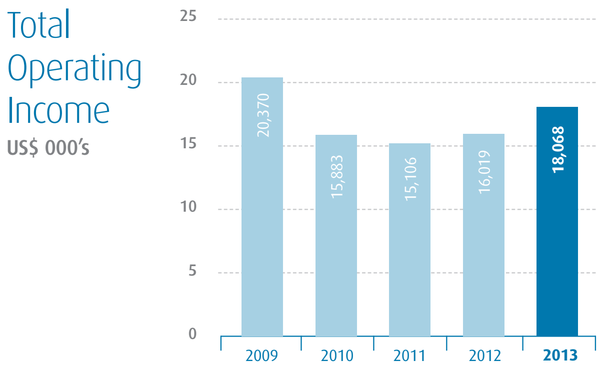
Mr. Mouzughi has been associated with the ABC Group for 19 years. He initially joined ABC's London Branch in 1989. In 1991, he took a university teaching assignment in Libya as well as some trading activities. He re-joined the ABC Group in 1996 in London with the Credit Function of ABC International Bank plc. During this period he progressed to the position of Deputy Head of Credit and in 2006 was transferred to Bahrain to head the Risk function of ABC Islamic Bank. He is the Deputy Chairman of the Board of Directors of Arab Banking Corporation – Algeria and a member of the Board of Jumhouria Bank, Libya and chairs the Board Risk Committees of both banks.

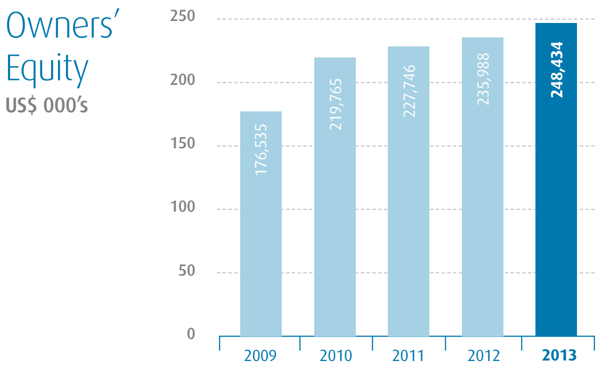
Organisational Chart



Financial Highlights

(All figures stated in US dollars)





FINANCIAL PERFORMANCE

Net profit after Zakah was $12.2 million compared to $8.3 million in 2012, an increase of 48%.

The bank's operating income and profitability improved significantly over 2012 on account of the following factors:

- New assets booked were at better pricing compared to some of the longer tenor investments booked earlier.
- Improved focus on fee based income helped in improving the overall return on assets.
- Continued targeting of niche markets like Turkey which remained largely unaffected by the global economic malaise.
- Stabilization of the impaired asset portfolio.

The prospects for Islamic Banking are promising in the region. More and more countries in GCC and the Arab World are focusing on developing Islamic markets, with demand initiated from the retail sectors of the economy. Oman and Libya being the more recent examples, with the same sentiment echoed in Egypt, Jordan, Algeria and Tunisia as well.

Statement of Financial Position

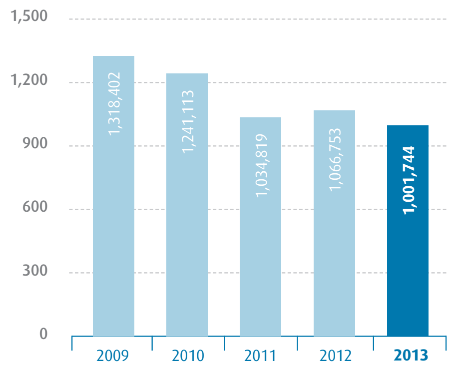
Total footings of the bank declined by $65 million or 6%. On a gross basis, the bank booked new assets of $520 million. However, these were off-set by repayments of $576 million from transactions maturing in 2013. The decline of $65 million in the total assets of the bank came about as a result of increase of $28 million in Murabaha receivables and $6 million in Ijara assets. A combination of this with $95 million of repayments on due dates in Investments brought about the above change on the asset side.

Income Statement

Total operating income amounted to $18.1 million, 12.8% higher than last year of $16 million. Murabaha receivables income has shown a positive trend with an increase of $2.5 million. Fee and commission income also showed an increase of 49% from $3.1 million in 2012 to $4.6 million in 2013, again mainly arising from bilateral and syndicated transactions done in niche markets like Turkey. This however, was offset by $3.2 million decrease in income from investments as a result of partial repayment and maturity on due dates of investments as mentioned above and also a decrease of $1.1 million in income from Ijarah assets, somewhat in line with a decrease in the profit paid on Murabaha Payables of 25% to $6.7 million versus $9 million in 2012. The reversal of part of compensation scheme relating to 2012, led to staff expenses category being lower by $0.8 million compared to 2012. Recurring expenses of $0.5 million were also lower than last year.

Zakah payments were above the AAOIFI requirement but in line with the index for inflation in Bahrain as a core Board Policy of community support and involvement.

Total Assets
US$ 000's



	2009	2010	2011	2012	**2013**
Ratios (%)					
Cost / income ratio	24.5	30.8	40.8	43.3	**30.6**
Return on average equity	6.6	1.2	3.6	3.6	**5.0**
Return on average assets	0.7	0.2	0.7	0.8	**1.2**
Liquidity assets ratio	31.9	30.6	25.9	17.7	**8.9**
Short-term assets to short-term liabilities	26.8	39.1	43.2	72.2	**62.9**
Risk asset ratio - Tier 1	23.0	24.2	26.5	25.3	**26.2**
Risk asset ratio - Total	24.1	24.5	27.5	26.2	**27.6**

Sources and applications of financial resources
The efforts made during the year in widening the bank's client base was evident in the positive cash flow coming from the substantial increase in banks and other financial institutions' accounts, which was reported to have amounted to $41 million. The Board decision not to pay any dividends to the Parent and the retention of the current years' net profit of $12.2 million led to healthy capitalization ratios. Total equity of the Bank grew to $248 million compared to $236 million in 2012.

Geographical diversification in assets and liabilities
The bank's core target market is concentrated largely in the Middle East, with the GCC countries accounting for more than 72% of its total portfolio and Turkey with 17.4% share. Saudi Arabia is the largest with a 49% share followed by UAE, Bahrain, Kuwait, Qatar and Oman.

Liabilities and owners' equity comprised 97.2% from the Middle East and North Africa, 1.5% from Europe (including Turkey), 1% from Far East and 0.3% from North America.

Industrial distribution of assets
Manufacturing made up 32.2%, banks and financial institutions 26.4%, trading 11.4%, construction and commercial real estate 11.4%, Government 10%, transportation 4.7%, tourism 2%, followed by mining & quarrying 1.6%.

Liquidity
ABC Islamic Bank has retained strong liquidity historically and last year due to the following main factors:

1. Strong loyalty from core customers because of niche liability products unmatched by other Islamic banks.

2. Continued strong support from the Parent for its backstop liquidity requirements as the bulk of Islamic liability marketing is domiciled at ABC BSC.

3. Retention of Capital at the level of ABC Islamic Bank well above regulatory requirements.

Capital adequacy
The Bank abides by international regulatory authorities' requirements in all its financial ratios. The bank is also keen to comply with Central Bank of Bahrain (CBB) regulations and directives pertaining to Islamic banking transactions and practises. The Bank's Capital Adequacy Ratio was calculated at 27.6% in 2013 compared to 26.2% in 2012. This ratio exceeds the minimum amount of 12% required by the CBB.

The Shari'a Supervisory Board

Report of the Shari'a Supervisory Board to the shareholders on performance of ABC Islamic Bank (E.C.) for the year 2013.

In the name of Allah, The Beneficent, The Merciful

Praise be to Allah, the Lord of the worlds, and blessing and peace be upon His Prophet Mohammad and the people of His house and His companions.

The Shareholders of ABC Islamic Bank (E.C.)

Assalam Alaikum Wa Rahmat Allah Wa Barakatuh

In compliance with the letter of appointment and the Bank's articles of association, we are required to submit the following report:

We have reviewed the principles and the contracts relating to the transactions and applications introduced by the ABC Islamic Bank (E.C.) (the Bank) during the year ended 31 December 2013. We have also conducted our review to form an opinion as to whether the Bank has complied with Shari'a Rules and Principles and also with the specific fatwas, rulings and guidelines issued by us.

The Bank's management is responsible for ensuring that the financial institution conducts its business in accordance with Islamic Shari'a Rules and Principles. It is our responsibility to form an independent opinion, based on our review of the operations of the Bank, and to report to you.

We conducted our review, with the cooperation of the Shari'a Compliance Officer, which included examining, on a test basis, each type of transaction, the relevant documentation and procedures adopted by the Bank.

We planned and performed our review so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Bank has not violated Islamic Shari'a Rules and Principles.

In our opinion:

a) the contracts, transactions and dealings entered into by the Bank during the year ended 31 December 2013 that we have reviewed are in compliance with the Islamic Shari'a Rules and Principles;

b) the allocation of profit and charging of losses relating to investment accounts conform to the basis that had been approved by us in accordance with Islamic Shari'a Rules and Principles;

c) all earnings that have been realized from sources or by means prohibited by Islamic Shari'a Rules and Principles have been disposed of to charitable causes; and

d) the calculation of Zakah is in compliance with Islamic Shari'a Rules and Principles.

The Board takes this opportunity to offer praise to Allah, exalted be He, His guidance, and to express its thanks to the Bank's management for their co-operation and their keenness in understanding and adherence to the rules of the noble Islamic Shari'a.

We beg Allah the Almighty to grant us all the success and straight-forwardness.

Wassalam Alaikum Wa Rahmat Allah Wa Barakatuh

Shari'a Supervisory Board

Dr. Abdul Latif Al Mahmood | **Shaikh Nedham Yaqoubi** | **Dr. Mohamed Ali Elgari**

5 Rabi Al-Thani 1435 H
5 February 2014 G
Manama, Kingdom of Bahrain

Corporate Governance

ABC Islamic Bank (E.C.) ("ABC Islamic") follows internationally recognised best practice principles and guidelines, having a corporate governance system that provides an effective and transparent control framework, which is fair and accountable.

(All figures stated in US dollars unless otherwise indicated)

The Central Bank of Bahrain **("CBB")** licenses ABC Islamic as an Islamic wholesale bank. Incorporated in 1985 as a Bahrain exempt closed joint stock company, ABC Islamic has an authorised capital of $200 million and a paid up capital of $132.5 million (as at 31 December 2013).

ABC Islamic communicates all relevant information to stakeholders punctually and clearly through a variety of channels, including a well-maintained website. In particular, ABC Islamic reports its profits on an annual, semi-annual and quarterly basis. At least the last three years' financial statements are maintained on the ABC Islamic corporate website.

Shareholders

The following table shows the ownership structure of ABC Islamic as at 31 December 2012 and 31 December 2013:

Name of Shareholder	Percentage Shareholding	Nationality
Arab Banking Corporation (B.S.C.)	99%	Bahrain
Varner Holdings Limited[1]	1%	Jersey
Total	100%	

Arab Banking Corporation (B.S.C.) **("ABC")** was incorporated in 1980 as a Bahrain joint stock company and its shares have been listed on the Bahrain Bourse since 1990. It has an authorised capital of $3.50 billion and a paid up capital of $3.11 billion (as at 31 December 2013). Accordingly, none of the shares of ABC Islamic are directly owned by a government. The CBB licenses ABC as a conventional wholesale bank.

[1] Varner Holdings Limited is 100% owned by Arab Banking Corporation (B.S.C.) and accordingly is a member of the ABC Group of Companies.

Name of subsidiary	Nature of business	Country of incorporation	Amount and percentage of holding
ABC Clearing Company	Investment Company	Cayman Islands	$2,000 and 100% of management shares

Recent Corporate Governance Changes
In 2010, the CBB substantially updated its corporate governance requirements (particularly the CBB Rulebook's High Level Controls module) for financial institutions which are incorporated in Bahrain (the **"CBB Corporate Governance Requirements"**). The CBB Corporate Governance Requirements took full effect at the end of 2011. The CBB updated the CBB Corporate Governance Requirements including the High Level Controls module, from time to time during 2013. The corporate governance charter of ABC Islamic was updated in February 2013 to reflect such updates.

The Board Risk Committee was strengthened by the appointment of a third voting member during 2013.

The Board reviewed the procedures for the evaluation of its own performance and the performance of each Board committee and individual Director in 2013. This review resulted in various enhancements to the Board evaluation procedures and these improvements were adopted for the evaluations undertaken for the 2013 financial year.

Compliance with CBB Corporate Governance Requirements
The CBB Corporate Governance Requirements contain a mixture of rules **("Rules")** and recommendations **("Guidance")**. The CBB requires the financial institutions to which the CBB Corporate Governance Requirements apply (including ABC Islamic), to comply with the Rules and expects them to comply with the Guidance, or explain their non-compliance in the Annual Report and to the CBB.

Save as may otherwise be disclosed in this Annual Report, ABC Islamic complied with the CBB Corporate Governance Requirements as at 31 December 2013, except where ABC Islamic obtained an exemption from the CBB.

ABC Islamic had two independent, non-executive Directors (representing one-third of the Board) and four non-independent, executive Directors as at 31 December 2013. As at 31 December 2013, the Nominations, Compensation & Corporate Governance Committee comprised of two independent Directors (including its Chairman) and one executive Director. This is not compliant with the Rule for Nominations Committee membership and the Guidance for Compensation Committee membership in the CBB Corporate Governance Requirements, which require only independent directors or, alternatively, only non-executive directors of whom a majority must be independent directors.[2]

ABC Islamic has previously adopted a corporate governance charter and charters for the various Board committees (the **"ABC Islamic Board Mandates"**). The corporate governance charter and the charters of the various Board committees are displayed on the ABC Islamic corporate website.

[2] *Approved by the CBB*

Corporate Governance (continued)

Below are some additional instances of non-compliance with certain Guidance, together with the required explanations as per the "Comply or Explain" requirement of the CBB:

- To dedicate a specific section of ABC Islamic's website to describing shareholders' rights to participate and vote at each shareholders meeting, and to post significant documents relating to meetings including the full text of notices and minutes: ABC Islamic is directly and indirectly 100% owned by ABC. Therefore, ABC Islamic does not propose to comply with this Guidance because such information is readily available to the shareholders by other means.

- To have at least three independent members in the Corporate Governance Committee one of whom is recommended to be a Shari'a scholar and Shari'a Supervisory Board member: The Nominations, Compensation and Corporate Governance Committee currently has three members, comprising two independent directors (including its Chairman) and one executive director, with a wide range of skills and experience. However, given its 100% direct and indirect ownership by ABC (which provides group-wide corporate governance oversight and which makes other expertise available to ABC Islamic), ABC Islamic does not intend to have three independent directors on this committee.

  Also, with regard to having a Shari'a scholar and Shari'a Supervisory Board member in the committee, ABC Islamic does not intend to comply with this Guidance since the Shari'a Compliance Officer of ABC Islamic performs his reviews as per the Shari'a and Corporate Governance Standards issued by the Accounting and Auditing Organization For Islamic Financial Institutions **("AAOIFI")** and reports his findings to the Shari'a Supervisory Board as well as to the Audit Committee on such matters, and hence is considered to be the link between the Shari'a Supervisory Board and the Board with respect to compliance and governance issues relating to Shari'a.

BOARD OF DIRECTORS

Responsibilities of the Board

The Board of Directors (the "**Board**") is responsible for the overall direction, supervision and control of ABC Islamic. In particular, the Board's responsibilities include (but are not limited to):

a) those responsibilities assigned to the Board by the Articles of Association of ABC Islamic;
b) establishing ABC Islamic's objectives;
c) ABC Islamic's overall business performance;
d) monitoring management performance;
e) the adoption and annual review of strategy;
f) monitoring the implementation of strategy by management;
g) causing financial statements to be prepared which accurately disclose ABC Islamic's financial position;
h) convening and preparing the agenda for shareholder meetings;
i) monitoring conflicts of interest and preventing abusive related-party transactions;
j) assuring equitable treatment of shareholders, including any minority shareholders;
k) the adoption and review of management structure and responsibilities; and
l) the adoption and review of the systems and controls framework.

The Board meets regularly (at least four times a year) to consider key aspects of ABC Islamic's affairs, strategy and operations.

The Board is responsible for the preparation and fair presentation of consolidated financial statements in accordance with the Financial Accounting Standards issued by AAOIFI, and for matters for which no AAOIFI standards exist, the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB"). The Board is also responsible for such internal controls as the Board determines are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Appointment of Directors

The shareholders appoint the Board for a term of three years. At the 2013 year end, there were six Directors on the Board, with diverse and relevant skills who worked well together as a team. Collectively, they exercised independent and objective judgement in meeting their responsibilities.

Directors are elected by the shareholders of ABC Islamic. When a new Director is inducted, the Chairman or ABC Islamic's Legal Counsel or Compliance Officer or other individual delegated by the Chairman, reviews the Board's role and duties with that person. In particular, they describe the legal and regulatory requirements of the ABC Islamic Board Mandates and the CBB Corporate Governance Requirements. The Chairman of the Board ensures that each new Director receives a formal and tailored induction to ensure his contribution to the Board from the beginning of his term. This includes meetings with senior management, internal and independent auditors and legal counsel; visits to ABC Islamic facilities; presentations regarding strategic plans, compliance programmes, and significant financial, accounting and risk management issues.

ABC Islamic has a written appointment agreement with each Director. This describes the Director's powers, duties, responsibilities and accountabilities, as well as other matters relating to his appointment including his term, the time commitment envisaged, the Board committee assignments (if any), Directors' remuneration and expense reimbursement entitlement, and Directors' access to independent professional advice when needed.

Assessment of the Board

The ABC Islamic Board Mandates require that the Board evaluates its own performance each year, as well as the performance of each Board Committee and individual Director. This evaluation includes:

a) assessing how the Board operates;
b) evaluating the performance of each Board committee in light of its specific purposes and responsibilities, which shall include review of the self-evaluations undertaken by each Board committee;
c) reviewing each Director's work, his attendance at Board and Board committee meetings, and his constructive involvement in discussions and decision making;
d) reviewing the Board's current composition against its desired composition in order to maintain an appropriate balance of skills and experience, and to ensure planned and progressive refreshing of the Board; and
e) recommendations for new Directors to replace long-standing Directors, or those Directors whose contribution to ABC Islamic or its Board committees (such as the Audit Committee) is not adequate.

The Board has conducted an evaluation and self-assessment of its performance, and the performance of each Board committee and each individual Director in relation to the financial year ending on 31 December 2013.

Corporate Governance (continued)

Independence of Directors
The ABC Islamic Board Mandates include detailed criteria to determine whether a Director should be classified as independent or not. The ABC Islamic independence criteria are at least as restrictive as the formal criteria specified in the CBB Corporate Governance Requirements.

As a rule, Directors do not have any direct or indirect material interest in any contract of significance with ABC Islamic or its subsidiary or any material conflicts of interest. This remained the case in 2013. The ABC Islamic Board Mandates require that any transaction that causes a Director to have a material conflict of interest must be unanimously approved by the Board (other than the relevant Director) or the shareholders. Each Director is required to inform the entire Board of any actual, or potential, conflicts of interest in their activities with, or commitments to, other organisations as they arise, and to abstain from voting on these matters. Disclosures shall include all material facts.

Each Director has a legal duty of loyalty to ABC Islamic, and can be personally sued by ABC Islamic or shareholders for any violation.

Compensation & Interests of Directors
The general remuneration policy of ABC Islamic with regard to Directors is included in the ABC Islamic Board Mandates (as set out on the ABC Islamic corporate website). The compensation for members of the Board of Directors (other than executive Directors) consists of the following elements:

a) an annual fee, which is approved by the Annual General Meeting of ABC Islamic; and
b) reimbursement to cover travelling and/or accommodation expenses while attending Board and Board Committee meetings.

Directors' remuneration, allowances and expenses for attendance at Board meetings for 2013 amounted to $142,000 (2012: $166,000). The remuneration of Directors (other than executive Directors who are members of senior management) is neither determined nor based on the performance of ABC Islamic.

No Director owned or traded ABC Islamic shares during 2013.

Board Committees
The Board and its committees are supplied with full and timely information to enable them to discharge their responsibilities. In this respect, the Board, its committees and all Directors have access to senior management, external consultants and advisors. The Board Secretary's duties include following up on the actions, decisions and meetings of the Board in books to be kept for that purpose.

The Board has delegated specific responsibilities to a number of Board Committees. Each such committee has its own formal written charter. The main Board committees are:

- **The Audit Committee**, which is responsible to the Board for the integrity and effectiveness of ABC Islamic's system of financial and accounting controls and practices, and for reviewing compliance with legal requirements. This Committee also recommends the appointment, compensation and oversight of the external auditors, as well as the exercise of the internal audit function which (notwithstanding the requirements contained in the CBB Corporate Governance Requirements) is exercised through the group audit function of the ABC group of companies **("ABC Group")** [3]. The Audit Committee also recommends the appointment of head of compliance and oversights the performance of compliance function. The Audit Committee meets not less than four times a year.

[3] *Approved by the CBB*

- **The Board Risk Committee**, which is responsible for the review and approval of ABC Islamic's Risk Policies and recommends the appointment/removal of head of risk. The Committee reviews and makes recommendations to the Board regarding the risk strategy/appetite, within which business strategy, objectives and targets are formulated. The Committee delegates authority to senior management to conduct day-to-day business within the prescribed policy and strategy parameters, while ensuring that processes and controls are adequate to manage ABC Islamic's risk policies and strategy. The Board Risk Committee meets not less than three times a year.

- **The Nominations, Compensation and Corporate Governance Committee**, the Committee ensures that effective procedures are in place to enable it, and senior management, to monitor and evaluate the performance of staff. The Committee also assists the Board in shaping and monitoring ABC Islamic's corporate governance policies and practices, reviewing and assessing the adequacy of these policies and practices, and evaluating ABC Islamic's compliance with them. The Nominations, Compensation and Corporate Governance Committee meets not less than twice a year.

The ABC Islamic Board Mandates (available on the ABC Islamic corporate website) include charters for each of the Board committees.

As at 31 December 2013, the members of each of the Board committees were as set out in the table below:

Board Committees	Member Name	Member Position
The Audit Committee	Mr. Saleh Hussain	Chairman
	Mr. Abdulrahman Al-Sayed	Deputy Chairman
	Mr. Andrew Wilson	Member
The Board Risk Committee	Dr. Khaled Kawan	Chairman
	Mr. Paul Jennings	Deputy Chairman
	Mr. Andrew Wilson	Member
	Mr. Vijay Srivastava [4]	Member
The Nominations, Compensation and Corporate Governance Committee	Mr. Abdulrahman Al-Sayed	Chairman
	Mr. Saleh Hussain	Member
	Mr. Andrew Wilson	Member

[4] *Non-Voting Member*

Corporate Governance (continued)

Attendance and Participation of Directors at Meetings

The details of Directors' attendance or participation (including by video conference or teleconference) at Board and Board committee meetings during 2013 are set out in the following table:

Board Members	Board Meetings	The Audit Committee	The Board Risk Committee	The Nominations Compensation and Corporate Governance Committee
Dr. Khaled Kawan - Chairman [5]	4 (4)	N/A	4 (4)	N/A
Mr. Paul Jennings - Deputy Chairman [6]	3 (4)	1 (2)	2 (3)	N/A
Mr. Abdulrahman Al Sayed - Director [7]	4 (4)	4 (4)	N/A	3 (3)
Mr. Saleh Hussain - Director [8]	4 (4)	4 (4)	N/A	3 (3)
Mr. Naveed Khan - Director [9]	4 (4)	N/A	N/A	N/A
Mr. Andrew Wilson - Director [10]	3 (3)	2 (2)	1 (1)	2 (2)
Mr. Graham Scopes - former Deputy Chairman [11]	1 (1)	N/A	1 (1)	1 (1)
Mr. Vijay Srivastava - Board Risk Committee Member[12]	N/A	N/A	4 (4)	N/A

Figures in brackets indicate the maximum number of meetings during the period of membership.
"N/A" indicates that a Director was not a member of the relevant Board committee during 2013.

Meeting Dates during 2013:

The details of the dates of the Board and Board committee meetings in 2013 are set out below:

Board of Directors	21 February, 19 May, 1 August and 19 November
Audit Committee	6 February, 25 April, 18 July and 9 October
Nominations, Compensation and Corporate Governance Committee	6 February, 19 November and 8 December
Board Risk Committee	21 February, 19 May, 1 August and 19 November

[5] *Current term start date: April 2013*
[6] *Current term start date: April 2013*
[7] *Current term start date: April 2013*
[8] *Current term start date: April 2013*
[9] *Current term start date: April 2013*
[10] *Current term start date: May 2013*
[11] *No longer a Board member as of April 2013*
[12] *Non-voting member. Meetings attended by Mr. Vijay Srivastava or his designate*

SHARI'A SUPERVISORY BOARD

The Shari'a Supervisory Board (the **"SSB"**) of ABC Islamic and its subsidiary (together the **"Group"**) consists of three Islamic scholars who review the Group's compliance with general Shari'a principles and specific pronouncements, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Group to ensure that its activities are conducted in accordance with Islamic Shari'a principles. The SSB meets not less than twice a year.

Composition of the SSB

- Dr. Sheikh Abdul Latif Al-Mahmood (chairman)
- Sheikh Nezam Yaqoubi (member)
- Dr. Sheikh Mohamed Elgari (member)

Key responsibilities of the SSB include the following:

a) Providing ABC Islamic with binding advice on all Shari'a related matters for products and services referred to it by ABC Islamic;

b) Giving an opinion on ABC Islamic's annual consolidated financial statements and operations from a Shari'a compliance perspective in the form of an annual report to the shareholders;

c) Preventing or minimising income that is impermissible from a Shari'a perspective and ensuring that such amounts (if received) are disbursed to charities;

d) Overseeing payments made by ABC Islamic of zakat and prohibited income; and

e) Performing documentation and transactional review to ensure compliance with the relevant Shari'a Standards issued by AAOIFI and pronouncements issued by the SSB.

The compensation for members of the SSB consists of the following elements:

(a) attendance fees payable to SSB members for attending SSB meetings;

(b) reimbursement to cover travelling and/or accommodation expenses while attending SSB meetings; and

(c) an annual fee, payable irrespective of the number of meetings held during the year or the financial results of the Group.

Shari'a Compliance

Shari'a compliance risk is an operational risk facing Islamic banks which may lead to non-recognition of income, reputational loss and resulting franchise risk on grounds of non-Shari'a compliance. To manage such risks, the Shari'a Compliance Officer of the Group has been tasked to conduct regular Shari'a compliance reviews to ensure that documentation, procedures and execution of transactions are in accordance with the Shari'a Standards issued by AAOIFI and Shari'a rules and principles as determined by the SSB. The results of such reviews are regularly reported to the SSB. Cases of Shari'a non-compliance (if any) are thoroughly investigated to establish their causes and to introduce adequate controls to avoid their recurrence in the future.

Shari'a non-compliant earnings during 2013 amounted to $2,909. This amount mainly represents penalty fees received from customers for making late payments ($3,042 in 2012). Such amounts are kept in a special suspense account and are disposed of to charitable causes.

Corporate Governance (continued)

SOCIAL RESPONSIBILITY

The Group discharges its social responsibility by making a voluntary payment of zakat to organisations selected by the Group and approved by the SSB. Also, prohibited income amounts earned by the Group are paid to such charitable foundations selected by the Group and approved by the SSB. The beneficiaries of zakat and prohibited income amounts are charitable foundations or Quran teaching centres within the Kingdom of Bahrain and are licensed by the relevant governmental authority.

INTERNAL CONTROLS

The Board of Directors is responsible for establishing and reviewing ABC Islamic's system of internal control. The Board receives minutes and reports from the Board Risk Committee and the Audit Committee, identifying any significant issues relating to the adequacy of the Group's risk management policies and procedures, as well as reports and recommendations from the Nominations, Compensation and Corporate Governance Committee. The Board then decides what action to take.

Management informs the Board regularly about how ABC Islamic is performing versus budget, identifying major business issues and examining the impact of the external business and economic environment.

Day-to-day responsibility for internal control rests with management. The key elements of the process for identifying, evaluating and managing the significant risks faced by ABC Islamic 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 to monitor the effectiveness of internal control procedures in controlling them and reporting on them.
- A robust compliance function including, but not limited to, regulatory compliance and anti-money laundering and combating the financing of terrorism policies.
- An internal audit function, exercised through the group audit function of the ABC Group, which reports to the Audit Committee on the effectiveness of key internal controls in relation to the major risks faced by ABC Islamic, and conducts reviews of the efficacy of management oversight in regard to delegated responsibilities, as part of its regular audits of ABC Group departments and business units.
- A comprehensive planning and budgeting process that delivers detailed annual financial forecasts and targets for Board of Directors approval.
- A Risk Management function exercised internally and through the group risk management function of the ABC Group, comprising overarching Head Office risk management committees and a dedicated risk management support group.

MANAGEMENT STRUCTURE

The Managing Director, supported by management, is responsible for managing the day-to-day operations of ABC Islamic. The heads of ABC Islamic's major functions report directly to the Managing Director. There is a clear segregation of duties.

No senior manager or employee owned or traded ABC Islamic shares during 2013.

Management compensation

Senior management and staff receive compensation based on a number of fixed elements, covering salary, allowances and benefits, as well as variable, performance-related elements.

The performance-related element of the compensation of senior management and staff is based on a Variable Compensation Scheme (the **"VCS"**). The VCS provides for an employee's (including a member of senior management) annual bonus to be determined in accordance with a formula, which takes into account the performance of ABC Islamic, that employee's grade and his/her individual performance (as assessed by the Performance Appraisal

Management (**"PAM"**) process). PAM provides for specific goals to be set at the commencement of each performance year, and then performance against these goals is assessed. At the end of each performance year, such performance is attributed a score. This score directly feeds into the VCS calculation. Compensation payable under the VCS is discretionary in nature.

Senior management's[13] remuneration in 2013 amounted to $2.821 million ($2.827 million in 2012).

COMPLIANCE

ABC Islamic is committed to complying with all applicable rules and regulations across all of its businesses and geographies. The Compliance function provides independent compliance oversight on behalf of the Board of Directors and senior management. So that the function can carry out its work freely and objectively, the ABC Islamic Compliance Officer, who is responsible for ensuring adherence to the applicable CBB rules and regulations, reports directly to senior management and the Audit Committee, with access to the Board of Directors when needed. Copies of reports of the ABC Islamic Compliance Officer are also provided periodically to the ABC Group Compliance Officer. Additionally, the ABC Islamic Compliance Officer has the right to contact the CBB, or any other local regulator where ABC Islamic operates.

ABC Islamic has published written guidelines to staff on policies and procedures for the appropriate implementation of laws, regulations, rules and standards (including in relation to conflicts of interest). This includes the Code of Conduct (see Appendix A) and Compliance Policy, which are approved by the Board of Directors and updated on a regular basis. ABC Islamic's Compliance Policy requires all officers and staff to comply with both the letter and the spirit of all relevant laws, rules, regulations and standards of good market practice.

ABC Islamic is committed to complying with laws and regulations relating to Anti-Money Laundering (**"AML"**), combating the financing of terrorism (**"CFT"**), know your customer and international sanctions, as well as the relevant recommendations of the Basel Committee and Financial Action Task Force.

ABC Islamic has appointed a Money Laundering Reporting Officer (**"MLRO"**). In accordance with the AML Manual, the MLRO maintains appropriate and effective systems, controls and records to ensure compliance with the applicable AML, CFT and sanctions regulations, as well as those of the CBB.

The MLRO develops and maintains ABC Islamic's AML strategy and policies, as well as overseeing staff AML training. Additionally, the MLRO reports critical money laundering issues to senior management, the Audit Committee and the Board of Directors, as appropriate. ABC Islamic also appointed a Deputy Money Laundering Reporting Officer to assist the MLRO in performing his duties and deputise for him in his absence.

The Compliance function has implemented strict policies to ensure adherence to all international applicable sanctions. In accordance with the sanctions policies, a Sanctions Committee has been formed at the ABC Group level, which is entrusted with the task of providing on-going oversight to the ever-changing sanctions landscape and of interpreting the sanctions policies.

ABC Islamic has a whistle-blowing policy that gives staff a formal channel for reporting any unethical conduct or corporate wrong-doing by staff members. Staff members are encouraged to report their concerns by ordinary mail, phone or email, without fear of reprisal, retaliation or victimisation. Reportable disclosures may include legal or regulatory wrong-doing, fraud or any other malpractice.

ABC Islamic has recently instituted documented policies and procedures for effective handling of customer complaints and designated a senior officer for this purpose. The contact details of the Complaints Officer are published on ABC Islamic's corporate website.

ABC Islamic is an Islamic wholesale bank and does not offer mediation or investment advices to its customer. Also, providing investor / consumer awareness programmes for information on new products and services is not particularly pertinent to its client base.

[13] *For this purpose, senior management includes the Managing Director and his direct management reports.*

Risk Management

Including Basel II - Pillar 3 disclosures

1 INTRODUCTION

ABC Islamic Bank and its subsidiary (the Group), being an integral part of Arab Banking Corporation Group (ABC), complies with the Central Bank of Bahrain (CBB) reporting requirements, within the Basel II risk management framework.

This report describes ABC's risk management framework, makes the disclosures required by the CBB and profiles the risk-weighted assets.

However, the credit risk exposures detailed here differ from the credit risk exposures reported in the consolidated financial statements, due to different methodologies applied respectively under Basel II and AAOIFI. These differences are as follows:

- Under the Basel II framework, for credit-related contingent items, the nominal value is converted to an exposure through the application of a credit conversion factor (CCF). The CCF is at 20%, 50% or 100% depending on the type of contingent item, and is used to convert off-statement of financial position notional amounts into an equivalent statement of financial position exposure. In the consolidated financial statements, the nominal values of credit-related contingent items are considered off-statement of financial position.

- Under this risk management section, the credit exposures are classified as per the 'Standard Portfolio' approach set out in the CBB's Basel II capital adequacy framework covering the 'Standardised Approach' for credit risk. In the case of guaranteed exposures, the exposures would normally be reported based on the guarantor. However, in the consolidated financial statements the assets are presented based on asset class (i.e Islamic financing facilities, securities, etc.).

- Eligible collateral is taken into consideration in arriving at the net exposure under the Basel II framework, whereas collateral is not netted in the consolidated financial statements.

- Equity investments are considered at cost under the Basel II framework, whereas they are considered at fair value in the consolidated financial statements.

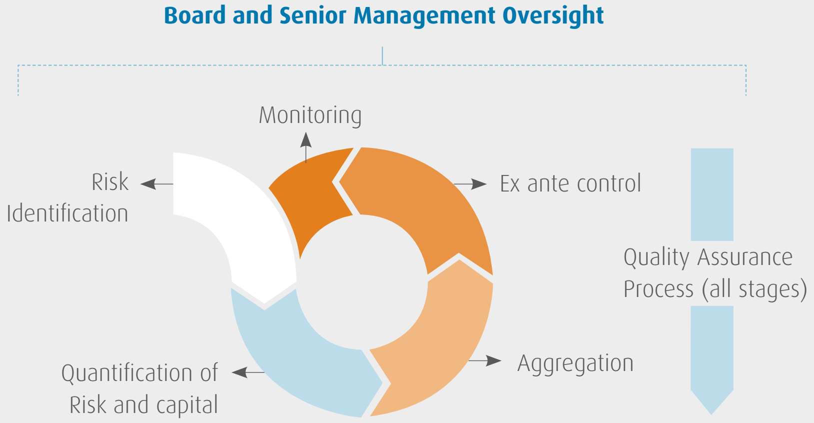
- Under the Basel II framework, certain items are considered as a part of the regulatory capital base, whereas these items are netted off against assets in the consolidated financial statements.

2 RISK MANAGEMENT FRAMEWORK

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

Over the last few years, ABC has invested heavily into developing a comprehensive and robust risk management infrastructure. This includes risk identification processes under credit, market and operational risk spectrums, risk measurement models and rating systems, as well as a strong business process to monitor and control these risks. Figure 1 outlines the various congruous stages of the risk process.

Figure 1:



Risk Management (continued)

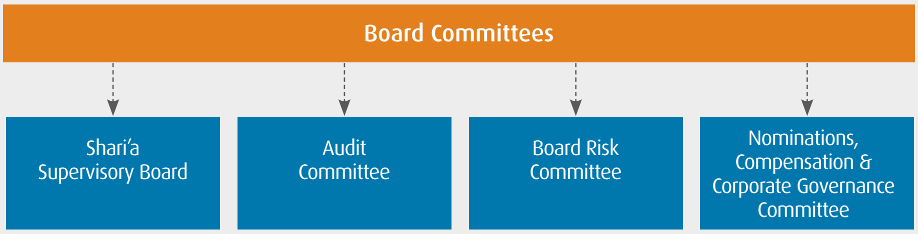
ABC's Executive Management is responsible for implementing the risk strategy / appetite and policy guidelines set by the Board Risk Committee [BRC], including the identification and evaluation on a continuous basis of all significant risks to the business and the design and implementation of appropriate internal controls to minimise them. This is done through the BRC, senior management committees and the Credit & Risk Group of the Head Office, as follows:

Figure 2: Risk Management Structure

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

At the second level, 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 ABC limits, dealing with impaired assets and general credit policy matters.

In addition to being part of the above structure, through the outsourcing of the support functions including the credit approval, the Group has the following risk management structure:



ABC's Asset and Liability Committee (ALCO) is responsible for defining long-term strategic plans and policy, as well as short-term tactical initiatives for prudently directing asset and liability allocation. ALCO monitors ABC's liquidity and market risks, and the risk profile, in the context of economic developments and market fluctuations.

ABC's Operational Risk Management Committee (ORCO) is responsible for defining long-term strategic plans and short-term tactical initiatives for the identification, prudent management, control and measurement of ABC's exposure to operational risk and other non-financial risks. ORCO frames policy and oversees the operational risk function.

The Credit & Risk Group (CRG) is responsible 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. Additionally, it identifies market and operational risks arising from ABC's activities, recommending to the relevant central committees appropriate policies and procedures for managing exposure.

Under the single obligor regulations of the CBB and other host regulators, the CRG and its local equivalents have to obtain approval for any planned exposures above specific thresholds to single counterparties, or groups of connected counterparties.

3 CREDIT RISK

ABC's portfolio and credit exposures are managed in accordance with the Group Credit Policy, which applies ABC Group-wide 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 are aligned with the Group Credit Policy, but may be adapted to suit local regulatory requirements as well as individual units' product and sectoral needs.

The first level of protection against undue credit risk is through ABC's counterparty, country, industry and other risk threshold limits, together with customer and customer group credit limits. The BRC and the HOCC sets these limits and allocates them between ABC and its banking subsidiaries. A tiered hierarchy of delegated approval authorities, based on the risk rating of the customer under ABC's internal credit rating system, controls credit exposure to individual customers or customer groups.

Credit limits are prudent, and ABC uses standard mitigation and credit control technologies.

ABC employs a Risk-Adjusted Return on Capital (RAROC) measure to evaluate risk/reward at the transaction approval stage. This is aggregated for each business segment and business unit, and for ABC as a whole. It is upgraded when appropriate.

Business unit account officers are responsible for day-to-day management of existing credit exposures, and for periodic review of the client and associated risks, within the framework developed and maintained by the CRG. ABC Group Audit, meanwhile, carries out separate risk asset reviews of business units, to provide an independent opinion on the quality of their credit exposures, and adherence to credit policies and procedures. These measures, collectively, constitute the main lines of defence against undue risk for ABC.

Credit exposures that have significantly deteriorated are segregated and supervised more actively by the CRG's Remedial Loans Unit (RLU). 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 losses, through a quarterly portfolio review and adequacy of provisioning exercise, which complies with IAS 39 reporting. (Collective impairment provision) is also maintained to cover unidentified possible future losses.

4 CAPITAL STRUCTURE

The Group's capital base comprises of (a) Tier 1 capital which includes share capital, reserves and retained earnings, and (b) Tier 2 capital which consists of the current year profit and unrealized gains arising from fair valuing equities.

The issued and paid-up share capital of the Bank was US$ 132.5 million at 31 December 2013, comprising of 1,325,000 shares of US$ 100 each.

The Group's capital base of US$ 248.1 million comprises Tier 1 capital of US$ 235.6 million and Tier 2 capital of US$ 12.5 million as detailed below:

Breakdown of capital base

US$ million	Tier 1	Tier 2	Total
Issued and fully paid ordinary shares	132.5	-	132.5
Legal / statutory reserves	16.1	-	16.1
Retained profit brought forward	87.0	-	87.0
Profit for the year	-	12.2	12.2
Unrealized gains arising from fair valuing equities	-	0.3	0.3
Capital base	**235.6**	**12.5**	**248.1**
Risk weighted assets [RWA]			
Credit risk			867.9
Market risk			-
Operational risk			31.7
			899.6
Tier 1 ratio			**26.2%**
Capital adequacy ratio			**27.6%**

5 CAPITAL ADEQUACY RATIOS [CAR]

The purpose of capital management at the Group is to ensure the efficient utilisation of capital in relation to business requirements and growth, risk profile and shareholders' returns and expectations.

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may issue capital / Tier 2 securities and / or adjust the amount of dividend payment to shareholders. No changes have been made in the objectives, policies and processes of the Group from the previous years.

The Group's total capital adequacy ratio as at 31 December 2013 was 27.6% compared with the minimum regulatory requirement of 12%. The Tier 1 ratio was 26.2% for the Group. The Group ensures adherence to the CBB's requirements by monitoring its capital adequacy against higher internal limits.

6 PROFILE OF RISK-WEIGHTED ASSETS AND CAPITAL CHARGE

The Group has adopted the standardised approach for credit, market and operational risks for regulatory reporting purposes. The Group's risk-weighted capital requirements for credit, market and operational risks are given below:

6.1 Credit risk

i) Definition of exposure classes per Standard Portfolio
The Group has a diversified funded and unfunded credit portfolio. The exposures are classified as per the Standard Portfolio approach mentioned under the CBB's Basel II capital adequacy framework covering the standardised approach for credit risk.

The descriptions of the counterparty classes along with the risk weights to be used to derive the risk-weighted assets are as follows:

a. Claims on sovereigns
These pertain to exposures to governments and their central banks. Claims on Bahrain and GCC sovereigns are risk weighted at 0%. Claims on all other sovereigns are given a risk weighting of 0% where such claims are denominated and funded in the relevant domestic currency of that sovereign. Claims on sovereigns, other than the aforementioned, are risk-weighted based on their credit ratings.

b. Claims on public sector entities [PSEs]
Listed Bahrain PSEs are assigned 0% risk weight. Other sovereign PSEs, in the relevant domestic currency and for which the local regulator has assigned risk weight as 0%, are assigned 0% risk weight by the CBB. PSEs other than the aforementioned are risk-weighted based on their credit ratings.

Risk Management (continued)

c. Claims on multilateral development banks [MDBs]
All MDBs are risk-weighted in accordance with their credit rating, except for banks part of the World Bank Group which is risk-weighted at 0%.

d. Claims on banks
Claims on banks are risk-weighted based on the ratings assigned to them by external rating agencies. However, short term claims on locally incorporated banks may be assigned a risk weighting of 20% where such claims on the banks are of an original maturity of three months or less and the claims are denominated and funded in either Bahraini Dinars or US Dollars.

Preferential risk weights that are one category more favourable than the standard risk weighting are assigned to claims on foreign banks licensed in Bahrain of an original maturity of three months or less denominated and funded in the relevant domestic currency. Such preferential risk weights for short-term claims on banks licensed in other jurisdictions are allowed only if the relevant supervisor also allows this preferential risk weighting to short-term claims on its banks.

No claim on an unrated bank would receive a risk weight lower than that applied to claims on its sovereign of incorporation.

e. Claims on corporates
Claims on corporates are risk-weighted based on credit ratings. Risk weights for unrated corporate claims are assigned at 100%.

f. Past due exposures
The unsecured portion of any facility (other than a qualifying residential mortgage facility) that is past due for more than 90 days, net of specific provisions (including partial write-offs), is risk-weighted as follows:

- 150% risk weight when specific provisions are less than 20% of the outstanding amount of the facility.

- 100% risk weight when specific provisions are greater than 20% of the outstanding amount of the facility.

g. Equity portfolios
Investments in listed equities are risk-weighted at 100% while unlisted equities are risk weighted at 150%.

h. Project finance exposures
Exposures on project finance are risk-weighted according to the Regulatory Slotting Criteria, in which the risk weighting ranges between 70% and 250%.

i. Other exposures
These are risk-weighted at 100%.

ii) Credit exposure and risk-weighted assets

US$ Thousands	Gross credit exposure	Funded exposure	Un-funded exposure	Risk-weighted assets for Funded exposure	Risk-weighted assets for Un-funded exposure	Total Risk-weighted assets	Capital charge (12%)
Sovereigns	101,228	101,228	-	43,323	-	43,323	5,199
Claims on banks	212,019	211,081	938	186,536	-	186,536	22,384
Claims on Corporates	516,661	460,413	56,248	432,973	56,248	489,221	58,706
Past due exposures	58,855	58,855	-	29,428	-	29,428	3,531
Project finance	169,070	169,070	-	118,349	-	118,349	14,202
Other	1,097	1,097	-	1,097	-	1,097	132
Total	**1,058,930**	**1,001,744**	**57,186**	**811,706**	**56,248**	**867,954**	**104,154**

Since the year end position is representative of the risk positions of the Group during the year, average gross exposures are not disclosed separately.

Breakdown of capital requirements for credit risk per type of Islamic financing contract is as follows:

US$ Thousands Type of Financing	Gross credit exposure	Funded exposure	Un-funded exposure	Risk-weighted assets for Funded exposure	Risk-weighted assets for Un-funded exposure	Total Risk-weighted assets	Capital charge (12%)
Murabaha	654,150	617,961	36,189	574,088	36,189	610,277	73,233
Ijara	296,967	296,967	-	195,047	-	195,047	23,406
Ijara Rec	747	747	-	617	-	617	74
Sukuk	74,255	74,255	-	34,461	-	34,461	4,135
Equity	2,127	2,127	-	2,127	-	2,127	255
LC	20,997	-	20,997	-	20,059	20,059	2,407
Other	9,687	9,687	-	5,366	-	5,366	644
Total	**1,058,930**	**1,001,744**	**57,186**	**811,706**	**56,248**	**867,954**	**104,154**

6.2 Market risk

The Group, with assistance from ABC, minimizes its market risk through:

(i) match-funding its assets to reduce its profit rate risk;
(ii) not taking commodity price risk by squaring position on transaction by transaction basis;
(iii) funding exposures in the same currency and, hence, avoiding any foreign exchange currency risk; and
(iv) maintaining no sukuk trading position.

Accordingly, the Group maintains no capital charge for market risk.

6.3 Operational risk

In accordance with the standardised methodology, the total capital charge in respect of operational risk was US$ 31.7 million. This capital charge was computed by categorising the Group's activities into two business lines (out of the eight business lines defined by the Basel II framework) and multiplying the business line's three-year average gross income by a pre-defined beta factor.

Indicators of operational risk exposures:

Gross income *US$ thousands*	18,068
Amount of non-Shari'a compliant income *US$ thousands*	3
Number of Shari'a violations	Nil

7 RISK MANAGEMENT

7.1 Large exposures

As at 31 December 2013, the Group's three largest exposures in excess of 15% of the capital base are shown below:

US$ Thousands	On Balance Sheet Exposure	Off Balance Sheet Exposure	Total Exposure
Counterparty [A]	60,298	-	60,298
Counterparty [B]	57,196	-	57,196
Counterparty [C]	17,797	32,857	50,654

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

In order to avoid excessive concentrations of risk, the ABC Group policies and procedures include specific guidelines to focus on country and counterparty limits and maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Single name concentrations are monitored on an individual basis. ABC's internal economic capital methodology for credit risk addresses concentration risk through the application of single-name concentration add-on. Under the CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's approval for any planned exposure to a single counterparty, or group of connected counterparties exceeding 15 percent of the regulatory capital base. This restriction applies only at the consolidated level of the ABC Group and, hence, the Bank has several exposures that exceed 15% of its capital base. However, none of these exposures exceed 15% of ABC's capital base.

Risk mitigation, collateral and other credit enhancements
The amount and type of collateral depends on an assessment of the credit risk of the counterparty. The types of collateral held by the Group mainly include cash, guarantees from banks and guarantees from ABC.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

Exposures by type of Islamic financing contract that are covered by guarantees or by eligible collaterals are as follows:

US$ thousands	Exposures	Guaranteed	Collateral	Net exposure
Funded Exposures (Murabaha)	58,855	58,855	3,782	55,073
Funded Exposures (Sukuk)	1,500	1,500	-	1,500
Unfunded Exposures (LC)	55,701	-	4,692	51,009

Risk Management (continued)

7.2 Geographical distribution of exposures

The Bank's nature of business, being an Islamic Bank, results in concentration of exposures in the Muslim world. Moreover, the Bank's approved concentration of activities, which is also in line with its role within the ABC Group, has large concentration in the GCC countries, as illustrated in the table below:

US$ Thousands Country / Region	Gross Exposure	Percentage of Exposure
Saudi Arabia	518,412	48.96%
Europe (Including Turkey)	219,019	20.68%
UAE	87,156	8.23%
Bahrain	62,404	5.89%
Kuwait	50,990	4.82%
Other Asia	35,653	3.37%
Qatar	34,749	3.28%
USA	25,125	2.37%
Oman	15,962	1.51%
Other MENA Countries	9,460	0.89%
Total	**1,058,930**	**100.00%**

The geographical distribution of gross credit exposures by major type of credit exposures can be analysed as follows:

US$ Thousands Type of Financing/Region	Bahrain	Saudi Arabia	Kuwait	Qatar	UAE	Oman	Other MENA countries	Other Asia	Europe (Including Turkey)	USA	Total
Sovereigns	53	-	-	-	50,182	-	-	35,653	15,340	-	101,228
Claims on banks	37,169	-	-	5,045	-	-	938	-	168,867	-	212,019
Claims on Corporates	20,016	371,960	3,309	15,943	36,974	-	8,522	-	34,812	25,125	516,661
Past due exposures	4,069	29,391	25,395	-	-	-	-	-	-	-	58,855
Project finance	-	117,061	22,286	13,761	-	15,962	-	-	-	-	169,070
Other	1,097	-	-	-	-	-	-	-	-	-	1,097
Total	**62,404**	**518,412**	**50,990**	**34,749**	**87,156**	**15,962**	**9,460**	**35,653**	**219,019**	**25,125**	**1,058,930**

7.3 Industrial sector analysis of the exposures

The industrial sector analysis of exposures is as follows:

US$ Thousands	Gross Exposure	Funded Exposure	Un-funded Exposure
Manufacturing	336,030	322,522	13,508
Financial Institutions	265,108	264,170	938
Trading	137,521	114,667	22,854
Government	101,228	101,228	-
Commercial real estate	100,285	96,828	3,457
Transportation	47,061	47,061	-
Construction	34,226	17,797	16,429
Tourism	20,361	20,361	-
Mining & Quarrying	16,013	16,013	-
Other	1,097	1,097	-
Total	**1,058,930**	**1,001,744**	**57,186**

The industrial sector analysis of gross credit exposures by major types of credit exposures can be analysed as follows:

US$ Thousands Type of Financing/ Industry	Financial Institutions	Commercial Real Estate	Manu-facturing	Cons-truction	Trading	Government	Trans-portation	Tourism	Mining & Quarrying	Other	Total
Sovereigns	-	-	-	-	-	101,228	-	-	-	-	101,228
Claims on banks	210,519	-	-	-	1,500	-	-	-	-	-	212,019
Claims on Corporates	25,125	100,285	182,973	34,226	106,630	-	47,061	20,361	-	-	516,661
Past due exposures	29,464	-	-	-	29,391	-	-	-	-	-	58,855
Project finance	-	-	153,057	-	-	-	-	-	16,013	-	169,070
Other	-	-	-	-	-	-	-	-	-	1,097	1,097
Total	**265,108**	**100,285**	**336,030**	**34,226**	**137,521**	**101,228**	**47,061**	**20,361**	**16,013**	**1,097**	**1,058,930**

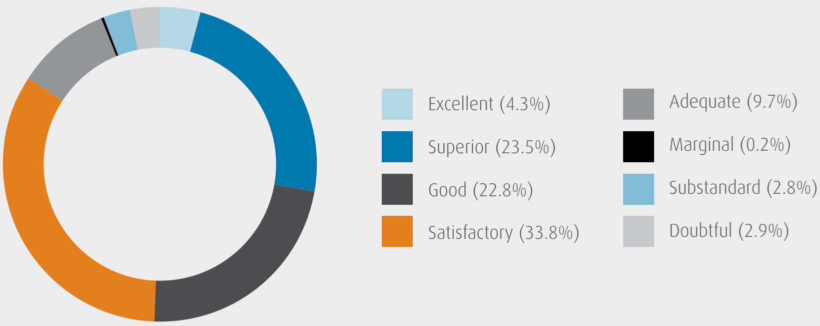
Risk Management (continued)

7.4 Exposure by external credit rating

The Group uses external ratings from Standard & Poor's, Moody's, Fitch Ratings and Capital Intelligence [accredited External Credit Assessment Institutions (ECAI's)]. The breakdown of the Group's exposure into rated and unrated categories is as follows:

US$ Thousands	Gross Credit Exposure	Rated Exposure	Unrated Exposure
Sovereigns	101,228	101,228	-
Claims on banks	212,019	209,581	2,438
Claims on Corporates	516,661	102,047	414,614
Past due exposures	58,855	-	58,855
Project finance	169,070	-	169,070
Other	1,097	-	1,097
Total	**1,058,930**	**412,856**	**646,074**

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio through its internal risk rating system. Risk ratings are supported by a variety of financial analytics, combined with processed market information, to provide the main inputs for the measurement of counterparty credit risk. All internal ratings are tailored to the various categories, are derived in accordance with ABC's credit policy, and are assessed and updated regularly. Each risk rating class is mapped to grades equivalent to Standard & Poor's, Moody's, Fitch Ratings and Capital Intelligence.



Percentages have been calculated internally based on the sum of funded counterparty exposure and unfunded exposures before applying credit conversion factors.

7.5 Maturity analysis of funded exposures

Residual contractual maturity analysis of the Group's major types of funded credit exposures are as follows:

US$ Thousands	within 1 month	1 - 3 months	3 - 6 months	6 - 12 months	Total within 12 months	1 – 5 years	5-10 years	Total over 12 months	Undated	Total
Sovereigns	13,680	4,015	17,892	12,748	48,335	52,840	-	52,840	53	101,228
Claims on banks	33,542	-	30,069	45,939	109,550	97,904	-	97,904	3,627	211,081
Claims on Corporates	97,951	48,549	68,874	78,288	293,662	154,991	11,760	166,751	-	460,413
Past due exposures	-	-	-	-	-	-	-	-	58,855	58,855
Project finance	1,063	-	7,777	8,670	17,510	81,316	70,244	151,560	-	169,070
Other	-	-	-	-	-	-	-	-	1,097	1,097
Total	**146,236**	**52,564**	**124,612**	**145,645**	**469,057**	**387,051**	**82,004**	**469,055**	**63,632**	**1,001,744**

Residual contractual maturity analysis of the Group's funded credit exposures per type of Islamic financing contract are as follows:

US$ Thousands	within 1 month	1 - 3 months	3 - 6 months	6 - 12 months	Total within 12 months	1 – 5 years	5-10 years	Total over 12 months	Undated	Total
Murabaha	133,028	46,244	107,377	66,903	353,552	205,554	-	205,554	58,855	617,961
Sukuk	-	-	-	45,486	45,486	27,269	-	27,269	1,500	74,255
Equity	-	-	-	-	-	-	-	-	2,127	2,127
Other	8,537	-	-	-	8,537	-	-	-	1,150	9,687
Ijara Rec	445	266	36	-	747	-	-	-	-	747
Ijara	4,226	6,054	17,199	33,256	60,735	154,228	82,004	236,232	-	296,967
Total	**146,236**	**52,564**	**124,612**	**145,645**	**469,057**	**387,051**	**82,004**	**469,055**	**63,632**	**1,001,744**

Risk Management (continued)

7.6 Maturity analysis of unfunded exposures

Residual contractual maturity analysis of the Group's major types of unfunded credit exposures are as follows:

US$ Thousands	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	1-5 years	Total over 12 months	Total
Claims on banks	-	-	-	938	938	-	-	938
Claims on Corporates	12,709	8,526	12,040	4,907	38,182	18,066	18,066	56,248
Total	**12,709**	**8,526**	**12,040**	**5,845**	**39,120**	**18,066**	**18,066**	**57,186**

Residual contractual maturity analysis of the Group's unfunded credit exposures per type of Islamic financing contract are as follows:

US$ Thousands	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	1-5 years	Total over 12 months	Total
Murabaha	-	6,479	11,403	241	18,123	18,066	18,066	36,189
LC	12,709	2,047	637	5,604	20,997	-	-	20,997
Total	**12,709**	**8,526**	**12,040**	**5,845**	**39,120**	**18,066**	**18,066**	**57,186**

Unfunded exposures include credit-related financial instruments, comprising of letters of credit, guarantees and commitments.

For credit-related contingent items, the nominal value is converted to an exposure through the application of a credit conversion factor [CCF]. The CCF is at 20%, 50% or 100% depending on the type of contingent item, and is used to convert off-Balance sheet notional amounts into an equivalent on-Balance sheet exposure.

Undrawn facilities and other commitments represent commitments that have not been drawn down or utilised at the reporting date. The nominal amount provides the calculation base to which a CCF is applied for calculating the exposure. CCF ranges between 20% and 50% for commitments with original maturity of up to one year and over one year respectively and 0% CCF is applicable for commitments which can be unconditionally cancelled at any time.

The table below summarises the notional principal amounts and the relative exposures before applying credit risk mitigation:

US$ thousands	Notional Principal	Credit Exposure*
Trade-related contingent items	22,844	4,569
Transaction-related contingent items	32,857	16,428
Undrawn facilities and other commitments	79,854	36,189
RWA for contingent items		**56,248**

** Credit exposure is after applying CCF.*

At 31 December 2013, the Group held cash collaterals in relation to credit-related contingent items amounting to US$ 4,692 thousand.

7.7 Penalties imposed on customers

Penalties imposed on customers during the year were US$ 3 thousand. This amount represents penalty fees received from customers for making late payments. Such amounts are disposed of to charitable causes.

7.8 Impairment of assets

Impairment and un-collectability of financial assets

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

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

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 profit rate;

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

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

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

Risk Management (continued)

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

Impairment against specific groups of financial assets
In addition to specific provisions against individually significant facilities 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 asset since it was granted. The amount of provision is based on the historical loss pattern for facilities within each grading and is adjusted to reflect current economic changes.

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

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

ABC has established risk management policies and limits within which exposure to market risk is monitored, measured and controlled by the Market Risk Management [MRM] with strategic oversight exercised by ABC's ALCO. MRM is responsible for developing and implementing market risk policy and risk measuring / monitoring methodology and for reviewing all new trading and investment products and product limits prior to ALCO approval. MRM's core responsibility is to measure, report, monitor and control market risk.

The Group classifies market risk into the following:

- **Non-trading market risk in securities**
  Non-trading market risk arises from market factors impacting securities that are held for long-term investment.

- **Asset and liability risk**
  Non-trading asset and liability risk exposures arise where the re-pricing characteristics of the Group's assets do not match with those of liabilities.

- **Liquidity Risk**
  Liquidity risk is the risk that maturing and encashable assets may not cover cash flow obligations (liabilities). In this respect, the Group is supported by ABC, through the provision of a line of credit to cover any shortfall in liquidity. Accordingly, the Group's liquidity needs are taken into consideration in ABC's liquidity management.

As there is no specific measure that reflects all aspects of market risk, ABC analyses risk using various risk measures, reporting results to senior management.

The measurement techniques used to measure and control market risk are:

- Value-at-Risk [VaR]
- Basis Point Value [BPV]
- Stress Testing / Scenario Analysis
- Non-Technical Risk Measures (e.g. nominal position values, stop loss vs. P&L, and concentration risk).

On an annual basis, ABC's BRC reviews and approves VaR trading limits, BPV trading and investment Limits, and Non-Technical Trading and Investment Limits.

It should be noted that the Bank applies BPV on the sukuk portfolio and the non-technical risk measures in its liquidity management at the Bank level. For the non-technical measures, notional limits are set for investment products, which are approved by the Board Risk Committee.

- **Currency risk**
  The Group is exposed to foreign exchange rate risk through its structural positions. In general, the Group uses matched currency funding to eliminate such a risk.

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

- **Commodity risk (price risk)**
  The Group would be exposed to commodity risk if it holds commodity for its Murabaha transactions. However, in order to minimise or eliminate this risk, the Group limits its holding of commodity to the day of the transaction and it settles its position for each specific transaction, hence eliminating overnight price risk in the commodities traded.

- **Profit Rate Risk in the Banking Book [PRRBB]**
  The Bank uses the BPV approach to control PRRBB. BPV measures changes in economic value resulting from changes in profit rates. In the BPV methodology, the modified duration approach and, for some products, the effective duration approach is used to measure the PRRBB. Modified duration is a good measure of linear risk for profit rate sensitive products.

  The BPV measure incorporates the entire rate sensitive segment of the statement of financial position for the Group and is classified into appropriate buckets. Non-maturity profit rate sensitive assets and liabilities are bucketed in the short term. Equity is excluded from these computations.

As at 31 December 2013, an immediate shift by 200 basis points in profit rates would potentially impact the Group's economic value by US$ 1,452 thousand.

At the year end, the Group was exposed to profit rate risk on its financial assets and financial liabilities. The following table indicates the profit rates during the year expressed as a percentage of the principal outstanding.

US$ thousands	%
Investments	1.42 – 4.95
Murabaha receivables	0.15 – 4.77
Ijara	0.85 – 6.10
Murabaha payables	0.46 – 2.29

Risk Management (continued)

7.10 Equity position risk

Equity position risk arises from the possibility that changes in the price of equities or equity indices will affect future profitability or the fair values of financial instruments. As of the reporting date, the Bank had an equity position amounting to US$ 2,127 thousand.

7.11 Business risk

Business risk represents the earnings volatility inherent in all business activities due to the uncertainty of revenues and costs associated with changes in the economic and competitive environment. Business risk is evaluated through a Business and Strategy Development Process. A Risk Budget is developed at the start of each year along with a Business Plan. Subsequently, the actual quarterly performance is compared with budget, including the historical volatility in earnings, and the detailed financial budget, which supports both the decision making and the planning process.

7.12 Liquidity risk

The Group's principal sources of liquidity are deposits placed with the subsidiary funds raised through commodity Murabahas. However, for any shortfall in liquidity, the Bank relies on ABC; hence, the Group's liquidity needs are taken into consideration in ABC's liquidity management process. 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. ABC is generally in a position of excess liquidity, its principal sources of liquidity being its deposit base, liquidity derived from its operations and inter-bank borrowings. The Minimum Liquidity Guideline [MLG] is used to manage and monitor daily liquidity. The MLG represents the minimum number of days ABC can survive the combined outflow of all deposits and contractual draw-downs under market value driven encashability scenarios.

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

The following table summarises the liquidity ratios as at 31 December 2013:

Liquid assets ratio	8.9%
Short-term assets to short-term liabilities	62.9%

7.13 Operational risk

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

ABC intends to make operational risk transparent throughout the enterprise, to which end processes are being developed to provide for regular reporting of relevant operational risk management information to business management, senior management, the Operational Risk Committee of ABC, the BRC of ABC and the Board of Directors.

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

7.14 Legal risk

Inadequate documentation, legal and regulatory incapacity, insufficient authority of a counterparty and contract invalidity or unenforceability are all examples of legal risk. Identification and management of this risk are the responsibilities of the Head Office Legal & Compliance Department [LCD] and are carried out through consultation with internal and external legal counsels, together with close monitoring of the litigation cases involving the Group, as well as ABC.

8. CAPITAL MANAGEMENT

Internal Capital Adequacy Assessment Process [ICAAP]

The Group's capital management aims to maintain an optimum level of capital to enable it to pursue strategies that build long-term shareholder value, whilst always meeting minimum regulatory ratio requirements. The diagram below illustrates this concept:

The key principles driving capital management at the Group include:

- Adequate capital is maintained as buffer for unexpected losses to protect stakeholders, i.e. shareholders and depositors; and
- Maximise return on capital and generate sustainable returns above the cost of capital.

The Group seeks to achieve the following goals by implementing an effective capital management framework:

- Effective internal capital adequacy;
- Meet the regulatory capital adequacy ratios and have a prudent buffer;
- Generate sufficient capital to support overall business strategy; and
- Integrate capital allocation decisions with strategic and financial planning process.

Risk Management (continued)

In addition, to prepare itself for compliance with the Foundation Internal Ratings-Based [FIRB] requirements, the Group has developed an ICAAP framework. The purpose of the ICAAP framework is to document the Group's structured process for the ongoing assessment of the Group's overall capital adequacy in relation to the Group's risk profile and a strategy for capital management as set out in Principle 1 of Basel II Pillar II.

This framework outlines the Group's risk strategy, capital objectives, methodology used to measure internal capital, the related assumptions underpinning the methodologies and a set of processes for capital management such as reviewing, monitoring and controlling capital usage and allocation, including:

- In January 2008, the CBB issued ICAAP guidelines for capital management. Within this framework the risk strategy as approved by the Board is incorporated, underscoring Board and senior management responsibility and oversight. The risk strategy document outlines the Group's risk appetite, capital adequacy goals and risk targets.

- The Group has an integrated approach to risk strategy and business strategy which analyses current and future capital requirements in relation to strategic objectives as part of the annual business planning process. The Business Plan is used in estimating the economic capital projections. In addition, throughout the year, as part of the process, actual usage is monitored against the projections.

- Comprehensive assessment of economic capital, i.e. credit, market and operational risks, and processes relating to other risks such as liquidity, profit rate risk in the banking book, strategic and reputational risks.

- The process in place for monitoring, reporting and internal audit review.

The methodologies for internally estimating capital for the Group's key risks are as follows:

a. **Credit Risk:** Assessed on the basis of FIRB Risk Weights (as set out in the table under Annexure 3 of the Basel II Accord – Illustrative IRB Risk Weights) for Unexpected Loss [UL]. This supports the internal estimation of Economic Capital per Business Segment and Business Unit, and aggregated at the Group level.
b. **Market Risk:** Computed for the banking book using the Internal Model approach.
c. **Operational Risk:** Applied on the Standardised Approach basis.

Other risks such as **Liquidity, Strategic and Reputational risks** are currently captured providing a capital buffer.

The results of the ICAAP process are subject to stress testing to take account of the breakdown of the underlying assumptions. Specific stress tests have been developed to focus on the key risks the Group faces based on its risk exposure, portfolio and strategic objectives.

The output of the ICAAP gives senior management and the Board an improved view of the risks the Group faces and the impact of these risks.

ABC has implemented an advanced Economic Capital Management System, which is now being implemented at the Bank. This tool will allow, at all levels of granularity, estimation of Economic Capital, RAROC, Sharpe Ratios, Risk Contributions, and effects of component accounts and counterparties for the effects of diversification benefits and concentration risks. This system will also allow an advanced capability for estimating economic capital under stress scenarios.

Supervisory Review and Evaluation Process [SERP]
The CBB is the lead regulator for the Group and sets and monitors capital requirements on both a consolidated and solo basis. 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. However, under the SERP guidelines, the CBB would also make an individual risk profile assessment of all banks and, instead of applying a standard minimum capital adequacy requirement, the supervisor may allow a lower capital adequacy ratio in excess of 8% for a bank with sound risk management capabilities. The CBB initiated this assessment process in the first quarter of 2008. The Group's capital management strategy is to currently maintain a buffer over the 12% minimum regulatory capital requirement while enhancing its risk management and risk control infrastructure. This would ultimately allow the Group to achieve a successful assessment and pursue possible lower capital requirements from the CBB. At the same time, senior management strongly believes in the economic value of capital and is committed to maximise intrinsic value for all stakeholders.

9 OTHER DISCLOSURES

9.1 Related party transactions
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 senior management and are at arm's length basis.

a. Exposures to related parties

US$ thousands	
Claims on shareholders	**73,076**
Claims on Directors and senior management	**782**
Claims on staff	**96**

b. Liabilities to related parties

US$ thousands	
Connected deposits	**596,439**

c.Income and expenses arising from dealing with related parties

US$ thousands	
Income from Murabaha receivables	**135**
Profit on Murabaha payables	**5,060**
Fees paid to ABC (B.S.C)	**618**
Charges by ABC (B.S.C)	**700**

9.2 Ageing analysis of non-performing / impaired Islamic financing and securities

In accordance with the guidelines issued by the CBB, credit facilities are placed on non-accrual status and profit suspended when either principal or profit is overdue by 90 days, whereupon profit credited to income is reversed. Following an assessment of impairment, specific provision is established if there is objective evidence that a credit facility is impaired.

An ageing analysis of all non-performing Islamic financing facilities on non-accrual basis, together with their related provisions, is as follows:

Islamic financing

US$ thousands	Principal*	Provisions	Net book value
Over 3 years	58,855	-	58,855
Total	**58,855**	**-**	**58,855**

** Carrying values of US$ 58,855 thousand have been guaranteed by ABC. All past due financing facilities are from GCC countries.*

Securities
The Group has specific impairment provisions of US$ 13,131 thousand on its securities portfolio, all of the securities are from GCC countries.

9.3 Restructured assets
As of 31 December 2013, financial assets whose terms were renegotiated during the year were US$ 25,395 thousands.

9.4 Assets sold under recourse agreements
The Group has not entered into any recourse agreement during the year ended 31 December 2013.

9.5 Movement in specific and collective impairment provisions

US$ thousands	Specific provision for securities
As at 1 January 2013	17,551
Provision written off	4,420
As at 31 December 2013	**13,131**

9.6 Industry sector analysis of the specific impairment provisions charges
Impairment of US$ 4,631 thousand is in the financial institution sector and US$ 8,500 thousand in the trading sector.

9.7 Equity positions in the banking book
As at 31 December 2013, the equity position of the Group amounted to US$ 2,127 thousand, all of which is quoted.

Independent Auditors' Report

to the shareholder of ABC Islamic Bank (E.C.)

Ernst & Young
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C.R. No. 6700

We have audited the accompanying consolidated statement of financial position of ABC Islamic Bank (E.C.) [the Bank] and its subsidiary [the Group] as of 31 December 2013, and the related consolidated statements of income, cash flows, changes in owner's equity, and sources and uses of Zakah and charity funds for the year then ended. These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a Rules and Principles are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by the Accounting and Auditing Organisation for Islamic Financial Institutions [AAOIFI]. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statements presentation. We believe that our audit provides a reasonable basis for our 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 2013, the results of its consolidated operations, its consolidated cash flows, consolidated changes in owner's equity, and consolidated sources and uses of Zakah and charity funds for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

OTHER MATTERS

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 2), we report that:

a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; and

b) the financial information contained in the Report of the Board of Directors is consistent with the consolidated financial statements.

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6) and CBB directives, or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2013 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position; and satisfactory explanations and information have been provided to us by management in response to all our requests. The Bank has also complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

Ernst & Young

23 February 2014
Manama, Kingdom of Bahrain

Consolidated Statement of Financial Position

31 December 2013

	Note	2013 US$ '000	2012 US$ '000
ASSETS			
Cash and bank balances	3	**8,537**	5,634
Investments	4	**75,569**	171,006
Murabaha receivables	5	**617,961**	590,095
Ijarah receivables		**747**	928
Mudaraba		**-**	889
Ijarah	6	**296,967**	291,423
Equipment		**23**	40
Other assets	7	**1,940**	6,738
TOTAL ASSETS		**1,001,744**	1,066,753
LIABILITIES AND OWNERS' EQUITY			
Liabilities			
Other liabilities	8	**8,509**	7,810
Murabaha payables	9	**744,801**	822,955
		753,310	830,765
Owners' Equity	10		
Share capital		**132,500**	132,500
Reserves		**115,934**	103,488
		248,434	235,988
TOTAL LIABILITIES AND OWNERS' EQUITY		**1,001,744**	1,066,753

Dr. Khaled S. Kawan
Chairman

Naveed Khan
Managing Director

The attached notes 1 to 21 form part of these consolidated financial statements.

Consolidated Statement of Income

Year Ended 31 December 2013

	Note	2013 US$ '000	2012 US$ '000
OPERATING INCOME			
Income from investments		**2,424**	5,579
Income from Murabaha receivables		**11,897**	9,374
Ijarah income – net	6	**5,836**	6,949
		20,157	21,902
Profit on Murabaha payables		**(6,661)**	(8,951)
		13,496	12,951
Fees and commission income	12	**4,572**	3,068
Total operating income		**18,068**	16,019
OPERATING EXPENSES			
Staff costs		**4,036**	4,883
Depreciation		**24**	131
Other expenses	13	**1,475**	1,924
Total operating expenses		**5,535**	6,938
Provision for impaired assets - net	4	**-**	500
PROFIT FOR THE YEAR BEFORE ZAKAH		**12,533**	8,581
Zakah		**(316)**	(304)
PROFIT FOR THE YEAR		**12,217**	8,277

Dr. Khaled S. Kawan
Chairman

Naveed Khan
Managing Director

The attached notes 1 to 21 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

Year Ended 31 December 2013

	Note	2013 US$ '000	2012 US$ '000
OPERATING ACTIVITIES			
Profit for the year		12,217	8,277
Adjustments for:			
Depreciation		24	131
Provision for impaired assets - net	4	-	500
		12,241	8,908
Changes in:			
Murabaha receivables		(27,866)	(154,858)
Ijarah receivables		181	(221)
Mudaraba		889	(40)
Ijarah		(5,544)	36,279
Other assets		4,798	(4,914)
Other liabilities		699	1,615
Murabaha payables		(78,154)	22,077
Net cash used in operating activities		(92,756)	(91,154)
INVESTING ACTIVITIES			
Purchase of investments		(15,075)	-
Proceeds from sale/redemption of investments		110,741	91,775
Purchase of equipment		(7)	(4)
Net cash from investing activities		95,659	91,771
NET CHANGE IN CASH AND CASH EQUIVALENTS		2,903	617
Cash and cash equivalents at 1 January		5,634	5,017
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	3	8,537	5,634

The attached notes 1 to 21 form part of these consolidated financial statements.

Consolidated Statement of Changes in Owners' Equity

Year Ended 31 December 2013

	Share capital US$ '000	Reserves: Statutory reserve US$ '000	Reserves: Investments fair value reserve US$ '000	Reserves: Retained earnings US$ '000	Reserves: Total reserves US$ '000	Total Owners' equity US$ '000
At 1 January 2013	132,500	14,860	354	88,274	103,488	235,988
Cumulative changes in fair value	-	-	229	-	229	229
Profit for the year	-	-	-	12,217	12,217	12,217
Transfer to statutory reserve (note 10)	-	1,222	-	(1,222)	-	-
At 31 December 2013	**132,500**	**16,082**	**583**	**99,269**	**115,934**	**248,434**
At 1 January 2012	132,500	14,032	389	80,825	95,246	227,746
Cumulative changes in fair value	-	-	(35)	-	(35)	(35)
Profit for the year	-	-	-	8,277	8,277	8,277
Transfer to statutory reserve (note 10)	-	828	-	(828)	-	-
At 31 December 2012	132,500	14,860	354	88,274	103,488	235,988

The attached notes 1 to 21 form part of these consolidated financial statements.

Consolidated Statement of Sources and Uses of Zakah and Charity Funds

Year Ended 31 December 2013

	2013 US$ '000	2012 US$ '000
SOURCES OF ZAKAH AND CHARITY FUNDS		
Balance at 1 January	**416**	409
Charity	**3**	3
Zakah due from the Bank (*)	**316**	304
Total sources of Zakah and charity funds	**735**	716
Uses of Zakah and charity funds		
Zakah and charity paid to the poor and needy	**(304)**	(300)
Undistributed Zakah and charity funds at end of the year (note 8)	**431**	416

* *Zakah is calculated on the Zakah base of the Group according to Financial Accounting Standard 9 issued by the Accounting and Auditing Organization for Islamic Financial Institutions using the net invested funds method and amounts to US$ 6,403 thousand (2012: US$ 6,082 thousand) of which US$ 316 thousand (2012: US$ 304 thousand) is payable by the Bank.*

The attached notes 1 to 21 form part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

31 December 2013

1 INCORPORATION AND ACTIVITIES

ABC Islamic Bank (E.C.) [the Bank] is an exempt joint stock company incorporated in the Kingdom of Bahrain on 10 December 1985 and registered with the Ministry of Industry and Commerce under commercial registration number 16864. The Bank and its subsidiary [the Group] operate under an Islamic wholesale banking license issued by the Central Bank of Bahrain [the CBB] and are engaged in financial trading in accordance with the teachings of Islam (Shari'a). The postal address of the Bank's registered office is PO Box 2808, Manama, Kingdom of Bahrain. As of 31 December 2013, total number of employees employed by the Bank was 13 (2012: 13).

Arab Banking Corporation (B.S.C.) [ABC (B.S.C.)], which operates under a wholesale banking license issued by the CBB, holds 100% of the share capital of the Bank.

The Bank's Shari'a Supervisory Board is entrusted with the responsibility to ensure the Group's adherence to Shari'a rules and principles in its transactions and activities.

The ownership in the subsidiary of the Bank as at 31 December 2013 is as follows:

Name	Nature of Business	Date of incorporation	Country of incorporation	Amount and % of holding
ABC Clearing Company	Islamic Investment Company	30 November 1993	Cayman Islands	US$ 2,000 100% management shares

The Bank operates only in the Kingdom of Bahrain and does not have any branches.

The consolidated financial statements have been authorised for issue by the Board of Directors on 23 February 2014.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance and basis of preparation

The consolidated financial statements have been prepared in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions [AAOIFI], the Islamic Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Group, and the applicable provisions of the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law and the CBB Rule Book (volume 2) and applicable provisions of volume 6 and the CBB directives. In accordance with the requirements of AAOIFI, for matters for which no AAOIFI standards exist, the Group uses International Financial Reporting Standards [IFRS] issued by the International Accounting Standards Board [IASB].

Accounting convention

The consolidated financial statements are prepared under the historical cost convention as modified for measurement at fair value of "equity type instruments carried at fair value through equity".

The consolidated financial statements have been presented in United States Dollars [US$], being the functional currency of the Group. All values are rounded to the nearest thousand (US$ '000) unless otherwise stated.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and its subsidiary as at 31 December each year. A subsidiary is an entity over which the Bank has power to control which is other than fiduciary in nature. The financial information of the subsidiary is prepared using accounting policies consistent with the Bank.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. Control is achieved where the Group has the power, directly or indirectly, to govern the financial and operating policies of the entity so as to obtain benefits from its activities. The results of subsidiaries acquired or disposed off during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal as appropriate.

All intra-group balances, transactions, income and expenses and profits and losses resulting from inter-group transactions are eliminated in full.

Non-controlling interests, if any, represents the portion of net income and net assets not held, directly or indirectly by the Group and are presented separately in the consolidated statement of income and within owners' equity in the consolidated statement of financial position, separately from parent shareholders' equity.

Summary of significant accounting policies
Following is a summary of significant accounting policies adopted in preparing the consolidated financial statements. These accounting policies are consistent with those used in the previous year.

Investments
These are classified as either carried at amortised cost, fair value through the statement of income or fair value through equity.

Initial measurement
All investments shall be recognised on the acquisition date and shall be recognised initially at their fair value plus transaction costs.

Debt type instrument carried at amortised cost
Investments which have fixed or determinable payments and where the Group has both the intention and the ability to hold till maturity are classified as debt type instruments carried at amortised cost. After initial measurement, such investments are carried at amortised cost, less provision for impairment in value,if any. Amortised cost is calculated by taking into account any premium or discount on acquisition. Any gain or loss on such type of instruments is recognised in the consolidated statement of income, when the type instruments de-recognised or impaired.

Equity type instrument carried at fair value through equity
Subsequent to acquisition, equity type instruments are remeasured at fair value, with unrealised gains and losses recognised in 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 recorded in equity is recognised in the consolidated statement of income.

Murabaha receivables
Murabaha receivables are stated net of deferred profits and provisions for credit losses. Murabaha receivables are sales on deferred terms. The Bank arranges a Murabaha transaction by buying a commodity (which represents the object of the Murabaha) and then resells this commodity to the Murabeh (beneficiary) after computing a margin of profit over cost. The sale price (cost plus the profit margin) is repaid in instalments by the Murabeh over the agreed period.

Ijarah receivables
Ijarah receivables is the outstanding rentals at the end of each year less any provision for doubtful receivables.

Mudaraba
Mudaraba are partnerships in which the Bank contributes capital. These are stated at the fair value of consideration given less provision for impairment, if any.

Equipment and Ijarah
These are initially recorded at cost. Ijarah comprises of plant and equipment.

Depreciation is provided on a straight-line basis on all equipment over its expected useful life.

Depreciation is provided on assets under Ijarah, at rates calculated to write-off the cost of the asset over lease term.

The estimated useful lives of assets for calculation of depreciation are as follows:

Ijarah assets	1-10 years
Equipment	3-5 years

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Murabaha payables
Murabaha payables are carried at cost plus accrued profit less amounts repaid.

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

Determination of fair values
For investments traded in organised financial markets, fair value is determined by reference to stock exchange quoted market bid prices at the close of business on the date of the statement of financial position.

For investments where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument with similar terms and characteristics, or is based on an assessment of the value of future cash flows or based on net asset value.

For Murabaha receivables, future cash flows are determined by the Group at current profit rates for financing contracts with similar terms and risk characteristics.

Revenue recognition

Income from Murabaha receivables
Income is recognised by proportionately allocating the attributable profits over the period of the credit, whereby each financial period carries its portion of profits, irrespective of when cash is received. Income related to accounts that are overdue 90 days or more, is excluded from the consolidated statement of income.

Income from Mudaraba
Income on Mudaraba is recognised when the right to receive payments is established or on distribution. Income related to accounts that are overdue 90 days or more, is excluded from the consolidated statement of income.

Ijarah income
Income net of depreciation is recognised on a time-apportioned basis over the lease term. Income that is overdue 90 days or more is excluded from income until it is received in cash.

Fees and commission income
Fees and commission income is recognised when earned.

Profit on Murabaha payables
Profit on Murabaha payables is accrued on the basis of terms and conditions of the individual contracts.

Foreign currencies
Foreign currency transactions are recorded in US dollars at the spot rate of exchange prevailing at the value dates of the transactions. Monetary assets and liabilities in foreign currency are retranslated into US dollars at the rates of exchange prevailing at the date of the consolidated statement of financial position. Any gains or losses are taken to consolidated statement of income.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the date of the initial transaction.

Translation gains or losses on non-monetary items carried at fair value are included in owners' equity as part of the fair value adjustments on fair value through equity investments.

Offsetting
Financial assets and financial liabilities are only offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

Derecognition of financial assets and financial liabilities

Financial assets
A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the right to receive cash flows from the asset have expired; or

- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to third party under a 'pass-through' arrangement; and

- either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the assets, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset.

Financial liabilities
A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

Zakah
Zakah is calculated on the Zakah base of the Group according to Financial Accounting Standard 9 issued by the Accounting and Auditing Organization for Islamic Financial Institutions using the net invested funds method.

Cash and cash equivalents
Cash and cash equivalents as referred to in the consolidated statement of cash flows comprise cash and bank balances with original maturities of 90 days or less.

Trade 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.

Employees' end of service benefits
The Group provides for end of service benefits to all its employees. Entitlement to these benefits is usually based upon the employees' length of service and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment. Bahraini employees are also covered by the Social Insurance Organisation and the Group's obligations are limited to the amounts contributed to the scheme, which is expensed when due.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Significant accounting judgments and estimates
The preparation of the consolidated financial statements requires management to exercise judgment and make estimates that affect the amounts reported in the consolidated financial statements. The most significant use of judgments and estimates are as follows:

Fair value of unquoted investments
Where the fair value of the Group's investment portfolio cannot be derived from an active market, they are determined using a variety of valuation techniques. These techniques rely on market observable data where possible. Judgment by management is required to establish fair values through the use of appropriate valuation models. Judgments include consideration of comparable assets or value of future cash flows.

Nonetheless, the actual amount that is realised in a future transaction may differ from the current estimate of fair value and may still be outside management estimates given the inherent uncertainty surrounding valuation of unquoted investments.

Impairment
The Group assesses at each statement of financial position date whether there is objective evidence that a specific asset or a group of assets may be impaired. An asset or a group of assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred "loss event") and that loss event(s) has an impact on the estimated future cash flows of the asset or group of the assets that can be reliably estimated.

The Group treats fair value through equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgment.

The Group assesses at each reporting date, or more frequently if events or changes in circumstances indicate whether the carrying value of investments in Ijarah may be impaired. If any such indication exists, the Group makes an estimate of the recoverable amount of each asset in the portfolio individually. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and an impairment loss is recognised in the consolidated statement of income.

3 CASH AND BANK BALANCES

	2013 US$ '000	2012 US$ '000
Balance with ABC (B.S.C.)	**7,721**	5,305
Cash and balance with other bank	**816**	329
	8,537	5,634

4 INVESTMENTS

2013	Amortised cost US$ '000	Fair value through equity US$ '000	Total US$ '000
Debt type			
Quoted investments			
Sukuk	**81,942**	**-**	**81,942**
Equity type			
Quoted investments			
Equity shares	**-**	**6,758**	**6,758**
	81,942	**6,758**	**88,700**
Allowance for impairment - net	**(8,500)**	**(4,631)**	**(13,131)**
At 31 December 2013	**73,442**	**2,127**	**75,569**

2012	Amortised cost US$ '000	Fair value through equity US$ '000	Total US$ '000
Debt type			
Quoted investments			
Sukuk	182,028	-	182,028
Equity type			
Quoted investments			
Equity shares	-	6,529	6,529
	182,028	6,529	188,557
Allowance for impairment - net	(12,920)	(4,631)	(17,551)
At 31 December 2012	169,108	1,898	171,006

The fair value of the Sukuk carried at amortised cost as at 31 December 2013 is US$ 74,752 thousand (31 December 2012: US$ 171,534 thousand).

Fair value gain that would have been recognised in the consolidated statement of changes in owners' equity for the year ended 31 December 2013 had the investments not been reclassified on adoption of FAS 25 amounts to US$ 1,310 thousand (31 December 2012: fair value gain of US$ 2,426 thousand).

The movement in allowance for impairment is as follows:

	2013 US$ '000	2012 US$ '000
At 1 January	**17,551**	17,092
Impairment provision during the year	**-**	500
Write-off	**(4,406)**	-
Foreign exchange translation adjustment	**(14)**	(41)
At 31 December	**13,131**	17,551

Total investments determined to be individually impaired amount to US$ 16,174 thousand (2012: US$ 22,068 thousand). These include investments amounting to US$ 1,500 thousand (2012: US$ 2,973) whose carrying values have been guaranteed by ABC (B.S.C.).

5 MURABAHA RECEIVABLES

	2013 US$ '000	2012 US$ '000
International Commodity Murabaha	**5,000**	12,318
Murabaha receivables	**615,471**	579,546
Deferred profits	**(2,510)**	(1,769)
	617,961	590,095

The Group considers the promise made by the purchase orderer in the Murabaha contract as obligatory.

Murabaha receivables, which are non-performing and whose carrying values is been guaranteed by ABC (B.S.C.) as of 31 December 2013, amount to US$ 58,855 thousand (2012: US$ 93,525 thousand). The Group also holds tangible collateral, the fair value of such collateral at 31 December 2013 amounts to US$ 3,782 thousand (2012: US$ 2,297 thousand).

6 IJARAH

In Ijarah Muntahia Bittamleek, the legal title of the leased asset passes to the lessee at the end of the Ijarah term provided that all Ijarah instalments are settled and the lessee purchases the asset.

Ijarah Muntahia Bittamleek	2013 US$ '000	2012 US$ '000
Cost:		
At 1 January	**404,448**	406,948
Transfers from other Ijarah	**-**	17,500
Additions during the year	**50,000**	30,000
Disposals during the year	**(7,036)**	(50,000)
At 31 December	**447,412**	404,448
Depreciation:		
At 1 January	**113,025**	96,746
Provided during the year	**39,972**	38,154
Relating to disposals during the year	**(2,552)**	(21,875)
At 31 December	**150,445**	113,025
Net book value:		
At 31 December	**296,967**	291,423

Details of Ijarah income are as follows:

	2013 US$ '000	2012 US$ '000
Ijarah income – gross	**45,808**	45,103
Depreciation provided during the year	**(39,972)**	(38,154)
Ijarah income – net	**5,836**	6,949

There are no impaired Ijarahs as at 31 December 2013 (2012: nil).

7 OTHER ASSETS

	2013 US$ '000	2012 US$ '000
Accrued income receivable	**813**	782
Reserve with the Central Bank of Bahrain	**53**	53
Others	**1,074**	5,903
	1,940	6,738

8 OTHER LIABILITIES

	2013 US$ '000	2012 US$ '000
Zakah and charity funds payable	**431**	416
Staff related accruals	**2,875**	3,398
Unearned income	**4,431**	2,839
Accrued charges	**772**	1,157
	8,509	7,810

9 MURABAHA PAYABLES

	2013 US$ '000	2012 US$ '000
Customers' accounts	**47,839**	52,330
Banks and other financial institutions	**133,614**	92,582
ABC (B.S.C.)	**563,348**	678,043
	744,801	822,955

10 OWNERS' EQUITY

(i) Share capital

	2013 US$ '000	2012 US$ '000
Authorised - 2,000,000 shares of US$ 100 each (2012: 2,000,000 shares of US$ 100 each)	**200,000**	200,000
Issued, subscribed and fully paid - 1,325,000 shares of US$ 100 each (2012: 1,325,000 shares of US$ 100 each)	**132,500**	132,500

10 OWNERS' EQUITY (continued)

(ii) Statutory reserve

In accordance with the requirements of the Bahrain Commercial Companies Law, 10% of the profit for the year has been transferred to statutory reserve. The Group may resolve to discontinue such annual transfers when the reserve total 50% of the paid up share capital. The reserve is not distributable but can be utilised as security for the purpose of a distribution in such circumstances as stipulated in the Bahrain Commercial Companies Law and with the prior approval of the CBB.

11 MEMORANDUM ITEMS

Credit-related financial instruments

These include commitments to enter into financing contracts, which are designed to meet the requirements of the Group's customers.

Commitments to extend financing represents contractual commitments under Murabaha receivables. Commitments generally have fixed expiration dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

Letters of credit, guarantees and acceptances commit the Group to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

The Group has the following contingent liabilities and commitments on behalf of customers:

	2013 US$ '000	2012 US$ '000
Letters of credit	**24,633**	16,463
Guarantees	**31,068**	34,699
Irrevocable commitments *	**79,854**	87,192
	135,555	138,354

* *Irrevocable commitments expiring in one year or less amount to US$ 43,718 thousand (2012: US$ 83,628 thousand).*

12 FEE AND COMMISSION INCOME

	2013 US$ '000	2012 US$ '000
Fee and commission income	**5,230**	3,850
Fee and commission expense	**(658)**	(782)
	4,572	3,068

13 OTHER EXPENSES

	2013 US$ '000	2012 US$ '000
Charges by ABC (B.S.C.)	**700**	700
Business related expenses	**153**	183
Professional fees and licenses	**143**	572
Other operating expenses	**479**	469
	1,475	1,924

14 TOTAL COMPREHENSIVE INCOME

	2013 US$ '000	2012 US$ '000
Profit for the year	**12,217**	8,277
Other comprehensive income		
Net fair value movements during the year after impairment effect	**229**	(35)
Total other comprehensive income for the year	**229**	(35)
Total comprehensive income for the year	**12,446**	8,242

15 SEGMENTAL INFORMATION

The activities of the Group are performed on an integrated basis. Therefore, any segmentation of operating income, expenses, assets and liabilities is not relevant. As such, operating income, expenses, assets and liabilities are not segmented.

The Group has physical operations and offices solely in the Kingdom of Bahrain and, as such, no geographical segment information is presented.

16 RELATED PARTY TRANSACTIONS

The Group enters into transactions with related parties in the ordinary course of business at commercial rates. All the financing contracts with the related parties are performing and are free of any provision for credit losses.

Balances with the related parties included in the consolidated statement of financial position are as follows:

	2013 US$ '000	2012 US$ '000
Balance with ABC (B.S.C.)	**7,721**	5,305
Murabaha receivables	**5,000**	12,318
Murabaha payables	**596,439**	710,668

Income and expenses arising from dealings with related parties included in the consolidated statement of income are as follows:

	2013 US$ '000	2012 US$ '000
Income from Murabaha receivables	**135**	64
Profit on Murabaha payables	**5,060**	7,699
Fees paid to ABC (B.S.C.)	**618**	762
Charges by ABC (B.S.C.)	**700**	700
Shari'a Supervisory Board	**99**	96

16 RELATED PARTY TRANSACTIONS (continued)

Compensation of key management personnel is as follows:

	2013 US$ '000	2012 US$ '000
Short term employee benefits	**2,351**	2,502
Post employment benefits	**470**	325

Key management personnel are those who possess significant decision making and direction setting responsibilities at different grades within the Group.

17 RISK MANAGEMENT

Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to credit risk, liquidity risk, market risk and operational risk.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Group's strategic planning process.

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.

Risk management structure

Executive Management is responsible for implementing the Group's Risk Strategy/Appetite and Policy guidelines set by the Board Risk Committee (BRC), including the identification and evaluation on a continuous basis of all significant risks to the business and the design and implementation of appropriate internal controls to minimise them. This is done with the involvement of a Risk Manager and through the following board committees:

a) The Audit Committee, which is responsible to the Board for ensuring the integrity and effectiveness of the Group's system of financial, accounting and risk management controls and practices and for monitoring compliance with the requirements of the regulatory authorities in the various countries in which the Group operates. The Committee is also responsible for recommending the appointment, compensation and oversight of the external auditors and the appointment of internal audit function.

b) The Board Risk Committee, which is responsible for the review and approval of the Group's credit and risk policies. The Committee reviews and makes recommendations to the Board regarding the risk strategy/appetite, within which business strategy, objectives and targets are formulated. The Committee 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 following committees of ABC (B.S.C.) assist the Group with its risk management:

The BRC is responsible for the continual review and approval of the ABC (B.S.C.)'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 ABC (B.S.C.) 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 Risk Policies and Strategy.

The Head Office Credit Committee (HOCC) is responsible for credit decisions, setting country and other high level 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 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.

Shari'a compliance risk is an operational risk facing Islamic banks which can lead to non-recognition of income, reputational loss and resulting franchise risk on grounds of non-Shari'a compliance. To manage such risks, the Shari'a Compliance Officer of the Group has been tasked to conduct regular Shari'a compliance reviews to ensure that documentation, procedures and execution of transactions are in accordance with the Shari'a Standards issued by the AAOIFI and Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank [the SSB]. The results of such reviews are being regularly reported to the SSB. Cases of non-Shari'a compliance are thoroughly investigated to establish causes of occurrence and to introduce adequate controls to avoid their recurrence in the future.

The Group's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Group also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Group. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept, with additional emphasis on selected industries. In addition, the Group monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

For all levels throughout the Group, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continuously assessing the creditworthiness of counterparties. In addition to monitoring credit limits, the Group manages the credit exposure by entering into collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposure. In certain cases the Group may also close out transactions or assign them to other counterparties to mitigate credit risk.

The first level of protection against undue credit risk is through ABC (B.S.C.)'s 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 subsidiaries of ABC (B.S.C.) Credit exposure to individual customers or customer groups is then controlled through a tiered hierarchy of delegated approval authorities based on the risk rating of the customer under the Group's internal credit rating system. Where unsecured facilities sought are considered to be beyond prudential limits, Group policies require collateral to mitigate the credit risk in the form of cash, securities, legal charges over the customer's assets or third-party guarantees. The Group also employs threshold 'risk adjusted return on capital' as a measure to evaluate the risk/reward relationship at the transaction approval stage.

Type of credit risk

Various contracts entered into by the Group mainly comprise Murabaha receivables and Ijarah.

Murabaha receivables

The Group finances Murabaha transactions through buying a commodity which represent the object of the Murabaha and then resells this commodity to the Murabeh (beneficiary) after computing a margin of profit over cost. The sale price (cost plus the profit margin) is repaid in instalments by the Murabeh over the agreed period. The Murabeh pays a down payment of the sale price upon signing the Murabaha contract.

17 RISK MANAGEMENT (continued)

Ijarah Muntahia Bittamleek
The legal title of the leased asset under Ijarah Muntahia Bittamleek passes to the lessee at the end of the Ijarah term, provided that all Ijarah instalments are settled and the lessee purchases the asset.

Maximum exposure to credit risk without taking account of any collateral and other credit enhancements
The table below shows the maximum exposure to credit risk for the components of the statement of financial position, including credit related commitments. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Gross maximum exposure 2013 US$ '000	Gross maximum exposure 2012 US$ '000
Cash and bank balances	**8,537**	5,634
Investments	**75,569**	171,006
Murabaha receivables	**617,961**	590,095
Ijarah receivables	**747**	928
Mudaraba	**-**	889
Ijarah	**296,967**	291,423
Other assets	**813**	782
Total	**1,000,594**	1,060,757
Letters of credit and guarantees	**55,701**	51,162
Irrevocable commitments to provide trading facilities	**79,854**	87,192
Total	**135,555**	138,354

Credit risk concentration
Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location. The Group seeks to manage its credit risk exposure through diversification of financing and investment activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses.

Notes to the Consolidated Financial Statements

31 December 2013

The Group's assets, liabilities, owners' equity and memorandum items can be analysed by the following geographical regions:

	2013			2012		
	Assets US$ '000	**Liabilities and owners' equity US$ '000**	**Memorandum items US$ '000**	Assets US$ '000	Liabilities and owners' Equity US$ '000	Memorandum items US$ '000
North America	**25,000**	**2,497**	**-**	124,979	2,497	-
Western Europe	**34,811**	**10,032**	**-**	36,576	10,018	-
Other Europe (including Turkey)	**183,868**	**5,013**	**-**	128,475	13	-
Arab World:						
- Middle East	**722,412**	**940,828**	**135,555**	761,559	1,021,304	138,354
- North Africa	**-**	**32,970**	**-**	-	32,789	-
Asia:						
- Japan	**-**	**-**	**-**	15,164	-	-
- Far East	**-**	**10,352**	**-**	-	6	-
- Other	**35,653**	**52**	**-**	-	126	-
	1,001,744	**1,001,744**	**135,555**	1,066,753	1,066,753	138,354

An industry sector analysis of the Group's assets, liabilities, owners' equity and memorandum items is as follows:

	2013			2012		
	Assets US$ '000	**Liabilities and owners' equity US$ '000**	**Memorandum items US$ '000**	Assets US$ '000	Liabilities and owners' Equity US$ '000	Memorandum items US$ '000
Manufacturing	**322,229**	**1,653**	**28,927**	354,433	717	46,552
Mining & quarrying	**16,012**	**-**	**-**	16,800	-	-
Construction	**17,788**	**-**	**32,857**	19,801	-	37,500
Trading	**114,668**	**830**	**62,165**	61,366	1,277	51,796
Banks and financial institutions	**264,057**	**729,562**	**4,692**	378,753	811,993	2,506
Government	**100,653**	**-**	**-**	31,896	-	-
Personal	**-**	**-**	**-**	-	15	-
Commercial real estate	**96,646**	**4,239**	**6,914**	158,382	-	-
Transportation	**46,970**	**4,344**	**-**	17,174	2,497	-
Tourism	**20,000**	**-**	**-**	20,143	-	-
Other	**2,721**	**261,116**	**-**	8,005	250,254	-
	1,001,744	**1,001,744**	**135,555**	1,066,753	1,066,753	138,354

17 RISK MANAGEMENT (continued)

The credit quality of financial assets is managed by the Group using internal credit ratings. These internal credit ratings range from 1 to 11 for each individual borrower. They are defined as follows:

High grade: These borrowers are rated between 1 and 3 and are of high credit quality, most with strong external credit ratings and considered as low risk.

Standard grade: These borrowers are rated between 4 and 8 and are of good to marginal credit quality, often with lower external credit ratings than high grade and considered as higher risk.

Substandard grade: These borrowers are rated between 9 and 10 and full repayment is questionable.

Past due or individually impaired: These borrowers are rated 11 and are expected to be total loss.

The table below shows the credit quality by class of financial asset, based on the Group's credit rating system.

	Neither past due nor impaired			
	High grade (1-3) 2013 US$ '000	Standard grade (4-8) 2013 US$ '000	Past due or individually impaired 2013 US$ '000	2013 Total US$ '000
Cash and bank balances	-	8,537	-	8,537
Investments	49,992	21,950	3,627	75,569
Murabaha receivables	71,765	487,341	58,855	617,961
Ijarah receivables	69	678	-	747
Ijarah	164,538	132,429	-	296,967
Other credit exposures	539	274	-	813
	286,903	651,209	62,482	1,000,594

	Neither past due nor impaired			
	High grade (1-3) 2012 US$ '000	Standard grade (4-8) 2012 US$ '000	Past due or individually impaired 2012 US$ '000	2012 Total US$ '000
Cash and bank balances	-	5,634	-	5,634
Investments	49,992	118,041	2,973	171,006
Murabaha receivables	144,171	352,399	93,525	590,095
Ijarah receivables	257	671	-	928
Mudaraba	-	889	-	889
Ijarah	185,520	105,903	-	291,423
Other credit exposures	542	240	-	782
	380,482	583,777	96,498	1,060,757

Financial assets whose terms have been renegotiated
As of 31 December 2013, financial assets whose terms were renegotiated during the year were US$ 25,395 thousand (2012: US$ Nil).

Collateral and other credit enhancements
The amount and type of collateral depends on an assessment of the credit risk of the counterparty. The types of collateral mainly includes cash, charges over real estate properties, inventory and trade receivables.

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

Market risk
The Group uses ABC (B.S.C.)'s established risk management policies and limits within which exposure to market risk is monitored. These are measured and controlled by the Risk Management Department (RMD) with strategic oversight exercised by Asset and Liability Committee (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 ABC (B.S.C.)'s subsidiaries.

Profit rate risk
Profit rate risk arises from the possibility that changes in profit rates will affect the future profitability or the fair values of the financial instruments. The Group is exposed to profit rate risk as a result of mismatches or gaps in the amounts of assets and liabilities that mature in a given period.

At the year end, the Group was exposed to profit rate risk on its financial assets and financial liabilities. The following table indicates the profit rates during the year expressed as a percentage of the principal outstanding.

	2013 **%**	2012 %
Investments	**1.42 - 4.95**	1.16 - 4.95
Murabaha receivables	**0.15 - 4.77**	0.40 - 4.63
Ijarah	**0.85 - 6.10**	0.96 - 6.19
Murabaha payables	**0.46 - 2.29**	0.46 - 2.29

For every 25 basis points increase/decrease in profit rate, the Group profit would increase/decrease by US$ 181 thousand (2012: US$ 157 thousand).

Currency risk
The Group's transactions are carried out substantially in US Dollars, and as such currency risk is minimal.

17 RISK MANAGEMENT (continued)

Liquidity risk

Liquidity risk is the risk that an institution will be unable to meet its net funding requirements. Liquidity risk can be caused by market disruptions or credit downgrades which may cause certain sources of funding to cease immediately. To guard against this risk, management has diversified funding sources and assets are managed with liquidity in mind.

The table below summarises the maturity profile of the Group's assets and liabilities. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period at the statement of financial position date to the contractual maturity date and do not take account of the effective maturities as indicated by the Group's deposit retention history.

The maturity profile of assets, liabilities, and owners' equity is as follows:

31 December 2013	Up to 1 month US$ '000	1 to 3 months US$ '000	3 to 6 months US$ '000	6 months to 1 year US$ '000	1 to 3 years US$ '000	Over 3 years US$ '000	No fixed maturity US$ '000	Total US$ '000
ASSETS								
Cash and bank balances	8,537	-	-	-	-	-	-	8,537
Investments	-	-	-	44,992	11,875	15,075	3,627	75,569
Murabaha receivables	126,479	46,118	114,054	66,902	161,033	44,520	58,855	617,961
Ijarah receivables	445	266	36	-	-	-	-	747
Ijarah	4,226	6,054	17,199	33,256	92,946	143,286	-	296,967
Equipment	-	-	-	-	-	-	23	23
Other assets	-	-	-	-	-	-	1,940	1,940
Total assets	139,687	52,438	131,289	145,150	265,854	202,881	64,445	1,001,744
LIABILITIES AND OWNERS' EQUITY								
Other liabilities	-	-	-	-	-	-	8,509	8,509
Murabaha payables	387,764	240,163	112,961	3,913	-	-	-	744,801
Owners' equity	-	-	-	-	-	-	248,434	248,434
Total liabilities and owners' equity	387,764	240,163	112,961	3,913	-	-	256,943	1,001,744
Net liquidity gap	(248,077)	(187,725)	18,328	141,237	265,854	202,881	(192,498)	
Cumulative liquidity gap	(248,077)	(435,802)	(417,474)	(276,237)	(10,383)	192,498	-	

31 December 2012	Up to 1 month US$ '000	1 to 3 months US$ '000	3 to 6 months US$ '000	6 months to 1 year US$ '000	1 to 3 years US$ '000	Over 3 years US$ '000	No fixed maturity US$ '000	Total US$ '000
ASSETS								
Cash and bank balances	5,634	-	-	-	-	-	-	5,634
Investments	-	31,896	74,872	-	49,992	9,375	4,871	171,006
Murabaha receivables	107,032	132,998	161,326	22,903	38,126	34,185	93,525	590,095
Ijarah receivables	763	101	64	-	-	-	-	928
Mudaraba	-	-	-	-	889	-	-	889
Ijarah	4,547	2,835	12,479	31,590	29,114	210,858	-	291,423
Equipment	-	-	-	-	-	-	40	40
Other assets	5,000	-	-	-	-	-	1,738	6,738
Total assets	122,976	167,830	248,741	54,493	118,121	254,418	100,174	1,066,753
LIABILITIES AND OWNERS' EQUITY								
Other liabilities	-	-	-	-	-	-	7,810	7,810
Murabaha payables	393,515	352,251	77,189	-	-	-	-	822,955
Owners' equity	-	-	-	-	-	-	235,988	235,988
Total liabilities and owners' equity	393,515	352,251	77,189	-	-	-	243,798	1,066,753
Net liquidity gap	(270,539)	(184,421)	171,552	54,493	118,121	254,418	(143,624)	
Cumulative liquidity gap	(270,539)	(454,960)	(283,408)	(228,915)	(110,794)	143,624	-	

18 FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair values of financial assets and financial liabilities are not materially different from their carrying values as stated in the consolidated statement of financial position.

19 SHARI'A SUPERVISORY BOARD

The Group's Shari'a Supervisory Board consists of three Islamic Scholars who review the Group's compliance with general Shari'a principles and specific Fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Group to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

20 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

Earnings realised during the year from transactions that were not permitted by Shari'a amounted to US$ 3 thousand (2012: US$ 3 thousand). This amount has been taken to the charity fund.

21 SOCIAL RESPONSIBILITY

The Group discharges its social responsibility by paying out Zakah and charity to organisations approved by Shari'a Supervisory Board.

Appendix

ABC Islamic Bank Code of Conduct

1 LEGAL COMPLIANCE

In every country where it operates, the Group will abide by the laws and regulations of that country. In situations where the law does not give guidance, the Group applies its own standards based on its corporate values and culture. In the event of conflict between mandatory law and the principles contained in the Code of Conduct, the law shall prevail.

2 INTEGRITY

We must all display high standards of professional integrity in our work. Integrity implies being completely worthy of the trust placed in us by our customers and employers. This is achieved by being honest and impartial, which means:-

- Adhering to the Islamic Shari'a principles, (as guided by the relevant industry Standards issued by the Accounting & Auditing Organisation For Islamic Financial Institutions and the Sharia Supervisory Board of the Group), implementing its principles and observing its requirements when conducting business.
- Acting at all times in an honest way in our business dealings or personal life so that no action of ours would, or would be likely to, bring the Bank into disrepute.
- Complying fully with the laws and regulations of all countries in which we do business.
- Refraining from illegal, fraudulent or unethical behaviour, particularly in relation to financial and/or business dealings, and also with respect to laws and regulations that affect us personally e.g. personal tax regulations.
- Not knowingly engaging in any actions outside or inside the Bank which might in any way be associated with, or regarded as supportive of, illegal or criminal activities.
- Maintaining Bank information and systems so that all transactions are recorded in an accurate and prompt fashion and not falsifying records or obscuring, omitting or misrepresenting facts in records or communications.
- Setting a good example in personal financial management and avoiding practices which could make us vulnerable to financial difficulties or which could lead to malpractice.
- Promoting equal opportunity in the Bank and treating colleagues, clients and other counterparties in a manner that does not discriminate with regard to gender, race, religion, age, disability, nationality, social or ethnic origin

3 CONFIDENTIALITY

The Group owes a strict duty of confidentiality to its customers.
You must keep customers' financial, business and personal affairs secret from any third party, unless:-

- The customer has given prior written consent to disclosure.
- Disclosure is compelled by a court or statutory authority of competent jurisdiction (an order of a foreign court or body will not normally be sufficient by itself).
- Disclosure is compelled by law.

You must keep information relating to the business and systems of the Group completely confidential.

You must be careful of what, and to whom, you say, write or communicate electronically and you must safeguard information relating to the Group's affairs, restricting access to any confidential or sensitive documents which should be carefully secured at the Bank.

This duty of confidentiality exists not only during your employment in the Bank but also at all times after you have left its employment.

All contracts of employment are accepted by employees in writing and incorporate a pledge of confidentiality on all business matters pertaining to the Group and its customers.

4 CONFLICT OF INTEREST

Employees will conduct their private and external activities and financial interests in a manner which does not conflict with the interests of the Group. All employees must avoid conflict between self-interest and the interest of the Group or its customers and should disclose any potentially compromising or conflicting business relationships or shareholdings.

Except as may otherwise be permitted under your Employment Contract with the Bank or with ABC (as the case may be), you should not have an interest or concern in any other business enterprise or activity.

You should decline secondary employment or offers of consultancies or directorships or partnerships except as may be provided for by your Employment Contract or expressly approved in writing by the Managing Director of the Bank (the "Managing Director") and the Head of Human Resources & Administration at ABC ("Human Resources & Admin.").

You should not act as an attorney, trustee, executor or administrator (except for an immediate relative) without prior permission of the Managing Director and the Head of Human Resources & Admin.

A conflict of interest may arise between a business unit and its customer or between customers or prospective customers. In this instance, the major consideration is to ensure the fair treatment of customers concerned. Guidance will be necessary from the Managing Director and the Group Compliance Officer.

When the Managing Director himself has to seek approval or guidance, this will be from his immediate superior.

5 INFORMATION SECURITY

Information and its supporting systems are critical business assets and, as such, must be protected by suitable controls. The ABC Information Security Policy specifies the requirements and sets the general direction for the ABC Group's information security and is supported with detailed guidelines and procedures. All employees of the Bank are required to carefully read and understand the ABC Information Security Policy (copy published on ABC's intranet page) upon joining the Bank.

The particular points of security of internet and electronic mail are brought to your attention:

- Internet and e-mails are to be used mainly for business purposes
- Reasonable, occasional personal use of the internet and e-mails is allowed
- Great care must be taken when downloading information and files from the internet to safeguard against malicious code and inappropriate material
- The attachment of data files to an e-mail is only permitted after confirming the classification of the information being sent and having scanned and verified the file for the possibility of a virus
- Unsolicited e-mail is to be treated with caution
- Ensure that information you are forwarding by e-mail is correctly addressed and only being sent to appropriate persons
- Incoming e-mail must be treated with the utmost care due to its inherent Information Security risks
- Data retention periods for e-mail must be established to meet legal and business requirements and must be adhered to by all staff

Any communications by employees via e-mail or voice mail that may constitute verbal abuse, slander, or defamation or may be considered offensive, harassing, vulgar, obscene, or threatening is prohibited. Offensive content would include, but not be limited to, sexual comments or images, racial slurs, gender-specific comments, or any comments that would offend someone on the basis of his or her age, race, sex, color, religion, national origin, handicap or disability. The communication, dissemination, or printing of any copyrighted materials in violation of copyright laws is also prohibited. Additionally, downloading, distributing, or sending pornographic or obscene materials is prohibited.

6 POLITICAL INVOLVEMENT

The Group maintains neutrality with regard to political parties and candidates and neither the names nor the assets of the ABC Group will be used to promote the interests of political parties or candidates.

7 GIFTS

You may not solicit from or accept for yourself or a relative, or offer to, an existing or prospective customer, counter-party, supplier or contractor of any Group company any favour, gift, service, entertainment or other benefit the size or frequency of which exceeds normal business contact; specifically cash or cash convertible gifts should not be given or accepted.

7 GIFTS (continued)

You must not accept anything which is likely to influence (or which other people may think is likely to influence) your independent, commercial judgment, the Group's reputation or the performance of your duties.

Normal business entertainment on a reciprocal basis or the receipt of non-monetary gifts below the value of US$ 100, (often for publicity or public relations purposes or at the time of traditional festive occasions) are acceptable but, if in doubt, refer to the Managing Director for guidance. If an unsolicited gift/benefit is received outside these guidelines and you believe that refusal would adversely affect a business relationship, you must immediately write for guidance to the Managing Director and Head of Human Resources & Admin.

When doing business with governmental customers, Bank's employees should refrain from offering any favors or gratuities to such customers, except as described above or with the approval of the Managing Director. Most governmental customers have a zero tolerance policy as regards soliciting or accepting favors or gratuities and this Group's policy is intended to avoid what could otherwise become embarrassing situations for the customer and become a reason for the customer terminating its business relationship with the Group.

When the Managing Director himself has to seek approval or guidance, this will be from his immediate superior.

8 STAFF DEALING RULES

Personal dealing in any kind of securities/investment by Bank employees is subject to specific rules which must be strictly observed at all times.

In particular, there are restrictions which apply if you are in possession of inside information. Confidential information must never be used for personal gain.

The ABC Insider Trading policy is made available to every staff member. It satisfies the obligation of ABC Group to prevent insider trading, help personnel of the ABC Group (including the Group) to comply with appropriate insider trading regulations and avoid the severe consequences associated with their violation.

9 MONEY LAUNDERING

Money Laundering is the process by which criminals attempt to conceal the true origin and ownership of the proceeds of their criminal activities by using the financial system to deposit funds, make payments and transfer funds. The objective of such activities is to transform illicit funds into legitimate funds.

Anti-money laundering is a continuous process. The Group is committed to promote the highest ethical and professional standards and strives to prevent the Group from being used, intentionally or unintentionally, by criminal elements. The Group has pledged to fully comply with the recommendations made by the Basel Committee and the FATF. This is in addition to the need to adhere to the applicable regulations issued in each of the countries in which the Group operates and the Money Laundering Regulations issued by the Central Bank of Bahrain. The substance of the CBB Regulations and of the recommendations made by the Basel Committee / FATF has been incorporated into the body of the ABC Group Anti-Money Laundering Manual, the text of which is available on ABC's intranet.

Bahrain's AML laws / regulations are applicable to all units of the Group both within and outside Bahrain. Where local standards differ the higher standards must be applied.

All staff who deal with customers and customer transactions or who are managerially responsible for such staff must be aware of the responsibilities imposed upon them under the AML Law and CBB Regulations. In particular:

a) Staff must ensure that adequate customer due diligence has been performed to ensure that a customer's identity (and that of any parties on whose behalf the customer may be acting) and source of funds has been satisfactorily established and (where necessary) verified before any business relationship is entered into.

b) Satisfactory Know Your Customer/Business procedures provide the basis for recognising unusual and suspicious activities. Where there is a business relationship with a customer, a suspicious activity or instruction will often be one that is inconsistent with a customer's known or pre-advised legitimate business, or with the normal business activities usually undertaken for that type of account or customer. Therefore the key to recognising suspicious transactions is to know the details of your customer and your customer's normal and anticipated activities.

c) You must be aware of the identity of the Group's Money Laundering Reporting Officer (the "MLRO"). This information is available on the Bank's section of ABC's intranet.

d) Staff have a personal responsibility under Bahrain's AML Laws to report 'Suspicious Transactions'. You must be aware of ABC's procedures adopted by the Bank (outlined below) in this regard.

If you have knowledge, suspicion, or reasonable grounds for knowing or suspecting, that any person is laundering the proceeds of any criminal conduct in the course of business activities or is acting fraudulently, you must make an Internal Suspicious Transaction Report (ISTR) in writing (which includes email) to the MLRO or his authorised designate. Your ISTR must be made as soon as is reasonably practical after the information comes to your attention and you should obtain an acknowledgement of receipt from the MLRO.

Failure to report could result in internal disciplinary proceedings but most importantly staff must realise that this also constitutes a criminal offence.

The opinion of your line manager or colleagues must not dissuade you from following your suspicions. It is your call. If in doubt, report suspicious circumstances to the MLRO. This will discharge you from your obligation under the AML law. All reports will be treated in confidence. If your ISTR is regarded as having foundation this will be reported by the MLRO to the relevant authorities.

In recent years, money laundering techniques have become increasingly sophisticated. While it is difficult to give firm guidance regarding the type of customer activity or transaction that may justify the raising of an internal STR, the following general typologies should be borne in mind:

1. transactions that do not appear to have a clear purpose or which make no obvious commercial sense and/or unusual patterns of transactions inconsistent with previous transaction volumes or the known status of the customer;

2. unusual investment transactions without any discernible profit motive;

3. a transaction which yields an apparent profit which is unusually high for the type of business being transacted;

4. where, the underlying business being undertaken is out of line with the customer's pre-advised or established pattern of business in terms of volume or frequency of transactions, the commodities or countries of business, or relative profitability;

5. where the customer refuses to provide the information requested;

6. where a customer uses the Bank for a single transaction or for only a very short period of time, and there is no continuity of business;

7. the wide use of offshore accounts, companies or structures in circumstances where the customer's needs do not appear to require them.

Staff are reminded that Money Laundering prevention is NOT a "box ticking exercise". Application of CBB Regulations/ABC's Group AML Manual requires professional thought to consider if there are reasonable grounds for suspicion and what documentary evidence must be requested to ensure that the identity and source of funds of our customers is adequately established and (where necessary) verified.

Relevant staff should maintain their knowledge of Bahrain's AML Regulations and the requirements of the ABC Group AML Manual on an ongoing basis. The text of these documents is published on ABC's intranet and it is recommended that staff read them periodically to update and remind themselves of their contents.

10 REGULATORS & AUDITORS

We must be completely open, candid, co-operative and prompt with regulators and external and internal auditors, keeping them fully informed about matters which should reasonably be disclosed to them.

It is essential that we demonstrate, as well as practise, full compliance with relevant laws and regulatory requirements and that the Group is seen to be professionally managed.

11 EXTERNAL COMMUNICATIONS

Employees should not answer any questions from outside parties relating to the Group's business activities unless they have been specifically authorized to do so. Any inquiries from industry analysts or reporters must be directed to the Managing Director or the Head of Corporate Communications at ABC. Any inquiries from attorney's, investigators or law enforcement officers that concern Group's business activities should be referred to ABC's Legal Counsel. All press releases must be approved by either the Managing Director or Head of Corporate Communications at ABC.

12 REPORTING

It is your duty to report to the Compliance Officer in addition to any of the Managing Director or Head of ABC Group Audit or Head of Human Resources & Admin. any contravention of the law, regulatory requirements or this Code. If you have reason to believe that these requirements are about to be broken, this must also be reported.

Any failure to comply with the Code or to report known breaches by others may result in disciplinary action.

13 CUSTOMER INTEREST

The Bank and its employees must pay due regard to the legitimate interests and information needs of their customers and communicate with them in a fair and transparent manner. The Bank and its approved employees, when dealing with customers who are entitled to rely on their advice or discretionary decisions, must take reasonable care to ensure the suitability of such advice or decisions.

14 CUSTOMER ASSETS

The Bank and its approved employees must take reasonable care to safeguard the assets of customers for which they are responsible

15 NON-DISCRIMINATION & NON-HARASSMENT

The Bank's employees must offer equal treatment to potential clients, customers and colleagues without regard to race, colour, nationality, religion, sex, ethnic or national origin, age, disability, marital status or sexual orientation.

It is the Group's policy to maintain a working environment free from discriminatory harassment. Any form of unlawful discrimination, including harassment based on race, colour, nationality, religion, sex, ethnic or national origin, age, disability, marital status or sexual orientation is strictly prohibited.

16 SUBSTANCE ABUSE

To protect employees and the Bank from the abuses of illegal or controlled substances or alcohol, the Bank's policy calls for disciplinary action up to and including termination for anyone who uses, sells, possesses or is under the influence of illegal drugs or the use of alcohol while conducting business for the Bank, whether or not consumed during working hours or whether or not consumed on ABC's premises. The Bank also reserves the right, in certain circumstances, to test for the presence of illegal or controlled substances.

17 HEALTH & SAFETY

The Group is committed to conducting its business in a manner designed to protect the health and safety of its employees, clients, customers and the environment. The Bank's employees must comply with all relevant laws and regulations and must promptly report to their management any conditions that may pose a health, safety or environmental hazard.

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