ABC ISLAMIC BANK
ANNUAL REPORT
2010




بنك المؤسسة العربية المصرفية الإسلامي (ش.م.ب.م)
ABC Islamic Bank (E.C.)


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iversity

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.

ABC Islamic Bank (E.C.) is a subsidiary of Arab Banking Corporation. The Group's international depth and strategic relationships within the region allow it to maintain its position as one of the leading banking groups in the Middle East and Europe. The Group has sought to build its practice beyond the traditional roles of regional banks and move into advanced high value-added activities, establishing itself as a regional leader with immeasurable international experience.

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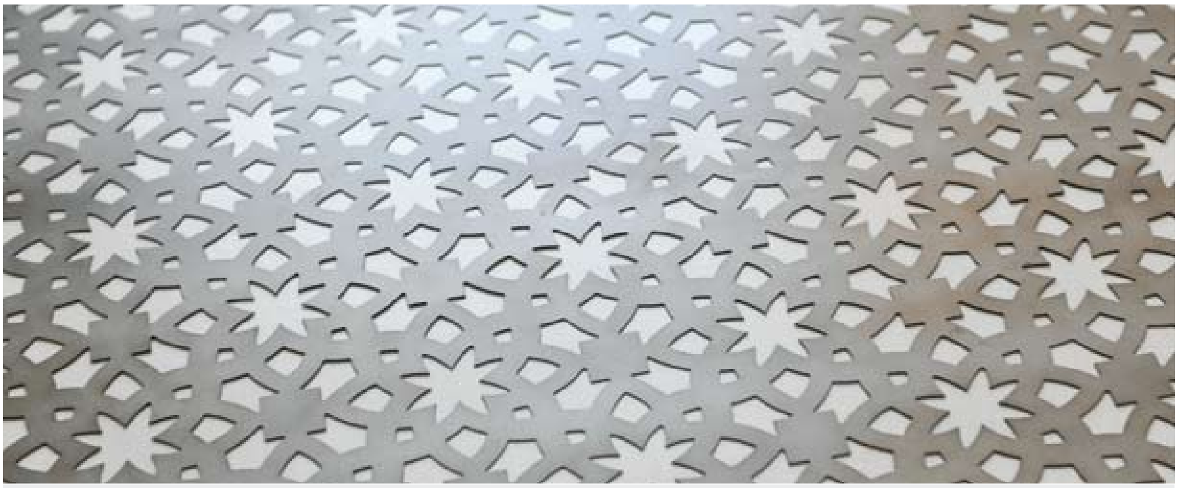


VISION

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

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.

Our Approach

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

المؤسسة العربية المصرفية
ARAB BANKING CORPORATION

When Arab Banking Corporation develops the Group's strategy, it focuses its vision on every possibility for each unit to nurture growth while foreseeing and realising opportunities for clients.

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

بنك المؤسسة العربية المصرفية
ABC Bank - Egypt

Since its inception, ABC Bank - Egypt has nurtured sustainable growth by understanding market needs and delivering customised products and services to its clients.

بنك المؤسسة العربية المصرفية
ABC Bank (Jordan)

ABC Bank (Jordan) attributes its success to its credibility and integrity as a reliable and effective partner with its customers and stakeholders.

بنك المؤسسة العربية المصرفية
ABC Bank - Tunisie

ABC – Tunisie continues to take the initiative to grow both its retail and wholesale operations, enhancing the volume of money market transactions and increasing its trade and structured finance business, as well as developing key business and consumer products and services.

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 ABC in June 1991, having previously spent some time with a prime French Law firm in Paris. He had been Group Legal Counsel until January 2010, when he was appointed Deputy Chief Executive. Dr. Kawan is Chairman of ABC Islamic Bank, Bahrain and also represents ABC as a Director on the board of Arab Banking Corporation – Egypt (S.A.E.).

Mr. Graham Scopes RC æ ⋇
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 GCC client relationships and commercial banking activities. Prior to joining ABC, Graham worked for 19 years for The Chase Manhattan Bank, based in London and Bahrain.

Mr. Amr Gadallah AC æ ⋇
Director
MA in Economics from the American University, Cairo, Egypt; MA in International Economics from George Washington University, Washington D.C., U.S.A.

Before joining ABC in 1990, Mr. Gadallah worked for 5 years for Arab International Bank, Cairo, Egypt and Dean Witter, Chicago U.S.A. Since 1999 he served as ABC's Assistant Group Treasurer, responsible for Money Markets, Derivatives, Structured Products and Treasury Support. Mr. Gadallah was appointed Group Treasurer in January 2007. He is a director of ABC Investments, Jordan.

Mr. Stephen Jenkins AC æ ⋇
Director

Mr. Jenkins joined ABC in April 1996 and is presently Head of the Remedial Loans Unit (RLU) part of the Credit and Risk Group based in Head Office. Prior to joining ABC, Stephen worked for 10 years at Royal Trust Bank in London and Toronto, including 6 years as Head of its Special Loans Unit managing its distressed assets. In a period spanning 8 years at The Royal Bank of Canada, Stephen was a Relationship Manager, responsible for UK and Nordic relationships and whilst at RBC started his career in managing remedial accounts. Mr. Jenkins's primary responsibilities are currently the management and oversight of all impaired assets throughout the ABC Group, whilst minimising the losses incurred and maximising recovery prospects through managed and effective exit strategies on each account.

The Shareholders of ABC Islamic Bank ratified the appointment of Mr. Abdulrahman Al Sayed as a director at the annual general meeting held on 21 April 2011.

AC Member of the Audit Committee
RC Member of the Risk Committee
æ Executive
⋇ Non-independent

Board of Directors

Mr. Faisal Alshowaikh æ ⋇

Director

Fellow of The Association of Chartered Certified Accountants, UK; BA in Accounting & Finance from Manchester Metropolitan University, UK

Mr. Alshowaikh has over 25 years experience in Banking & Finance at senior levels in the GCC, South East Asia and the UK. Since April 2009 he assumed the position of Head of Islamic Financial Services at ABC International Bank plc. Prior to that, he was instrumental in setting up two Islamic Banks in the UAE and Malaysia where he acted as Deputy Chief Executive Officer and Chief Executive Officer respectively.

Mr. Mohammed El Qaq AC æ ⋇

Director

MBA, Howard University, Washington, D.C., U.S.A.; Bachelor in Business Administration (Finance & Banking), Kuwait University, Kuwait

Mr. El Qaq joined ABC in May 2000. He has more than 20 years experience in commercial banking namely in Corporate Banking and Financial Institutions. Mr. El Qaq's principal responsibilities are the origination of new transactions and development of the loan portfolio as Country Manager for Kuwait, Qatar and UAE. Prior to joining ABC, Mr. El Qaq worked from 1995 to 2000 as a corporate banker with Qatar National Bank (QNB), Doha. Before that Mr. El Qaq spent three years at Arab Bank's Head Office in Jordan as Section Head at the Credit Facilities Division for Arab Countries. Prior to that, Mr. El Qaq worked from 1990 to 1992 as an Investment Officer with the Housing Bank for Trade and Finance, in Jordan.

Mr. Naveed Khan æ ⋇

Global Head of Islamic Banking & Managing Director

MBA (Finance) University of the Punjab, Pakistan

Mr. Khan 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 Bank 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 Citi affiliate, Saudi American Bank. In 2004 Mr. Khan moved to ABC Islamic Bank as Managing Director. In 2009 he was appointed as the Global Head for Islamic Banking for ABC Group.

Mr. Luke Wells

Secretary to the Board

B.Com/LLB (Hons), University of Auckland in 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 in Auckland, New Zealand and Herbert Smith in London and Moscow.

AC Member of the Audit Committee
RC Member of the Risk Committee
æ Executive
⋇ Non-independent

Management

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 17 years of banking experience, most of it with Citigroup and its affiliate in Saudi Arabia, Samba Financial Group, 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 and origination.

Mr. Abdulkarim Ismaeel Ahmed
MLRO / Regulatory & Sharia Compliance Officer

Post Graduate Accounting Diploma, Gulf Polytechnic, Bahrain

MLRO and Regulatory/Sharia Compliance Officer, has 29 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 positions held at Banco do Brazil, Banque Nationale De Paris and the ABC Group. His 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. 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 17 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 rejoined 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 a member of the Board of Directors of Arab Banking Corporation – Algeria and chairs its Board Risk Committee.

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. Abd Ali Hassan Salman
Manager, Operations

Bsc in Business Administration, University of Baghdad, Republic of Iraq

Mr. Salman has 32 years of experience in banking operational activities with a view to provide back-up operations support for the bank's overall operations. He started his career with American Express Bank (AMEX), Bahrain in 1978. In 1981 Mr. Salman joined United Gulf Bank (UGB) as Manager, Head of Operations. In 1989 he joined UBS (formally SBC, Bahrain) as Head of Accounting responsible for the entire accounting and operations of Bahrain branch. He initially joined ABC in 1995 as Assistant Manager responsible for managing and controlling Treasury Operations. In January 2000 he was transferred to ABC Islamic Bank, Middle Office function.

Chairman's Statement

in view of the adverse market conditions that continued for most of 2010, the financial results of ABC Islamic Bank are encouraging.

Dr. Khaled S. Kawan
Chairman

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

The financial turmoil which started in 2007-2008 continued to impact global markets in 2010 as well. The stability expected to accompany the tepid recovery in the U.S did not materialize as financial bail outs of Greece and Ireland sent shock waves reverberating through financial markets. G.C.C and middle-eastern economies which are heavily reliant on oil prices saw a faint hope towards the fourth quarter of 2010 on the back of firmer oil prices, only to be dashed by violent political protests sweeping the Arab World at the start of 2011. It is against this backdrop that I 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, 2010.

Indeed, in view of the adverse market conditions that continued for most of 2010, the financial results of ABC Islamic Bank are encouraging. Operating income of $15.9 million in 2010 adjusted for amortising participation fees for a few large deals which matured in 2009 compares favourably with a similar figure of $20.4 million from the previous year.

Operating efficiency was kept under review and 2010 ended with a reduction in overall operating expenses of $4.89 million. Despite much higher conservative provisions ($8.6 million in 2010 versus $5.0 million in 2009) for legacy accounts from previous years, the bank ended the year positively with a profit of $2.1 million in 2010.

I would also like to highlight important qualitative changes and improvements which the bank has been working on through 2010, some of which are listed below.

The bank has used this period of economic uncertainty to position itself for:

Improvement in service quality to existing customers

By segmenting its existing customer base on a global basis the bank has focused the Group's key global product strengths (Islamic, Treasury, Trade Finance, Project and Structured Finance) on customer needs and by aligning its global organization towards supporting its customer base.

Building up a customer pipeline for the future

Focused marketing calls have developed a screening process of prospects with both asset and liability opportunities which will serve as the base for future business opportunities for the bank.

Initiating new relationships and closing landmark transactions

During the year the bank led three landmark transactions where ABC Islamic Bank was a Mandated Lead Arranger including sole arranger status for a Japanese bank's first foray into Islamic finance, underscoring how Islamic finance can provide conventional borrowers access to a diversified finance pool. The year also saw initiation of more than 10 new relationships with key customers in chosen target markets.

Ensuring full compliance with Regulatory and Shari'a requirements

The compliance environment also witnessed an important addition during the year 2010 through the establishment of a dedicated compliance function to manage regulatory compliance risk. This involved instituting a full set of policies and procedures and putting in place the necessary infrastructure for smooth implementation and effective monitoring of both regulatory and Shari'a compliance policies.

ABC Islamic Bank's core activity continues to be the provision of a range of Shari'a-compliant financial solutions to institutional and corporate clients in the Arab and Muslim world.

ABC Islamic Bank's core activity continues to be the provision of a range of Shari'a-compliant financial solutions to institutional and corporate clients in the Arab and Muslim world and towards this corporate objective, the Bank offers one of the largest Shari'a-compliant product offerings under one roof.

On the liability side of the statement of financial position, ABC Clearing Company, the industry's benchmark overnight liquidity management instrument programme, continued to attract ever growing volumes of institutional funds and a healthy level of new funding from other institutions to fund the Bank's statement of financial position, reflecting a high degree of confidence both in ABC Islamic Bank and in the parent company.

As to 2011 which will be a challenging year, and beyond, we are confident that the consolidation process in the G.C.C's financial services industry particularly for Islamic banking, that is yet to follow, will only provide opportunities for stronger institutions to emerge.

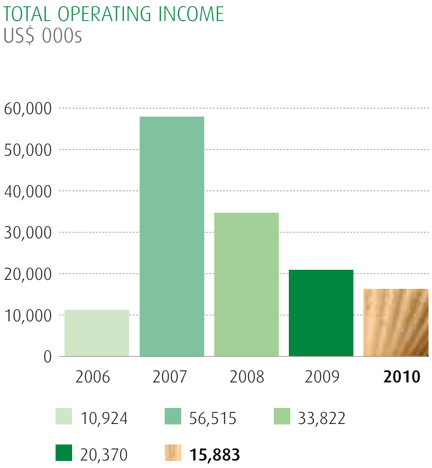
In conclusion, I would like to thank the Central Bank of Bahrain for its continued diligence, regulatory oversight and promotion of Islamic banking within the region; the Bank's management has found its support and guidance invaluable.

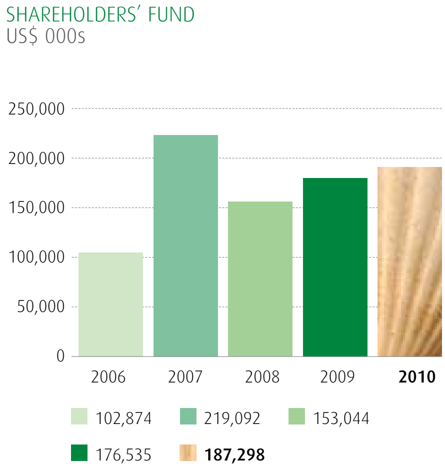
I also take this opportunity to thank all of ABC Islamic Bank's clients for their valued custom and the close co-operation shown, and to express the Board's appreciation to our Shari'a Board for their valuable direction and wisdom in all Shari'a matters, and to the staff of ABC Islamic for their dedication and support through a difficult and challenging period.

Dr. Khaled S. Kawan
Chairman

Financial Highlights

(All figures in US dollars)





FINANCIAL PERFORMANCE

Total footings of the bank declined by 8.3% year on year, as a result of concerted effort to further de-risk the statement of financial position amidst continued slow economic recovery for the region. Net profit after provisions and Zakah came in at $2.1 million compared to $10.1 million in 2009. The main factors which affected financial performance for 2010 were;

- Cut back in bank borrowings by well managed and conservative customers. These customers represent the core target market of the bank.
- Global recession and its impact on asset and investment values
- Conservative provisioning for key markets in the GCC.

The impact of the unrest in the Arab world at the start of the year is expected to make 2011 a challenging year for banks. No significant new acquisition or discontinuation of business is anticipated for 2011. The capital structure and shareholding is expected to remain unchanged for this year.

STATEMENT OF FINANCIAL POSITION

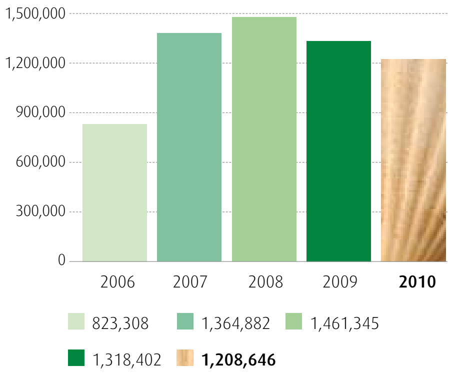
Total assets of the bank declined by $110 million taking the total asset figure in 2010 to $1.208 billion versus $1.318 billion in 2009. The decline was due to a decrease in Murabaha receivables of $52 million, combined with a decrease in Ijarah assets of $49 million and a small decrease in available-for-sale investments of $11 million. The reduction in total assets reflects an across the board contraction of credit demand.

INCOME STATEMENT

Gross income from assets decreased from $40.9 million in 2009 to $25.9 million in 2010 reflecting largely a further drop in profit rates and relatively lower assets. Profit on Murabaha payables also declined from $20.9 million in 2009 to $10.7 million in 2010. Yields on new business booked and rollover of the existing portfolio was marginally higher.

Fee and commission income was higher at $0.7 million in 2010 compared to $0.3 million in 2009 as there was a concerted effort to obtain ancillary business commensurate with the size of wallet.

TOTAL ASSETS
US$ 000s



RATIOS
(%)

	2006	2007	2008	2009	**2010**
Cost / income ratio	46.3	10.1	14.7	24.5	**30.8**
Return on average equity	9.0	34.7	13.1	6.6	**1.2**
Return on average assets	0.7	4.7	1.8	0.7	**0.2**
Liquidity assets ratio	40.1	26.2	24.6	31.9	**30.6**
Short-term assets to short-term liabilities	54.2	63.5	29.5	26.8	**39.1**
Risk asset ratio - Tier 1	16.4	15.1	15.4	23.0	**24.2**
Risk asset ratio - Total	16.6	15.7	17.6	24.1	**24.5**

Cost efficiency and expense rationalization helped decrease operating expenses further by 2% compared to last year, while it was agreed to increase the Zakah liability in line with the retail inflation index to show community support.

SOURCES AND APPLICATIONS OF FINANCIAL RESOURCES

No dividend payments were made in 2010 to the parent. Retention of profit of $2 million and an increase in fair market values of available-for-sale investments by $9 million helped bolster total equity to $187 million in 2010 versus $176 million in 2009.

GEOGRAPHICAL DIVERSIFICATION IN ASSETS AND LIABILITIES

The bank's core target markets are concentrated largely in the Middle East, with the GCC countries accounting for more than 90% of the total portfolio of the bank. Saudi Arabia is the largest exposure, followed by Abu Dhabi, Kuwait, Bahrain, Qatar and Oman in the same order. In 2010 the bank, through its long standing representative office in Turkey, increased its exposure to financial institutions in the country which has remained insulated from the global recessionary impact.

LIQUIDITY

ABC has always enjoyed a strong liquidity position on account of two factors;

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

2. With the treasury function outsourced to the Group Treasury, ABC Islamic Bank relies on the parent for its backstop liquidity as the bulk of Islamic liability marketing is domiciled at ABC BSC.

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 practices. The bank's Capital Adequacy Ratio was calculated at 24.5% in 2010 compared to 24.1% in 2009. 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 2010.

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 2010. 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 2010 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 realised 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 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**

3 Rabi Al-Awaal 1432 H
6 February 2011 G

Manama, Kingdom of Bahrain

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ERNST & YOUNG

P.O. Box 140
14th Floor - The Tower
Bahrain Commercial Complex
Manama, Kingdom of Bahrain
Tel: +973 1753 5455 Fax: +973 1753 5405
manama@bh.ey.com
www.ey.com/me
C.R. No. 6700

Independent Auditors' Report

TO THE SHAREHOLDERS OF ABC ISLAMIC BANK (E.C.)

We have audited the accompanying statement of financial position of ABC Islamic Bank (E.C.) [the Bank] and its subsidiary [the Group] as of 31 December 2010, and the related consolidated statements of income, cash flows, changes in equity, and sources and uses of zakah and charity fund 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 financial position of the Group as of 31 December 2010, the results of its operations, its cash flows, changes in equity, and sources and uses of zakah and charity fund for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

Other Matters

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements, and the contents of the Report of the Board of Directors relating to these financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank, have occurred during the year ended 31 December 2010 that might have had a material adverse effect on the business of the Bank or on its financial position and that the Bank has complied with the terms of its banking license and has also complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Group.

Ernst & Young

24 February 2011
Manama, Kingdom of Bahrain

Consolidated Statement of Financial Position

31 December 2010

	Note	2010 US$ '000	2009 US$ '000
ASSETS			
Cash and bank balances	3	**4,054**	1,142
Available-for-sale investments	4	**357,630**	368,911
Murabaha receivables	5	**418,898**	470,413
Ijarah receivables		**962**	879
Musharaka financing		**802**	2,144
Mudaraba		**854**	888
Ijarah	6	**422,593**	471,118
Equipment		**238**	367
Other assets	7	**2,615**	2,540
TOTAL ASSETS		**1,208,646**	1,318,402
LIABILITIES AND EQUITY			
Liabilities			
Other liabilities	8	**6,867**	8,388
Murabaha payables	9	**1,014,481**	1,133,479
		1,021,348	1,141,867
Equity	10		
Share capital		**132,500**	132,500
Reserves		**54,798**	44,035
		187,298	176,535
TOTAL LIABILITIES AND EQUITY		**1,208,646**	1,318,402

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 2010

	Note	**2010 US$ '000**	2009 US$ '000
OPERATING INCOME			
Income from available-for-sale investments		**8,762**	12,162
Income from Murabaha receivables		**8,547**	16,922
Income from Musharaka financing		**129**	208
Ijarah income – net	6	**8,496**	11,583
		25,934	40,875
Profit on Murabaha payables		**(10,720)**	(20,856)
		15,214	20,019
Fee and commission income	12	**669**	351
Total operating income		**15,883**	20,370
OPERATING EXPENSES			
Staff costs		**3,063**	3,009
Depreciation		**132**	36
Other expenses	13	**1,702**	1,941
Total operating expenses		**4,897**	4,986
Provision for impaired assets	4	**(8,631)**	(5,000)
PROFIT FOR THE YEAR BEFORE ZAKAH		**2,355**	10,384
Zakah		**(281)**	(270)
PROFIT FOR THE YEAR		**2,074**	10,114

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

Consolidated Statement of Cash Flows

Year ended 31 December 2010

	Note	2010 US$ '000	2009 US$ '000
OPERATING ACTIVITIES			
Profit for the year		**2,074**	10,114
Adjustment for:			
Depreciation		**132**	36
Provision for impaired assets	4	**8,631**	5,000
		10,837	15,150
Changes in:			
Murabaha receivables		**51,515**	221,758
Ijarah receivables		**(83)**	804
Musharaka financing		**1,342**	1,472
Mudaraba		**34**	(85)
Ijarah		**48,525**	(43,169)
Other assets		**(75)**	7,143
Other liabilities		**(1,521)**	(2,552)
Murabaha payables		**(118,998)**	(163,882)
Net cash (used in) from operating activities		**(8,424)**	36,639
INVESTING ACTIVITIES			
Purchase of available-for-sale investments		**(23,164)**	(48,044)
Proceeds from sale/redemption of available-for-sale investments		**34,500**	12,500
Purchase of equipment		**-**	(363)
Net cash from (used in) investing activities		**11,336**	(35,907)
NET CHANGE IN CASH AND CASH EQUIVALENTS		**2,912**	732
Cash and cash equivalents at 1 January		**1,142**	410
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	3	**4,054**	1,142

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

Consolidated Statement of Changes in Equity

Year ended 31 December 2010

		Reserves			
	Share capital US$ '000	Statutory reserve US$ '000	Available-for-sale reserve US$ '000	Retained earnings US$ '000	Total equity US$ '000
Balance at 1 January 2010	**132,500**	**13,010**	**(40,599)**	**71,624**	**176,535**
Change in fair values	**-**	**-**	**8,689**	**-**	**8,689**
Profit for the year	**-**	**-**	**-**	**2,074**	**2,074**
Net income recognised during the year	**-**	**-**	**8,689**	**2,074**	**10,763**
Transfer to statutory reserve (note 10)	**-**	**207**	**-**	**(207)**	**-**
Balance at 31 December 2010	**132,500**	**13,217**	**(31,910)**	**73,491**	**187,298**
Balance at 1 January 2009	132,500	11,999	(53,976)	62,521	153,044
Change in fair values	-	-	13,377	-	13,377
Profit for the year	-	-	-	10,114	10,114
Net income recognised during the year	-	-	13,377	10,114	23,491
Transfer to statutory reserve (note 10)	-	1,011	-	(1,011)	-
Balance at 31 December 2009	132,500	13,010	(40,599)	71,624	176,535

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 2010

	Note	2010 US$ '000	2009 US$ '000
Sources of zakah and charity funds			
Balance at 1 January		**389**	275
Charity		**20**	104
Zakah due from the Bank (*)		**281**	270
Total sources		**690**	649
Uses of zakah and charity funds			
Zakah and charity paid to poor and needy		**(287)**	(260)
Undistributed zakah and charity funds at end of the year (note 8)		**403**	389

* 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$ 4,821 thousand (2009: US$ 4,541 thousand) of which US$ 281 thousand (2009: US$ 270 thousand) is payable by the Bank.

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

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 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 P O Box 2808, Manama, Kingdom of Bahrain. As of 31 December 2010, the total number of employees employed by the Bank was 15 (2009: 17).

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 2010 was 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 24 February 2011.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

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 Sharia'a rules and principles as determined by the Shari'a supervisory board of the Bank, and the applicable provisions of the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law. In accordance with the requirements of AAOIFI, for matters for which no AAOIFI standards exist, the Group uses the International Financial Reporting Standards [IFRS] issued by International Accounting Standards Board [IASB].

Accounting convention

The consolidated financial statements are prepared under the historical cost convention as modified for the re-measurement at fair value of available-for-sale investments.

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

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, except as noted below:

New financial accounting standards

Following are the new financial accounting standards that have been adopted by the Group during the year. Adoption of these new standards did not have any material effect on the consolidated financial statements of the Group.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial accounting standard No. 23 - Consolidation
During the year, the group has adopted FAS 23 issued by the AAOIFI which sets out the principles for determining entities that are subject to be included in the consolidated financial statements of a parent and prescribes the accounting for investment in subsidiaries by parent. The adoption of this standard is effective for financial periods commencing on or after 1 January 2010.

Financial accounting standard No. 24 - Associates
During the year, the Group has adopted FAS 24 issued by the AAOIFI which sets out the accounting principles for recognising, measuring, presenting and disclosing the investments in associate. The adoption of this standard is effective for financial periods commencing on or after 1 January 2010.

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 Group.

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 of during the year are included in the consolidated statement of income from the date of acquisition or up to date of disposal as appropriate.

All intra-group balances, transactions, income and expenses have been eliminated in full.

Non-controlling interest, 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 equity in the consolidated statement of financial position, separately from parent shareholders' equity.

Available-for-sale investments

Initial recognition
All investments are initially recognized at cost, being the fair value of the consideration on acquisition including related direct expenses. Direct expenses are transaction costs and include fees and commissions paid to agents, advisors and consultants levies by regulatory agencies and transfer taxes and duties.

Re-measurement to fair value
Subsequent to initial recognition, investments that are classified as "available for sale" are re-measured at fair value. The fair value changes of investments available for sale are reported in consolidated statement of changes in equity until such time as the investments are sold, realised or deemed to be impaired, at which time the realised gain or loss is reported in the consolidated statement of income.

The losses arising from impairment of such investments are recognised in the consolidated statement of income in "impairment losses" and removed from the investment fair value reserve. Impairment losses recognised in the consolidated statement of income for an equity instrument classified as available for sale are not reversed through the consolidated statement of income.

Murabaha receivables
Murabaha receivables stated net of deferred profits and provision 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 installments by the Murabeh over the agreed period.

Ijarah receivables
Ijarah receivables is the outstanding rental at the end of the year less any provision for doubtful amount.

Musharaka financing and Mudaraba
Musharaka financing and Mudaraba are partnerships in which the Bank contributes capital. These are stated at the fair value of consideration given less impairment.

Equipment and Ijarah
These are initially recorded at cost. Ijarah comprise 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 the assets for the calculation of depreciation are as follows:

Ijarah assets	1-10 years
Equipment	3-5 years

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

Provisions
Provisions are recognised when the Group has a present obligation (legal or constructive) arising from a past event and the cost to settle the obligation are both probable and able to be reliably measured.

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 statement of financial position date.

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 90 days overdue is excluded from the consolidated statement of income.

Income from Musharaka financing and Mudaraba
Income on musharaka financing and mudaraba is recognised when the right to receive payment is established or on distribution. Income related to accounts that are 90 days overdue 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 90 days overdue is excluded from income until it is received in cash.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Fee and commission income
Fee 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.

Taxation
There is no tax on corporate income in the Kingdom of Bahrain or in the Cayman Islands.

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

Translation gains or losses on non-monetary items carried at fair value are included in equity as part of the fair value adjustment on available-for-sale 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.

Significant accounting judgements and estimates
The preparation of the consolidated financial statements requires management to excercise judgement and make estimates that affect the amounts reported in the consolidated financial statements. The most significant use of judgement 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. Judgement by management is required to establish fair values through the use of appropriate valuation models. The judgements include consideration of comparable assets, discount rates and the assumptions used to forecast 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) have an impact on the estimated future cash flows of the asset or the group of the assets that can be reliably estimated.

The Group treats available for sale 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 so, whether the carrying value of investments in leases 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 any impairment loss is recognised in the consolidated statement of income.

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 Organization and the Group's obligations are limited to the amount contributed to the scheme.

3 CASH AND BANK BALANCES

	2010	2009
	US$ '000	US$ '000
Balance with ABC (B.S.C.)	**3,446**	437
Cash and balance with other bank	**608**	705
	4,054	1,142

4 AVAILABLE-FOR-SALE INVESTMENTS

	2010			2009
	Cost US$ '000	Cumulative changes in fair values US$ '000	Total carrying value US$ '000	Total US$ '000
Quoted Sukuks at fair value	**387,996**	**(15,836)**	**372,160**	372,030
Listed equities	**1,544**	**557**	**2,101**	4,881
	389,540	**(15,279)**	**374,261**	376,911
Allowance for impairment	**-**	**(16,631)**	**(16,631)**	(8,000)
	389,540	**(31,910)**	**357,630**	368,911

The movement in allowance for impairment is as follows:

	2010 US$ '000	2009 US$ '000
At 1 January	**8,000**	3,000
Impairment provision during the year	**8,631**	5,000
At 31 December	**16,631**	8,000

Total available-for-sale investments determined to be individually impaired amounted to US$ 22,174 thousand (2009: US$ 16,000 thousand).

5 MURABAHA RECEIVABLES

	2010 US$ '000	2009 US$ '000
International Commodity Murabaha	**8,030**	50,846
Murabaha receivables	**411,979**	421,055
Deferred profits	**(1,111)**	(1,488)
	418,898	470,413

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

Murabaha receivables, which are non-performing as of 31 December 2010, amounted to US$ 139,596 thousand (2009: US$ 128,647 thousand). Included in this are Murabaha receivables amounting to US$ 135,527 thousand (2009: US$ 124,578 thousand) whose carrying values have been guaranteed by ABC (B.S.C.). In addition, for the balance of the non-performing Murabaha receivable, the Group holds tangible collateral, the fair value of such collateral at 31 December 2010 amounts to US$ 5,733 thousand (2009: US$ 7,947 thousand).

6 IJARAH

	2010 US$ '000	2009 US$ '000
Ijarah Muntahia Bittamleek *	**300,985**	232,909
Others	**121,608**	238,209
	422,593	471,118

There are no impaired Ijarahs as at 31 December 2010 (2009: nil).

* 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 installments are settled and the lessee purchases the asset.

	2010 US$ '000	2009 US$ '000
Ijarah Muntahia Bittamleek		
Cost:		
At 1 January	**267,256**	120,622
Transfers from other Ijarah	**126,995**	182,474
Additions during the year	**2,291**	38,947
Disposals during the year	**-**	(74,787)
At 31 December	**396,542**	267,256
Depreciation:		
At 1 January	**34,347**	44,900
Provided during the year	**61,210**	25,287
Relating to disposals during the year	**-**	(35,840)
At 31 December	**95,557**	34,347
Net book amount:		
At 31 December	**300,985**	232,909

The details of Ijarah income are as follows:

	2010 US$ '000	2009 US$ '000
Ijarah income – gross	**69,706**	36,870
Depreciation provided during the year	**(61,210)**	(25,287)
Ijarah income – net	**8,496**	11,583

7 OTHER ASSETS

	2010 US$ '000	2009 US$ '000
Accrued income receivable	**1,764**	1,729
Reserve with the Central Bank of Bahrain	**53**	53
Others	**798**	758
	2,615	2,540

8 OTHER LIABILITIES

	2010 US$ '000	2009 US$ '000
Zakah and charity funds payable	**403**	389
Staff related accruals	**975**	1,415
Unearned income	**3,658**	4,923
Accrued charges	**1,831**	1,661
	6,867	8,388

9 MURABAHA PAYABLES

	2010 US$ '000	2009 US$ '000
Customers' accounts	**10,427**	19,950
Banks and other financial institutions	**182,501**	249,376
ABC (B.S.C.)	**821,553**	864,153
	1,014,481	1,133,479

10 EQUITY

(i) Share capital

	2010 US$ '000	2009 US$ '000
Authorised - 2,000,000 shares of US$ 100 each (2009: 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 (2009: 1,325,000 shares of US$ 100 each)	**132,500**	132,500

(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:

	2010 US$ '000	2009 US$ '000
Letters of credit	**3,981**	2,578
Guarantees	**2,309**	3,206
Irrevocable commitments *	**36,778**	28,847
	43,068	34,631

* Out of total irrevocable commitments, US$ 35,000 thousand (2009: US$ 11,397 thousand) expire in less than one year.

12 FEE AND COMMISSION INCOME

	2010 US$ '000	2009 US$ '000
Income from fiduciary services	-	13
Other fee and commission income	669	338
	669	351

13 OTHER EXPENSES

	2010 US$ '000	2009 US$ '000
Charges by ABC (B.S.C.)	700	700
Business related expenses	192	207
Professional fees and licenses	398	513
Other operating expenses	412	521
	1,702	1,941

14 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.

15 RELATED PARTY TRANSACTIONS

The Group enters into transactions with ABC (B.S.C.) in the ordinary course of business at commercial rates. All the financing contracts with the related party are performing and are free of any provision for credit losses.

The balances with ABC (B.S.C.) as of the statement of financial position date are as follows:

	2010 US$ '000	2009 US$ '000
Balance with ABC (B.S.C.)	3,446	437
Murabaha receivables	8,030	50,846
Murabaha payables	821,553	864,153

The income and expenses arising from dealing with ABC (B.S.C.) included in the consolidated statement of income are as follows:

	2010 US$ '000	2009 US$ '000
Income from Murabaha receivables	28	25
Profit on Murabaha payables	8,604	18,165
Charges by ABC (B.S.C.)	700	700

15 RELATED PARTY TRANSACTIONS (continued)

In addition to transactions with ABC (B.S.C.), the Group incurred the following expenses relating to related parties:

	2010 **US$ '000**	2009 US$ '000
Shari'a Supervisory Board	**83**	124
Short term employee benefits to key management personnel	**658**	557

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

16 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 senior management committee:

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

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 installments by the Murabeh over the agreed period. The Murabeh pays a down payment of the sale price upon signing the Murabaha contract.

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 installments are settled and the lessee purchases the asset.

16 RISK MANAGEMENT (continued)

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

The table below shows the maximum exposure to credit risk for the components of the statement of financial position, including credit related commitments. The maximum exposure is shown gross, before the effect of migration through the use of master netting and collateral agreements.

	Gross maximum exposure 2010 US$ '000	Gross maximum exposure 2009 US$ '000
Cash and bank balances	**4,054**	1,142
Available-for-sale investments	**355,529**	364,030
Murabaha receivables	**418,898**	470,413
Ijarah receivables	**962**	879
Musharaka financing	**802**	2,144
Mudaraba	**854**	888
Ijarah	**422,593**	471,118
Other assets	**1,764**	1,729
Total	**1,205,456**	1,312,343
Letters of credit and guarantees	**6,290**	5,784
Irrevocable commitments to provide trading facilities	**36,778**	28,847
Total	**43,068**	34,631

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.

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

	2010			2009		
	Assets US$ '000	**Liabilities and equity US$ '000**	**Memorandum items US$ '000**	Assets US$ '000	Liabilities and Equity US$ '000	Memorandum items US$ '000
North America	**25,968**	**-**	**-**	6,917	-	-
Western Europe	**854**	**-**	**-**	888	-	-
Other Europe (including Turkey)	**50,643**	**-**	**-**	4,129	-	-
Arab World:						
- Middle East	**1,116,019**	**1,203,580**	**8,068**	1,291,548	1,309,912	31,709
- North Africa	**-**	**4,794**	**20,000**	-	8,291	2,578
Asia:						
- Japan	**15,162**	**-**	**-**	-	-	-
- Far East	**-**	**6**	**-**	-	6	-
- Other	**-**	**266**	**15,000**	14,920	193	344
	1,208,646	**1,208,646**	**43,068**	1,318,402	1,318,402	34,631

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

	2010			2009		
	Assets US$ '000	**Liabilities and equity US$ '000**	**Memorandum items US$ '000**	Assets US$ '000	Liabilities and Equity US$ '000	Memorandum items US$ '0000
Manufacturing	**439,559**	**272**	**21,778**	420,636	905	27,789
Construction	**24,209**	**-**	**-**	30,475	1,588	-
Trading	**29,391**	**59**	**-**	29,391	731	-
Banks and financial institutions	**406,170**	**1,011,733**	**6,290**	369,895	1,128,062	5,784
Government	**38,538**	**-**	**15,000**	59,323	-	344
Personal	**-**	**1,634**	**-**	-	30	-
Commercial real estate	**230,791**	**-**	**-**	367,662	-	714
Transportation	**17,779**	**783**	**-**	19,958	-	-
Toursim	**21,173**	**-**	**-**	19,937	-	-
Other	**1,036**	**194,165**	**-**	1,125	187,086	-
	1,208,646	**1,208,646**	**43,068**	1,318,402	1,318,402	34,631

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) 2010 US$ '000	**Standard grade (4-8) 2010 US$ '000**	**Past due or individually impaired 2010 US$ '000**	**2010 Total US$ '000**
Cash and bank balances	**4,054**	**-**	**-**	**4,054**
Available-for-sale investments	**83,334**	**268,195**	**4,000**	**355,529**
Murabaha receivables	**63,533**	**215,769**	**139,596**	**418,898**
Ijarah receivables	**371**	**591**	**-**	**962**
Musharaka financing	**-**	**802**	**-**	**802**
Mudaraba	**-**	**854**	**-**	**854**
Ijarah	**225,148**	**197,445**	**-**	**422,593**
Other credit exposures	**567**	**1,197**	**-**	**1,764**
	377,007	**684,853**	**143,596**	**1,205,456**

16 RISK MANAGEMENT (continued)

	Neither past due nor impaired			
	High grade (1-3) 2009 US$ '000	Standard grade (4-8) 2009 US$ '000	Past due or individually impaired 2009 US$ '000	2009 Total US$ '000
Cash and bank balances	1,142	-	-	1,142
Available-for-sale investments	56,332	302,198	5,500	364,030
Murabaha receivables	71,599	270,167	128,647	470,413
Ijarah receivables	437	442	-	879
Musharaka financing	-	2,144	-	2,144
Mudaraba	888	-	-	888
Ijarah	217,969	253,149	-	471,118
Other credit exposures	-	1,729	-	1,729
	348,367	829,829	134,147	1,312,343

Financial assets whose terms have been renegotiated
As of 31 December 2010, there were no financial assets whose terms were renegotiated during the year (2009: 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.

	2010	2009
	%	%
Available-for-sale investments	**0.65 - 5.77**	0.65 - 6.14
Murabaha receivables	**0.10 - 5.91**	0.10 - 9.19
Musharaka financing	**4.90 - 6.33**	4.90 - 6.33
Ijarah	**0.63 - 6.00**	0.88 - 6.00
Murabaha payables	**0.40 - 3.70**	0.45 - 5.91

For every 25 basis points increase/decrease in profit rate, the Group profit would decrease/increase by US$ 865 thousand (2009: US$ 814 thousand).

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

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.

16 RISK MANAGEMENT (continued)

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

31 December 2010	**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	4,054	-	-	-	-	-	-	4,054
Available-for-sale investments	-	-	-	115,946	170,109	65,474	6,101	357,630
Murabaha receivables	23,012	69,574	62,949	15,000	50,030	58,737	139,596	418,898
Ijarah receivables	448	362	152	-	-	-	-	962
Musharaka financing	101	198	242	261	-	-	-	802
Mudaraba	-	-	-	-	854	-	-	854
Ijarah	1,707	13,400	68,826	17,740	89,031	231,889	-	422,593
Equipment	-	-	-	-	-	-	238	238
Other assets	742	615	651	184	184	186	53	2,615
Total assets	30,064	84,149	132,820	149,131	310,208	356,286	145,988	1,208,646
LIABILITIES AND EQUITY								
Other liabilities	-	300	1,245	403	-	-	4,919	6,867
Murabaha payables	456,101	454,830	100,620	-	2,930	-	-	1,014,481
Equity	-	-	-	-	-	-	187,298	187,298
Total liabilities and equity	456,101	455,130	101,865	403	2,930	-	192,217	1,208,646
Net liquidity gap	(426,037)	(370,981)	30,955	148,728	307,278	356,286	(46,229)	
Cumulative liquidity gap	(426,037)	(797,018)	(766,063)	(617,335)	(310,057)	46,229	-	

31 December 2009	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	1,142	-	-	-	-	-	-	1,142
Available-for-sale investments	-	27,578	-	-	190,733	140,219	10,381	368,911
Murabaha receivables	54,288	28,798	12,867	89,524	69,500	86,789	128,647	470,413
Ijarah receivables	204	493	91	21	70	-	-	879
Musharaka financing	119	236	340	646	803	-	-	2,144
Mudaraba	-	-	-	-	-	888	-	888
Ijarah	6,070	25,947	17,840	35,587	91,960	293,714	-	471,118
Equipment	-	-	-	-	-	-	367	367
Other assets	822	715	244	-	-	706	53	2,540
Total assets	62,645	83,767	31,382	125,778	353,066	522,316	139,448	1,318,402
LIABILITIES AND EQUITY								
Other liabilities	-	431	-	389	538	-	7,030	8,388
Murabaha payables	506,613	496,216	127,720	-	2,930	-	-	1,133,479
Equity	-	-	-	-	-	-	176,535	176,535
Total liabilities and equity	506,613	496,647	127,720	389	3,468	-	183,565	1,318,402
Net liquidity gap	(443,968)	(412,880)	(96,338)	125,389	349,598	522,316	(44,117)	
Cumulative liquidity gap	(443,968)	(856,848)	(953,186)	(827,797)	(478,199)	44,117	-	

17 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.

18 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.

19 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

Earnings realised during the year from transactions that were not permitted by Shari'a amounted to US$ 20 thousand (2009: US$ 104 thousand) out of which US$ nil (2009: US$ 2 thousand) is interest from money at call with banks. This amount has been taken to the charity fund.

20 SOCIAL RESPONSIBILITY

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

21 COMPARATIVE FIGURES

Certain prior year amounts have been reclassified to conform the presentation in the current year. Such reclassifications do not affect previously reported net income or equity.

ABC - Group Directory

ABC ISLAMIC BANK (E.C.)
ABC Tower, Diplomatic Area,
PO Box 2808, Manama,
Kingdom of Bahrain
Tel: (973) 17 543 342
Fax: (973) 17 536 379 / 17 533 972
Naveed Khan,
Global Head of Islamic Banking &
Managing Director

HEAD OFFICE
ABC Tower, Diplomatic Area,
PO Box 5698, Manama,
Kingdom of Bahrain
Tel: (973) 17 543 000
Fax: (973) 17 533 163 / 17 533 062
http://www.arabbanking.com
webmaster@arabbanking.com

Hassan. A. Juma
President & Chief Executive

Dr. Khaled Kawan
Deputy Chief Executive

Sael Al Waary
Group Chief Operating Officer

MENA SUBSIDIARIES

Arab Banking Corporation - Algeria (ABC Bank, Algeria)
PO Box 367,
54 Avenue des Trois Freres Bouaddou,
Bir Mourad Rais, Algiers, Algeria
Tel: (213) (21) 449 000 / 449 007
541 586
Fax: (213) (21) 541 122 / 541 604
information@arabbanking.com.dz
Nadir Idir,
Acting General Manager

Arab Banking Corporation - Egypt (S.A.E.) (ABC Bank, Egypt)
1, El Saleh Ayoub St., Zamalek,
Cairo, Egypt
Tel: (202) 2736 2684 (10 lines)
Fax: (202) 27363614 /43
abcegypt@arabbanking.com.eg
Akram Tinawi,
Managing Director & CEO

Arab Banking Corporation (Jordan)
P.O. Box 926691, Amman 11190, Jordan
Tel: (962) (6)5664 183
Fax: (962) (6) 5686291
info@arabbanking.com.jo
Simona Sabella Bishouty,
General Manager

Arab Banking Corporation - Tunisie
ABC Building, Rue du Lac d'Annecy,
Les Berges du Lac, 1053 Tunis, Tunisia
Tel: (216) (71) 861 861
Fax: (216) (71) 960 427 / 960 406 / 860
921
abc.tunis@arabbanking.com
Ali Kooli,
General Manager

Arab Financial Services Company B.S.C. (c)
PO Box 2152, Manama,
Kingdom of Bahrain
Tel: (973) 17 290 333
Fax: (973) 17 290 050
B. Chandrasekhar,
Acting Chief Executive Officer

INTERNATIONAL SUBSIDIARIES

ABC International Bank plc
Head Office and London Branch
Arab Banking Corporation House
1-5 Moorgate, London EC2R 6AB, UK
Tel: (44) (20) 7776 4000
Fax: (44) (20) 7606 9987
Nofal Barbar
CEO & Managing Director

ABC International Bank plc - Branches
ABC International Bank plc (Frankfurt Branch)
Neue Mainzer Strasse 75
60311 Frankfurt am Main
Germany
Tel: (49) (69) 7140 30
Fax: (49) (69) 7140 3240
Swift: ABCA DE FF
abcib.fra@arabbanking.com
Gerald Bumharter
General Manager

ABC International Bank plc (Milan Branch)
Via Amedei, 8
20123 Milan
Italy
Tel: (39) (02) 863 331
Fax: (39) (02) 8645 0117
Paolo Provera
General Manager

ABC International Bank plc (Paris Branch)
4 rue Auber
75009 Paris
France
Tel: (33) (1) 4952 5400
Fax: (33) (1) 4720 7469
Alexander Ashton
General Manager

ABC - Group Directory

ABC International Bank plc - Representative Offices

Iberia – Representative Office
Paseo de la Castellana 153
2° Dcha, Madrid 28046, Spain
Tel: (34) (91) 5672822
Fax: (34) (91) 5672829
Usama Zenaty

Moscow - Representative Office
4th floor, 10 block C,
Presnenskaya naberezhnaya
Moscow 123317, Russia
Tel: (7) 495 651 6649
Fax: (7) 495 651 6696
moscow@arabbanking.com
Dmitry Kuryshev

Turkey – Representative Office
Eski Büyükdere Cad. Ayazaga Yolu Sk.
Iz Plaza No: 9 Kat:19 D:69
34398 Maslak
Istanbul
Turkey
Tel: (90) (212) 329 8000
Fax: (90) (212) 290 6891
Muzaffer Aksoy

ABC International Bank plc - Marketing Offices

Nordic Region – Marketing Office
Stortorget 18-20
SE-111 29 Stockholm
Sweden
Tel: (46) 823 0450
Fax: (46) 823 0523
Klas Henrikson

UK & Ireland – Marketing Office
Station House, Station Court, Rawtenstall
Rossendale
Lancashire
BB4 6AJ, UK
Tel: (44) (1706) 237 900
Fax: (44) (1706) 237 909
David Beeley

ABC (IT) Services Ltd.

Arab Banking Corporation House
1-5 Moorgate, London EC2R 6AB, UK
Tel: (44) (20) 7776 4050
Fax: (44) (20) 7606 2708
abcits@arabbanking.com
John Bates,
General Manager

Banco ABC Brasil S.A.
Av. Pres. Juscelino Kubitschek, 1400
04543-000 Itaim Bibi
São Paulo – SP, Brazil
Tel: (55) (11) 317 02000
Fax: (55) (11) 317 02001
Anis Chacur,
Chief Executive Officer

ABC - Group Directory

BRANCHES

Tunis (OBU)
ABC Building, Rue du Lac d'Annecy,
Les Berges du Lac, 1053 Tunis,
Tunisia
Tel: (216) (71) 861 861
Fax: (216) (71) 860 921/ 960 406
960 427
abc.tunis@arabbanking.com
Nour Nahawi,
Resident Country Manager &
General Manager

Baghdad
Al Saadon St., Al Firdaws Square
National Bank of Iraq Building
Baghdad, Iraq
Tel: (964) (1) 7173774 / 7173776
717 3779/ 790 360 0518 (mobile)
info.iraq@arabbanking.com
Mowafaq H. Mahmood,
General Manager
Mobile: (964) 790 161 8048

New York
27^{th} Floor,
600 Third Avenue
New York, NY 10016, USA
Tel: (1) (212) 583 4720
Fax: (1) (212) 583 0921
Robert Ivosevich,
General Manager

Grand Cayman
c/o ABC New York Branch

REPRESENTATIVE OFFICES

Abu Dhabi
10th Floor, East Tower at the Trade Centre
2nd Street, Abu Dhabi Mall,
PO Box 6689, Abu Dhabi, UAE
Tel: (971) (2) 644 7666
Fax: (971) (2) 644 4429
abcrep@eim.ae
Mohamed El Calamawy,
Chief Representative

Beirut
Berytus Parks
Block B, 2nd Floor
Minet El Hosn, Solidere
PO Box 11-5225
Beirut, Lebanon
Tel: (961) (1) 970770 / 970432
Fax: (961) (1) 985809
Mobile: (961) (3) 724644
Ghina Haddad,
Chief Representative

Tehran
4th Floor West
No. 17 Haghani Expressway
Tehran 15188, Iran
Tel: (98) (21) 8879 1105 / 8879 1106
Fax: (98) (21) 8888 2198
arabbanking.teh@parsonline.net
Aziz Farrashi,
Chief Representative

Tripoli
That Emad Administrative Centre Tower 5,
16th Floor, PO Box 91191, Tripoli, Libya
Tel: (218) (21) 335 0226/
335 0227 / 335 0228
Fax: (218) (21) 335 0229
abc_rep_ly@lttnet.net
Mansour Abouen,
Chief Representative

Singapore
9 Raffles Place, #60-03 Republic Plaza
Singapore 048619
Tel: (65) 653 59339
Fax: (65) 653 26288
Kah Eng Leaw,
Chief Representative

Public Disclosures

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Public Disclosures

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1 INTRODUCTION

This document gathers together all the elements of the disclosures required under Pillar III, which are not covered in the interim condensed consolidated financial statements, and is organized as follows:

Firstly, it gives an overview of the approach taken by ABC Islamic Bank (E.C.) [the Bank] to Pillar I and provides the profile of the risk-weighted assets according to the "standard portfolio" as defined by the Central Bank of Bahrain [the CBB].

Secondly, an overview of risk management practices and framework at the Bank is presented with specific emphasis on credit, market and operational risks and the related monitoring processes and credit mitigation initiatives are set out.

Finally, this document provides all other disclosures required under the Public Disclosure Requirements Module of the CBB.

The disclosures in this section are in addition to the interim condensed consolidated financial statements and are presented in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions [AAOIFI] and the relevant provisions of the CBB and Financial Institutions Law. For matters which are not covered by AAOIFI standards, the Bank and its subsidiary [together the Group] uses the International Financial Reporting Standards [IFRS] and other sections of the interim condensed consolidated financial statements. However, the credit risk exposures considered in this section differ from the credit risk exposures reported in the consolidated interim condensed financial statements due to the application of different methodologies between Basel II and IFRS, primarily on account of the following:

- 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 on-statement of financial position exposure. In the interim condensed consolidated financial statements, the nominal values of credit-related contingent items are treated as off- statement of financial position.

- Under this section, the credit exposures are classified as per the Standard Portfolio approach mentioned in the CBB's Basel II capital adequacy framework covering the standardised approach for credit risk. Besides in case of guaranteed exposures, the exposure would be reported based on the guarantor. However, in the interim condensed consolidated financial statements, the assets are presented based on asset class (i.e. Islamic financing, securities, etc).

- Eligible collaterals are considered to arrive at the net exposure under the Basel II framework whereas collaterals are not netted in the interim condensed consolidated financial statements.

- The available-for-sale investments portfolio is considered at cost in the Basel II framework whereas it is considered at fair value in the interim condensed consolidated financial statements.

- Under 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 interim condensed consolidated financial statements.

2 GROUP STRUCTURE

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 Group operates under a wholesale banking licence issued by the CBB and are engaged in financial trading in accordance with the teachings of Islam [Shari'a].

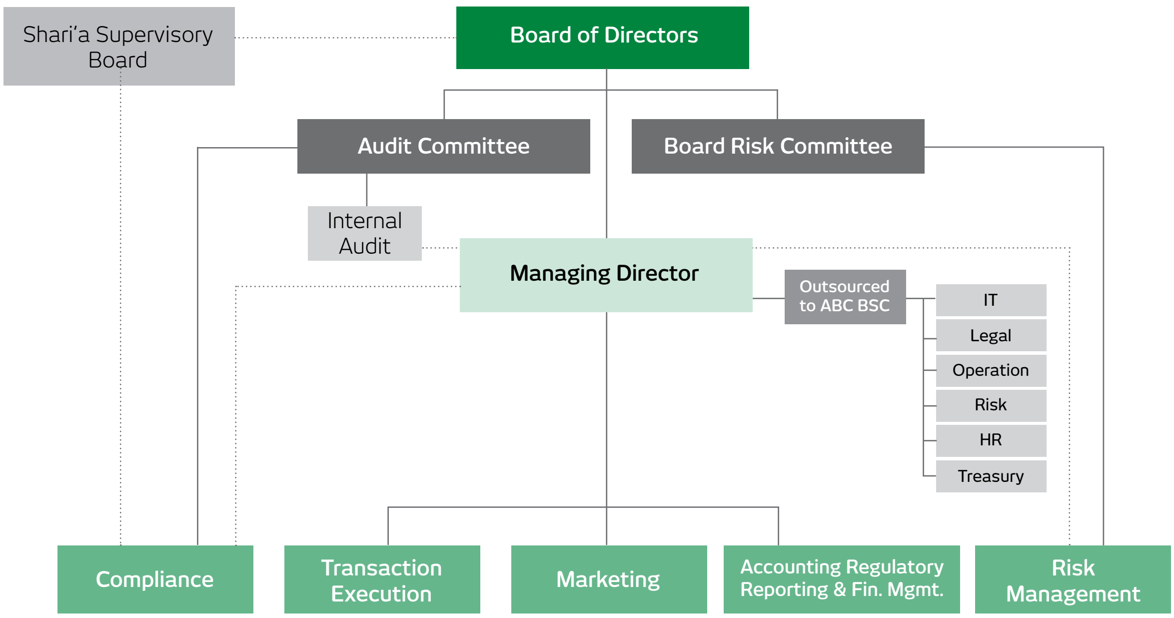
Arab Banking Corporation B.S.C. [ABC], which operates under a wholesale banking licence issued by the CBB, holds 100% of the share capital of the Bank.

The interim condensed consolidated financial statements and capital adequacy regulatory reports of the Group have been prepared and consolidated on a consistent basis.

The ownership in the subsidiary as at 31 December 2010 is as follows:

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

Whilst the Board of Directors [BOD] supervise the overall activities of the Bank, the BOD, Audit and Governance Committee and the Board Risk Committee are tasked with overseeing the respective areas. The following chart shows the organisational structure of the Bank, including the reporting lines to the various BOD committees.



The Bank has in place comprehensive policies regarding the remuneration and benefits provided to members of the BOD and its committees, senior management and staff. With regard to directors, compensation comprises fixed annual remuneration and attendance allowances, while for senior management and staff, compensation comprises a number of fixed elements, covering salary, allowances and benefits, in addition to variable, performance-related elements.

The Group is committed to best practice Corporate Governance Principles and Guidelines and as such, communicates all relevant information to its stakeholders on time, clearly and through a variety of channels, including maintaining an up-to-date website.

3 SHARI'A COMPLIANCE

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.

Non-Shari'a compliant earnings during the period ended 31 December 2010 mainly represent introduction fees. These have been disposed off to charitable causes.

The SSB of the Group consists of three Shari'a scholars (Chairman and two members). The SSB meets periodically or as and when there is a need to hold a meeting. The members receive a fixed sum of money as attendance fee for every meeting they attend, in addition to a fixed amount paid annually to each member as remuneration, irrespective of the number of meetings held during the year or the financial results of the Group.

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.

The issued and paid-up share capital of the Bank was US$132.5 million at 31 December 2010, comprising of 1,325,000 shares of US$100 each.

The Group's capital base of US$219.5 million comprises Tier 1 capital of US$217.1 million and Tier 2 capital of US$2.4 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	13.2	-	13.2
Retained profit brought forward	71.4	-	71.4
Profit for the year	-	2.1	2.1
Unrealized gains arising from fair valuing equities	-	0.3	0.3
Capital base	**217.1**	**2.4**	**219.5**
Risk weighted assets [RWA]			
Credit risk			852.0
Market risk			-
Operational risk			43.9
			895.9
Tier 1 ratio			**24.2%**
Capital adequacy ratio			**24.5%**

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 2010 was 24.5% compared with the minimum regulatory requirement of 12%. The Tier 1 ratio was 24.2% 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.

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 Exposures**	**Risk-weighted assets for Un-Funded Exposures**	**Total Risk weighted Assets**	**Capital Charge (12%)**
Sovereigns	72,685	69,685	3,000	-	3,000	3,000	360
Claims on banks	189,366	186,261	3,105	105,371	245	105,616	12,674
Claims on Corporates	640,082	635,995	4,087	517,920	4,087	522,007	62,641
Past due exposures	139,596	139,596	-	73,867	-	73,867	8,864
Project finance	208,785	207,983	802	145,910	561	146,471	17,577
Other	1,036	1,036	-	1,036	-	1,036	124
Total	**1,251,550**	**1,240,556**	**10,994**	**844,104**	**7,893**	**851,997**	**102,240**

Since the period 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 Exposures**	**Risk-weighted assets for Un-Funded Exposures**	**Total Risk weighted Assets**	**Capital Charge (12%)**
Murabaha	425,985	418,898	7,087	248,020	7,087	255,107	30,613
Ijara	423,395	422,593	802	295,935	561	296,496	35,580
Ijara Rec	962	962	-	640	-	640	77
Sukuk	389,757	389,757	-	294,805	-	294,805	35,377
Mudaraba	854	854	-	427	-	427	51
Musharaka	805	805	-	886	-	886	106
Equity	1,544	1,544	-	1,544	-	1,544	185
LC	3,105	-	3,105	-	245	245	29
Other	5,143	5,143	-	1,847	-	1,847	222
Total	**1,251,550**	**1,240,556**	**10,994**	**844,104**	**7,893**	**851,997**	**102,240**

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$43.9 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	15,883
Amount of non-Shari'a compliant income US$ thousands	20
Number of Shari'a violations	Nil

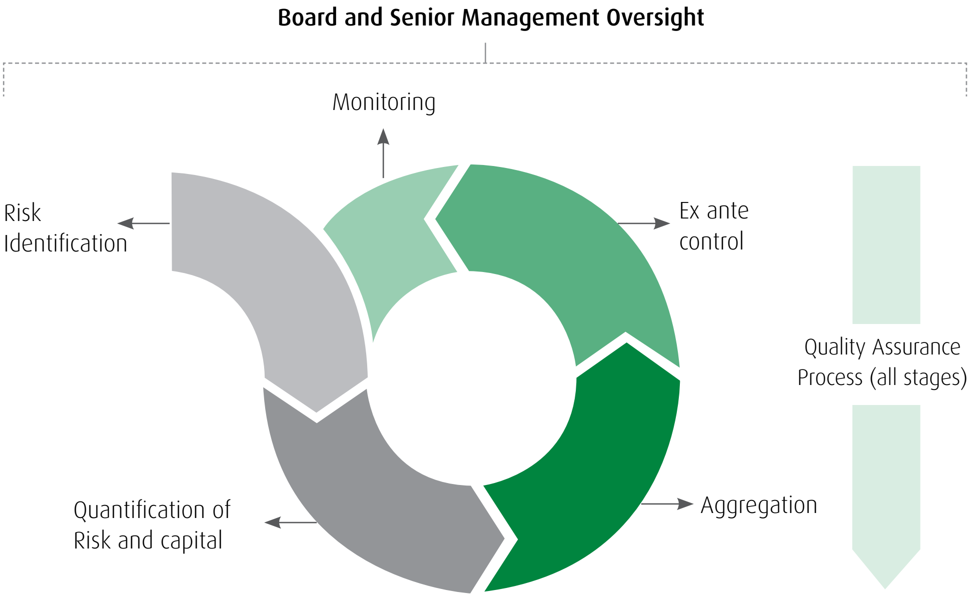
7 RISK MANAGEMENT

7.1 Introduction

Risk is inherent in the Group's activities and is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. The Group is exposed to credit risk, 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.

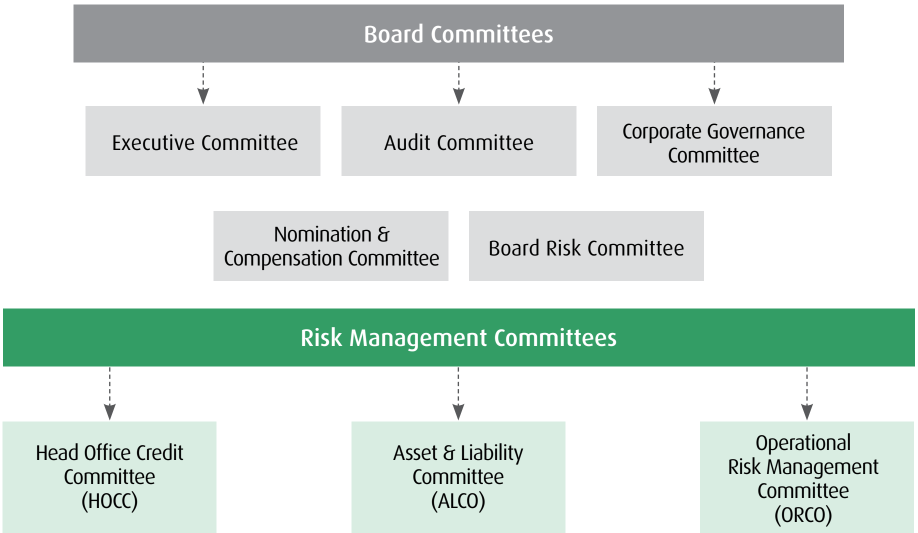
Figure 1:



7.2 Risk management structure

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:

ALCO is mainly responsible for defining long-term strategic plans and short-term tactical initiatives for directing asset and liability allocation prudently for the achievement of ABC's strategic goals. ALCO monitors ABC's liquidity and market risks and the risk profile in the context of economic developments and market fluctuations, to ensure that ABC's ongoing activities are compatible with the risk/reward guidelines approved by the BRC. The above management structure, supported by teams of risk and credit analysts, as well as the IT systems, provide a coherent infrastructure to carry credit and risk functions in a seamless manner.

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

Credit risk concentrations and thresholds

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

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.

As at 31 December 2010, the Group's three largest exposures in excess of 15% of the capital base are shown below:

US$ Thousands	On Balance Sheet Exposure
Counterparty [A]	158,882
Counterparty [B]	63,070
Counterparty [C]	51,500

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.

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 and guarantees from banks.

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

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)	139,596	135,527	5,733	133,863
Unfunded Exposures (LCs/LGs)	6,290	-	3,841	2,449

7.3 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
Bahrain	169,138	13.51%
Saudi Arabia	373,661	29.86%
Kuwait	171,041	13.67%
Qatar	68,312	5.46%
UAE	348,838	27.87%
Oman	18,936	1.51%
Other MENA Countries	7,105	0.57%
Other Asia	18,162	1.45%
Europe (Including Turkey)	51,497	4.11%
USA	24,860	1.99%
Total	**1,251,550**	**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	31,147	-	-	-	38,538	-	-	3,000	-	-	72,685
Claims on banks	48,633	-	15,898	5,045	50,026	-	3,105	15,162	51,497	-	189,366
Claims on Corporates	84,253	174,651	47,599	44,445	260,274	-	4,000	-	-	24,860	640,082
Past due exposures	4,069	56,978	78,549	-	-	-	-	-	-	-	139,596
Project finance	-	142,032	28,995	18,822	-	18,936	-	-	-	-	208,785
Other	1,036	-	-	-	-	-	-	-	-	-	1,036
Total	**169,138**	**373,661**	**171,041**	**68,312**	**348,838**	**18,936**	**7,105**	**18,162**	**51,497**	**24,860**	**1,251,550**

7.4 Industrial sector analysis of the exposures

The industrial sector analysis of exposures is as follows:

US$ Thousands	Gross Exposure	Funded Exposure	Un-funded Exposure
Financial Institutions	424,568	421,463	3,105
Commercial real estate	241,708	241,708	-
Manufacturing	450,588	445,699	4,889
Construction	24,399	24,399	-
Trading	29,391	29,391	-
Government	41,538	38,538	3,000
Transportation	17,779	17,779	-
Tourism	20,543	20,543	-
Other	1,036	1,036	-
Total	**1,251,550**	**1,240,556**	**10,994**

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

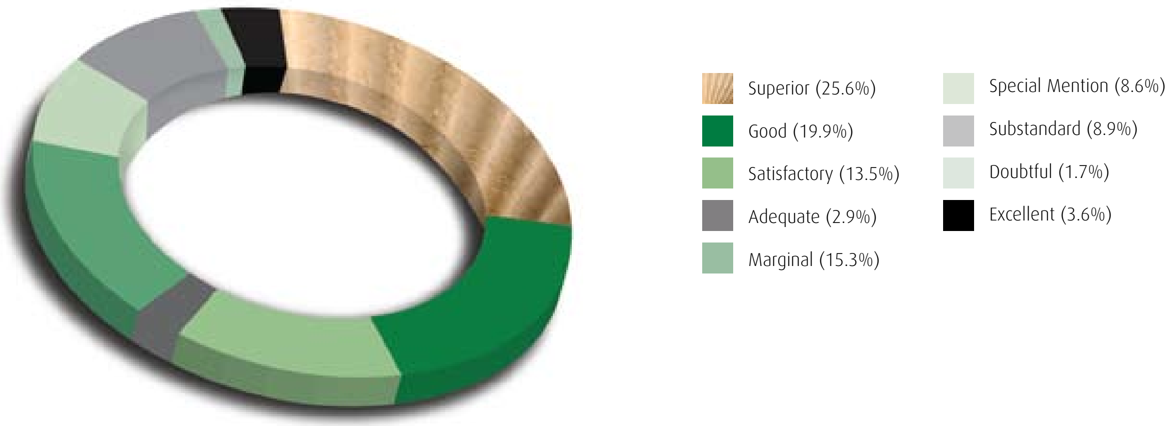
US$ Thousands Type of Financing/Industry	Financial Institutions	Commercial real estate	Manufacturing	Construction	Trading	Government	Transportation	Tourism	Other	Total
Sovereigns	31,147	-	-	-	-	41,538	-	-	-	72,685
Claims on banks	189,366	-	-	-	-	-	-	-	-	189,366
Claims on Corporates	131,581	230,759	215,021	24,399	-	-	17,779	20,543	-	640,082
Past due exposures	71,669	10,949	27,587	-	29,391	-	-	-	-	139,596
Project finance	805	-	207,980	-	-	-	-	-	-	208,785
Other	-	-	-	-	-	-	-	-	1,036	1,036
Total	**424,568**	**241,708**	**450,588**	**24,399**	**29,391**	**41,538**	**17,779**	**20,543**	**1,036**	**1,251,550**

7.5 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	72,685	69,685	3,000
Claims on banks	189,366	186,261	3,105
Claims on Corporates	640,082	298,920	341,162
Past due exposures	139,596	-	139,596
Project finance	208,785	-	208,785
Other	1,036	-	1,036
Total	**1,251,550**	**554,866**	**696,684**

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.

7.6 Maturity analysis of funded exposures

Residual contractual maturity analysis of the Group's major types of funded credit exposures, amounting to US$1,240,556 thousand, is 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	10-20 years	Total over 12 years	Undated	Total
Sovereigns	-	1,775	1,458	2,917	6,150	63,482	-	-	63,482	53	69,685
Claims on banks	20,239	24,441	54,210	64,973	163,863	20,854	-	-	20,854	1,544	186,261
Claims on Corporates	8,896	57,658	71,641	93,637	231,832	316,452	83,711	-	400,163	4,000	635,995
Past due exposures	-	-	-	-	-	-	-	-	-	139,596	139,596
Project finance	929	215	5,327	5,451	11,922	64,782	96,150	35,129	196,061	-	207,983
Other	-	60	184	184	428	370	-	-	370	238	1,036
Total	**30,064**	**84,149**	**132,820**	**167,162**	**414,195**	**465,940**	**179,861**	**35,129**	**680,930**	**145,431**	**1,240,556**

7.7 Maturity analysis of unfunded exposures

The residual contractual maturity analysis of unfunded exposures is 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
Sovereigns	-	-	3,000	-	3,000	-	-	3,000
Claims on banks	27	409	322	39	797	2,308	2,308	3,105
Claims on Corporates	-	-	4,000	-	4,000	87	87	4,087
Project finance	-	-	-	-	-	802	802	802
Total	**27**	**409**	**7,322**	**39**	**7,797**	**3,197**	**3,197**	**10,994**

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- statement of financial position notional amounts into an equivalent on- statement of financial position 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*
Short-term self-liquidating trade and transaction-related contingent items	3,981	796
Direct credit substitutes, guarantees and acceptances	2,309	2,309
Undrawn facilities and other commitments	36,778	7,889
RWA for contingent items		**7,893**

* Credit exposure is after applying CCF.

At 31 December 2010, the Group held cash collaterals in relation to credit-related contingent items amounting to US$3,841 thousand.

Penalties imposed on customers
During the year, no penalties were imposed on customers.

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.

Impairment losses on financial assets
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
- Non-Technical Risk Measures

On an annual basis, ABC's BRC reviews and approves VaR trading limits, BPV trading and investment Limits, Options Stress Testing Trading 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 2010, an immediate shift by 25 basis points in profit rates would potentially impact the Group's economic value by US$865 thousand.

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$2,101 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 2010:

Liquid assets ratio	30.6%
Short-term assets to short-term liabilities	39.1%

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.

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 processes 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 an unconsolidated 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-statement of financial position 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	149,693
Claims on Directors and senior management	570
Claims on staff	165

b. Liabilities to related parties

US$ thousands	
Connected deposits	821,553

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
3 months up to 1 year	10,949	-	10,949
1 to 3 years	124,578	-	124,578
Over 3 years	4,069	-	4,069
Total	**139,596**	**-**	**139,596**

* Carrying values of US$135,527 thousand have been guaranteed by ABC.

Securities

The Group has specific impairment provisions of US$16,631 thousand in its available-for-sale securities portfolio. This impairment is in the GCC.

9.3 Restructured facilities

There were no facilities which were restructured during the year ended 31 December 2010.

9.4 Assets sold under recourse agreements

The Group has not entered into any recourse agreement during the year ended 31 December 2010.

9.5 Movement in specific and collective impairment provisions

US$ thousands	Specific provision for securities
As at 1 January 2009	8,000
Additional provisions made	8,631
As at 31 December 2010	**16,631**

9.6 Industry sector analysis of the specific impairment provisions charges

Impairment of US$ 9,131 thousand is in the financial institution sector and US$7,500 thousand in the construction and real estate sector.

9.7 Equity positions in the banking book

As at the year end, the equity position of the Group amounted to US$2,101 thousand, all of which is quoted.