Strengthening from the Core

Annual Report 2008

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

ABC Islamic Bank (E.C.)

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.

CONTENTS

ABC Group is managing change by solidifying its offering at a regional level, expanding its operations and opening new avenues across the MENA region, bridging the gaps and building on its potential by strengthening from the core.

ABC Islamic Bank...
Where Shari'a Compliance meets banking excellence.

VISION

To be the Islamic Bank of choice in the region and provide banking solutions for customer's 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 purist 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.

CHAIRMAN'S STATEMENT

(All figures stated in US dollars)

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

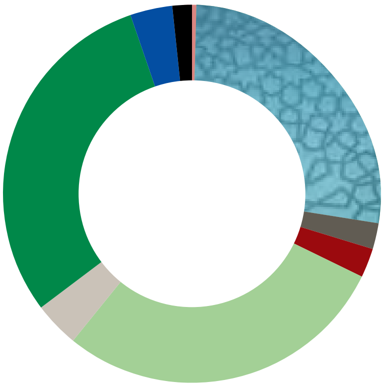
The financial turmoil of 2007 has continued to affect global markets throughout the year, and with particular intensity in the fourth quarter of 2008. The global recession has also spilled over into the GCC with some markets like Dubai and the Kuwaiti investment sector affected severely. It is against 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, 2008.

ABC Islamic Bank's core activity is the provision of a range of Shari'a-compliant financial solutions to institutional and corporate clients in the Arab and Islamic world and towards this corporate objective 2008 was another year of healthy growth. Despite the unprecedented market volatility, the bank enjoyed a record rise in operating revenues and profitability. Gross operating income was $33.8 million, representing a 34% increase over the previous year's equivalent figure, excluding the exceptional $32.8 million capital gain in that year from the partial disposal of a sukuk investment.

After lower operating expenses, net operating income was $28.84 million. This strong performance in core profitability reflected an increased proportion of fee income, enabling growth of the balance sheet to be well controlled at only 7% year-on-year. Following fourth quarter provisions - a direct consequence of the impact of economic slowdown on the region - ABC Islamic Bank closed 2008 with a net profit of $25.6 million, as compared with 2007's exceptional $50.9 million.

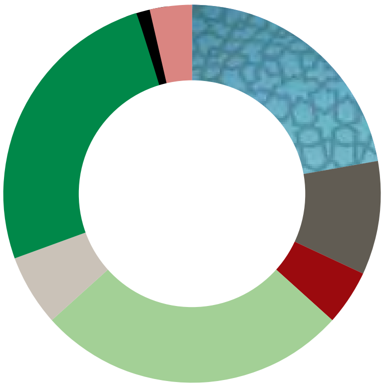
The bank originated and structured a number of high value syndicated transactions for Saudi Arabian and Kuwaiti clients, earning attractive fees and supplementing its margin earnings. 2008 was also a year of innovation, which saw the bank successfully launching a couple of industry-first Shari'a-compliant hedging products, both of which were well received by its customers – Wa'ad-based options for foreign exchange hedging and profit rate hedging structures.

BREAKDOWN OF ASSETS BY INDUSTRY SECTOR - 2008
PERCENTAGE



- Manufacturing 27.4%
- Construction 2.2%
- Trading 2.7%
- Banks and Financial Institutions 28.4%
- Government 4.1%
- Commercial Real Estate 29.9%
- Technology, Media, Telecomms 3.7%
- Transportation 1.5%
- Other 0.1%

BREAKDOWN OF ASSETS BY INDUSTRY SECTOR - 2007
PERCENTAGE



- Manufacturing 22.1%
- Construction 9.7%
- Trading 4.5%
- Banks and Financial Institutions 26.4%
- Government 6.2%
- Commercial Real Estate 26.8%
- Transportation 0.9%
- Other 3.4%

On the liability side of the balance sheet, 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 balance sheet growth, reflecting a high degree of confidence both in ABC Islamic Bank and in the parent company.

As to 2009 and beyond, we are confident that the consolidation process in the GCC's Financial Services Industry, particularly for the Sharia based practitioners that is yet to follow due to the impending global recession, troubled global financial markets, and the low price of crude oil will only provide opportunities for stronger institutions to emerge.

In conclusion, I would like to thank the CBB 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 ABC Islamic Bank's clients for their 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.

Abdulmagid Breish
Chairman

BOARD OF DIRECTORS

Abdulmagid Breish

Souheil Badro

Naveed Khan

Amr Gadallah

Luke Wells

Mr. Abdulmagid Breish*
Chairman
B.A. Political Sciences, American University of Beirut; Financial Analysis & Policy Diploma, IMF, Washington D.C., U.S.A. Member of the Guild of International Bankers, U.K.
Mr. Breish started his career in banking in 1975 when he joined the Libyan Arab Foreign Bank in Tripoli, Libya. He joined ABC in 1980 and served as Head of Business Development until 1985 before transferring to Tokyo as Chief Representative. In 1988 Mr. Breish took over as Managing director of ABC Investment & Services Co. (E.C.) the ABC Group's Investment Bank in Bahrain. In 1991 he assumed the position of General Manager of ABC International Bank plc, and was appointed that bank's Chief Executive Officer in 1993. In November 2002, Mr. Breish assumed the position of Deputy Chief Executive and Chief Banking Officer of the ABC Group. During 2008 Mr. Breish held the following directorships: Chairman of ABC Islamic Bank (E.C.), Bahrain, Chairman of ABC Securities, Chairman of the Bahrain Stock Exchange Audit Committee, and Board member of the Bahrain Stock Exchange. On 8th October 2008 Mr. Breish chose to seek early retirement with effect from 31st March 2009.

Mr. Souheil Badro
Deputy Chairman
MBA in Finance, American University, Washington, D.C., U.S.A.; MSc in Economics, St. Joseph University, Lebanon.
Mr. Badro joined ABC as Arab World Division Head in September 2006, and assumed his present position as Universal Banking Division Head in September 2008. He also serves as a director of Arab Banking Corporation – Algeria, Arab Banking Corporation – Tunisie and ABC Islamic Bank (E.C.). Mr. Badro began his banking career at Credit Libanais in 1975, before moving to Manufacturers Hanover Trust, where he held the position of Vice President in New York., Paris and Bahrain. Remaining in Bahrain, in 1992, he moved to Chemical Bank and in 1996 to Chase Manhattan Bank, as Vice President & Head of Financial Institutions. In September 1998, Mr. Badro joined Société Générale, where he was seconded to the Dubai Regional Representative Office to manage the MENA region in the capacity of Managing Director, Corporate and Investment Banking.

Mr. Amr Gadallah
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 Islamic Bank (E.C.), Bahrain and ABC Investments, Jordan.

Mr. Naveed Khan
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 following education at the University of Punjab, Lahore where an honours degree in Economics was followed by an MBA with Finance and Treasury specializations. 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. His responsibilities included most aspects of treasury and capital markets products. In 1999, Mr. Khan moved to Riyadh to become Head of Islamic Banking at Citi affiliate Saudi American Bank. The role was a wide one covering Shari'a-compliant consumer, corporate, treasury and private banking services as Division Head in SAMBA. In mid 2004 Mr. Khan was approached by Arab Banking Corporation to move over to Bahrain to re-shape and re-focus its wholly-owned subsidiary ABC Islamic Bank; he joined the bank in the newly created position of Managing Director in August 2004.

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.

** During the first quarter of 2009, the shareholders nominated Mr. Hassan Ali Juma, Mr. Graham Scopes and Mr. Mohamed El Qaq as replacements for Mr. Abdulmagid Breish, Shaikh Rasheid Al Khalifa and Mr. Duncan Smith respectively.*

MANAGEMENT

Mr. Naveed Khan
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 following education at the University of Punjab, Lahore where an honours degree in Economics was followed by an MBA with Finance and Treasury specializations. 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. His responsibilities included most aspects of treasury and capital markets products. In 1999, Mr. Khan moved to Riyadh to become Head of Islamic Banking at Citi affiliate Saudi American Bank. The role was a wide one covering Shari'a-compliant consumer, corporate, treasury and private banking services as Division Head in SAMBA. In mid 2004 Mr. Khan was approached by Arab Banking Corporation to move over to Bahrain to re-shape and re-focus its wholly-owned subsidiary ABC Islamic Bank; he joined the bank in the newly created position of Managing Director in August 2004.

Mr. Hammad Hassan
Head of Marketing
MBA, Lahore University of Management Sciences, Pakistan
B.Sc. Electrical Engineering, University of Engineering & Technology, Lahore, Pakistan.
Hammad has over fourteen 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 (product development and relationship management) and Islamic Finance. After completing his education, Hammad joined Citigroup in Pakistan in 1994. In 1997, Hammad 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 this role, Hammad was responsible for product development and structuring of complex financial transactions - mostly related to project & structured finance and treasury solutions in a Shariah compliant manner. In the business development role, he was instrumental in concluding several landmark Islamic transactions in petrochemicals, telecommunications and real estate sectors. In early 2005, Hammad moved to ABC Islamic Bank. In his current role as head of marketing and origination, he has lead managed and closed several high profile transactions including Islamic advisory mandates and Sukuk issues.

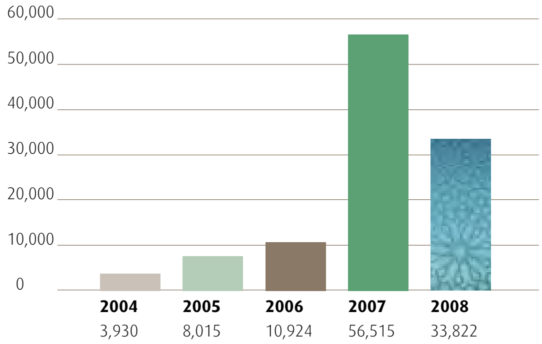
Mr. Abdulkarim Ismaeel Ahmed
Investment Funds Asset Manager
Acting Shari'a Compliance Officer, has 27 years of experience in both Islamic and conventional banking activities covering a wide spectrum including fund managing, administration, operations, accounting, auditing and Shari'a-compliance through various positions held at Banco do Brazil, Banque Nationale De Paris and the ABC Group. His long years of audit experience with the Group Audit Department of ABC at various Arab and international branches and subsidiaries further exposed him to a wider range of Islamic, retail and wholesale products and enhanced his awareness of compliance issues. He holds a Post Graduate Accounting Diploma from the Gulf Polytechnic, Bahrain

Mr. Hisham Mouzughi
Head of Risk & Credit Support
Hisham's association with the ABC group has been for 15 years. He initially joined the London Branch of ABC in 1989, following the completion of his Masters of Science in Business Administration (MSBA) from Boston University. 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. In addition to the MSBA, Hisham holds an MBA, a Postgraduate Diploma in Accounting & Finance from London School of Economics and a Postgraduate Diploma in Islamic Banking & Insurance from the Institute of Islamic Banking & Insurance in London.

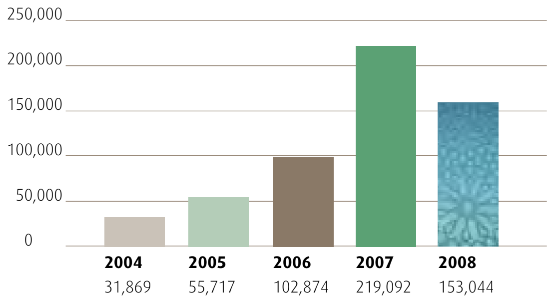
Mr. Khalid Alraee
Chief Financial Officer
B.Com, University of the Punjab, Pakistan
Mr. Alraee started his career with Peat Marwick, Mitchell & Co (merged with KPMG Fakhro), auditing banking clients, trading and shipping companies in 1984. Two years later he joined Reuters Middle East limited as the Regional Assistant Manager, Financial Control - responsible for financial reporting and accounting systems for the Bahrain, Saudi Arabia, Qatar and Yemen offices. In 1992, Mr Alraee began his career with ABC Group as Assistant Manager in the Accounting Systems & Compliance Department of ABC Investment and Services Co, which was later converted to a full fledged Islamic entity and consequently renamed ABC Islamic Bank. He currently holds the position of Chief Financial Officer, responsible for the development and maintenance of financial policies and procedures for the Bank's information systems for internal and external financial reporting. His responsibilities also include budgeting and performance review and reporting to management, shareholders and regulators.

FINANCIAL HIGHLIGHTS
(All figures stated in US dollars)

TOTAL OPERATING INCOME
US$ 000s



SHAREHOLDERS' FUNDS
US$ 000s



Total footings of the bank grew by only 7% year on year, as a result of the global slowdown affecting the GCC region as well. Net profit before provisions, Zakat and extra-ordinary items however registered a 49% increase. This was accomplished by a higher proportion of fee income and also a rationalization of the expense structure of the bank. The bank was affected though by having to take provisions for its exposure to the investment companies sector in Kuwait, as a consequence of which the net profit figure for 2008 came down to $25.6 million compared to the record figure of $50.9 million for 2007. The latter included a $33 million one off capital gain on disposal of a Sukuk.

The main factors which affected financial performance for 2008 were;

• Global recession and its impact on asset and investment values.
• Sharp reduction in rates.
• Credit contraction against the backdrop of customers relying on short term financing for longer term investments.

These factors are expected to continue in 2009 and will therefore continue to affect performance of the bank. No new acquisition or discontinuation of business is anticipated for 2009. The Capital structure and shareholding is expected to remain unchanged for this year.

BALANCE SHEET

Total assets of the bank grew by only $96 million taking the total asset figure in 2008 to $1.461 billion versus $1.365 billion in 2007. This came about as an increase in Ijara assets of $163 million, combined with a decrease in Morabaha receivables of $38 million, whereas the available for sale investments remained the same as last year around the $325 million mark. This was a concerted effort to change the mix of assets in favor of Ijara assets which are more tradeable and therefore provide more flexibility in structuring liability products like ABC Clearing Company.

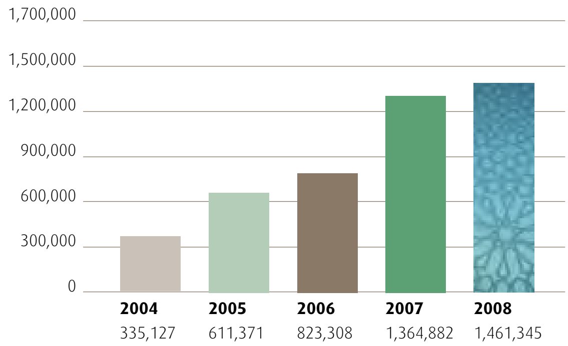
INCOME STATEMENT

Gross income from assets was down marginally from $71 million in 2007 to $69.8 milion in 2008 reflecting a sharp drop in Libor rates, but the cost of funding these assets decreased proportionately more. This was due to an improvement in spreads as a result of the liquidity squeeze and global credit crunch, which pushed yields higher.

Fee and commission income was also higher, increasing from $4.6 million in 2007 to $5.9 million in 2008. There was however a very large item of $32.9 million in 2007 which came about as a result of a capital gain on a Sukuk disposition, which could not be matched by a much lower figure of $2 million for a similar item in 2008.

Cost efficiency and expense rationalization helped decrease total costs and expenses by over 12% compared to last year, showing a very healthy increase of 49% in net profit before provisions, Zakat and extra-ordinary items.

TOTAL ASSETS
US$ 000s



RATIOS
(%)

	2004	2005	2006	2007	2008
Cost/income ratio	68.5	51.9	46.3	10.1	14.7
Return on average equity	4.5	8.5	9.0	34.7	13.1
Return on average assets	0.5	0.8	0.7	4.7	1.8
Liquidity assets ratio	34.6	38.4	40.1	26.2	24.6
Risk asset ratio-Tier 1	30.4	19.9	16.4	15.1	15.4
Risk asset ratio-Total	30.7	21.4	16.6	15.7	17.6

SOURCES AND APPLICATIONS OF FINANCIAL RESOURCES

A dividend payment of $20 million was paid to the parent in 2008 from retained earnings accumulated by a record profit of $50.9 million in 2007. The financial resources were however replenished by the retention of $25.6 million profit in 2008.

GEOGRAPHICAL AND SECTORAL 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 95% 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.

Institutional depositors & financial institutions provided the bulk of the bank's funding with $1,263 million (97% of the total).

LIQUIDITY

Against the backdrop of a regional liquidity crunch, perhaps more pronounced in U.S Dollars than other regional currencies, the bank launched an aggressive liability marketing campaign, and was successful in retaining the average level of deposits it has enjoyed historically even during the critical periods when initially the market was expecting an appreciation of regional currencies against the U.S Dollar and then when there was a general shortage of U.S Dollars in the regional currency markets.

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 17.6% in 2008 compared to 15.7% in 2007. This ratio exceeds the minimum amount of 12% required by the CBB.

REPORT OF THE SHARI'A SUPERVISORY BOARD TO THE SHAREHOLDERS ON PERFORMANCE OF ABC ISLAMIC BANK (E.C.) FOR THE YEAR 2008

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 reviewede 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 2008. 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 2008 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 the success and straight-forwardness.

Wassalam Alaikum Wa Rahmat Allah Wa Barakatuh

Shari'a Supervisory Board

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

27 Saffar 1430 H
22 February 2009 G
Manama, Kingdom of Bahrain

US$500 million Syndicated Ijara Facility

Core Arranger for Syndicated Ijara Facility, for the development and construction of Abraj AlBait Shopping Center in Makkah (a Saudi Binladin Group project).

CONTENTS

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ABC ISLAMIC BANK (E.C.)

We have audited the accompanying consolidated balance sheet of ABC Islamic Bank (E.C.) [the Bank] and its subsidiary [the Group] as of 31 December 2008, and the related consolidated statements of income, cash flows, changes in equity and sources and uses of zakah and charity funds for the year then ended. These consolidated financial statements and the Bank'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.

The Board of Directors is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and to operate in accordance with Islamic Shari'a. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

We conducted our audit in accordance with both International Standards on Auditing and Auditing Standards for Islamic Financial Institutions. 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.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2008, the results of its operations, its cash flows, changes in equity and changes in sources and uses of zakah and charity funds for the year then ended in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions and the Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

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

Ernst + Young

23 February 2009
Manama, Kingdom of Bahrain

CONSOLIDATED BALANCE SHEET
31 December 2008

	Notes	2008 US$ '000	2007 US$ '000
ASSETS			
Cash and bank balances	3	410	3,453
Available-for-sale investments	4	324,990	328,920
Murabaha receivables	5	692,171	730,373
Ijarah receivables		1,683	-
Musharaka financing		3,616	2,084
Mudaraba		803	-
Ijarah	6	427,949	265,061
Equipment		40	75
Other assets	7	9,683	34,916
TOTAL ASSETS		1,461,345	1,364,882
LIABILITIES AND EQUITY			
Liabilities			
Other liabilities	8	10,940	14,296
Murabaha payables	9	1,297,361	1,131,494
		1,308,301	1,145,790
Equity			
Share capital	10	132,500	132,500
Retained earnings and reserves	10	20,544	86,592
		153,044	219,092
TOTAL LIABILITIES AND EQUITY		1,461,345	1,364,882
MEMORANDUM ITEMS	11	124,849	346,909

Abdulmagid Breish
Chairman

Naveed Khan
Managing Director

The attached explanatory notes 1 to 20 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME

Year ended 31 December 2008

	Notes	2008 US$ 000	2007 US$ 000
Income from available-for-sale investments		**17,533**	21,382
Income from Murabaha receivables		**36,479**	37,648
Income from Musharaka financing		**279**	88
Ijarah income – net	6	**15,499**	11,871
		69,790	70,989
Profit on Murabaha payables		**(43,896)**	(51,959)
		25,894	19,030
Gain on sale of available-for-sale investments - net		**2,022**	32,866
Fees and commission income	12	**5,906**	4,619
		33,822	56,515
Staff costs		**3,222**	3,534
Depreciation		**51**	72
Other expenses	13	**1,709**	2,084
		4,982	5,690
(Provision for credit losses)/Recoveries	4 & 5	**(3,000)**	303
Profit for the year before Zakah		**25,840**	51,128
Zakah		**(260)**	(250)
PROFIT FOR THE YEAR AFTER ZAKAH		**25,580**	50,878

The attached explanatory notes 1 to 20 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
Year ended 31 December 2008

	Notes	2008 US$ '000	2007 US$ '000
OPERATING ACTIVITIES			
Profit for the year after Zakah		**25,580**	50,878
Adjustment for:			
Depreciation		**51**	72
Gain on sale of available-for-sale investments		**(2,022)**	(32,866)
Provision for credit losses/(Recoveries)	4 & 5	**3,000**	(303)
		26,609	17,781
Changes in:			
Murabaha receivables		**38,202**	(311,440)
Ijarah receivables		**(1,683)**	-
Musharaka financing		**(1,532)**	(2,084)
Mudaraba		**(803)**	-
Ijarah		**(162,888)**	(137,215)
Other assets		**25,233**	(27,262)
Other liabilities		**(3,356)**	6,511
Murabaha payables		**165,867**	418,845
Net cash from (used in) operating activities		**85,649**	(34,864)
INVESTING ACTIVITIES			
Purchase of available-for-sale investments		**(90,869)**	(199,896)
Proceeds from sale/redemption of available-for-sale investments		**22,193**	186,350
Purchase of equipment		**(16)**	(19)
Net cash used in investing activities		**(68,692)**	(13,565)
FINANCING ACTIVITIES			
Increase in paid-up capital	10	**-**	50,000
Dividends paid	10	**(20,000)**	-
Net cash (used in) from financing activities		**(20,000)**	50,000
NET CHANGE IN CASH AND CASH EQUIVALENTS		**(3,043)**	1,571
Cash and cash equivalents at 1 January		**3,453**	1,882
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	3	**410**	3,453
OPERATIONAL CASH FLOWS FROM PROFITS			
Profit paid		**50,365**	47,111
Profit received		**76,153**	67,530

The attached explanatory notes 1 to 20 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Year ended 31 December 2008

	Share capital	Statutory reserve	Available -for-sale reserve	Retained earnings	Total equity
	US$ 000	US$ 000	US$ 000	US$ 000	US$ 000
Balance at 1 January 2008	132,500	9,441	17,652	59,499	219,092
Cumulative changes in fair values					
Transfer to profit and loss	-	-	(18,450)	-	(18,450)
Change in fair values	-	-	(53,178)	-	(53,178)
	-	-	(71,628)	-	(71,628)
Profit for the year – 2008	-	-	-	25,580	25,580
Net income recognised during the year	-	-	(71,628)	25,580	(46,048)
Dividends paid (note 10)		-	-	(20,000)	(20,000)
Transfer to statutory reserve	-	2,558	-	(2,558)	-
Balance at 31 December 2008	**132,500**	**11,999**	**(53,976)**	**62,521**	**153,044**
Balance at 1 January 2007	82,500	4,353	2,312	13,709	102,874
Cumulative changes in fair values					
Transfer to profit and loss	-	-	(11,556)	-	(11,556)
Change in fair values	-	-	26,896	-	26,896
	-	-	15,340	-	15,340
Profit for the year – 2007	-	-	-	50,878	50,878
Net income recognised during the year	-	-	15,340	50,878	66,218
Increase in share capital	50,000	-	-	-	50,000
Transfer to statutory reserve	-	5,088	-	(5,088)	-
Balance at 31 December 2007	132,500	9,441	17,652	59,499	219,092

The attached explanatory notes 1 to 20 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF SOURCES AND USES OF ZAKAH AND CHARITY FUNDS

Year ended 31 December 2008

	2008 US$ 000	2007 US$ 000
Sources of zakah and charity funds		
Balance at 1 January	**310**	361
Charity	**15**	31
Zakah due from the Bank (*)	**260**	250
Total sources	**585**	642
Uses of zakah and charity funds		
Zakah and charity paid to poor and needy	**(310)**	(332)
Undistributed zakah & charity funds at end of the year (Note 8)	**275**	310

* 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$ 3,944 thousand (2007: US$ 5,645 thousand) of which US$ 260 thousand (2007: US$ 250 thousand) is payable by the Bank.

The attached explanatory notes 1 to 20 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 a 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 2008, the total number of employees employed by the Bank was 18 (2007: 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 Bank'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 2008 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 23 February 2009.

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] and the relevant provisions of the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law. For matters which are not covered by AAOIFI standards, the Group uses the International Financial Reporting Standards [IFRS].

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

The consolidated financial statements are prepared in US Dollars, being the functional currency of the Group's operations.

Basis of consolidation
The consolidated financial statements incorporate the financial statements of the Bank and its subsidiary. A subsidiary is an entity over which the Bank has control to govern its financial and operating policies in order to obtain benefits from its activities.

The results of subsidiary are included in the consolidated financial statements from the date on which control is transferred to the Bank and cease to be consolidated from the date on which control is transferred out of the Bank. All intercompany balances, transactions, income and expenses have been eliminated on consolidation.

2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Significant accounting policies
Following is a summary of the significant accounting policies adopted in preparing the consolidated financial statements. These accounting policies are consistent with those used in the previous year, except for the following:

On 30 October 2008, AAOIFI issued a guidance statement on accounting for investments and amendment in Financial Accounting Standard 17 Investments. This amendment allows Islamic Financial Institutions to carry unrealised losses from re-measurement of investments in sukuk and shares in the statement of equity under the available-for-sale reserve. Previously, any net negative unrealised losses were to be taken to the statement of income. The amendment is effective from 1 July 2008 and has been adopted by the Group.

As a result of the application of the revised standard, negative fair value of US$ 53,976 thousand relating to investments in sukuk has been retained under available-for-sale reserve in the statement of changes in equity.

Available-for-sale investments
All investments are initially recognised at cost, being the fair value of the consideration given including acquisition costs associated with the investment.

After initial recognition, investments are remeasured at fair value. Fair value changes are reported as a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as "available-for-sale reserve " within equity, is included in the statement of income for the year.

The reversal of previously recognised impairment losses are recorded as increases in fair value reserve through equity.

Investments for which fair value cannot be determined or cannot be remeasured to fair value are carried at cost or at a previously revalued amount, less provision for credit losses.

Murabaha receivables
Murabaha receivables consist mainly of deferred sales transaction agreements (Murabaha) and are stated net of deferred profits and provision for credit losses.

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.

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 balance sheet date.

Fair values (continued)
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

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.

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 or more overdue is excluded from income until it is received in cash.

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

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

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 balance sheet. 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 balance sheet 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.

2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 comprise cash and bank balances.

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

Classification of investments
Management decides on acquisition of an investment whether it should be classified as held to maturity, held for trading, or available-for-sale.

For those deemed to be held to maturity management ensures that the requirements of FAS 17 and IAS 39 are met and in particular the Group has the intention and ability to hold these to maturity.

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

All other investments are classified as available-for-sale.

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

Impairment
An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the assessment by the Group of the value to it of anticipated future cash flows, is recognised in the consolidated statement of income. Specific provisions are created to reduce all impaired financial contracts to their expected realisable value.

Fair valuation of investments
The determination of fair values of unquoted investments requires management to make estimates and assumptions that may affect the reported amount of assets at the date of financial statements. The valuation of such investments is based on the fair value criteria explained above.

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.

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 General Organisation of Social Insurance scheme and the Group's obligations are limited to the amount contributed to the scheme.

3. CASH AND BANK BALANCES

	2008	2007
	US$ 000	US$ 000
Balance with ABC (B.S.C.)	352	2,918
Cash and balance with other bank	58	535
	410	3,453

4. AVAILABLE-FOR-SALE INVESTMENTS

	2008			2007
	Cost	Cumulative changes in fair values	Total carrying value	Total
	US$ '000	US$ '000	US$ '000	US$ '000
Quoted Sukuk at fair value	381,966	(53,976)	327,990	325,169
Others	-	-	-	3,751
	381,966	(53,976)	327,990	328,920
Provision for credit losses	-	-	(3,000)	-
	381,966	(53,976)	324,990	328,920

The movement in provisions for credit losses is as follows:

	2008	2007
	US$ 000	US$ 000
At 1 January	-	-
Impairment	3,000	-
At 31 December	3,000	-

5. MURABAHA RECEIVABLES

	2008	2007
	US$ 000	US$ 000
International Commodity Murabaha	33,800	25,500
Murabaha receivables	665,645	716,893
Deferred profits	(7,274)	(12,020)
	692,171	730,373

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 2008, amounted to US$ 101,622 thousand (2007: US$ 4,069 thousand). Included in the above are Murabaha receivables amounting to US$ 95,200 thousand (2007: nil) whose carrying values have been guaranteed by ABC (B.S.C.).

5. MURABAHA RECEIVABLES (CONTINUED)

The movement in provisions for credit losses is as follows:

	2008	2007
	US$ 000	US$ 000
At 1 January	**-**	303
Recoveries	**-**	(303)
	-	-

6. IJARAH

Ijarah comprise:

	2008	2007
	US$ 000	US$ 000
Ijarah Muntahia Bittamleek *	**182,976**	152,881
Others	**244,973**	112,180
	427,949	265,061

There are no impaired Ijarahs as of 31 December 2008 (2007: 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 instalments are settled and the lessee purchases the asset.

	2008	2007
	US$ 000	US$ 000
Cost:		
At 1 January	**184,628**	125,985
Additions	**47,345**	100,505
Disposals	**(4,097)**	(41,862)
At 31 December	**227,876**	184,628
Depreciation:		
At 1 January	**31,747**	30,873
Provided during the year	**14,044**	14,164
Relating to disposals	**(891)**	(13,290)
At 31 December	**44,900**	31,747
Net book amount:		
At 31 December	**182,976**	152,881

6. IJARAH (CONTINUED)

The details of Ijarah income are as follows:

	2008 US$ 000	2007 US$ 000
Ijarah income – gross	**29,543**	26,035
Depreciation provided during the year	**(14,044)**	(14,164)
Ijarah income – net	**15,499**	11,871

7. OTHER ASSETS

	2008 US$ 000	2007 US$ 000
Receivable on sale of available-for-sale investments	**6,044**	27,222
Accrued income receivable	**3,040**	7,043
Mandatory reserve with Central Bank of Bahrain	**53**	53
Others	**546**	598
	9,683	34,916

8. OTHER LIABILITIES

	2008 US$ 000	2007 US$ 000
Zakah and charity funds payable	**275**	310
Staff related accruals	**1,600**	1,739
Unearned income	**8,583**	9,964
Accrued charges	**482**	2,283
	10,940	14,296

9. MURABAHA PAYABLES

	2008 US$ 000	2007 US$ 000
Customers' accounts	**33,526**	44,662
Banks and other financial institutions	**223,664**	132,746
ABC (B.S.C.)	**1,040,171**	954,086
	1,297,361	1,131,494

10. EQUITY

(i) Share capital

	Ordinary shares of US $ 100 each	
	2008	2007
	US$ 000	US$ 000
Authorised	**200,000**	200,000
Issued, subscribed and fully paid	**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.

(iii) Dividends paid
At the Annual General Meeting held on 28 February 2008, the shareholders of the Bank resolved to pay a dividend of US$ 0.151 per share amounting to US$ 20,000 thousand.

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.

11. MEMORANDUM ITEMS (CONTINUED)

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

	2008	2007
	US$ 000	US$ 000
Letters of credit	**17,940**	23,234
Guarantees	**837**	54,869
Acceptances	**-**	132
Irrevocable commitments*	**106,072**	268,674
	124,849	346,909

* Out of total irrevocable commitments, US$ nil (2007: US$ 21,381 thousand) expire in less than one year.

12. FEES AND COMMISSION INCOME

	2008	2007
	US$ 000	US$ 000
Income from fiduciary services	**207**	1,501
Other fees and comission income	**5,699**	3,118
	5,906	4,619

13. OTHER EXPENSES

	2008	2007
	US$ 000	US$ 000
Charges by ABC (B.S.C.)	**700**	700
Business related expenses	**306**	421
Professional fees and licenses	**165**	427
Other operating expenses	**538**	536
	1,709	2,084

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 operates 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.), the parent, 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 balance sheet date are as follows:

	2008	2007
	US$ 000	US$ 000
Balance with ABC (B.S.C.)	**352**	2,918
Murabaha receivables	**33,800**	25,500
Murabaha payables	**1,040,171**	954,086

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

	2008	2007
	US$ 000	US$ 000
Income from Murabaha receivables	**1,009**	1,317
Profit on Murabaha payables	**36,563**	41,710
Charges by ABC (B.S.C.)	**700**	700

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

	2008	2007
	US$ 000	US$ 000
Shari'a Supervisory Board	**121**	67
Short term employee benefits to key management personnel	**707**	644

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 and market risk. It is also subject to operating risks.

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.

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.

16. RISK MANAGEMENT (CONTINUED)

Risk management structure (continued)
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 continually 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 Bank's internal credit rating system. Where unsecured facilities sought are considered to be beyond prudential limits, Group policies require collateral to mitigate the credit risk in the form of cash, securities, legal charges over the customer's assets or third-party guarantees. The Group also employs threshold 'risk adjusted return on capital' as a measure to evaluate the risk/reward relationship at the transaction approval stage.

Type of credit risk
Various contracts entered into by the Group mainly comprise Murabaha receivables and Ijarah.

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

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

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 balance sheet, 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	Gross maximum exposure
	2008	2007
	US$ '000	US$ '000
Available-for-sale investments	**327,990**	328,920
Murabaha receivables	**692,171**	730,373
Ijarah receivables	**1,683**	-
Musharaka financing	**3,616**	2,084
Mudaraba	**803**	-
Ijarah	**427,949**	265,061
Other assets	**3,040**	7,043
Total	**1,457,252**	1,333,481
Letters of credit, guarantees and acceptances	**18,777**	78,235
Irrevocable commitments to provide trading facilities	**106,072**	268,674
Total	**124,849**	346,909

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.

16. RISK MANAGEMENT (CONTINUED)

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

	2008			2007		
	Assets	**Liabilities and Equity**	**Memorandum items**	Assets	Liabilities and Equity	Memorandum items
	US$ 000	**US$ 000**	**US$ 000**	US$ 000	US$ 000	US$ 000
Geographic region:						
North America	**291**	**-**	**-**	3,868	-	-
Western Europe	**803**	**-**	**-**	-	-	-
Other Europe (including Turkey)	**35,457**	**-**	**-**	49,813	-	-
Arab World:						
- Middle East	**1,415,550**	**1,461,224**	**118,921**	1,276,506	1,364,791	345,847
- North Africa	**-**	**21**	**-**	-	7	-
Asia:						
- Far East	**-**	**-**	**-**	34,695	84	-
- Other	**9,244**	**100**	**5,928**	-	-	1,062
	1,461,345	**1,461,345**	**124,849**	1,364,882	1,364,882	346,909

16. RISK MANAGEMENT (CONTINUED)

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

	2008			2007		
	Assets	**Liabilities and Equity**	**Memorandum items**	Assets	Liabilities and Equity	Memorandum items
	US$ 000	**US$ 000**	**US$ 000**	US$ 000	US$ 000	US$ 000
Industry sector:						
Manufacturing	**400,051**	**7,236**	**72,824**	301,650	12	199,839
Construction	**31,687**	**2,542**	**-**	132,880	22	-
Trading	**39,475**	**743**	**696**	61,278	26	457
Banks and financial institutions	**415,017**	**1,275,662**	**25,161**	359,825	944,306	12,889
Government	**59,397**	**-**	**5,928**	85,122	-	1,062
Personal		**21**	**-**	-	7	-
Commercial real estate	**438,235**	**-**	**20,240**	365,113	-	81,662
Technology, Media, Telecomms	**54,452**	**-**	**-**	-	-	51,000
Transportation	**22,445**	**-**	**-**	12,357	-	-
Other	**586**	**175,141**	**-**	46,657	420,509	-
	1,461,345	**1,461,345**	**124,849**	1,364,882	1,364,882	346,909

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.

16. RISK MANAGEMENT (CONTINUED)

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

	Not impaired			
	High grade (1-3) 2008 US$ 000	**Standard grade (4-8) 2008 US$ 000**	**Sub-standard grade (9-10) 2008 US$ 000**	**Total 2008 US$ 000**
Available-for-sale investments	94,175	230,815	-	324,990
Murabaha receivables	163,401	524,701	4,069	692,171
Ijarah receivables	1,140	543	-	1,683
Musharaka financing	-	3,616	-	3,616
Mudaraba	803	-	-	803
Ijarah	218,081	209,868	-	427,949
	477,600	969,543	4,069	1,451,212

	NoT impaired			
	High grade (1-3) 2007 US$ 000	Standard grade (4-8) 2007 US$ 000	Sub-standard grade (9-10) 2007 US$ 000	Total 2007 US$ 000
Available for sale investments	46,221	282,699	-	328,920
Murabaha receivables	119,424	606,880	4,069	730,373
Musharaka financing	-	2,084	-	2,084
Ijarah	224,967	40,094	-	265,061
	390,612	931,757	4,069	1,326,438

Past due but not impaired financial assets
As of 31 December 2008, Murabaha receivables that were past due amounted to US$ 101,622 thousand (2007: US$ 4,069 thousand), out of which US$ 97,553 thousand (2007: nil) was past due for less than 30 days and US$ 4,069 thousand (2007: US$ 4,069 thousand) was past due for more than 90 days.

Financial assets whose terms have been renegotiated
As of 31 December 2008, there were no financial assets whose terms were renegotiated during the year (2007: 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.

16. RISK MANAGEMENT (CONTINUED)

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.

	2008	2007
	%	%
Available-for-sale investments	**2.28 - 7.15**	5.17 - 7.61
Murabaha receivables	**0.03 - 9.19**	4.83 - 9.19
Musharaka financing	**4.90 - 6.33**	6.33
Ijarah	**0.86 - 6.90**	4.24 - 6.90
Murabaha payables	**1.60 - 5.58**	4.50 - 5.70

The sensitivity for every 25 basis points increase in profit rates of the Group's statement of income, with all other variables held constant, would be an increase of profit by US$ 806 thousand (2007: US$ 1,038 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 balance sheet 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)

Liquidity risk (continued)
The maturity profile of assets, liabilities, and equity is as follows:

31 December 2008	Up to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 to 3 years	Over 3 years	No fixed maturity	Total
	US$ 000	US$ 000	US$ 000	US$ 000	US$ 000	US$ 000	US$ 000	US$ 000
ASSETS								
Cash and bank balances	410	-	-	-	-	-	-	410
Available for sale investments	-	-	-	10,004	157,749	157,237	-	324,990
Murabaha receivables	35,922	32,601	111,668	201,825	232,370	77,785	-	692,171
Ijarah receivables	501	1,013	169	-	-	-	-	1,683
Musharaka financing	125	251	373	723	2,144	-	-	3,616
Mudaraba	-	-	-	-	-	803	-	803
Ijarah	10,568	17,362	6,581	10,073	78,382	304,983	-	427,949
Equipment	-	-	-	-	-	-	40	40
Other assets	-	6,044	3,040	-	546	-	53	9,683
Total assets	47,526	57,271	121,831	222,625	471,191	540,808	93	1,461,345
LIABILITIES AND EQUITY								
Other liabilities	-	-	-	275	1,184	-	9,481	10,940
Murabaha payables	535,994	587,179	128,143	43,115	2,930	-	-	1,297,361
Equity	-	-	-	-	-	-	153,044	153,044
Total liabilities and equity	535,994	587,179	128,143	43,390	4,114	-	162,525	1,461,345
Net liquidity gap	(488,468)	(529,908)	(6,312)	179,235	467,077	540,808	(162,432)	
Cumulative liquidity gap	(488,468)	(1,018,376)	(1,024,688)	(845,453)	(378,376)	162,432	-	

16. RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

31 December 2007	Up to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 to 3 years	Over 3 years	No fixed maturity	Total
	US$ 000	US$ 000	US$ 000	US$ 000	US$ 000	US$ 000	US$ 000	US$ 000
ASSETS								
Cash and bank balances	3,453	-	-	-	-	-	-	3,453
Available for sale investments	2,993	3,751	1,500	1,500	43,815	275,361	-	328,920
Murabaha receivables	142,077	166,677	227,838	102,128	79,790	11,863	-	730,373
Musharaka financing	-	-	-	-	2,084	-	-	2,084
Ijarah	908	8,693	6,712	5,265	89,982	153,501	-	265,061
Equipment	-	-	-	-	-	-	75	75
Other assets	27,222	-	7,043	-	598	-	53	34,916
Total assets	176,653	179,121	243,093	108,893	216,269	440,725	128	1,364,882
LIABILITIES AND EQUITY								
Other liabilities	-	-	-	310	3,326	-	10,660	14,296
Murabaha payables	377,813	376,934	281,472	77,847	17,428	-	-	1,131,494
Equity	-	-	-	-	-	-	219,092	219,092
Total liabilities and equity	377,813	376,934	281,472	78,157	20,754	-	229,752	1,364,882
Net liquidity gap	(201,160)	(197,813)	(38,379)	30,736	195,515	440,725	(229,624)	
Cumulative liquidity gap	(201,160)	(398,973)	(437,352)	(406,616)	(211,101)	229,624	-	

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 balance sheet.

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$ 15 thousand (2007: US$ 31 thousand) out of which US$ 7 thousand (2007: US$ 4 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.

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Tito Enrique da Silva Neto
President

TABLE OF CONTENTS

PUBLIC DISCLOSURES
31 December 2008

1. INTRODUCTION
This document gathers together all the elements of the disclosure required under Pillar III, which are not covered in the 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 sets out the related monitoring processes and credit mitigation initiatives.

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

The disclosures in this section are in addition to the consolidated financial statements and 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 Central of Bahrain and Financial Institutions Law. For matters which are not covered by AAOIFI standards, the Group uses the International Financial Reporting Standards (IFRS) and other sections of the annual report. However the credit risk exposures considered in this section differ from the credit risk exposures reported in the consolidated financial statements due to the application of different methodologies between Basel II and IFRS 7, Differences primarily arise due to 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-balance sheet notional amounts into an equivalent on-balance sheet exposure. In the consolidated financial statements, the nominal values of credit-related contingent items are treated as off-balance sheet.

- 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 consolidated financial statements, the assets are presented based on asset class (i.e. securities, Islamic financing etc).

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

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

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

2. GROUP STRUCTURE

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 a wholesale banking license issued by the Central Bank of Bahrain {CBB} and are engaged in financial trading in accordance with the teachings of Islam (Shari'a).

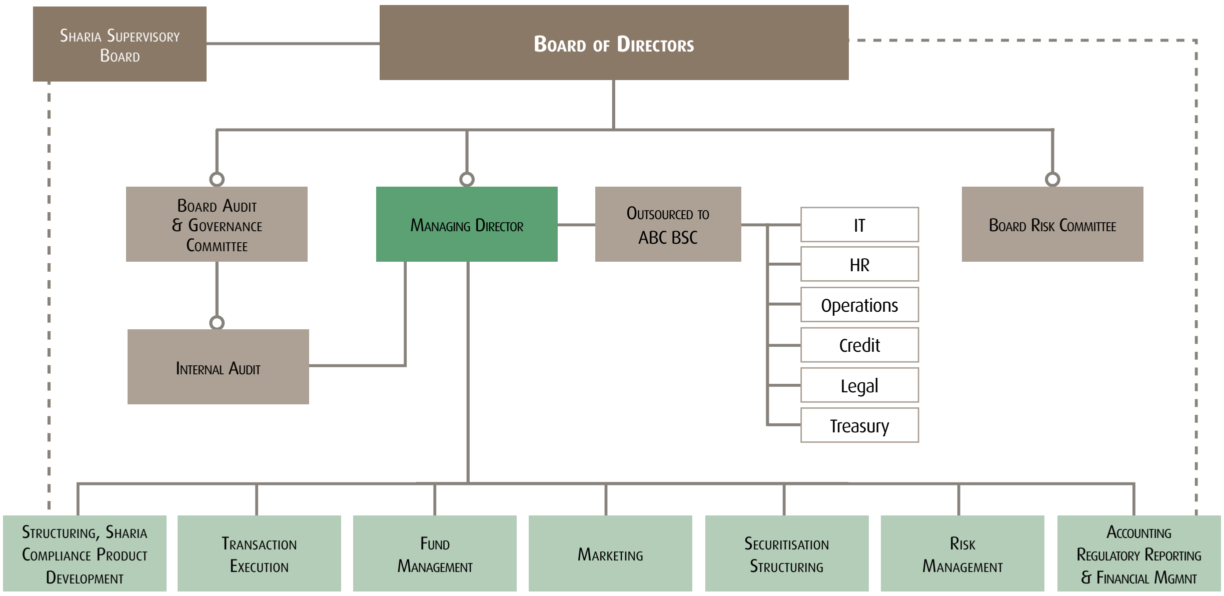
Arab Banking Corporation B.S.C. {"ABC"}, which operates under a wholesale banking license issued by the CBB, holds 100% of the share capital of the Bank.

The financial statements and capital adequacy regulatory reports of ABC Islamic Bank (E.C.) and its subsidiary [the Group] have been prepared and consolidated on a consistent basis.

The ownership in the subsidiary as at 31 December 2008 is as follows:

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



The Bank has in place comprehensive policies regarding the remuneration and benefits provided to members of the Board of Directors and its Committees, senior management and staff. In regard to Directors, compensation comprises fixed annual remuneration fees 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.

3. SHARIA COMPLIANCE

The Sharia Compliance Officer of the Bank conducts regular Sharia compliance reviews to ensure that documentation, procedures and execution of transactions are in accordance with the Sharia Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions and the Sharia rules and principles as determined by the Sharia Supervisory Board of the Bank {The SSB}. The results of such reviews are reported to the SSB. Cases of non-Sharia compliance are thoroughly investigated to establish causes of their occurrence and to ensure introduction of adequate controls to avoid their reoccurrence in the future.

Non-Sharia compliant earnings in 2008 mainly represent interest received on money at call with banks and amounts of penalty charges received from clients on late payments. These have been disposed off to charitable causes.

The SSB of the Group consists of three Sharia scholars (Chairman and two members). The SSB meet periodically (3-4 times a year) or whenever 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 fee, irrespective of the number of meetings held during the year or the financial results of the Bank. The Bank also pays for hotel accommodation and travel expenses for the non Bahrain-based members to facilitate their attendance of the SSB meetings.

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's profit.

The issued and paid up share capital of the Bank was US$132.5 million at 31 December 2008, comprising of 132.5 million shares of US$ 1 each.

The Group's capital base of US$207.0 million comprises Tier 1 capital of US$181.4 million and Tier 2 capital of US$25.6 million as detailed below:

Breakdown of Capital Base

US$ million	Tier 1	Tier 2	Total
Share capital	132.5	-	132.5
Statutory reserve	12.0	-	12.0
Retained earnings	36.9	-	36.9
Profit for the year	-	25.6	25.6
Tier 1 and Tier 2 capital base	181.4	25.6	207.0

Risk weighted assets (RWA)	
Credit risk	1,150.0
Market risk	-
Operational risk	27.6
	1,177.6
Tier 1 ratio	15.4%
Capital adequacy ratio	17.6%

5. CAPITAL ADEQUACY RATIOS (CAR)

The purpose of capital management at the Group is to ensure the efficient utilization 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 or adjust the amount of dividend payment to shareholders. No changes have been made in the objectives, policies and processes from the previous years.

The Group's total capital adequacy ratio as at 31 December 2008 was 17.6% compared with the minimum regulatory requirement of 12%. The Tier 1 ratio was 15.4% 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 risk, market risk and operational risk for regulatory reporting purposes. The Group's risk-weighted capital requirement 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 those mentioned above 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 PSE's, 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 those mentioned above are risk weighted based on their credit ratings.

c. *Claims on multilateral development banks (MDBs)*
   All MDBs are risk weighted in accordance with the banks credit rating except for those members listed in the World Bank Group which are 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 favorable 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 corporate portfolio*
   Claims on corporate portfolio are risk weighted based on credit ratings. Risk weightings for unrated corporate claims are assigned at 100%.

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

(a) 150% risk weight when specific provisions are less than 20% of the outstanding amount of the financing.
(b) 100% risk weight when specific provisions are greater than 20% of the outstanding amount of the financing.

g. *Equity portfolios*
Investments in listed equities are risk weighted at 100% while unlisted equities are risk weighted at 150%. Nonetheless, the Bank maintains no equity position.

h. *Project finance exposures*
Exposures on project finance are risk weighted according to the Regulatory Slotting Criteria, in which the risk weighting range 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**	**Unfunded Exposure**	**Risk-weighted assets for Funded Exposures**	**Risk-weighted assets for Un-Funded Exposures**	**Total Risk Weighted Assets**	**Capital charge (12%)**
Sovereigns	88,591	85,627	2,964	9,244	2,964	12,208	1,465
Claims on public sector	94,126	94,126	-	-	-	-	-
Claims on banks	267,277	262,852	4,425	131,089	1,617	132,706	15,925
Claims on corporates	829,635	784,981	44,654	784,981	44,654	829,635	99,556
Past due exposures	101,622	101,622	-	39,833	-	39,833	4,780
Project finance	190,945	185,527	5,418	130,594	4,431	135,025	16,203
Other exposures	586	586	-	586	-	586	70
Total	1,572,782	1,515,321	57,461	1,096,327	53,666	1,149,993	137,999

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

Breakdown of capital requirements for credit risk per types of Islamic financing contracts:

US$ thousands **Type of Financing**	**Gross Credit exposure**	**Funded Exposure**	**Un-Funded Exposure**	**RWA - Funded**	**RWA - Unfunded**	**Total RWA**	**Capital charge (12%)**
Murabaha	708,862	692,171	16,691	472,526	16,691	489,217	58,706
Ijara	461,102	427,949	33,153	290,835	32,485	323,320	38,798
Ijara Receivable	1,683	1,683	-	1,119	-	1,119	134
Sukuk	381,996	381,996	-	324,894	-	324,894	38,987
Mudaraba	803	803	-	-	-	-	-
Musharaka	6,818	3,626	3,192	3,263	2,873	6,136	737
LC	4,425	-	4,425	-	1,617	1,617	194
Other	7,093	7,093	-	3,690	-	3,690	443
Total	1,572,782	1,515,321	57,461	1,096,327	53,666	1,149,993	137,999

6.2 Market risk
The Bank, 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, hence avoiding any foreign exchange currency risk; and
(iv) maintain no sukuk trading position.

Accordingly, the Bank 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$27.6 million. This capital charge was computed by categorizing 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:

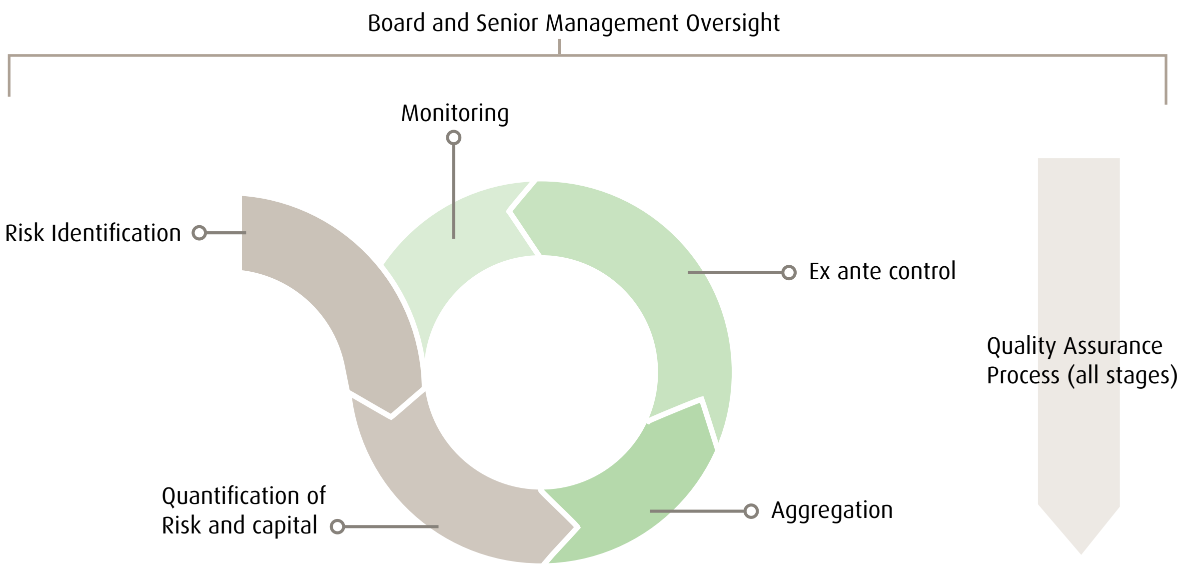
Gross income *US$ thousands*	31,800
Amount of non Sharia compliant income *US$ thousands*	15
Number of Sharia violations	2

7. RISK MANAGEMENT

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

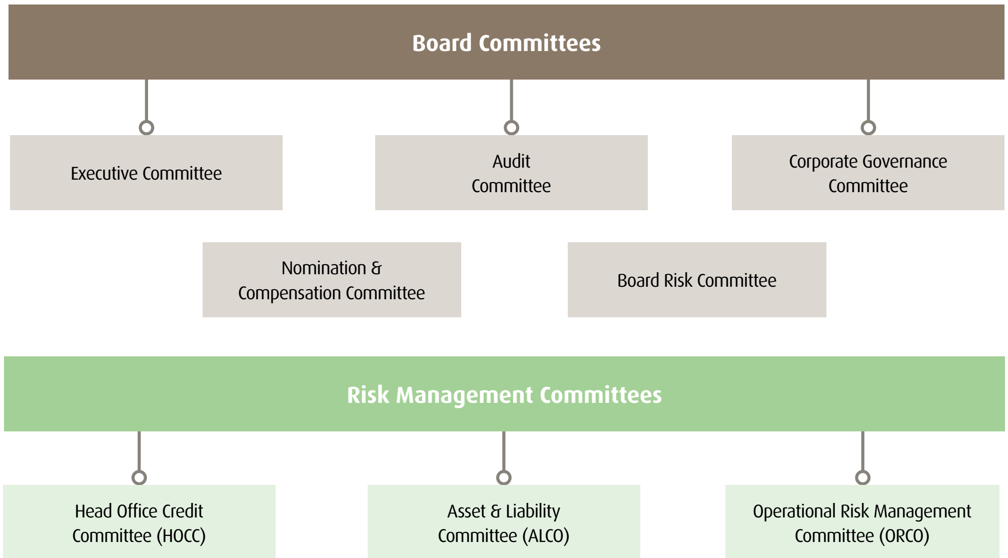
Figure 1:



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 in 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 to coordinate with other Board Committees for monitoring compliance with the requirements of the regulatory authorities in the various countries in which the 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 Bank 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, 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 2008, the Bank's three largest exposures in excess of 15% of the capital base are shown below:

US$ thousands	**On Balance Sheet Exposure**	**Off Balance Sheet Exposure**	**Total Exposure**
Counterparty A	172,544	20,240	192,784
Counterparty B	83,443	-	83,443
Counterparty c	75,938	-	75,938

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, 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 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.

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 countries of GCC, as illustrated in the table below:

US$ thousands

Country / Region	Gross Exposure	Percentage of Exposure
Bahrain	200,272	12.73%
Saudi Arabia	488,391	31.05%
Kuwait	293,319	18.65%
Qatar	145,910	9.28%
UAE	368,911	23.45%
Oman	20,057	1.27%
Other MENA Countries	7,163	0.46%
Other Asia	12,208	0.78%
Europe (Including Turkey)	36,260	2.31%
USA	291	0.02%
Total	1,572,782	100.00%

7.4 Industrial sector analysis of the exposures

The industrial sector analysis of exposures is provided in note 16 to the consolidated financial statements.

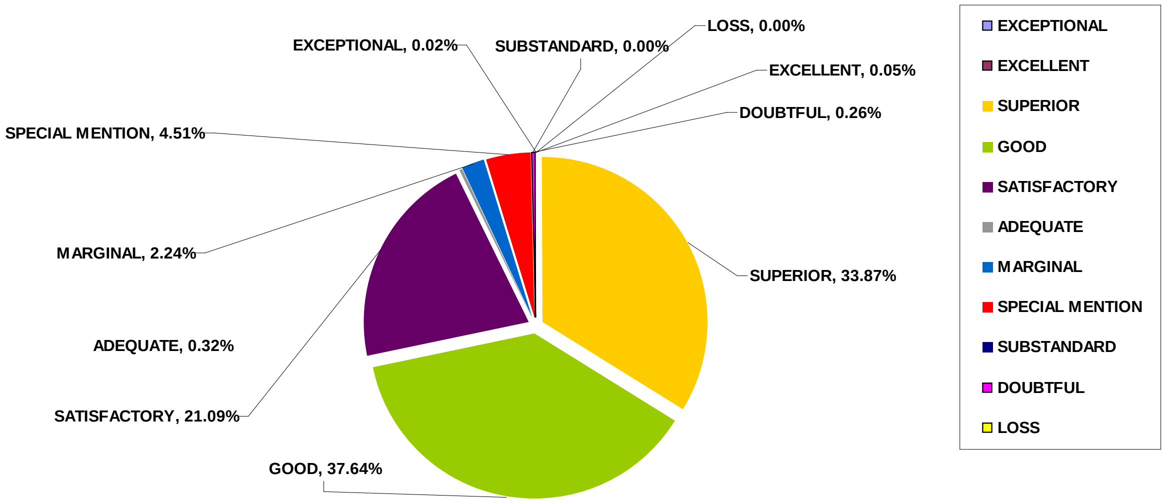
7.5 Exposure by external credit rating

The Group uses external ratings from Standard & Poors', 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	88,591	26,230	62,361
Claims on public sector	94,126	-	94,126
Claims on banks	267,277	227,845	39,432
Claims on corporates	829,635	33,475	796,160
Past due exposures	101,622	-	101,622
Project finance	190,945	-	190,945
Other exposures	586	-	586
Total	1,572,782	287,550	1,285,232

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio through 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 and are derived in accordance with ABC's credit policy, are assessed and updated regularly. Each risk rating class is mapped to grades equivalent to Standard & Poors', Moody's, Fitch ratings and Capital Intelligence rating agencies.



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 of the Group's major types of funded credit exposures amounting to US$ 1,515,321 thousand, which are based on expected maturities is as follows:

US$ thousands	within 1 month	1-3 months	3-6 months	6-12 months	Total wihin 12 months	1-5 years	5-10 years	10-20 years	Undated	Total over 12 months	Total
Sovereigns	2,122	8,630	1,355	12,710	24,817	37,851	22,906	-	53	60,757	85,627
Claims on public sector	-	200	33,123	2,805	36,128	47,488	7,352	3,158	-	57,998	94,126
Claims on banks	34,210	31,523	10,083	78,296	154,112	108,740	-	-	-	108,740	262,852
Claims on Corporates	7,468	2,592	72,355	59,023	141,438	550,428	63,670	29,445	-	643,543	784,981
Past due exposures	-	-	-	67,600	67,600	34,022	-	-	-	34,022	101,622
Project finance	3,736	14,326	1,875	2,188	22,125	21,574	52,949	88,879	-	163,402	185,527
Other exposures	-	-	-	-	-	546	-	-	40	546	586
Total	47,536	57,271	118,791	222,622	446,220	800,649	164,877	121,482	93	1,069,008	1,515,321

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 wihin 12 months	1-5 years	5-10 years	10-20 years	Total over 12 months	Total
Sovereigns	-	2,964	-	-	2,964	-	-	-	-	2,964
Claims on banks	2,452	1,973	-	-	4,425	-	-	-	-	4,425
Claims on Corporates	-	-	2,522	3,750	6,272	10,120	7,456	20,806	38,382	44,654
Project finance	2,226	-	-	-	2,226	3,192	-	-	3,192	5,418
Total	4,678	4,937	2,522	3,750	15,887	13,312	7,456	20,806	41,574	57,461

Unfunded exposures are divided into the following exposure types in accordance with the calculation of credit risk weighted assets in the CBB's Basel II capital adequacy framework:

Credit-related contingent items: Credit-related contingent items comprise letters of credit, acceptances and guarantees and commitments.

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

Undrawn loans and other commitments represent commitments that have not been drawn down or utilized 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 & 0% CCF is applicable for commitments which can be unconditionally cancelled at any time.

The table below summarizes the notional principal amounts and the relative exposure before applying credit risk mitigation:

US$ thousands	Notional Principal	Credit Exposure*
Short-term self-liquidating trade and transaction-related contingent items	17,940	3,588
Direct credit substitutes, guarantees, and acceptances	837	837
Undrawn facilities and other commitments	106,072	46,377
RWA for contingent items	124,849	53,666

* Credit exposure is after applying CCF.

At 31 December 2008, the Group held cash collaterals in relation to credit-related contingent items amounting to US$4,425 thousand.

Penalties imposed on customers

During the year, the amount of US$985 was charged to clients as penalties, which were disposed off to charities.

7.8 Impairment of assets

Impairment and un-collectability of financial assets

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

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

The internal grading process takes into consideration factors such as 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 that 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 Bank is supported by its parent bank, ABC, through the provision of a line of credit to cover any shortfall in liquidity. Accordingly, the Bank 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, the ABC 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.

a. 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.

b. 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 minimized 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.

c. Commodity risk (Price risk)

The Bank would be exposed to commodity risk if it holds commodity for its murabaha transactions, however, in order to minimize or eliminate this risk the bank 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.

d. Profit Rate Risk in the Banking Book (PRRBB)

The Bank uses the Basis Point Value (BPV) approach to control the PRRBB. BPV measures changes in economic value resulting from changes in profit rates. In the BPV methodology, the modified duration 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 balance sheet 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 2008, an immediate shift by 25 basis points in profit rates would potentially impact the Group's economic value by US$0.806 million.

7.10 Equity position risk
Equity position risk arises from the possibility of 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 no equity position.

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 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 Clearing Company or funds raised through commodity murabahas. However, for any shortfall in liquidity, the Bank relies on the parent bank; hence the Bank'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 drawdowns, under market value driven encashability scenarios.

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

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, and 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 and 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.

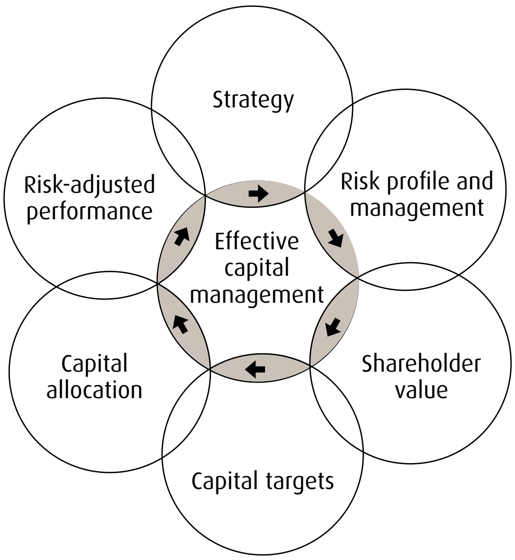
ABC policy dictates that the operational functions of booking, recording and monitoring of transactions are carried out by staff that are independent of the individuals initiating the transactions. Each business line – including Operations, Information Technology, Human Resources, Legal & Compliance 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 or 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.
- Maximise return on capital and generate sustainable return above the cost of capital.

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

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

In addition, the Group prepares itself for compliance with the Foundation Internal Ratings Based (FIRB) requirements it 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 Foundation IRB Risk Weights (as set out in the table under Annex 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, Business Unit and aggregated at the Group level.

b. **Market Risk:** Computed for the Banking books 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 components 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 balance sheet transactions. However, under the SERP guidelines the CBB would also make an individual risk profile assessment of all banks and instead of applying a standard minimum capital adequacy requirement, the supervisor may allow a lower capital adequacy ratio in excess of 8% for a bank with sound risk management capabilities. The CBB initiated this assessment process in 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 maximize 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	33,800
Claims on directors & senior management	395
Claims on staff	392

b. Liabilities to related parties

US$ thousands	
Connected deposits	1,040,171

9.2 Ageing analysis of all 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 impaired Islamic financing and securities on non-accrual basis, together with their related provisions is as follows:

Islamic financing

US$ thousands	Principal	Provisions	Net book value
Less than 3 months	97,553*	-	97,553
3 months to 1 year	-	-	-
1 to 3 years	-	-	-
Over 3 years	4,069	-	4,069
Total	101,622	-	101,622

* Carrying Values of US$95,200 thousand have been guaranteed by ABC.

Securities
The Bank has expected impairment loss of US$3 million 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 2008.

9.4 Assets sold under recourse agreements
The Group has not entered into any recourse agreement during the year ended 31 December 2008.

9.5 Movement in specific and collective impairment provisions

	Specific Provisions			
US$ thousands	Islamic financing	Securities	Other assets and off balance sheet items	Collective Impairment provision
At beginning of the year	-	-	-	-
Amounts written off	-	-	-	-
Write backs / cancellation due to improvement	-	-	-	-
Additional provisions made	-	3,000	-	-
Exchange adjustment and other movements	-	-	-	-
Balance at reporting date	-	3,000	-	-

9.6 Industry sector analysis of the specific impairment provisions charges
The above mentioned impairment is in the financial institution sector.

9.7 Equity positions in the banking book
The Bank maintains no equity position.

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