

# PRUDENT AND PROGRESSIVE

ANNUAL REPORT 2008



البنك الأهلي المتحد



**ahli united bank**

BAHRAIN • KUWAIT • QATAR • OMAN • EGYPT • IRAQ • UNITED KINGDOM

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# GROUP MISSION STATEMENT

## MISSION STATEMENT

*TO CREATE AN UNRIVALLED ABILITY TO MEET CUSTOMER NEEDS, PROVIDE FULFILLMENT AND DEVELOPMENT FOR OUR STAFF AND DELIVER OUTSTANDING SHAREHOLDER VALUE.*

## OBJECTIVES

*TO MAXIMISE SHAREHOLDER VALUE ON A SUSTAINABLE BASIS.*

*TO MAINTAIN THE HIGHEST INTERNATIONAL STANDARDS OF CORPORATE GOVERNANCE AND REGULATORY COMPLIANCE.*

*TO MAINTAIN SOLID CAPITAL ADEQUACY AND LIQUIDITY RATIOS.*

*TO ENTRENCH A DISCIPLINED RISK AND COST MANAGEMENT CULTURE.*

*TO DEVELOP A CROSS-CULTURAL MERITOCRATIC MANAGEMENT STRUCTURE.*

*TO OPTIMISE STAFF DEVELOPMENT THROUGH BUSINESS DRIVEN TRAINING AND PROFIT RELATED INCENTIVE.*

*TO CONTRIBUTE TO THE SOCIAL AND ECONOMIC ADVANCEMENT OF THE COMMUNITIES IN WHICH THE GROUP OPERATES.*

# OPERATING DIVISIONS

## COMMERCIAL BANKING, TREASURY & INVESTMENTS

This division covers all the Bank's capital-intensive activities in risk asset generation and funding regionally and internationally.

- Corporate and Trade Finance
- Treasury
- Commercial Property Finance
- Residential Property Finance
- Acquisition and Structured Finance
- Correspondent Banking

## PRIVATE BANKING & WEALTH MANAGEMENT

This division generally includes all the low capital-intensive sectors of the business, offering wealth management services to individuals and institutions based on performance and a balanced product mix.

- Private Banking and Asset Management
- Real Estate Fund Management
- Islamic Banking

## RETAIL BANKING

This division covers all individual customers' deposits, loans, overdrafts, credit cards and residential mortgages.

## RISK MANAGEMENT

This division is responsible for the identification, assessment and ongoing control of all material risks that could affect the Group's business & operations.

- Risk Management
- Legal
- Compliance
- Audit

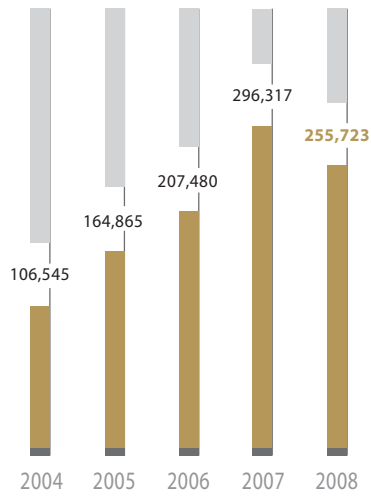
## SUPPORT SERVICES

These divisions provide banking services for on-going business activities of the Group, as well as supporting the Group's expansion through mergers and acquisitions.

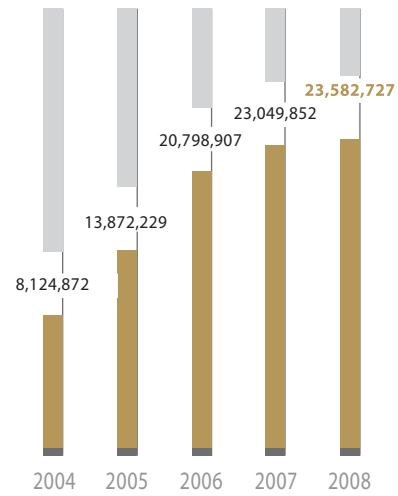
- Finance
- Information Technology
- Operations
- Services
- Human Resources

# FINANCIAL HIGHLIGHTS

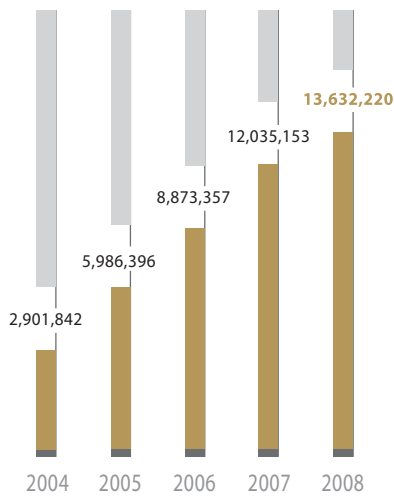
US\$'000



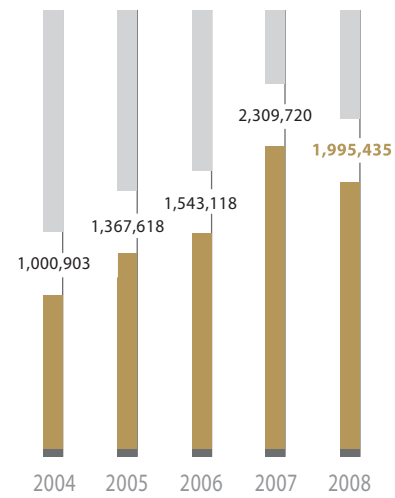
NET PROFIT



TOTAL ASSETS



TOTAL LOANS



SHAREHOLDERS' EQUITY

# CONSOLIDATED PERFORMANCE SUMMARY

## US\$ 255.7 MILLION

Net Profit for the Year

	2008	2007	2006	2005	2004
	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000
NET PROFIT **	<b>255,723</b>	296,317	207,480	164,865	106,545
TOTAL ASSETS	<b>23,582,727</b>	23,049,852	20,798,907	13,872,229	8,124,872
TOTAL LOANS	<b>13,632,220</b>	12,035,153	8,873,357	5,986,396	2,901,842
TOTAL LIABILITIES & SUBORDINATED LIABILITIES	<b>21,187,950</b>	20,401,731	18,972,235	12,249,031	7,123,969
SHAREHOLDERS' EQUITY **	<b>1,995,435</b>	2,309,720	1,543,118	1,367,618	1,000,903
MINORITY INTEREST	<b>399,342</b>	338,401	283,554	255,580	N.A.
RETURN ON AVERAGE ASSETS	<b>1.3%</b>	1.7%	1.7%	2.1%	1.6%
RETURN ON AVERAGE EQUITY	<b>11.4%</b>	18.0%	15.1%	13.5%	11.3%
COST TO INCOME	<b>39.1%</b>	37.5%	40.1%	37.6%	41.8%
FINANCIAL LEVERAGE	<b>10.2</b>	8.5	12.0	8.7	6.9
RISK ASSET RATIO	<b>13.8%*</b>	16.2%	14.8%	16.4%	23.7%
NET INTEREST MARGIN	<b>2.2%</b>	2.2%	1.8%	1.9%	2.1%
EARNINGS PER SHARE (US cents) - BASIC	<b>5.6</b>	8.3	5.8	4.7	3.2
EARNINGS PER SHARE (US cents) - DILUTED	<b>5.6</b>	7.2	5.1	4.0	3.2

\* Under BASEL II

\*\* Attributable to Bank's equity shareholders

# PRINCIPAL SUBSIDIARIES

## AHLI UNITED BANK (UK) P.L.C.

	2008	2007	2006	2005	2004
	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000
NET PROFIT	<b>7,088</b>	24,537	15,152	12,176	9,751
TOTAL ASSETS	<b>2,305,646</b>	2,541,853	3,445,908	2,619,619	3,054,370
TOTAL LOANS	<b>1,095,061</b>	1,210,724	1,089,040	830,621	1,198,111
TOTAL LIABILITIES	<b>2,101,818</b>	2,323,757	3,220,410	2,397,599	2,845,622
SHAREHOLDERS' EQUITY	<b>203,828</b>	218,097	225,498	222,020	208,748
RETURN ON AVERAGE ASSETS	<b>0.3%</b>	0.8%	0.5%	0.4%	0.4%
RETURN ON AVERAGE EQUITY	<b>3.4%</b>	11.1%	6.8%	5.7%	4.6%
COST TO INCOME	<b>48.3%</b>	44.1%	70.3%	66.0%	67.0%
FINANCIAL LEVERAGE	<b>10.0</b>	10.4	14.0	10.5	13.3
RISK ASSET RATIO	<b>15.6%</b>	14.6%	13.9%	18.3%	14.6%
EARNINGS PER SHARE (US cents)	<b>3.5</b>	12.3	7.6	6.1	4.9

## THE BANK OF KUWAIT & THE MIDDLE EAST K.S.C. (BKME)

	2008	2007	2006	2005	2004
	KD'000	KD'000	KD'000	KD'000	KD'000
NET PROFIT *	<b>51,365</b>	48,179	45,111	39,919	22,776
TOTAL ASSETS	<b>2,237,018</b>	2,238,549	1,929,406	1,612,717	1,754,331
TOTAL LOANS	<b>1,472,932</b>	1,251,476	922,987	757,827	822,348
TOTAL LIABILITIES	<b>1,965,126</b>	1,935,285	1,672,475	1,386,261	1,542,035
SHAREHOLDERS' EQUITY	<b>243,066</b>	269,884	235,097	204,917	196,042
RETURN ON AVERAGE ASSETS	<b>2.2%</b>	2.5%	2.7%	2.5%	1.4%
RETURN ON AVERAGE EQUITY	<b>20.2%</b>	20.5%	21.5%	20.5%	12.4%
COST TO INCOME	<b>32.0%</b>	34.5%	34.2%	31.5%	34.2%
FINANCIAL LEVERAGE	<b>7.9</b>	7.0	6.9	6.6	7.8
RISK ASSET RATIO	<b>14.8% **</b>	15.6% **	18.1% **	19.5% **	17.6%
EARNINGS PER SHARE (Fils)	<b>64.3</b>	60.3	56.5	46.9	25.7

\* Net Profit attributable to Bank's equity shareholders

\*\* Under BASEL II

## PRINCIPAL SUBSIDIARIES

### AHLI UNITED BANK (EGYPT) S.A.E.

	2008	2007	2006	2005	2004
	EGP'000	EGP'000	EGP'000	EGP'000	EGP'000
NET PROFIT	<b>183,054</b>	147,409	222	138,874	126,644
TOTAL ASSETS	<b>7,282,769</b>	5,790,900	4,029,218	3,690,938	3,738,611
TOTAL LOANS	<b>4,105,418</b>	2,521,147	1,075,300	1,512,436	1,591,265
TOTAL LIABILITIES	<b>6,353,411</b>	5,030,441	3,359,437	3,117,579	3,174,375
SHAREHOLDERS' EQUITY	<b>929,358</b>	760,459	669,781	573,359	564,235
RETURN ON AVERAGE ASSETS	<b>3.3%</b>	3.0%	0.0%	3.7%	3.6%
RETURN ON AVERAGE EQUITY	<b>21.8%</b>	21.0%	0.0%	24.4%	22.7%
COST TO INCOME RATIO	<b>41.7%</b>	35.7%	56.6%	23.3%	25.2%
FINANCIAL LEVERAGE	<b>6.6</b>	5.7	4.4	4.3	4.5
RISK ASSET RATIO	<b>17.4%</b>	20.4%	46.8%	30.7%	29.1%
EARNINGS PER SHARE (EGP)	<b>3.0</b>	2.4	-	2.8	2.5

Results in line with Egyptian Accounting Standards

### COMMERCIAL BANK OF IRAQ P.S.C.

	2007	2006	2005	2004	2003
	IQD millions	IQD millions	IQD millions	IQD millions	IQD millions
NET PROFIT	<b>2,407</b>	2,101	1,660	1,416	968
TOTAL ASSETS	<b>213,177</b>	164,594	155,585	73,466	56,578
TOTAL LOANS	<b>23,434</b>	25,706	25,044	14,482	7,773
TOTAL LIABILITIES	<b>96,559</b>	78,864	92,943	60,917	51,338
SHAREHOLDERS' EQUITY	<b>65,304</b>	63,777	62,642	12,549	5,240
RETURN ON AVERAGE ASSETS	<b>1.3%</b>	1.3%	1.8%	2.2%	2.0%
RETURN ON AVERAGE EQUITY	<b>3.7%</b>	3.3%	11.3%	15.9%	20.4%
COST TO INCOME RATIO	<b>26.4%</b>	24.7%	41.6%	53.1%	46.3%
FINANCIAL LEVERAGE	<b>1.5</b>	1.2	1.3	2.7	5.2
RISK ASSET RATIO	<b>201.5%</b>	114.8%	101.3%	47.8%	47.6%
EARNINGS PER SHARE (Fils)	<b>40.1</b>	35.0	117.1	142.0	282.0

2008 financial statements are under audit

Results are in line with local GAAP

## PRINCIPAL SUBSIDIARIES

### KUWAIT & MIDDLE EAST FINANCIAL INVESTMENT COMPANY K.S.C.(C) (KMEFIC)

	2008	2007	2006	2005	2004
	KWD'000	KWD'000	KWD'000	KWD'000	KWD'000
NET PROFIT	<b>3,934</b>	13,262	8,610	10,168	9,525
TOTAL ASSETS	<b>95,003</b>	112,869	81,106	65,067	41,999
TOTAL LOANS	<b>15,382</b>	13,719	10,129	12,710	4,361
TOTAL LIABILITIES	<b>39,797</b>	48,258	38,367	21,921	10,355
SHAREHOLDERS' EQUITY	<b>52,565</b>	62,184	40,792	43,090	31,644
RETURN ON AVERAGE ASSETS	<b>3.8%</b>	13.7%	12.4%	15.6%	22.7%
RETURN ON AVERAGE EQUITY	<b>6.9%</b>	27.4%	20.8%	32.1%	30.1%
COST TO INCOME	<b>62.4%</b>	38.1%	46.9%	37.0%	24.2%
EARNINGS PER SHARE (Fils)	<b>16.6</b>	56.9	37.7	43.2	40.5

## PRINCIPAL ASSOCIATES

### AHLI BANK Q.S.C.

	2008	2007	2006	2005	2004
	QR'000	QR'000	QR'000	QR'000	QR'000
NET PROFIT	<b>425,781</b>	302,652	202,241	138,621	83,914
TOTAL ASSETS	<b>17,799,276</b>	15,576,381	9,556,360	6,181,033	4,285,935
TOTAL LOANS	<b>11,547,061</b>	10,105,785	6,294,372	3,490,141	1,444,843
TOTAL LIABILITIES	<b>16,158,893</b>	14,052,534	8,373,890	5,108,875	3,398,037
SHAREHOLDERS' EQUITY	<b>1,640,383</b>	1,523,847	1,182,470	1,072,158	887,898
RETURN ON AVERAGE ASSETS	<b>2.6%</b>	2.7%	2.7%	2.8%	3.5%
RETURN ON AVERAGE EQUITY	<b>26.0%</b>	24.6%	18.5%	15.0%	22.6%
COST TO INCOME	<b>25.3%</b>	30.0%	37.7%	39.4%	54.0%
FINANCIAL LEVERAGE	<b>9.6</b>	9.1	6.9	4.6	3.7
RISK ASSET RATIO	<b>12.1%*</b>	12.9%*	13.2%*	19.5%	31.3%
EARNINGS PER SHARE (QR)	<b>7.3</b>	5.2	3.5	2.4	1.4

\* Under BASEL II

### AHLI BANK S.A.O.G.

	2008	2007	2006	2005	2004
	RO'000	RO'000	RO'000	RO'000	RO'000
NET PROFIT	<b>5,933</b>	2,219	3,914	4,418	3,560
TOTAL ASSETS	<b>455,323</b>	305,967	175,178	155,258	124,892
TOTAL LOANS	<b>375,298</b>	239,413	150,717	132,592	102,538
TOTAL LIABILITIES	<b>368,268</b>	224,978	143,512	123,475	95,717
SHAREHOLDERS' EQUITY	<b>87,055</b>	80,988	31,666	31,782	29,175
RETURN ON AVERAGE ASSETS	<b>1.6%</b>	0.9%	2.4%	3.2%	3.3%
RETURN ON AVERAGE EQUITY	<b>7.1%</b>	2.7%	13.8%	17.2%	14.0%
COST TO INCOME RATIO	<b>54.0%</b>	56.0%	36.7%	25.1%	32.9%
FINANCIAL LEVERAGE	<b>4.2</b>	2.7	4.4	3.8	3.2
RISK ASSET RATIO	<b>23.4%*</b>	40.9%*	33.1%	41.2%	55.4%
EARNINGS PER SHARE (Baizas)	<b>9.0</b>	5.0	9.0	11.0	8.0

\* Under BASEL II

# BOARD OF DIRECTORS' REPORT

DESPITE THE CLEAR CHALLENGES IN 2009 AND POTENTIALLY LONGER, AUB IS WELL POSITIONED TO PURSUE ITS BUSINESS OBJECTIVES IN A PRUDENT AND FOCUSED MANNER.

The Directors of Ahli United Bank ("AUB" or the "Bank") are pleased to submit the Annual Report and accompanying consolidated Financial Statements for the year ended 31 December 2008.

## GENERAL OPERATING ENVIRONMENT

The global financial services industry has witnessed one of the most challenging years in decades with the extreme volatile conditions permeating across global credit and capital markets and the resultant severe economic downturn, stemming from the US sub-prime crisis followed by the collapse of Lehman Brothers Holdings Inc., causing an unprecedented ripple effect across the global financial and banking markets. The pan Arab Gulf region has been no exception with the situation being further exacerbated by the significant correction in the oil prices in 2009 to date to a range of US\$ 35 to US\$ 49 per barrel after reaching a record peak of US\$ 147 per barrel in July 2008.

The current volatility and systemic dislocation of the global financial markets and the recessionary conditions has affected all economies leading to increased uncertainty and an acute crisis of confidence in terms of counterparty risk. The credit crunch stepped up the pressures on liquidity and pushed the spreads up in the global markets. Furthermore, it is placing increasing strains on the performances of corporate and retail clients.

## PERFORMANCE OVERVIEW

The Bank's results for the year 2008 need to be viewed against the backdrop of the currently prevailing very adverse and unexpected operating and business environment which have continued to deteriorate since the fourth quarter of 2008.

The adverse market conditions led to increased credit risks and significant decline in value of investments, including blue-chip and high investment grade securities. The Bank, having recognised the early signs of the worsening business environment, re-adjusted its management focus, while maintaining its core business model, to mitigate its adverse impact. Under the adjusted business model, AUB increased its rigorous focus on liquidity, asset quality, risk and operational management areas by:

- Immediate problem recognition and prompt undertaking of remedial efforts including necessary provisioning and asset write-offs
- Sustain growth in customers' deposits reducing wholesale market dependence

# BOARD OF DIRECTORS' REPORT

- Selective business growth with tight risk parameters focusing on contra-cyclical sectors
- Assessing and securing refinancing of its medium term syndicated deposit
- Prudent cost management;

Such measures enabled the Bank to produce the following results for the year 2008:

- Total assets growth of 2.3% to US\$ 23.6 billion (2007 – US\$ 23.0 billion) funded increasingly by customers' deposits which rose by 22.2% to US\$ 13.2 billion (2007: US\$ 10.8 billion).
- Total operating income increased by 4.5% to US\$ 665.5 million from US\$ 637.0 million in 2007, supported by higher Net Interest Income (+22.8%) through prudent funding cost and asset quality management.
- Consolidated net profit, attributable to the Bank's equity shareholders, of US\$ 255.7 million as against US\$ 296.3 million in 2007, a drop of 13.7%, caused by realised trading losses/impairment provisions of US\$ 159.9 million created by fully providing/writing off certain identified problem non-trading investment exposures together with a higher level of net loan loss provisions (including US\$41.6 million of collective impairment provisions charge) of US\$96.8 million to ensure appropriate coverage of problematic exposures and maintenance of asset quality (2007 – net loan loss provision: US\$24.4 million) in a prudent manner anticipating a difficult operating environment in 2009.
- Secured refinancing extension for two years of US\$ 800 million out of its existing medium term syndicated loan facility from 30 October 2009 to 30 October 2011 at competitive terms, despite very adverse wholesale funding market conditions.

## BUSINESS DIVERSIFICATION

In line with AUB strategy to become a leading pan-Gulf provider of comprehensive financial services, AUB signed a Shareholders' Agreement with the UK based Legal & General Group PLC to offer conventional and takaful life insurance products and services in the Gulf and other Middle East countries. The proposed JV companies have received CBB approval and will be launching their commercial operations in the second half of 2009. AUB holds 50% of the US\$25 million paid up capital.

## EXTERNAL RATINGS

S&P maintained the Long Term Issue Credit Rating of 'A-' (stable) for AUB in September 2008. The S&P move followed affirmation of the Bank's long term credit risk rating of A-(stable) by Fitch in August 2008 and earlier by Capital Intelligence of A (stable) in June 2008.

# BOARD OF DIRECTORS' REPORT

## RECOGNITION

The Bank continued to be recognised as a leading bank in the region as evidenced by receipt of the following prestigious awards during the year:

- Best Bank in the Middle East 2008 – Global Finance (third consecutive year).
- Best Bank of the Year - Bahrain 2008 – Euromoney (third consecutive year).
- Bank of the Year - Bahrain 2008 – The Banker Magazine (third consecutive year).
- Best Trade Finance Provider Award 2009 - Bahrain – Global Finance.
- Best Commercial Bank - Bahrain 2008 – Asia Money.
- Best Foreign Exchange Bank - Middle East 2009 – Global Finance (third consecutive year).
- Elite Quality Recognition Award for the tenth consecutive year by JP Morgan Chase, for achieving consistently outstanding and high quality operational performance standards in the area of funds transfers and trade finance activity.

## DIRECTORS' SHAREHOLDINGS & REMUNERATION

Directors held 237,994,932 ordinary shares (2007: 218,952,383), 52,517,513 Class-A preference shares (2007: 105,035,029) and 95,602,794 Class-B preference shares as at 31 December 2008 (2007: 74,414,000). Directors' fees, allowances, expenses, salaries and remuneration totalled US\$3,812,795 (2007: US\$2,797,624). Senior management held 30,169,192 Class-B preference shares as at 31 December 2008 (2007: 23,476,000).

## APPROPRIATIONS

On the basis of the results of the Bank for the year ended 31 December 2008, the Board of Directors recommends the following appropriations of the Bank's net profit for approval by the shareholders:

	US\$
Transfer to statutory reserve	25,572,348
Proposed dividend – Class B preference shares at US cents 4.7 per share	3,493,389
Proposed cash dividend – Ordinary shares	112,658,101
Proposed bonus issue @ 5%	56,329,051
Proposed directors' fees	1,167,751
Proposed donations	1,000,000
<b>Transfer to retained earnings</b>	<b>55,502,841</b>

# BOARD OF DIRECTORS' REPORT

## CONCLUSION

On behalf of the Board, I would like to take this opportunity to thank the shareholders and investors for the confidence reposed in us. I also would like to thank all our regulators, business partners, customers and dedicated staff for their unstinting support to AUB in 2008.

Despite the clear challenges in 2009 and potentially longer, AUB is well positioned to pursue its business objectives in a prudent and focused manner.



**Fahad Al-Rajaan**  
Chairman  
18 February 2009

# BOARD OF DIRECTORS



**FAHAD AL-RAJAAN**  
Chairman and Chairman of the Executive Committee

Director General, The Public Institution for Social Security (Kuwait); Chairman, Ahli United Bank (UK) plc; Chairman, Wafra Investment Advisory Group (New York); Board Member, National Industries Group (Kuwait); Chairman, Ahli United Bank (Egypt) S.A.E.



**HAMAD A. AL MARZOUQ**  
Deputy Chairman and Member of the Executive Committee

Deputy Chairman, Ahli United Bank (UK) plc; Chairman and Managing Director, Bank of Kuwait & the Middle East KSC, Kuwait; Deputy Chairman Ahli Bank QSC, Qatar; Deputy Chairman, Ahli United Bank (Egypt) S.A.E.; Deputy Chairman, Ahli Bank SAOG, Oman; Deputy Chairman, Commerical Bank of Iraq, Iraq.



**RASHID ISMAIL AL-MEER**  
Deputy Chairman and Member of the Executive Committee

Director, Ahli United Bank (UK) plc; Director, Social Insurance Organisation & Member of Investment Committee; Director, (Deputy Chairman), Esterad Investment Co. and Member of the Board Investment Committee; Deputy Chairman of the Board of Directors, Solidarity Islamic Insurance & Assurance Co. and Chairman of Audit Committee; Formerly Director General, Pension Fund Commission; Formerly, Asst. Undersecretary for Financial Affairs, Ministry of Finance & National Economy; Formerly, Asst. Undersecretary for Economic Affairs, Ministry of Finance & National Economy. Formerly, Director of Investment, Various Positions, Central Bank of Bahrain; Formerly, Head of Statistics Section, Ministry of Health.



**HAMAD AL-ATTIYAH**  
Director and Member of the Audit Committee

Director General of The General Retirement and Pension Authority of Qatar (GRPA); Chairman of Dlala' Brokerage & Investment Holding Co. (DLALA); Board Member, The Supreme Council of Communication and Information Technology (ICT); Board Member, Masraf Al-Rayan; Director, Ahli United Bank (Egypt) S.A.E.



**MOHAMMED JASSIM AL-MARZOUK**  
Director and Member of the Executive Committee

Chairman & CEO, Tamdeen Real Estate Co. Kuwait; Deputy Chairman of Board of Directors, Barwa Al Doha Real Estate Co., Qatar; Board Member, Fateh Al Kheer Co., Kuwait; Board Member, Global Omani Development & Investment Co., Sultanate of Oman; Board Member of Al Maalem Holding Co, Bahrain; Chairman, Tamdeen Bahraini Real Estate Co., Bahrain. Former Deputy Chairman, Tamdeen Shopping Centres Co. Kuwait; Former Board Member Bank of Kuwait & The Middle East; Former Deputy Chairman, Tamdeen Investment Co; Former Board Member, Al Ahli Bank of Kuwait; Former Board Member, Kuwait National Cinema Co; Former Board Member, Arab Financial Consulting Co; Former Chief of Executive Staff, Real Estate Investment Fund; Former Board Member, The Public Warehousing Co.



**MOHAMMED AL-GHANIM**  
Director and Member of the Audit Committee

Vice Chairman and Managing Director, Fouad Alghanim & Sons Group of Companies, Kuwait; Chairman, Al-Ghanim Industrial Company KSC, Kuwait; Board Member, Tamdeen Real Estate Company KSCC, Kuwait; Member, Supervisory Board, Jet Alliance Holding AG, Austria.; Chairman, Fluor Kuwait Co. KSC, Kuwait.

**MOHAMMED SALEH BEHBEHANI****Director and Member of the Executive Committee**

President, Mohammad Saleh & Reza Yousif Behbehani Co.; President, Behbehani Jeep Motors Co. WLL; President, Shereen Motor Co. WLL; President, Behbehani Automall Co. WLL; Partner, Mohammed Saleh Behbehani & Co. WLL; Chairman, Maersk Kuwait Co. WLL; Chairman, Kuwait Insurance Co. SAK; Vice Chairman, United Beverage Co., Board Member, The Bank of Kuwait & The Middle East KSC; Former Deputy Chairman, Al Ahli Bank of Kuwait, Former Director Swiss Kuwaiti Bank; Former Director, UBAF (Hong Kong) Limited.

**ABDULLA MH AL-SUMAIT****Director and Member of the Audit Committee**

Head of Legal Department, The Public Institution for Social Security, (Kuwait); Director, Kuwait Commercial Facilities Company; Director, Ahli United Bank (Egypt) SAE.

**HERSCHEL POST****Director and Chairman of the Audit Committee**

Director and Chairman of the Audit Committee, Ahli United Bank (UK) plc; Director and Chairman of the Audit Committee, Ahli United Bank (Egypt) S.A.E.; Director Euroclear SA/NV & Euroclear plc; Director and Chairman of the Audit Committee, Euroclear UK and Ireland Ltd; Director, Investors Capital Trust plc.; Director and Chairman of the Audit Committee, Threadneedle Asset Management Holdings Ltd.; Chairman, Earthwatch Institute (Europe). Former Deputy Chairman of the London Stock Exchange; Former CEO and Deputy Chairman, Coutts & Co.; Former Chief Operating Officer, Lehman Brothers International Ltd.; Former International Managing Director, Business Development, Christie's International Limited.

**DR. KARL OTTO PÖHL****Director and Member of the Audit Committee (Resigned w.e.f 3 March 2008)**

Former Board Member, Sal. Oppenheim jr. & Cie (Schweiz) AG Switzerland; Former Board Member, GAMCO Investors Inc., New York; Former President of Deutsche Bundesbank and Chairman of the Central Bank Council; Former Chairman of Sal. Oppenheim.

**ADEL A. EL-LABBAN****Group Chief Executive Officer & Managing Director and Member of the Executive Committee**

Director, Ahli United Bank (UK) plc; Director, Bank of Kuwait & the Middle East KSC, Kuwait; Director Ahli Bank QSC, Qatar; Director, Ahli United Bank (Egypt) S.A.E., Egypt; Director Ahli Bank SAOG, Oman; Director, Commercial Bank of Iraq; Director Kuwait & Middle East Financial Investment Co. (KMEFIC), Kuwait; Board Member of Bahrain Stock Exchange; Director - Board of Trustees, Bankers Society of Bahrain; Formerly Chief Executive Officer and Director of the United Bank of Kuwait PLC, London; Managing Director, Commercial International Bank of Egypt; Chairman, Commercial International Investment Company; Vice President, Corporate Finance, Morgan Stanley; Director, National Work Fund, Bahrain; Director, Bahrain Institute of Banking & Finance (BIBF).

# CHAIRMAN'S STATEMENT

IN 2009 AND DESPITE VOLATILE AND UNPREDICTABLE ECONOMIC CONDITIONS, AUB WILL REMAIN FOCUSED ON MAINTAINING ITS CORE REGIONAL BUSINESS MODEL AND DEVELOPING OPPORTUNITIES FOR GROWTH ON A CONSERVATIVE AND SUSTAINABLE BASIS.



On behalf of the Board of Directors of Ahli United Bank, it gives me great pleasure to present AUB's 9th annual report for the year ended 31 December 2008.

Ahli United Bank recorded a solid performance in 2008 and continued to consolidate its position as a leading bank in the region with a significant cross border presence and strategy.

The year brought exceptional and unprecedented challenges for the global financial services industry, creating severe operating pressures at the regional and local levels. As the crisis deepened in the wake of the Lehman Brothers' collapse in September 2008, its impact became increasingly evident in restricting liquidity flows and exacerbated by a rise in the cost of funds. The fourth quarter also witnessed a sharp reduction in corporate and retail lending activities, the tightening of lending criteria and a focus

on capital and liquidity preservation. The negative contagion of the financial crisis was also evident in the regional stock markets where share prices dropped sharply and real estate markets came under severe pressure as oil prices fell sharply.

Against this backdrop, and to mitigate the impact of the crisis on the Bank's balance sheet and financial position, AUB took early steps to adjust the Bank's business model and risk appetite in line with the new economic realities. As a result, AUB was able to achieve a profit of US\$255.7 million, albeit 13.7% below 2007 level, but a creditable achievement in an extremely challenging and adverse market environment. The drop in profitability must also be assessed against the bank's very conservative stance in terms of recognising, providing and writing off, as required, all identified problematic assets.

AUB crossed another milestone in 2008 through the opening of its hundredth branch. At year end, AUB Group was able to offer its services from 106 branches in seven countries, making it into a more exclusive tier of banks in the MENA region.

We continued to pursue our strategy to extend and enhance our Shari'a-compliant business focus, and AUB's subsidiary in Kuwait, the Bank of Kuwait and Middle East (BKME), is now in full swing towards converting into an Islamic Bank by year end 2009 after it received preliminary approval from the Central Bank of Kuwait.

In another landmark achievement in 2008, AUB successfully secured a US\$800 million syndicated refinancing loan facility in September 2008, which was substantially oversubscribed on an initial launch amount of US\$500 million. Twenty-eight banks from across Europe, North America, Asia and the Middle East, participated in the facility.

Going forward, and in line with our strategy to become a leading pan-Gulf-Middle Eastern provider of comprehensive financial services, we signed a shareholders' agreement with the UK-based Legal & General Group PLC, to offer conventional and Takaful insurance products and services in the Middle East. The two joint venture companies have recently received CBB approval and will be launching their commercial operations in 2009. This represents an important complement to our range of financial products and services and will add to our wealth management and savings products.

We are also pleased with the confidence reposed by the international financial community, as evidenced in maintaining our high rating by international rating agencies. In 2008, both Fitch and S&P reaffirmed AUB's Credit Rating of "A-" (stable) while Capital Intelligence reaffirmed AUB's rating as A (Stable). The key reasons cited were AUB's leading commercial position in the Kingdom of Bahrain, better geographic diversification than for regional peers, improving financial performance and strong asset quality.

In 2009 and despite volatile and unpredictable economic conditions, AUB will remain focused on maintaining its core regional business model and developing opportunities for growth on a conservative and sustainable basis. This will be undertaken within a framework of prudent risk management to ensure capital and liquidity protection and value creation for all our clients and shareholders, fully recognising the significantly enhanced risk levels affecting our operating markets.

In closing, I would like to extend my appreciation to our clients and shareholders for their ongoing and loyal support and to our staff whose commitment and professionalism underpins our success.



**Fahad Al-Rajaan**  
Chairman

# GROUP CEO & MANAGING DIRECTOR'S STATEMENT

WE WILL CONTINUE OUR EFFORTS TO MITIGATE RISK AND TARGET SELECTIVE BUSINESS GROWTH OPPORTUNITIES THAT FOCUS ON CONTRA-CYCLICAL SECTORS WHILE IMPLEMENTING RIGOROUS COST MANAGEMENT MEASURES ACROSS ALL AREAS OF OUR BUSINESS AND ENSURING THAT CAPITAL PRESERVATION IS ALWAYS THE FOREMOST PRIORITY IN AN ENVIRONMENT OF HEIGHTENED RISKS.

2008 was an exceptional year marked by a global financial crisis and unprecedented fallouts and challenges for markets and financial institutions everywhere. While AUB was not immune to the ripple effects of the crisis, our focus since early in the year was geared to anticipate and mitigate, to the extent possible, its adverse impact on our financial position and balance sheet. Having recognised the early signs of a potentially widening contagion and worsening operating environment, we responded by realigning our business model, and taking precautionary and corrective measures with particular focus on liquidity, asset quality, risk and operational management.

As a result, AUB was able to end the year on an overall positive profitability note, posting a net profit of US\$ 255.7 million compared to US\$ 296.3 million for 2007. While this represents a drop of 13.7% from the previous year, it nevertheless reflects a prudent and required approach to address prevailing market conditions which have considerably increased risk levels. On a positive and encouraging note, our core business earnings continued to show healthy and diversified growth, generating a 4.5% increase in total operating income to a record US\$ 665.5 million (2007: US\$ 637.0 million), despite difficult market conditions.

AUB's profits for 2008 were impacted by our conservative stance towards prevailing market and business risks. The bank increased its net provisions to US\$ 98.6 million as compared to US\$ 26.2 million in 2007 to adequately cover identified loan risks. This decision will maintain our specific provisions against identified problem loans at a solid 90% level, further backed by our strong collective impairment provisions. Non-performing loans stand at an acceptable 1.9% of our overall loan and advances portfolio (1.2% in 2007).

AUB has also pro-actively identified and written-off all its impaired international securities and investments, generating a net loss of US\$ 12.4 million against a net profit of US\$ 25 million on the same non-trading investments account in 2007. This is a practical and tangible demonstration of our risk asset management approach which centres on immediate problem recognition and prompt implementation of required remedial actions including full write-offs as implemented in 2008 to ensure a healthy balance sheet going forward.

Given our assessment of increased risk levels, asset growth was also de-accelerated from the second half of 2008 with focus directed towards deposit accumulation and liability management. In this respect, client deposits increased by a very solid 22.2% to US\$ 13.2

## GROUP CEO & MANAGING DIRECTOR'S STATEMENT

billion, reflecting our clients' strong underlying confidence in the Bank, while total assets growth was prudently managed at a level of 2.3% to reach US\$ 23.6 billion by 2008 end (US\$ 23.0 billion in 2007).

Total equity, including minority interests were at US\$ 2.4 billion. The drop in equity funds of US\$ 253 million was mostly caused by the full write-off of impaired international investments (mitigated by the sale of investments to realize gains in the first half of 2008 prior to significant market corrections); the sharp drop in values of "available for sale" investment bond portfolios (due to widening of credit spreads) and the cash flow hedges which were hit by the sharp drops in interest rates. In this context, it is important to note that the negative mark to market adjustments were thoroughly analyzed in terms of potential impairment and do not represent currently impaired or problematic exposures. They represent very high quality investment grade bonds (c.90% of portfolio) whose prices have been disrupted by exceptional market conditions but are expected based on historic and current performance to service all their payment obligations as and when they fall due. Their related hedges are not speculative positions. They represent a liability management tool to lock in funding costs enabling maintenance of asset yields. As noted above, all identified impaired assets have been written off in 2008.

AUB was also able to secure extended refinancing for two years of US\$ 800 million out of its existing medium term syndicated loan facility from 30 October 2009 to 30 October 2011 at very competitive terms, despite adverse market conditions. This represents a watershed transaction, given the prevailing turmoil, demonstrating AUB's credentials in the global banking community and its successful focus on proper liquidity management and in recognition AUB was a recipient of three prestigious awards for the loan facility from Euroweek, including one for "Best Middle Eastern Loan for Financial Institutions".

Despite the current constraints and challenges, we continue to develop strategically. Our joint venture with the UK-based Legal & General Plc has received its commercial registration. It will add conventional and Takaful life insurance products to our product offerings in 2009 and will broaden our wealth management options. We are also on track to convert our 75% subsidiary bank, Bank of Kuwait & the Middle East K.S.C., into a full fledged Sharia compliant bank by the end of 2009 which will add another important product dimension and business capability to the AUB Group.

In 2008, AUB Group achieved another milestone, with the number of our branches crossing the 100 threshold, propelling AUB into a more exclusive tier of regional banks. As at 2008 year end, AUB Group's branch network including associates stood at 106 in seven countries (Bahrain, Kuwait, Qatar, Oman, Egypt, Iraq and the UK), demonstrating our commitment to widen the breadth and depth of our network and other delivery channels to our customers everywhere. Our branch network provides a number of unique cross border services to our 444,000 clients. This represents an integral dimension of our regional strategy to provide effective services on both a single country and cross border basis.


We are also pleased with the vote of confidence by the international financial community in AUB's standing, performance and future outlook, as evidenced in maintaining our ratings to date by international rating agencies. In 2008, both Fitch and Standard & Poor's reaffirmed AUB's Credit Rating of "A-" (stable) while Capital Intelligence reaffirmed AUB's rating as A (Stable). The key reasons cited were AUB's leading commercial position in the Kingdom of Bahrain, better geographic diversification than other regional peers, improving financial performance and strong asset quality.

## GROUP CEO & MANAGING DIRECTOR'S STATEMENT

In 2008, AUB continued to receive several prestigious awards in recognition of its growth and service excellence. These are indicative both of industry esteem and client appreciation. AUB received the award for the Best Bank in Middle East 2008 from Global Finance, the Bank of the Year 2008, Bahrain awarded by The Banker Magazine (for the third consecutive year), and the award for the Best Foreign Exchange Bank in the Middle East 2008 from Global Finance.

In 2009, we move ahead into uncharted territory to face unprecedented challenges. However, I believe that we can continue to build on the sound business platform we have created, and to rely on the same principles that have guided our trajectory over the years namely; to stay focused on realizable targets, to be pro-active and to serve our clients well and with the highest integrity. We will continue our efforts to mitigate risk and target selective business growth opportunities that focus on contra-cyclical sectors while implementing rigorous cost management measures across all areas of our business and ensuring that capital preservation is always the foremost priority in an environment of heightened risks.

I am reassured in these endeavours that we have clear guidance from our Board of Directors, the strong support of our shareholder base which includes major regional and international institutional investors and the ongoing dedication of a strong and professional management team and staff. I also want to extend my sincere thanks and appreciation to our customers and partners for their loyalty and invaluable contribution to our achievements in 2008.



**Adel A. El-Labban**

Group Chief Executive Officer & Managing Director

# CORPORATE GOVERNANCE

## BOARD OF DIRECTORS

The Board of Directors is responsible for the overall governance of the Bank. This includes determining the strategy, providing direction to the Group Management, ensuring that the control function is robust and conforms to international best practice and monitoring management's performance within an agreed framework. The Board has created three sub-committees to assist in carrying out its duties.



**The Executive Committee** deputises for the Board on urgent matters normally reserved for the full Board and discharges responsibilities delegated by the Board, including credit and market risk matters.

**The Audit and Compliance Committee** assists the Board to execute its responsibilities relating to the Bank's accounting policies, internal control, compliance procedures, financial reporting and liaison with the bank's regulators, Bahrain Stock Exchange and external auditors. This Committee is chaired by an independent Director.

**The Compensation Committee** has been established to assist the Board in authorising and managing the Bank's compensation arrangements and recommending the remuneration of Directors for approval by the shareholders in their Annual General Meeting.

# CORPORATE GOVERNANCE

## COMPENSATION COMMITTEE

The Board of Directors has established a Compensation Committee comprised of 3 non-executive Directors. One of the Directors on the Committee is an independent Director.

The Committee is guided by the Group Human Resources Policy on Compensation approved by the Board as follows:

The objectives of the compensation policy are:

- To provide employees with financial motivation to deliver optimum Group performance;
- To reward performance by individual contribution within a team oriented approach;
- To remunerate individuals who achieve personal, divisional and Group results; and
- To provide a long term incentive to performing staff.

Group-wide compensation arrangements are determined by the Group Compensation Committee. Group banks may have Compensation Committees as required by regulatory or other considerations. In such a case, consistency must be achieved and monitored in terms of compensation across Group entities.

Compensation is benchmarked against comparable and relevant compensation in each operating entity, as determined by industry measurable statistics.

Compensation will be set at a level which will attract appropriate talent to the AUB Group.

Compensation will include base remuneration, performance related incentives and long term incentive arrangements, each as defined and approved by the Compensation Committee.

## RESPONSIBILITIES

The Committee reviews and makes recommendations to the Board in relation to the quantum and structure of awards under the AUB Employee Share Purchase Plan.

The Committee reviews and approves recommendations in relation to:

- (a) the quantum and structure of remuneration for Directors, including base fees, committee fees and expense reimbursements;
- (b) the quantum and structure of remuneration (including the appropriate proportion of base remuneration, short-term and long-term 'at risk' remuneration, bonus and incentive payments and any equity-based component) for

## CORPORATE GOVERNANCE

- Deputy Chairman and Group CEO & Managing Director
  - Direct reports to the Group CEO & Managing Director
  - Individual bonus recommendations for staff whose proposed bonus exceeded 100% of their annual base salary.
- (c) the quantum for other staff for annual salary increments, annual performance bonus
- (d) the nature and value of staff benefits provided by the Bank
- (e) remuneration and benefit policies appropriate to the Bank for employees including the administration of any employee share plan.

### Incentive Structure for Group CEO & MD, Senior Management and Staff:

- All staff having a minimum service period are eligible to participate in the Bank's performance bonus scheme.
- The scheme is fully discretionary in terms of whether any bonus is paid and the quantum of bonus paid to any individual staff member.
- Individual bonus recommendations are made on the basis of reviewed performance against annual plans and objectives.
- AUB Employee Share Purchase Plan as described in detail under note 21(f) to the consolidated financial statements.

# CORPORATE GOVERNANCE

## MANAGEMENT

The Bank's management monitors the performance of the parent Bank and each of the subsidiaries and associates on an ongoing basis and advises the Board. Monitoring of the performance is carried out through a regular assessment of performance trends against budget and prior periods and peer banks in each of the markets and collectively through six Group committees. The minutes of all management committees are sent to the Audit and Compliance Committee and the Board of Directors who assess the effectiveness of the committees and the sub-committees.

The Group Management Committee (GMC) is the collective group management forum providing a formal framework for effective consultation and transparent decision-making by the AUB Group's senior management on cross-organisational issues such as those relating to strategy, budget, personnel, audit and compliance. It comprises the Group CEO & Managing Director, all Deputy Group CEOs and the CEOs of AUB's subsidiaries and managed affiliates. The GMC is chaired by the Group CEO & MD. AUB as the parent bank also has a separate Management Committee (MC), which is in charge of the general management of AUB's Bahrain operations only. The Group CEO and MD chairs this committee which has ten other members.

The Group Asset and Liability Committee (GALCO) sets, reviews and manages the liquidity, market risk and funding strategy of the Group and reviews and allocates capacity on the balance sheet to achieve targeted return on capital, return on asset and liquidity ratios. It is chaired by the Senior DGCEO – Commercial Banking and Treasury and comprises four additional members.

The Group New Product Committee (GNPC) reviews and approves new products processes and services, for the wealth management, treasury, retail, commercial banking and other areas of the AUB Group. It assesses all related reputational, operational, credit, liquidity and market risk, IT, legal, compliance, control, staffing and capital/profit allocation issues related to approving new products. It has a total membership of ten and is chaired by Group CEO and MD.

The Group Information Technology Steering Committee (GITSC) oversees the information technology function of the Group. It recommends the annual IT budget to the Group CEO & Managing Director for submission to the Board of Directors for review and approval. It supervises the implementation of the approved IT annual plan within set deadlines and budgetary allocations. It is chaired by the DGCEO-Finance, Operations and IT and comprises six other members.

The Group Risk Committee (GRC) reviews and manages the risk asset policies, approvals, exposures and recoveries related to credit market, operational and compliance risks. It acts as a general forum for the discussions of any aspect of risk which could potentially face AUB or its subsidiaries and managed affiliates resulting in reputational or financial loss to the Group. The Committee has six members and is chaired by the DGCEO – Risk, Legal & Compliance.

The GRC also oversees the operation of the Group Operational Risk Sub-Committee and Group Special Assets Sub-Committee.

The responsibilities of the Group Operational Risk Sub-Committee (GORC) include ensuring that the Group's approach to operational risk management is in accordance with all regulatory requirements including Basel II. It also has responsibility for ensuring the adequacy of the Group's business continuity and disaster recovery plans. This sub-committee has eight members and is chaired by the Group Head of Risk Management.

## CORPORATE GOVERNANCE

The Group Special Assets Committee (GSAC) is responsible for the management of the non-performing assets of the bank. It has responsibility for monitoring accounts downgraded to watch list and criticised asset status and ensuring that a focused and disciplined recovery strategy is adopted to maximise recoveries. The sub-committee has eight members and is chaired by DGCEO-Risk, Legal & Compliance.

### ADDITIONAL GOVERNANCE MEASURES

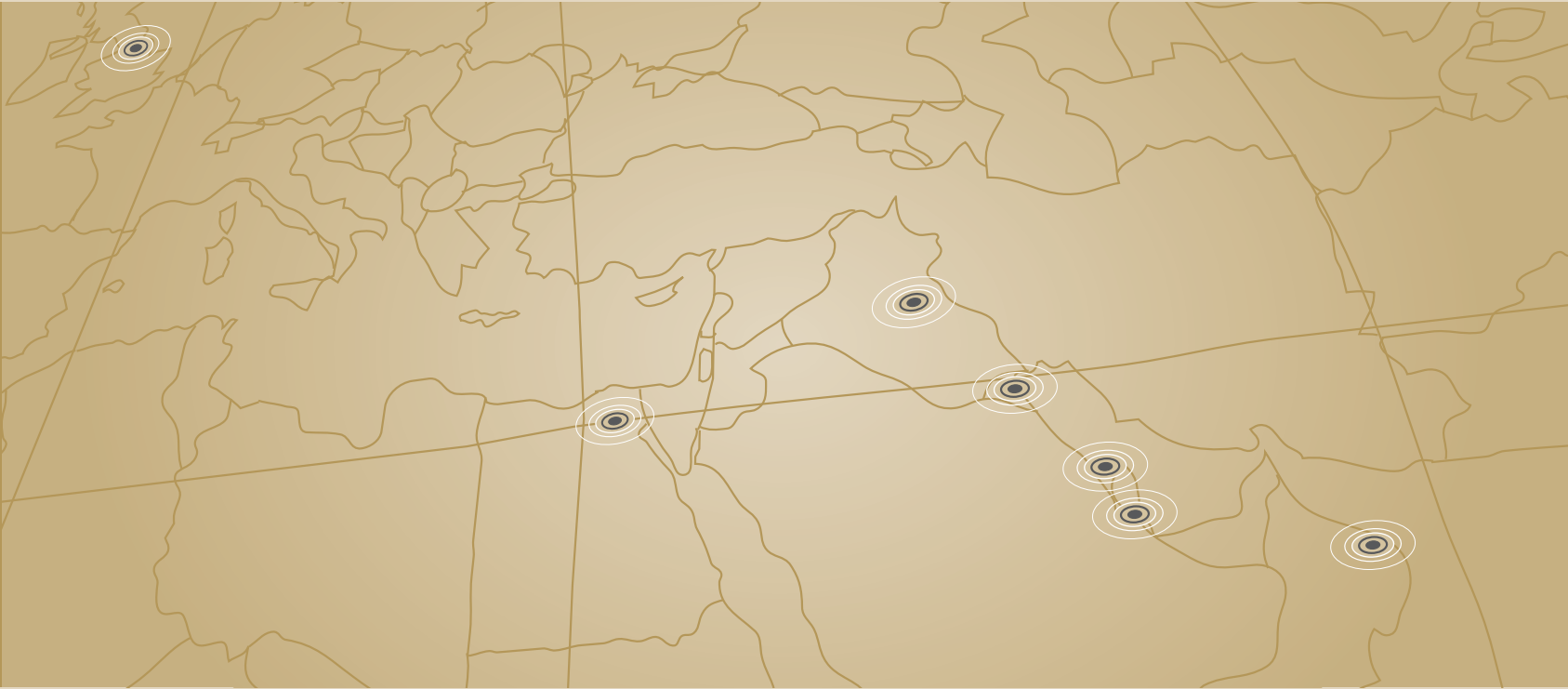
In addition to the Board and management committee structures, the Board of Directors has approved a number of group policies to support clarity and consistency in the operations of the AUB Group. These policies, which are communicated to staff, cover subjects such as the prevention of money laundering, confidentiality, personal share dealing, communications, legal issues and human resources related issues. Underpinning these policies is the Group Code of Business Conduct which was introduced by the Board in 2005 to establish standards of ethical business behaviour and personal conduct for the Bank's Directors, its senior management (officers) and its employees.

As a supporting governance measure, the Board is able to rely on ongoing reviews performed by internal and external auditors on the AUB Group's internal control functions. These reviews are conducted in order to identify any weaknesses, which enables management to immediately put remedial action plans in place. It is important to highlight that the AUB Group maintains adequate insurance coverage and contingency plans for systems failure including back-up systems with off-site data storage.

The Board of Directors and management believe that these high standards of corporate governance will continue to enhance the AUB Group's performance and hence shareholder value over the long-term, as well as provide confidence to all shareholders, customers, regulators, rating agencies and current and future staff.

IN 2008, AUB GROUP ACHIEVED ANOTHER MILESTONE WITH THE NUMBER OF OUR BRANCHES CROSSING THE 100 THRESHOLD, PROPELLING AUB INTO A MORE EXCLUSIVE TIER OF REGIONAL BANKS. AS AT 2008 YEAR END, AUB GROUP'S BRANCHES STOOD AT 106 IN SEVEN COUNTRIES (BAHRAIN, KUWAIT, QATAR, OMAN, EGYPT, IRAQ AND THE UK), DEMONSTRATING OUR COMMITMENT TO WIDEN THE BREADTH AND DEPTH OF OUR NETWORK IN CONJUNCTION WITH OTHER DELIVERY CHANNELS TO BETTER SERVE OUR CUSTOMERS EVERYWHERE.

# GROUP BUSINESS & RISK REVIEW



# GROUP BUSINESS & RISK REVIEW

## PRIVATE BANKING & WEALTH MANAGEMENT

During 2008, at a Group level, the Private Banking & Wealth Management (PB&WM) gained market share through the creation of additional private banking business in the countries where new banks have been integrated into the Group as well as through the organic growth.

Despite unprecedented challenges, the PB&WM strategy remained focused on the provision of professional services as part of a complete client solution. This necessarily entails the enhancement and growth of the existing range of wealth management products and services.

Real estate is a vital component in private financial planning and investments in this asset class remain essential to improve returns and preserve wealth in the long-term. During the year, we launched two new property funds, namely the AUB Global Select Property Fund and the AUB Emerging Markets Property Fund.

Structured investment products are continuously offered to provide another dimension to the traditional range of funds, and 2008 saw the addition of both the AUB Capital Protected Elite Financial Recovery Deposit and the AUB Capital Protected Elite Commodity Linked Deposit to our existing portfolio.

The year saw an increase in the number of private banking teams across the AUB network. This trend reflects the positive growth of the business in 2008. Advisory services were also introduced by AUB UK Private Banking to enhance the range and level of customer service.

In turbulent times predicted for the coming year, it is more important than ever for clients to have the benefit of counsel from knowledgeable sources with in-depth market understanding. This is accessible through PB&WM, which can provide reliable insight into market performance in the short and longer term.

In 2009, despite market challenges, and a more cautious approach by clients, we remain committed to managing our clients' wealth as effectively as possible to ensure its sustainable long-term growth. PB&WM will continue to enhance its wealth management package through a diversified and innovative range of products and services.

## REAL ESTATE FUND MANAGEMENT

2008 has been one of the most challenging years in the property industry since the early 1990's. Limited liquidity in both the institutional and private investor sector is symptomatic of the tightening credit conditions, declining asset values and reduced corporate activity.

During the second half of 2008 our UK and European funds fell 25% and 15% respectively. Our US and Asian funds are also down in value, although to a certain extent in the case of The AUB Pan Asia Industrial Fund Limited it will be able to capitalise on the distress in the financial markets and this may enhance returns in the medium to long term.

*FROM ITS HEADQUARTERS IN BAHRAIN, AUB GROUP OVERSEES THE DELIVERY OF BEST IN CLASS BANKING PRODUCTS AND SERVICES TO ITS 444,000 CLIENTS IN 7 COUNTRIES, THROUGH 7 BANKS AND OVER 100 BRANCHES ACROSS THE MENA REGION AND THE UNITED KINGDOM.*



Ahli United Bank, Bahrain

Despite the year's challenges, approximately US\$320 million was raised for AUB REFM products in 2008 which is a significant 20 per cent increase to REFM's total assets under management. This is a positive result mindful of current market conditions, although raising equity for real estate investments was difficult in the second half of the year due to investor level liquidity issues. Sentiment is expected to turn in 2009 for solid recovery based fund propositions.

In 2008 REFM focused on the launch of two major funds with independent product propositions, and different risk return profiles. Firstly, The AUB Global Select Property Fund Limited was launched in January 2008 and is a diversified global real estate fund which allows investors to enter or exit the fund on a quarterly basis, targeting total returns of 11 per cent in core+/value added investments. Total capital raised to date is approximately US\$145 million and the fund is managed by Aviva Investors (formerly Morley Fund Management). Whilst still at an early stage in its investment cycle the fund has performed relatively well and preserved much of its initial investor equity commitments. The open-ended nature of this product is of strategic significance to AUB's Private Banking business as it is a flexible ever open cornerstone investment vehicle.

The AUB Emerging Markets Real Estate Fund Limited was the second fund launched in 2008, and provides diversified exposure to key emerging markets. The fund is also managed by Aviva Investors and is closed ended with an opportunistic development bias targeting an annual total return of 20 per cent. The fund raised about US\$78.5 million of capital at its initial closing however it has not yet commenced its investment program and the average investor dollar is expected to be placed over the next 12 to 24 months, which should represent an ideal entry point in the market cycle.

In this current period of difficult economic performance, AUB's European and Asian real estate funds are focusing on prudent debt management as well as active tenant and asset management. These initiatives have had a positive impact on preserving values and managing downside risk, resulting in all AUB funds performing well relative to the market and their respective peer groups.

A further US\$100 million has been pledged by a single institutional investor for a UK recovery vehicle. The vehicle is expected to commence its investment phase in late 2009, subject to suitable market conditions.

The realignment of REFM's dual reporting lines to the Deputy Group CEO-Private Banking (Bahrain) and the CEO of AUB UK (London) was the primary structural change for the business in 2008. This dual reporting line brings the business' decision making and product development processes closer to the distribution teams and investors. This enhances accountability and increases the probability of success for each fund launch and realigns the product development process to AUB's distribution capability.

Going forward there are several anticipated challenges for 2009. The most obvious of these is the limited liquidity amongst investors and falling capital values in existing funds. We will also have to contend with volatility across all asset classes which is expected to affect investor willingness to invest in global real estate markets and at the same time the execution of currency and interest rate hedging strategies. Diversification will play a key role in mitigating these risks and for equity rich investors it is anticipated that there will be excellent buying opportunities throughout the year.

## GROUP BUSINESS & RISK REVIEW

2009 will also see a shift in the business focus from conventional real estate funds to new Sharia'a compliant funds. The intention is to launch two funds in 2009, and the first fund is likely to have a UK or European distressed / recovery orientation.

It is important to continue with expansion of AUB's distribution capability into the Gulf, where increasing numbers of trained personnel are required to provide investment advice to the bank's Private Banking customers.

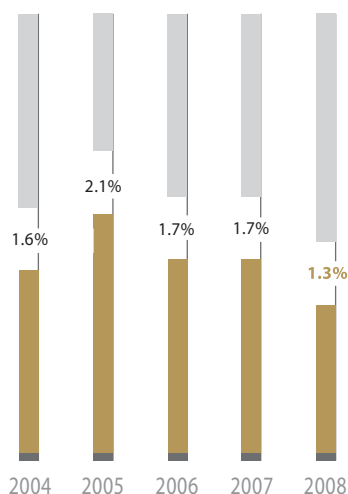
Appropriate strategic relationships (particularly of a Sharia'a nature) with partners that meet the bank's pedigree requirements, as well as the growth and diversification requirements of investors, will also be central to the continued success and growth of the REFM business. With capital values and yields looking very attractive across emerging and developed markets, there is opportunity to initiate new distressed / recovery funds of an opportunistic nature.

Additionally, co-investment / club transactions may also become more prevalent in order to deliver tailored deal level exposure to a smaller group of larger investors that would prefer to avoid funds. This will allow the business to expand its total funds under management.

### ISLAMIC BANKING

#### MIDDLE EAST

The Islamic banking industry globally is worth more than US\$ 1 trillion and its value is increasing at a rate of 15 per cent annually (Accounting & Auditing Organization of Islamic Financial Institutions, World Bank Conference on Islamic Banking & Finance). This phenomenal growth is largely attributable to an increased focus on Islamic banking which is evident in new Islamic banks being set up, the opening of Islamic banking windows or branches at conventional banks, and the conversion of conventional banks to Islamic institutions.



RETURN ON AVERAGE ASSETS

While Al Hilal is a new entrant in the Islamic banking arena, there has been pleasing and steady growth in its assets and revenues since its establishment. Within one year of Al Hilal's start of operations in Bahrain there has been significant growth in customer numbers and assets which stand at over 1,600 and US\$ 98.6 million respectively. This was achieved largely through a strategic focus on the development of products and services, and the effective management of sales and delivery channels.

2008 saw the opening of a new branch in AUB Bahrain and two new branches in Ahli Bank, Qatar. In addition to the strong improvement in distribution, the bank took steps to streamline and enhance back office operations and support by the creation of a dedicated Islamic banking

*AHLI BANK – QATAR HAS SEEN BOTH ITS PROFITABILITY AND REACH GROW BY LEAPS AND BOUNDS SINCE IT PARTNERED WITH AUB IN 2004. LAST YEAR ALONE, IT EXPANDED ITS NETWORK BY ADDING EIGHT NEW BRANCHES, TWO OF WHICH ARE ISLAMIC, BRINGING THE TOTAL NUMBER OF BRANCHES TO 19 BY THE END OF 2008, IN PARALLEL TO LAUNCHING ITS INTERNET BANKING AND SMS BANKING CHANNELS.*



Ahli Bank, Qatar

back office team at the head office to ensure the smooth functioning of Al Hilal operations. Standard operating procedures were also introduced at all the Islamic banking branches during 2008.

Despite the challenging global environment in the international banking system, the outlook for continued and robust expansion in the Islamic finance and banking industry is very positive. From an operational point of view, competition from new entrants is likely to increase. This will require an ongoing focus on product development and innovation, and the development of strong brand attributes based on transparency and high service quality backed by consistent delivery.

The successful launch of Al Hilal Islamic Banking Services has set the stage for the future growth of the bank in this vital area. In addition to acquiring a substantial customer base, assets and liabilities, a significant human resource process infrastructure has also been put in place to gear the bank for anticipated future expansion.

The strategic focus for 2009 will be to pursue and build on the momentum already achieved thereby increasing market share across the various markets in GCC. It is understood that this may require models appropriate for the various regions and compliance with different regulatory requirements and market norms, while maintaining a consistency in the products and the brand attributes.

Further expansion, specifically in Bahrain and Qatar, is planned and additional branches and dedicated sales teams will be established in 2009. In other entities, the Islamic Banking Products will be offered as per the strategic priorities, market potential and regulatory requirements. Additionally as a major strategic step, Group entity Bank of Kuwait and Middle East is being converted from conventional to Islamic bank which shows the commitment of the management towards this strategically vital segment.

## UNITED KINGDOM

In the United Kingdom, the Islamic home finance market - and the UK property market as a whole - witnessed a steep decline in transaction volumes and values due to the global financial downturn. Reliable estimates of the overall size of the Islamic home finance market are difficult to quantify or ascertain with relatively small volumes of business written by existing providers. Market indicators show that the overall demand for Islamic home finance may have been overestimated originally.

Despite these indications, increased competition and lower prices, AUB's new business levels for this sector in the UK were up by 14 per cent over 2007 and we maintained our market position within our segment of the market. Our strategy to avoid highly geared facilities at low margins has proved to be correct with the Manzil Home Purchase Plan book remaining robust and low risk. The successful increase in business volume reflects the success of our strategy and also confirms the ability of the Manzil Home Purchase Plan team to deliver consistently.

The year saw a continued focus on increasing business levels by proactively marketing our products to our existing UK client base as well as the ever-increasing Gulf base. Products were also marketed to the independent mortgage market and high net-worth individuals. This was accompanied by a commitment to provide high levels of service to existing and new clients without exposing the bank to undue risk in the process.

## GROUP BUSINESS & RISK REVIEW

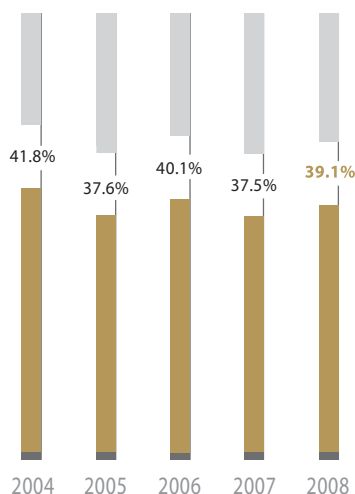
The year saw the revision of the Manzil Ijara Home Purchase Plan (“HPP”) contractual documentation. This will allow the bank to increase its existing Ijara HPP product range whilst remaining competitive.

As the Group grows, the increase in new clients as well as the opportunities to cross-sell our products should provide an increase in business. However to fully benefit from the potential of the Group’s increasing client base, it is of critical importance that relationship managers be supported, trained and educated to provide clients with unrivalled levels of service and satisfaction.

Going forward, we will continue to promote the products during our residential property finance marketing and relationship management development trips to the MENA. Our marketing campaign to the independent mortgage advisor market will continue as will our research into the provision of rent-only Ijara facilities and the ability to provide an Ijara product with a fixed rent review period of five years. In addition to working on new product development and innovation, we will also work to re-introduce the Murabaha product to the UK market.

### RETAIL BANKING

With a commanding footprint of retail branches, ATMs and remote banking services in a number of key markets in the GCC, Egypt, Iraq and the UK, AUB’s retail banking services achieved significant results in the area of consolidation for further improvements in service standards, balance sheet growth and profitability.



COST TO INCOME RATIO

A number of key operating processes were centralised to enhance efficiencies and improve customer service. With the launch of an improved e-banking platform, SMS banking services, mobile remit and advancements in the bank’s contact centres, AUB customers now have access to the full range of banking services from the convenience of their home or office. AUB’s global online trading platform, the first ever online trading solution launched by a regional bank in the Middle East, was also enhanced with respect to its functionality.

With the advantage of a strong regional network, the regional banking requirements of high net worth clients were addressed through the launch of MyGlobal services supported by a team of relationship managers with strong local knowledge in the markets within which AUB operates.

Following the establishment of a joint venture with the UK based Legal & General Group in 2008, AUB will soon offer a range of insurance products and services through its retail branch network to further complement existing products and services.

*FOLLOWING ITS STRATEGIC TIE-UP WITH AUB IN 2007, AHLI BANK HAS UNDERGONE A SUCCESSFUL TRANSFORMATION FROM GCC'S FIRST PRIVATE SECTOR HOUSING BANK TO A FULL COMMERCIAL BANK OFFERING A WIDE RANGE OF BANKING PRODUCTS AND SERVICES TO ITS RETAIL AND CORPORATE CLIENTS IN OMAN.*



Ahli Bank, Oman

AUB's commitment in the area of e-commerce led to the Bank's involvement with Bahrain e- Government, as a partner in the online payment system for services provided by the various government departments.

Significant progress was also made during the year in building the secured asset book portfolio of the bank through the introduction of innovative mortgage structures and auto-finance promotions, in line with the bank's objective to maintain its position as the preferred bank in Bahrain in these asset classes. Ongoing improvements in credit control and collections procedures have resulted in enhanced revenues on the retail asset book.

Throughout 2008, AUB focused on developing new market opportunities to sustain growth while continuing to improve penetration levels across product and market segments. The product range was accordingly expanded with the introduction of new deposit products and lending products for both nationals and expatriates.

Further growth in the coming years will continue to be driven by efforts aimed at expanding market share through cost efficient acquisitions and by maintaining market leadership in being the first to launch unique product offerings that are aligned to changes in the market environment and the emergence of new market opportunities.

## CORPORATE BANKING

It is expected that the extreme global market challenges currently prevailing will prove to be more daunting to corporates in the region than originally envisaged. The full extent of the sub-prime loan problem became apparent at the beginning of 2008 when its effects on liquidity in the region were first felt, with a subsequent reduction in inflationary pressures after commodity prices hit record levels.

In these conditions, the supply of credit was directed mainly and selectively to fund short-term requirements, predominantly to the bank's existing customers.

In light of this volatility, the year saw a strategic focus on mitigating the risk exposure of our asset portfolio, by exiting high risk industries, and re-pricing the loan book to reflect the prevailing risk-reward conditions. This was accompanied by a rigorous monitoring system for the asset portfolio while ensuring that the asset base remained profitable.

Despite these challenges and constraints, commercial banking continued to be at the forefront within the group as its leading revenue generator. It succeeded in negotiating US\$2 billion documentary credit with its customers.

In 2009, the department aims to maintain a high quality asset portfolio, implementing tighter credit terms in selected industries, while protecting and increasing our customer depository base and improving shareholder returns.

# GROUP BUSINESS & RISK REVIEW

## CORPORATE BANKING – SME BUSINESS

SME businesses constitute the majority of the new and existing businesses in the countries where AUB operates. While banks traditionally cater to the needs of larger businesses, few have a focused approach to addressing the banking needs of SME companies. Our objective to support SMEs is in line with those of the governments who work to assist small businesses to create economic activity and generate employment opportunities.

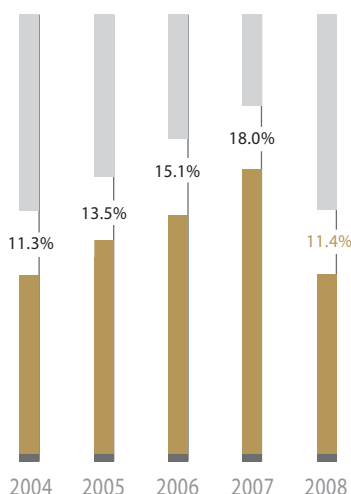
To establish market presence and to cater to the banking needs of SME businesses in our markets, SME business units have been established in the AUB Group presence countries. These units are providing services to this important segment and helping in its growth. This early association with SME companies will help generate an increasing share of future business as these companies grow. These services include asset, liability and cash management products to address the banking needs of SME businesses, providing additional impetus to growing market share.

In Bahrain, AUB was chosen by the Labour Market Regulatory Authority (LMRA) to be the only commercial bank to have an office within the LMRA headquarters building to offer services benefiting LMRA and its customers.

Our focused approach has yielded positive growth in number of customers, assets and liabilities. Although no official market data is available, we believe that AUB's market share has increased based on growth achieved in our own balance sheet.

The economic slowdown has started to impact countries internationally and is now affecting the previously positive economic drivers in the regional economies such as real estate and contracting etc. The trickle down effect on the SMEs is imminent and necessitates a robust, proactive approach entailing active review of the portfolio and regular dialogue with the customers to minimise risks.

In 2009 our aim is to build on the success of 2008, continuing to expand the customer base and grow the size of the business, offering convenient solutions across industries and selective growth in the portfolio.



RETURN ON AVERAGE EQUITY

## TREASURY

Treasury faced unprecedented challenges in 2008 as the credit crisis deepened; amid successive and numerous failures of international banks in the global arena. This in turn reduced liquidity in the financial markets and triggered emergency policy moves by the world's governments and Central Banks. Global interest rates are now at historic lows as the world braces for what is predicted to be the worst economic recession since the great depression of 1929.

*IN 1941, THE PREDECESSOR OF BANK OF KUWAIT AND THE MIDDLE EAST MADE HISTORY AS THE FIRST MODERN BANK TO OPERATE IN KUWAIT. THIS YEAR, BKME WILL MAKE HISTORY AGAIN BY BEING OPERATIONALLY READY TO CONVERT INTO A FULL FLEDGED SHARIA-COMPLIANT BANK.*



BKME, Kuwait

The department's focus for 2008 was on broadening the liability base, minimizing any dependence on wholesale funding, and strengthening our margin-based profitability through greater client interaction. Proactive management of the liability base meant that the Group remained very liquid through the Q4 liquidity crisis, meeting all of its financial obligations and being a net provider of funding to the wholesale markets.

In these challenging market conditions our client orientated focus reaped dividends; Foreign Exchange sales revenue recorded year on year growth of 400 per cent, while trading revenue increased by over 200 per cent, year on year. In recognition of these results, we were awarded 'Best Foreign Exchange Bank in the Middle East' by Global Finance Magazine, for the third successive year.

The global marketplace has changed forever and the excesses of the past 10 years are unlikely to be seen again for a generation. 2009 will be a year of significant deleveraging which will lead to a reduction in available credit both amongst financial institutions and the broader economy. In this environment we will need to be more dynamic in our approach to the markets. This will necessitate further strengthening of our client focus, coupled with a broadening of our liability product offerings and programmes, leveraging the Group's extensive regional presence.

## PROPERTY FINANCE

Market conditions deteriorated significantly during the course of 2008, and the reluctance of banks to lend further exacerbated weak market sentiment. This resulted in fewer property sales and a softening in yields.

In this environment, the bank's primary objective was to manage and monitor the existing portfolio ensuring covenants were maintained. The department did, however, continue to progress plans to identify sound investment opportunities for Gulf clients as and when the market improves.

While AUB did not gain any significant market share during the year, it performed better than most of its competitors, having recognised the realities and potential effects of the market decline earlier. The department adopted a cautious approach and its decision not to provide highly geared investment facilities at low margins, proved correct with the book not suffering the level of write-downs seen by other banks.

The key challenge in 2009 will be to manage the portfolio proactively and professionally. It is believed that the lack of finance in the market may create opportunities to provide conservatively structured deals at historically high returns. The main priority in 2009 will therefore be to continue to manage our existing book. We will however provide conservatively geared investment facilities on well let properties with good equity investment where the returns provide justification for this activity. Additionally, we intend to place a greater emphasis on developing business with our Gulf colleagues for the benefit of our Gulf customers.

# GROUP BUSINESS & RISK REVIEW

## RESIDENTIAL PROPERTY FINANCE

The general sentiment of the residential property market remained weak throughout 2008 amid a worsening economy and an increasing reluctance by banks to lend. This in turn led to a significant decline in mortgage transactions, resulting in fewer properties changing hands and a softening of yields.

The Department's strategy to avoid highly geared investment facilities at low margins was fully vindicated with the book not suffering the level of write-downs seen by other banks, although the year did not see any marked increase in market share.

As a result the key objective during 2008 was to manage and monitor the existing portfolio, revaluing assets and obtaining capital repayments as and when required. Despite the difficult conditions, the department continued to work to identify investment opportunities to introduce to Gulf contacts, enabling clients to position themselves when the market improves.

The key challenge going forward remains the sound management of existing portfolio. The lack of finance in the market may result in the Department having an opportunity to provide conservatively geared investment facilities on well let properties ensuring good equity margins and historically high returns. Additionally, the department intends to continue a greater emphasis on developing business with Group entities in the Gulf for the benefit of our Gulf customers.

## STRUCTURED FINANCE

Signs of a wider contagion of the sub-prime credit crunch were already on the horizon at the start of 2008. After some early activity, we pulled back from the market during Q1 in expectation of a deteriorating economic climate. This early caution has now proved to be fully justified, and while we did not gain significant market share in the year under review, AUB performed better than its competitors, calling the market downturn six months beforehand and adopting a much more conservative approach to risk for the 12 months before that.

The key accountability during 2008 was to manage and monitor the existing portfolio, improving reporting procedures to reflect an expectation of rising defaults linked to harsher economic conditions. The department also sought to identify areas where there will be opportunities that could be introduced to Gulf contacts. Preparation work was carried out which should be productive when investor appetite returns and the market improves. Structurally, the department was downsized in 2008 and was refocused to reflect the change from new business generation to portfolio management.

In 2009, the key challenge will be to prudently but proactively manage our portfolio. In a deteriorating business climate this will significantly improve our overall profitability. It will be important to secure our existing book before growing assets, mainly in the secondary market, where seasoned deals can be acquired on exceptional terms. In terms of business generation the opportunities offered in the LBO secondary debt market are potentially very attractive with available returns driven up by tight liquidity, forced sellers and a re-pricing of risk. Additionally a greater emphasis will be placed upon developing business with our Gulf colleagues for the benefit of our Gulf customers.

*THE FIRST PRIVATE BANK TO OPERATE IN IRAQ, COMMERCIAL BANK OF IRAQ BECAME ALSO THE FIRST IRAQI BANK TO RECEIVE A LICENSE FROM MASTERCARD INTERNATIONAL TO ISSUE MASTERCARD CREDIT AND DEBIT CARDS, THUS OFFERING ACCESS TO A WORLD OF FACILITIES TO ITS CUSTOMERS BOTH INSIDE AND OUTSIDE IRAQ.*



CBIQ, Iraq

## INFORMATION TECHNOLOGY

The Information Technology (IT) division has played a key role in enhancing productivity and delivery of customer focused solutions across AUB's operating horizon; through continued deployment of cost effective business driven solutions building upon the technological framework. AUB has continued on the path of creating a dynamic structure that offers its regional clients leading-edge financial opportunities, allied with the highest standards of customer service. This has been realized by way of using standardized procedures and systems and cost effective centralization of Information Technology infrastructure and operations.

During the year, Ahli Bank Oman, has migrated to a new Core Banking solution, thus facilitating a successful conversion of ABO into a commercial bank offering full range of retail and corporate banking products.

Technology continues to play a critical role in fulfilling AUB's ongoing strategy to ensure that our client base is able to receive the desired commercial banking and sharia compliant products and services through dedicated channels. The AUB Islamic core banking system currently supports eight Islamic branches in Bahrain and Qatar.

A highly functional and robust retail internet banking system (Mye-Bank), was introduced in Bahrain early in 2008, as part of further enhancing the suite of services available online, followed by Ahli Bank Qatar and AUB Egypt. These new electronic banking services provide customers with a single access point for conducting their electronic banking transactions wherever they have a banking relationship with AUB.

AUB's strategy of cost effective use of technical resources through centralized systems development and processing continues to maximise returns on investments in technology. In addition to a centralized internet banking system, new systems hosted in Bahrain include a single customer statement-MyGlobal- which consolidates, at customer's request, all the accounts and transaction information covering AUB entities where the customer has a banking relationship. Centralized Anti-Money Laundering, staff management, payroll processing, Basel II reporting and debit card processing are all examples of AUB executing a uniform presence in AUB's operating jurisdictions.

The deployment of coherent Information Security policies and procedures supported by highly trained and responsive professionals are the cornerstone of AUB's strategies for delivering sophisticated and safe banking functionality to our customers. During 2008, AUB implemented one of the industry's most sophisticated fraud detection systems and solicited third party reviews from internationally recognized e-commerce companies to ensure that our Mye-Bank customers are able to operate and transact business in a safe and secure manner. During the year, security awareness sessions and periodic external and internal information security assessments have been conducted in all of AUB's locations.

The coming year will see further consolidation in integration of Group IT resources and application platforms commensurate with enhanced centralization and standardisation of processes, procedures, and system implementation strategies across the Group. AUB will continue the enhancement and deployment of the Retail and Corporate internet banking system, leverage investments in Retail Banking, Treasury, Human Resource systems and enhanced enterprise management information systems.

# GROUP BUSINESS & RISK REVIEW

## HUMAN RESOURCES

In the first half of 2008 HR programmes and activities focused on implementing a range of initiatives to strengthen the Group's human and organisational capability to drive business growth in the Group's different cross border markets. With the impact of the global financial crisis in the third quarter of 2008, the focus became one of cost containment, as well as working with line managers to streamline and refocus operations on the critical challenges faced as a result of the global economic downturn.

During 2008 the HR group implemented a number of strategic initiatives, including:

- Restructuring of HR departments to align key resources with core business and support units.
- Training and accreditation of staff from all Group entities to deliver the core training programmes in the Group's retail banking and credit academies, with the subsequent training of staff in all Group entities.
- Detailed human resources planning for the conversion of BKME to Islamic banking, including training of staff and the review of HR policies to ensure Sharia'a compliance.
- Implementation of the new HRMIS in all Group entities, providing a common platform for HR financial transactions, analysis and reporting.

Staff development remained a key focus in 2008, with the Group training plan delivering 76 common core training programs to 1,727 staff. In addition, 458 staff attended external training programmes and development conferences and a further 543 staff participated in the Group's e-learning programmes. At year end, the Group's total workforce was 2617.

As we look to the uncertainties of 2009 the primary focus will be one of disciplined cost management. Within this area, critical attention will be paid to streamlining business units and support functions, performance management, retention of key talent, in-house staff development and the review of total employment cost. A key strategy in this environment will be the delivery of world class e-learning development and certification programs, which will more than double the training and development opportunities available to staff whilst simultaneously almost halving training costs compared to 2008.

## RISK MANAGEMENT

Risk management involves the identification, analysis, evaluation, acceptance and management of all financial and non-financial risks that could have a negative impact on the Group's performance and reputation.

The major risks associated with AUB's business are credit risk, market risk which includes foreign exchange, interest rate and equity price risk, liquidity risk, operational risk and reputational risk.

*WITH A NEW HEADQUARTERS UNDER CONSTRUCTION AND 26 BRANCHES, AHLI UNITED BANK (EGYPT) IS EMBARKING ON AN AMBITIOUS EXPANSION STRATEGY THAT WILL SEE ITS NETWORK EXPAND RAPIDLY THROUGHOUT EGYPT, OFFERING MODERN AND CONVENIENT BANKING SOLUTIONS TO CUSTOMERS WHEREVER THEY ARE.*



Ahli United Bank, Egypt

AUB's risk management policies have been developed to:

- identify and analyse these risks,
- set appropriate risk limits and controls,
- monitor the risks and adherence to limits,

The risk management function is not responsible for eliminating risks that are embedded in any banking business, but aims to effectively manage these risks with the objective of earning competitive returns over the degree of assumed risk. Risk is financially evaluated as the potential impact on income and asset value, taking into consideration changes in political, economic and market conditions, and the creditworthiness of the Bank's clients.

The risk management function relies on the competence, experience and dedication of its professional staff, sound risk management policies and procedures, and ongoing investment in technology and training.

The Board of Directors and senior management are involved in the establishment of all risk processes and the periodic oversight and guidance of the risk management function. The Risk Management processes are subject to additional scrutiny by independent internal and external auditors, and the Bank's regulators which help further strengthen the risk management practices.

The risk management control process is based on detailed policies and procedures that encompass:

- business line accountability for all risks taken, each business line is responsible for developing a plan that includes adequate risk/return parameters, as well as risk acceptance criteria;
- a credit function that understands, monitors and independently controls each credit relationship ensuring that the appropriate approval authorities are obtained and a uniform risk management standard including risk ratings, have been correctly assigned to each and every credit relationship;
- product and business policies, which are clearly understood, monitored and are in agreement with the overall credit policy and the Board approved risk framework;
- the ongoing assessment of portfolio credit risk and approval of new products; and
- an integrated limits structure as an essential component that permits management to control exposures and monitor the assumption of risk against predetermined approved tolerances with global limits established for each major type of risk that is sub-allocated to individual business units.

# GROUP BUSINESS & RISK REVIEW

## CREDIT RISK

Credit risk is the risk of potential financial loss due to the failure of a counter party to perform according to agreed terms. It arises principally from lending, trade finance and treasury activities. The credit process is consistent for all forms of credit risk to a single obligor. Overall exposure is evaluated on an ongoing basis to ensure a broad diversification of credit risk. Potential concentrations by country, product, industry, and risk grade are regularly reviewed to avoid excessive exposure and ensure a broad diversification.

Credit risk within the Group is actively managed by a rigorous process from initiation to approval to disbursement. All day-to-day management is in accordance with well-defined credit policies and procedures (CP&P) that details all credit approval requirements and are designed to identify at an early stage exposures which require more detailed review and closer monitoring. If an asset is considered unrecoverable, a mandatory write-off takes place. This is conducted by a risk management process, which is completely independent in reporting terms from the asset generating departments.

The CP&P includes a robust risk rating system that stratifies the credit portfolio by level of risk to monitor the credit quality and to be able to assess the pricing and aid in the prompt identification of problem exposures. Management of material problem exposures is vested with Special Exposure Groups in the respective Group operating entities, all of which report to the Group Risk Management area. All exposures are subject to quarterly and in certain cases monthly reviews.

In addition to the Group Risk Management function, credit risk is overseen by the Group Risk Committee (GRC) which is vested with the overall day-to-day responsibility for all matters relating to group credit risk. Its responsibilities include the following:

- formulating and implementation of credit policies and monitoring compliance,
- acts as a credit approval body for credits within its delegated authority,
- recommends to the Executive Committee all policy issue changes related to credit risk as well as credits falling outside its discretion,
- determines appropriate pricing and security guidelines for all risk asset products,
- reviews the ongoing risk profile of the Group as a whole and by individual business sectors and countries,
- ensures the adequacy of specific and collective impairment provisions and makes appropriate recommendations to the Executive Committee.

## MARKET RISK

Market risk is the risk that adverse movements in market risk factors including foreign exchange rates, interest rates, credit spreads, commodity prices and equity prices will reduce the Bank's income or the value of its portfolios.

Given the Group's ongoing low risk strategy, aggregate market risk levels are low relative to the size of the Bank's balance sheet. The Group utilizes Value-at-Risk (VaR) models to assist in estimating potential losses that may arise from adverse market movements in addition to non-quantitative risk management techniques.

*ESTABLISHED IN 1966, AHLI UNITED BANK (UK) PLC HAS A LONG AND PROUD HISTORY OF UNDERSTANDING AND MEETING THE NEEDS OF OFFSHORE INVESTORS AND VISITORS FROM THE GULF, SERVING AS THE BRIDGE OF CHOICE BETWEEN INDIVIDUALS AND INSTITUTIONS IN THE REGION AND THE GLOBAL FINANCIAL MARKETS.*



Ahli United Bank, UK

The Group calculates VaR using a one-day holding period at a confidence level of 95%, which takes into account the actual correlations observed historically between different markets and rates.

#### VALUE AT RISK

	<b>2008</b>	2007
	<b>US\$ Millions</b>	US\$ Millions
Average	<b>0.54</b>	0.77
Minimum	<b>0.23</b>	0.25
Maximum	<b>1.19</b>	1.87

VaR limits are delegated by the Board to the Group Asset and Liability Committee (GALCO) and sub-delegated to the Group's subsidiaries.

The Group recognizes that VaR is based on the assumption of normal market conditions and that certain market shocks can result in losses greater than anticipated. Therefore, a strict limit structure and control process is adopted to effectively manage market risks and monitor daily position limits and stop losses.

## LIQUIDITY RISK

Liquidity risk is the risk of being unable to meet the Bank's cash commitments without having to raise funds at unreasonable prices or sell assets on a forced basis. It is measured by estimating the Group's potential liquidity and funding requirements under different stress scenarios.

The Group's liquidity management policies and procedures are designed to ensure that funds are available under all circumstances to meet the funding requirements of the Group not only under adverse conditions but at sufficient levels to capitalize on opportunities for business expansion.

A prudent mix of liquidity control based on expected economic and Group specific events substantially ensures access to liquidity without the need to increase cost. It also provides for the maintenance of a stock of liquid and marketable assets and an adequately diversified deposit base in terms of maturity profile and number of counter parties.

The Group Risk Management function continuously monitors liquidity risk and actively manages the balance sheet to control liquidity. At the subsidiary level, the respective treasury function manages this risk with monitoring by the Risk Management department and jurisdiction of its Assets and Liabilities Committee (ALCO). At the Group level liquidity risk is managed by the Group Assets and Liabilities Committee (GALCO), which is vested with the overall day-to-day responsibility for all matters relating to Group liquidity.

# GROUP BUSINESS & RISK REVIEW

## OPERATIONAL RISK

AUB defines Operational Risk as “the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.”

No material losses have occurred in 2008. However, due to nature of the risk, there is no assurance that this risk can be totally eliminated.

Operational risk is managed by the Group Operational Risk Committee (GORC). The Group adopts an ongoing Operational Risk Self-Assessment (ORSA) process in accordance with best practice. Assessments are made of the operational risks facing each function within the Bank and these are reviewed regularly to monitor significant changes. Operational risk loss data is collected and reported to senior management on a regular basis.

The Group’s independent audit function regularly evaluates operational procedures and advises senior management and the Board of any potential problems. Additionally, the Group maintains adequate insurance coverage and disaster recovery/business continuity contingency plans utilizing offsite data storage and backup systems.

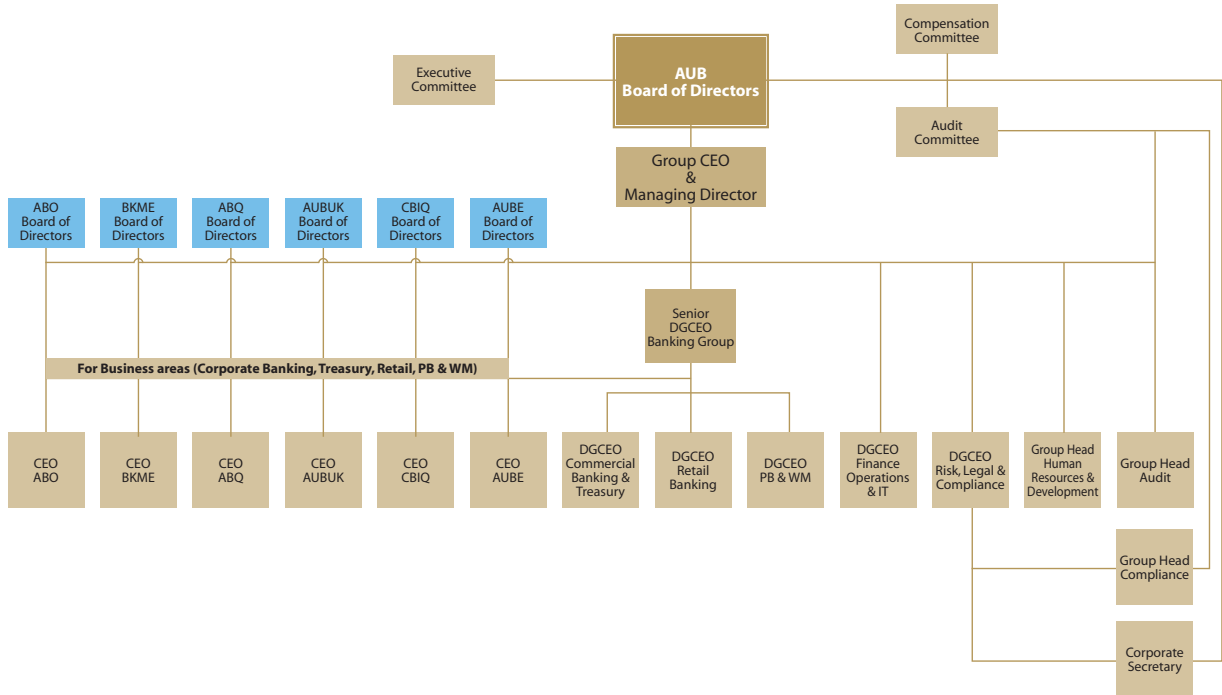
### BASEL II

The Central Bank of Bahrain implemented the Basel II Accord for calculating minimum capital requirements with effect from 1 January 2008. The Basel II framework consists of three pillars – minimum capital requirements, the supervisory review process and market discipline. The principal objectives of Basel II are to enhance soundness in the financial system and introduce a more comprehensive approach to addressing risk.

Under Pillar I the new accord provides three approaches to the calculation of credit risk related regulatory capital. The standardized approach which AUB has adopted requires the Bank to use external credit ratings to determine the risk-weightings applied to rated counterparties, and groups counterparties into categories and then applies standardized risk weightings. The Bank has adopted the standardised method of calculating market risk. The market risks faced by the Bank are confined to interest rate and foreign exchange risks. The standardised methodology calculates capital changes by applying risk weightings to interest rate exposures and to net open foreign exchange positions.

Basel II has introduced a capital requirement in respect of Operational Risk and again has created three methods of calculation. The capital required under the basic indicator approach, as adopted by the Bank, is a simple percentage of gross revenues. In due course as historical data is built we would expect to move to the advanced measurement approach which will allow the Bank to use its own statistical analysis of operational risk data to determine the capital requirement.

# GROUP ORGANISATION AND SHAREHOLDING



## DISTRIBUTION OF BENEFICIAL ORDINARY SHARES AS ON 31/12/08

Categories	No. of Shares	No. of Shareholders	% of Total Outstanding Shares
50% and above	0	0	0.00
20% up to less than 50%	0	0	0.00
10% up to less than 20%	1,349,882,825	2	29.96
5% up to less than 10%	677,332,880	2	15.03
1% up to less than 5%	1,283,441,819	13	28.48
less than 1%	1,195,666,520	3,344	26.53
<b>TOTAL</b>	<b>4,506,324,044</b>	<b>3,361</b>	<b>100.00</b>

## DISTRIBUTION OF BENEFICIAL PREFERENCE SHARES AS ON 31/12/08

Categories	No. of Shares	No. of Shareholders	% of Total Outstanding Shares
50% and above	0	0	0
20% up to less than 50%	101,256,515	1	20.25
10% up to less than 20%	174,306,958	2	34.86
5% up to less than 10%	57,383,498	2	11.48
1% up to less than 5%	130,661,469	10	26.13
less than 1%	36,391,560	348	7.28
<b>TOTAL</b>	<b>500,000,000</b>	<b>363</b>	<b>100.00</b>

# GROUP MANAGEMENT

## **Adel A. El-Labban**

Group Chief Executive Officer and Managing Director

Director, Ahli United Bank (UK) PLC; Director, Bank of Kuwait & the Middle East KSC, Kuwait; Director Ahli Bank QSC, Qatar; Director, Ahli United Bank (Egypt) SAE, Egypt; Director Ahli Bank SAOG, Oman; Director, Commercial Bank of Iraq; Director Kuwait & Middle East Financial Investment Co. (KMEFIC), Kuwait; Board Member of Bahrain Stock Exchange; Director - Board of Trustees, Bankers Society of Bahrain; Formerly Chief Executive Officer and Director of the United Bank of Kuwait PLC, London; Managing Director, Commercial International Bank of Egypt; Chairman, Commercial International Investment Company; Vice President, Corporate Finance, Morgan Stanley; Director, National Work Fund, Bahrain; Director, Bahrain Institute of Banking & Finance (BIBF).

## **Bassel Gamal**

Senior Deputy Group Chief Executive Officer – Banking Group

Director, Ahli Bank QSC, Qatar; Director, Bank of Kuwait & the Middle East KSC, Kuwait; Director, Ahli United Bank (Egypt) SAE, Egypt; Formerly CEO, Ahli Bank QSC, Qatar; DCEO-Risk, Finance & Operations, Ahli Bank QSC, Qatar; Deputy Group Head of Risk Management, Ahli United Bank, Bahrain; Senior Manager, Corporate Banking-Commercial International Bank (Egypt).

## **Sawsan Abulhassan**

Deputy Group Chief Executive Officer - Private Banking and Wealth Management

Director, AUB Nominees Ltd.; Member of the Board of Directors and Member of Audit Committee, Securities & Investment Company (SICO), Bahrain; Member of the Board of Directors, National Social Work Fund - Bahrain; Previously with Citibank N.A. Bahrain, Head of Wealth Management and Distribution; and Standard Chartered Bank - Bahrain, Head of Wealth Management.

## **Abdulla Al-Raeesi**

Deputy Group Chief Executive Officer – Retail Banking

Director, Ahli Bank QSC, Qatar; Director, Ahli United Bank SAE, Egypt; Director, International Chamber of Commerce, Bahrain; Former Director, Benefit Company, Bahrain; Former Acting CEO, Ahli Bank, Qatar; Deputy CEO Retail Banking, Ahli United Bank, Bahrain; AGM & Head of Delivery Channels, Commercial Bank of Qatar; AGM, Support Group, Doha Bank, Qatar; Head of Business & Technology Consulting Group, Arthur Andersen.

## **Sanjeev Baijal**

Deputy Group Chief Executive Officer – Finance, Operations and IT

Director, Ahli Bank SAOG, Oman; Director, Bank of Kuwait & The Middle East KSC; Director, Kuwait and Middle East Financial Investment KSC(c); Previously Group Head of Finance, Ahli United Bank, Bahrain; Financial Controller, Al-Ahli Commercial Bank, Bahrain; Ernst & Young, Bahrain and Price Waterhouse in India. Member of the American Institute of Certified Public Accountants (AICPA) and Associate Member of the Institute of Chartered Accountants of India (ACA).

## **Keith Gale**

Deputy Group Chief Executive Officer – Risk, Legal and Compliance

Director, Ahli Bank SAOG, Oman; Previously Group Head of Risk Management, Ahli United Bank, Bahrain; Head of Credit and Risk at ABC International Bank PLC; Assistant Vice President – Internal Audit Department, Arab Banking Corporation, Bahrain. Held various positions in the UK with KPMG and Ernst & Young. Associate Member of the Institute of Chartered Accountants England & Wales (ACA).

# CONTACT DETAILS

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# AUDITORS' REPORT AND CONSOLIDATED FINANCIAL STATEMENTS 2008

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## INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI UNITED BANK B.S.C.

We have audited the accompanying consolidated financial statements of Ahli United Bank B.S.C. ('the Bank') and its subsidiaries ('the Group'), as at 31 December 2008 comprising the consolidated balance sheet as at 31 December 2008 and the related consolidated statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### **Board of Directors' Responsibility for the Consolidated Financial Statements**

The Board of Directors is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of 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.

### **Auditors' Responsibility**

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

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

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

### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2008 and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

### **Other Regulatory Matters**

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements, and the contents of the Board of Directors' Report relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank have occurred during the year ended 31 December 2008 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position and that the Bank has complied with the terms of its banking licence.



18 February 2009  
Manama, Kingdom of Bahrain.

# CONSOLIDATED STATEMENT OF INCOME

Year ended 31 December 2008

	<i>Note</i>	<b>2008</b>	2007
		<b>US\$ '000</b>	US\$ '000
Interest income	4	<b>1,240,072</b>	1,310,634
Interest expense	5	<b>836,967</b>	982,516
Net interest income		<b>403,105</b>	328,118
Fees and commissions - net	6	<b>150,630</b>	157,525
Trading income - net	7	<b>24,896</b>	44,068
Net (loss) gain on available-for-sale investments	8	<b>(12,391)</b>	24,962
Share of profit from associates		<b>66,455</b>	57,134
Dividend income		<b>20,032</b>	17,811
Other operating income		<b>12,806</b>	7,385
		<b>262,428</b>	308,885
<b>OPERATING INCOME</b>		<b>665,533</b>	637,003
Provision for loan losses and contingencies - net	10f	<b>98,625</b>	26,200
<b>NET OPERATING INCOME</b>		<b>566,908</b>	610,803
Staff costs		<b>152,689</b>	140,749
Depreciation		<b>16,834</b>	15,750
Other operating expenses		<b>90,930</b>	82,124
<b>OPERATING EXPENSES</b>		<b>260,453</b>	238,623
<b>PROFIT BEFORE TAX</b>		<b>306,455</b>	372,180
Income tax (credit) expense	23	<b>(3,287)</b>	12,354
<b>NET PROFIT FOR THE YEAR</b>		<b>309,742</b>	359,826
<b>Attributable to:</b>			
Bank's equity shareholders		<b>255,723</b>	296,317
Minority interest		<b>54,019</b>	63,509
		<b>309,742</b>	359,826
<b>EARNINGS PER SHARE ATTRIBUTABLE TO BANK'S EQUITY SHAREHOLDERS FOR THE YEAR:</b>			
Basic earnings per share (US cents)	24	<b>5.6</b>	8.3
Diluted earnings per share (US cents)	24	<b>5.6</b>	7.2

The attached notes 1 to 39 form part of these consolidated financial statements.

# CONSOLIDATED BALANCE SHEET

Year ended 31 December 2008

	Note	2008 US\$ '000	2007 US\$ '000
<b>ASSETS</b>			
Cash and balances with central banks	9	392,251	142,590
Treasury bills and bonds		1,236,997	867,074
Trading securities		23,364	112,201
Deposits with banks and other financial institutions		2,867,959	4,396,781
Loans and advances	10	13,632,220	12,035,153
Non-trading investments	11	3,353,570	3,525,277
Investments in associates and joint venture	12	534,916	768,471
Premises and equipment	14	389,009	292,461
Other assets	15	517,871	414,487
Goodwill and other intangible assets	16	634,570	495,357
<b>TOTAL ASSETS</b>		<b>23,582,727</b>	23,049,852
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES</b>			
Deposits from banks and other financial institutions		5,153,514	6,989,024
Customers' deposits	17	13,178,079	10,780,914
Term debts	18	1,350,000	1,350,000
Other liabilities	19	882,781	693,569
Subordinated liabilities	20	623,576	588,224
<b>TOTAL LIABILITIES</b>		<b>21,187,950</b>	20,401,731
<b>EQUITY</b>			
Ordinary share capital	21	1,126,561	844,201
Preference share capital	21	17,128	173,001
Reserves	22	851,746	1,292,518
Attributable to the Bank's equity shareholders		1,995,435	2,309,720
Minority interest		399,342	338,401
<b>TOTAL EQUITY</b>		<b>2,394,777</b>	2,648,121
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>23,582,727</b>	23,049,852

**Fahad Al-Rajaan**  
Chairman

**Hamad Al-Marzouq**  
Deputy Chairman

**Adel A. El-Labban**  
Group Chief Executive Officer  
& Managing Director

The attached notes 1 to 39 form part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2008

	Note	2008	2007
		US\$ '000	US\$ '000
<b>OPERATING ACTIVITIES</b>			
Profit before tax		306,455	372,180
Adjustments for:			
Depreciation		16,834	15,750
Net loss (gain) on available-for-sale investments	8	12,391	(24,962)
Provision for loan losses and contingencies - net	10f	98,625	26,200
Share of profit from associates		(66,455)	(57,134)
Staff costs - fair value amortisation of share based transactions	24	4,730	5,196
Operating profit before changes in operating assets and liabilities		372,580	337,230
Changes in:			
Mandatory reserve deposits with central banks		(48,281)	(21,485)
Treasury bills and bonds		(207,025)	92,639
Trading securities		89,604	(36,372)
Deposits with banks and other financial institutions		1,501,640	(359,380)
Loans and advances		(1,006,360)	(3,186,184)
Other assets		(75,548)	(145,531)
Deposits from banks and other financial institutions		(1,858,319)	(337,892)
Customers' deposits		1,258,079	1,741,448
Other liabilities		113,199	253,790
Cash from (used in) operations		139,569	(1,661,737)
Income tax paid		(5,057)	(1,367)
Net cash from (used in) operating activities		134,512	(1,663,104)
<b>INVESTING ACTIVITIES</b>			
Purchase of non-trading investments		(564,760)	(1,270,425)
Proceeds from sale or redemption of non-trading investments		793,063	1,114,527
Investments in associates and joint venture		(12,500)	(185,540)
Additional investment in a subsidiary		-	(74,611)
Increase in premises and equipment		(50,662)	(67,420)
Net cost of combinations	13	(121,944)	-
Dividends received from associates		16,636	10,696
Net cash from (used in) investing activities		59,833	(472,773)
<b>FINANCING ACTIVITIES</b>			
Proceeds from rights issue		-	373,805
Proceeds from issue of Class B preference shares		-	69,259
Increase (repayment) of subordinated liabilities		35,352	(35,353)
Increase (repayment) of term debt		-	(192,497)
Dividends and other appropriations paid		(162,014)	(110,114)
Net cash (used in) from financing activities		(126,662)	105,100
Foreign currency translation adjustments		2,339	40,455
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>		<b>70,022</b>	<b>(1,990,322)</b>
Cash and cash equivalents at 1 January		2,376,886	4,367,208
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>	25	<b>2,446,908</b>	<b>2,376,886</b>

The attached notes 1 to 39 form part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2008

	Attributable to Bank's equity shareholders									
	Ordinary share capital US\$ '000	Preference share capital US\$'000	Share premium US\$ '000	Statutory reserve US\$ '000	Retained earnings US\$ '000	Reserves				Total US\$'000
						Proposed appropriations US\$ '000	Other reserves (Note 22(i)) US\$ '000	Minority interest US\$'000	Total US\$'000	
Balance at 31 December 2007	844,201	173,001	561,373	101,052	228,472	128,864	272,757	1,292,518	338,401	2,648,121
Directors' fees paid	-	-	-	-	-	(1,002)	-	(1,002)	-	(1,002)
Donations approved	-	-	-	-	-	(1,000)	-	(1,000)	-	(1,000)
Currency translation adjustments	-	-	-	-	-	-	2,339	2,339	(5,164)	(2,825)
Share of changes in fair value reserve of associates	-	-	-	-	-	-	(22,731)	(22,731)	-	(22,731)
Net realised gain recycled to consolidated statement of income	-	-	-	-	-	-	(147,473)	(147,473)	-	(147,473)
Net realised gain on cashflow hedges recycled to consolidated statement of income	-	-	-	-	-	-	1,743	1,743	-	1,743
Net fair value movements on available-for-sale investments	-	-	-	-	-	-	(225,762)	(225,762)	(42,628)	(268,390)
Net fair value movements on cashflow hedges	-	-	-	-	-	-	(72,810)	(72,810)	-	(72,810)
Revaluation of freehold land	-	-	-	-	-	-	26,816	26,816	4,845	31,661
Net (expense) income recognised directly in equity	-	-	-	-	-	(2,002)	(437,878)	(439,880)	(42,947)	(482,827)
Net profit for the year	-	-	-	-	255,723	-	-	255,723	54,019	309,742
Total recognised income (expense) for the year	-	-	-	-	255,723	(2,002)	(437,878)	(184,157)	11,072	(173,085)
Class A preference share dividend paid (note 22(j))	-	-	-	-	-	(15,366)	-	(15,366)	-	(15,366)
Class B preference share dividend paid (note 22(j))	-	-	-	-	-	(5,716)	-	(5,716)	-	(5,716)
Ordinary share dividend paid (note 22(j))	-	-	-	-	-	(105,780)	-	(105,780)	(41,407)	(147,187)
Bonus shares issued (note 21(b) and (c))	102,417	-	-	-	(102,417)	-	-	(102,417)	-	-
Arising on acquisition of a subsidiary	-	-	-	-	-	-	-	-	109,906	109,906
Other equity movements of a subsidiary	-	-	-	-	-	-	-	-	(18,630)	(18,630)
Conversion of preference shares (note 21(d) and (g))	179,963	(154,963)	(19,008)	-	-	-	(5,992)	(25,000)	-	-
Class B preference shares (surrendered) issued	-	(910)	(2,336)	-	-	-	-	(2,336)	-	(3,246)
Treasury shares purchased	(20)	-	-	-	-	-	-	-	-	(20)
Transfer to statutory reserve (note 22(c))	-	-	-	25,572	(25,572)	-	-	-	-	-
Proposed dividend on Class B preference shares (note 22(j))	-	-	-	-	(3,493)	3,493	-	-	-	-
Proposed dividend on ordinary shares (note 22(j))	-	-	-	-	(112,658)	112,658	-	-	-	-
Proposed directors' fees	-	-	-	-	(1,168)	1,168	-	-	-	-
Proposed donations	-	-	-	-	(1,000)	1,000	-	-	-	-
<b>Balance at 31 December 2008</b>	<b>1,126,561</b>	<b>17,128</b>	<b>540,029</b>	<b>126,624</b>	<b>237,887</b>	<b>118,319</b>	<b>(171,113)</b>	<b>851,746</b>	<b>399,342</b>	<b>2,394,777</b>

The attached notes 1 to 39 form part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2008

	Attributable to Bank's equity shareholders									
	Ordinary share capital US\$ '000	Preference share capital US\$ '000	Share premium US\$ '000	Statutory reserve US\$ '000	Retained earnings US\$ '000	Reserves				Total US\$ '000
						Proposed appropriations US\$ '000	Other reserves (Note 22(i)) US\$ '000	Total reserves US\$ '000	Minority interest US\$ '000	
Balance at 31 December 2006	682,500	148,941	235,820	71,420	158,901	112,097	133,439	711,677	283,554	1,826,672
Directors' fees paid	-	-	-	-	-	(833)	-	(833)	-	(833)
Donations approved	-	-	-	-	-	(500)	-	(500)	-	(500)
Currency translation adjustments	-	-	-	-	-	-	40,455	40,455	11,419	51,874
Share of changes in fair value reserve of associates	-	-	-	-	-	-	10,427	10,427	-	10,427
Net realised gain recycled to consolidated statement of income	-	-	-	-	-	-	(54,724)	(54,724)	-	(54,724)
Net realised gain on cashflow hedges recycled to consolidated statement of income	-	-	-	-	-	-	252	252	-	252
Net fair value movements on available-for-sale investments	-	-	-	-	-	-	64,873	64,873	21,230	86,103
Net fair value movements on cashflow hedges	-	-	-	-	-	-	(16,255)	(16,255)	-	(16,255)
Revaluation of freehold land	-	-	-	-	-	-	94,290	94,290	2,718	97,008
Net (expense) income recognised directly in equity	-	-	-	-	-	(1,333)	139,318	137,985	35,367	173,352
Net profit for the year	-	-	-	-	296,317	-	-	296,317	63,509	359,826
Total recognised income (expense) for the year	-	-	-	-	296,317	(1,333)	139,318	434,302	98,876	533,178
Class A preference share dividend paid (note 22(j))	-	-	-	-	-	(14,288)	-	(14,288)	-	(14,288)
Class B preference share dividend paid (note 22(j))	-	-	-	-	-	(926)	-	(926)	-	(926)
Ordinary share dividend paid (note 22(j))	-	-	-	-	-	(95,550)	-	(95,550)	(34,868)	(130,418)
Bonus shares issued (note 21(b) and (c))	68,250	-	-	-	(68,250)	-	-	(68,250)	-	-
Other equity movements of a subsidiary	-	-	-	-	-	-	-	-	(9,161)	(9,161)
Rights issue	93,451	-	280,354	-	-	-	-	280,354	-	373,805
Class B preference shares issued (note 21 (f))	-	24,060	45,199	-	-	-	-	45,199	-	69,259
Transfer to statutory reserve (note 22(c))	-	-	-	29,632	(29,632)	-	-	-	-	-
Proposed dividend on Class A preference shares – convertible portion (note 22(j))	-	-	-	-	(15,366)	15,366	-	-	-	-
Proposed dividend on Class B preference shares (note 22(j))	-	-	-	-	(5,716)	5,716	-	-	-	-
Proposed dividend on ordinary shares (note 22 (j))	-	-	-	-	(105,780)	105,780	-	-	-	-
Proposed directors' fees	-	-	-	-	(1,002)	1,002	-	-	-	-
Proposed donations	-	-	-	-	(1,000)	1,000	-	-	-	-
<b>Balance at 31 December 2007</b>	<b>844,201</b>	<b>173,001</b>	<b>561,373</b>	<b>101,052</b>	<b>228,472</b>	<b>128,864</b>	<b>272,757</b>	<b>1,292,518</b>	<b>338,401</b>	<b>2,648,121</b>

The attached notes 1 to 39 form part of these consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 1 CORPORATE INFORMATION

The parent company, Ahli United Bank B.S.C. (AUB or the Bank) was incorporated in the Kingdom of Bahrain on 31 May 2000 originally as a closed company and changed on 12 July 2000 to a public shareholding company by Amiri Decree number 16/2000. The Bank and its subsidiaries as detailed below (collectively known as the Group) are engaged in retail, commercial, islamic and investment banking business, global fund management and private banking services through 80 branches, as at 31 December 2008, in the Kingdom of Bahrain, the State of Kuwait, the Arab Republic of Egypt, Republic of Iraq and the United Kingdom. It also operates in the State of Qatar and Sultanate of Oman through its associates. The Bank operates under a retail banking licence issued by the Central Bank of Bahrain. The Bank's registered office is located at Building 2495, Road 2832, Al Seef District 428, Kingdom of Bahrain.

The consolidated financial statements for the year ended 31 December 2008 were authorised for issue in accordance with a resolution of the directors on 18 February 2009.

## 2 BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries as at and for the year ended 31 December 2008. The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies.

All material intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated on consolidation.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired are included in the consolidated statement of income from the date of acquisition.

The following are the Bank's principal subsidiaries:

Name	Country of incorporation	Nominal holding*	
		31 December 2008	31 December 2007
Ahli United Bank (U.K.) PLC (AUBUK)	United Kingdom	100%	100%
The Bank of Kuwait and the Middle East K.S.C. (BKME)	State of Kuwait	75%	75%
Kuwait and Middle East Financial Investment Co. K.S.C. (closed) (KMEFIC), a subsidiary of BKME.	State of Kuwait	75%	75%
Ahli United Bank (Egypt) S.A.E. (AUBE)	Arab Republic of Egypt	51%	-
Commercial Bank of Iraq P.S.C. (CBIQ)	Republic of Iraq	50%	-

\* Adjusted for subsidiaries' holdings

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES

### 3.1 Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis as modified for the re-measurement at fair value of freehold land, trading and available-for-sale financial assets and all derivatives. In addition, as more fully discussed below in note 3.3 (i), assets and liabilities that are fair value hedged are adjusted to the extent of the fair value of the risk being hedged. The consolidated financial statements are presented in US Dollars which is the Group's functional currency, and all values are rounded to the nearest thousand (US Dollar thousand) except where otherwise indicated.

In order to further enhance the reader's understanding of the loss/gain on non-trading investments, a presentational change has been made during the year to the consolidated statement of income. The collective impairment charge relating to "non-trading investments" is now included as part of "net (loss) gain on available-for-sale investments" with comparatives appropriately restated (refer note 8).

#### Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law.

#### New standards and interpretations issued but not yet effective

The following standards and interpretations have been issued by the International Accounting Standards Board (IASB) but are not yet mandatory for year ended 31 December 2008:

- IFRS 1 First time Adoption of International Financial Reporting Standards - cost of an investment in a subsidiary, jointly controlled entity or associate (Amendments) effective 1 January 2009
- IFRS 2 Share-based Payment (Revised) effective 1 January 2009
- IFRS 3 Business Combinations (Revised) and consequential amendments to IAS 27 Consolidated and Separate Financial Statements effective 1 July 2009
- IFRS 8 Operating Segments effective 1 January 2009
- IAS 1 - Presentation of Financial Statements (Revised) effective 1 January 2009
- IAS 23 Borrowing Costs (Revised) effective 1 January 2009

The application of the above is not expected to have a material impact on the consolidated financial statements as and when they become effective, with exception of the application of IAS 1 (Revised) and IFRS 8. The application of IAS 1 (Revised) and IFRS 8 may result in amendments to the presentation of the consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.2 Significant accounting judgements and estimates

The preparation of the consolidated financial statements requires management to make judgements and estimates that affect the reported amount of financial assets and liabilities and disclosure of contingent liabilities. These judgements and estimates also affect the revenues and expenses and the resultant provisions as well as fair value changes reported in equity.

#### **Judgements**

Judgements are made in the classification of available-for-sale, held-for-trading and held-to-maturity investments based on management's intention at acquisition of the financial asset, and the allocation of goodwill to cash generating units. Judgements are also made in determination of the objective evidence that a financial asset is impaired.

#### **Estimates**

##### ***Pension plans***

Estimates and assumptions are used in determining the Group's pension liabilities. The principal actuarial assumptions used for the defined benefit plan are set out in note 27 to the consolidated financial statements.

##### ***Impairment losses on loans and advances and non-trading investments***

Estimates are made regarding the amount and timing of future cash flows when measuring the level of provisions required for non-performing loans, portfolios of performing loans with similar risk characteristics where the risk of default has increased, as well as provisions for non-trading investments. These are more fully described in note 3.3 (g).

##### ***Fair value of financial instruments***

Estimates are also made in determining the fair values of financial assets and derivatives that are not quoted in an active market. Such estimates are necessarily based on assumptions about several factors involving varying degrees of uncertainty and actual results may differ resulting in future changes in such provisions.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

### 3.3 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, except for reclassification of certain financial instruments, as detailed in note 11.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Summary of significant accounting policies (continued)

#### (a) Investments in associates and joint venture

Associated companies are companies in which the Group exerts significant influence but does not control, normally represented by an interest of between 20% and 50% in the voting capital. The Group classifies its investments as joint venture where it is a party to a contractual joint venture agreement. Investments in associated companies and joint ventures are accounted for using the equity method.

The reporting dates of the associates and joint venture and the Group are identical and the associates' and joint venture accounting policies materially conform to those used by the Group for like transactions and events in similar circumstances. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

#### (b) Foreign currency translation

##### (i) Transactions and balances

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

Monetary assets and liabilities denominated in foreign currencies are retranslated at the relevant functional currency rate of exchange ruling at the balance sheet date. All differences are taken to "trading income - net" in the consolidated statement of income.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary available-for-sale items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined and the differences are included in equity as part of the fair value adjustment of the respective items, unless these items are part of Trading Securities as explained in note 3.3(c)(iii) or are part of an effective hedging strategy.

##### (ii) Group companies

Assets and liabilities of foreign subsidiaries are translated into US Dollars at the rates of exchange prevailing at the balance sheet date. Income and expense items are translated at average exchange rates prevailing for the period. Any exchange differences arising on translation are taken to "foreign exchange translation reserve" forming part of equity.

#### (c) Financial instruments

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are initially recognised at the fair value of consideration given, including acquisition costs associated with the investment, except in the case of trading securities, the acquisition costs of which are expensed. Premiums and discounts are amortised on a systematic basis to maturity using the effective interest method and taken to interest income or interest expense as appropriate.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Summary of significant accounting policies (continued)

#### (c) Financial instruments (continued)

(i) Date of recognition

All "regular way" purchases and sales of financial assets are recognised on the settlement date, i.e. the date that the Group receives or delivers the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

The Group accounts for any changes in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. The change in fair value is recognised in the consolidated statement of income for assets classified as "Trading securities" and it is recognised in equity for assets classified as available-for-sale. The change in value is not recognised for assets carried at cost or amortised cost.

(ii) Treasury bills and bonds

Treasury bills and bonds are initially recognised at cost. Premiums and discounts are amortised on a systematic basis to their maturity. These treasury bonds are issued by the Central Bank of Kuwait on behalf of the Ministry of Finance of the Government of Kuwait and are held to maturity.

(iii) Trading securities

A financial asset is classified as "held-for-trading" if it is acquired or incurred principally for the purpose of generating profit from short term fluctuations in price. Trading securities are initially recognised at cost, being the fair value of the consideration given and are subsequently measured at fair value. Resultant unrealised gains and losses arising from changes in fair value are included in the consolidated statement of income under "trading income - net" while dividend income is recorded in "dividend income" when the right of the payment has been established.

(iv) Held-to-maturity

Non-trading investments with fixed or determinable payments and fixed maturities and which the Group has the intention and ability to hold to maturity are classified as held-to-maturity. After initial measurement, these are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. The losses arising from impairment of such investments are recognised in the consolidated statement of income line "Net (loss) gain on available-for-sale investments".

(v) Loans and advances

Loans and advances are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. This accounting policy relates to the balance sheet captions "Deposits with banks and other financial institutions" and "Loans and advances". After initial measurement, the loans and advances are subsequently measured at amortised cost using the effective interest rate method, adjusted for effective fair value hedges, less any amounts written off and provision for impairment. The losses arising from impairment of such loans and advances are recognised in the consolidated statement of income in "Provision for loan losses and contingencies-net" and in an impairment allowance account in the consolidated balance sheet. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in "Interest income" in the consolidated statement of income.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Summary of significant accounting policies (continued)

#### (c) Financial instruments (continued)

(vi) Available-for-sale

Non-trading investments that are not classified as held-to-maturity, held-for-trading or loans and advances are classified as available-for-sale. After initial recognition, available-for-sale investments are remeasured at fair value. For investments in equity instruments, where a reasonable estimate of the fair value cannot be determined, the investment is carried at cost less impairment provision. Unless unrealised gains and losses on remeasurement to fair value are part of an effective hedging relationship, they are reported as a separate component of equity until the investment is sold, collected or otherwise disposed of, or the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the consolidated statement of income for the period.

Any gain or loss arising from a change in fair value of available-for-sale investments, which is part of an effective hedging relationship, is recognised directly in the consolidated statement of income to the extent of the changes in fair value being hedged.

(vii) Derivatives recorded at fair value through consolidated statement of income

Changes in fair values of the derivatives held for trading are included in the consolidated statement of income under "Trading income - net"

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value, when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried as held for trading. The changes in fair value of such embedded derivatives are recognised in the consolidated statement of income.

(viii) Deposits, term debts and subordinated liabilities.

These financial liabilities are carried at amortised cost, less amounts repaid.

(ix) Reclassification of financial assets

As permitted by Reclassification of Financial Assets: Amendments to IAS 39 - Recognition and Measurement and IFRS 7: Disclosures, the Group has made the following reclassifications with effect from 1 July 2008:

- (i) Certain investments classified initially as "Available-for-sale" investments into "Loans and receivables" category within "Non-trading investments".
- (ii) Certain investments classified initially as "Trading securities" into "Available-for-sale" category.

Refer note 11 for further details.

#### (d) Derecognition of financial assets and financial liabilities

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Summary of significant accounting policies (continued)

#### (d) Derecognition of financial assets and financial liabilities (continued)

- the rights to receive cash flows from the asset have expired;
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (i) has transferred substantially all the risks and rewards of the asset, or (ii) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

#### (e) Repurchase and resale agreements

Where investments, including those reclassified into "Loans and receivables", are sold subject to a commitment to repurchase them at a predetermined price, they remain on the consolidated balance sheet and the consideration received is classified as "Deposits from banks and other financial institutions". The difference between the sale price and repurchase price is treated as interest expense and is accrued over the life of the agreement using the effective interest rate method.

Conversely, securities purchased under similar commitments to resell are not recognised on the consolidated balance sheet and the consideration paid is recorded in "Deposits with banks and other financial institutions". The difference between the purchase price and resale price is treated as interest income and is accrued over the life of the agreement using the effective interest rate method.

#### (f) Determination of fair value

The fair value of financial instruments that are quoted in an active market is determined by reference to market bid prices respectively at the close of business on the balance sheet date.

The fair value of liabilities with a demand feature is the amount payable on demand.

The fair value of interest-bearing financial assets and liabilities that are not quoted in an active market and are not payable on demand is determined by a discounted cash flow model using the current market interest rates for financial instruments with similar terms and risk characteristics.

For equity investments that are not quoted in an active market, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument that is substantially similar, or is determined using net present valuation techniques.

Investment in funds are stated at net asset values provided by the fund managers.

The fair value of unquoted derivatives is determined either by discounted cash flows or option-pricing models.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Summary of significant accounting policies (continued)

#### (g) Impairment of financial assets

An assessment is made at each balance sheet date to determine whether there is any objective evidence that a specific financial asset or a group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset or a group of financial assets is determined and any impairment loss, based on the net present value of future anticipated cash flows, is recognised in the consolidated statement of income and credited to an allowance account. In the case of equity investments, impairment is reflected directly as a write down of the financial asset. Impairment losses on equity investments are not reversed through the consolidated statement of income while any subsequent increases in their fair value are recognised directly in equity.

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

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

In addition to specific provisions against individually significant financial assets, the Group also makes collective impairment provisions on groups of financial assets, which although not identified as requiring a specific provision, have a greater risk of default than the risk at initial recognition. Financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms and the collective impairment provision is estimated for any such group where credit risk characteristics of the group of financial assets has deteriorated. Factors such as any deterioration in country risk, industry, technological obsolescence as well as identified structural weaknesses or deterioration in cash flows are taken into consideration and the amount of the provision is based on the historical loss pattern within each group, adjusted to reflect current economic changes.

Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the 'Provision for loan losses and contingencies - net' in the consolidated statement of income.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Summary of significant accounting policies (continued)

#### (h) Hedge accounting

The Group enters into derivative instruments including futures, forwards, swaps and options to manage exposures to interest rate and foreign currency risks, including exposures arising from forecast transactions. In order to manage particular risks, the Group applies hedge accounting for transactions which meet the specified criteria. Derivatives are stated at fair value. Derivatives with positive market values are included in "Other assets" and derivatives with negative market values are included in "Other liabilities" in the consolidated balance sheet.

At inception of the hedge relationship, the Group formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, management objectives and strategy for undertaking the hedge. The methods that will be used to assess the effectiveness of the hedging relationship form part of the Group's documentation.

Also at the inception of the hedge relationship, a formal assessment is undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. Hedges are formally assessed at each reporting date. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated were offset in a range of 80% to 125%. For situations where the hedged item is a forecast transaction, the Group assesses whether the transaction is highly probable and presents an exposure to variations in cash flows that could ultimately affect the consolidated statement of income.

For the purposes of hedge accounting, hedges are classified into two categories: (i) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (ii) cash flow hedges which hedge exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction.

#### (i) Fair value hedges

For fair value hedges which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument at fair value is recognised immediately in the consolidated statement of income. The hedged item is adjusted for fair value changes relating to the risk being hedged and the difference is recognised in the consolidated statement of income.

If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated. For hedged items recorded at amortised cost, the difference between the carrying value of the hedged item on termination and the value at which it would have been carried without being hedged is amortised over the remaining term of the original hedge. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the consolidated statement of income.

#### (ii) Cash flow hedges

For cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument which is determined to be an effective hedge is recognised initially in equity. The ineffective portion of the gain or loss, if any, on the hedging instrument is recognised immediately in the consolidated statement of income as "Trading income - net".

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Summary of significant accounting policies (continued)

#### (h) Hedge accounting (continued)

The gains or losses on effective cash flow hedges recognised initially in equity are either transferred to the consolidated statement of income in the period in which the hedged transaction impacts the consolidated statement of income or included in the initial measurement of the related asset or liability.

For hedges which do not qualify for hedge accounting, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated statement of income for the year.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. In the case of cash flow hedges, the cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the forecasted transaction occurs, unless the hedged transaction is no longer expected to occur, in which case the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of income for the year.

#### (i) Offsetting financial instruments

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

#### (j) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

##### (i) Interest income

Interest income is recognised using the effective interest method, taking account of the principal outstanding and the rate applicable. Interest that is 90 days or more overdue is excluded from income. Notional interest is recognised on impaired loans and advances and other financial assets based on the rate used to discount future cash flows to their net present values.

##### (ii) Fees and commissions income

Credit origination fees are treated as an integral part of the effective interest rate of financial instruments and are recognised over their lives, except when the underlying risk is sold to a third party at which time it is recognised immediately. Other fees and commissions income are recognised when earned.

##### (iii) Dividend income

Dividend income is recognised when the right to receive payment is established.

#### (k) Business combination, goodwill and other intangible assets

Business combinations are accounted for using the purchase method of accounting. Assets and liabilities acquired are recognised at the acquisition date fair values with any excess of the cost of acquisition over the net assets acquired is recognised as goodwill.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Summary of significant accounting policies (continued)

#### (k) Business combination, goodwill and other intangible assets (continued)

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Following initial recognition, goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount, an impairment loss is recognised immediately in the consolidated statement of income.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- is not larger than a segment based on either the Group's primary or the Group's secondary reporting format determined in accordance with IAS 14 Segment Reporting.

Intangible assets are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or infinite. Intangible assets with finite lives are amortised over their useful economic lives and assessed for impairment whenever there is an indication that an intangible asset may be impaired. Intangible assets with infinite useful lives are not amortised but are tested annually for impairment or more frequently whenever there is an indication that they may be impaired.

#### (l) Premises and equipment

Freehold land is initially recognised at cost. After initial recognition, freehold land is carried at the revalued amount. The revaluation is carried out periodically by independent professional property valuers. The resultant revaluation surplus is recognised, as a separate component under equity. Revaluation deficit, if any, is recognised in the consolidated statement of income, except that a deficit directly offsetting a previously recognised surplus on the same asset is directly offset against the surplus in the revaluation reserve.

Premises and equipment are stated at cost, less accumulated depreciation.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Summary of significant accounting policies (continued)

#### (l) Premises and equipment (continued)

Depreciation on buildings and other premises and equipment is provided on a straight-line basis over their estimated useful lives.

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

- Freehold buildings 15 to 30 years
- Leasehold land and buildings Over the lease period
- Other premises and equipment 2 to 5 years

#### (m) Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with central banks, excluding mandatory reserve deposits, together with those deposits with banks and other financial institutions and treasury bills having an original maturity of three months or less.

#### (n) Provisions

Provisions are recognised when the Group has a present obligation arising from a past event, and the costs to settle the obligation are both probable and able to be reliably estimated.

#### (o) Employee benefits

##### *Defined benefit pension plan*

Pension costs are recognised on a systematic basis so that the costs of providing retirement benefits to employees are evenly matched, so far as possible, to the service lives of the employees concerned. Any excess or deficiency of the actuarial value of assets over the actuarial value of liabilities of the pension scheme is allocated over the average remaining service lives of the scheme members.

##### *Other defined benefit plan*

In accordance with the labour laws prevalent in each country where the Group operates, the Group provides for end of service benefits for its expatriate employees. The provision is based on accumulated periods of service and latest salary.

##### *Defined contribution plans*

For defined contribution plans, the Group makes contributions to publicly administered pension insurance plans. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Summary of significant accounting policies (continued)

#### (p) Taxes

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on income from foreign entities is provided for in accordance with the fiscal regulations of the countries in which the respective Group entities operate.

Deferred taxation is provided for using the liability method on all temporary differences calculated at the rate at which it is expected to be payable. Deferred tax assets are only recognised if recovery is probable.

#### (q) Fiduciary assets

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

#### (r) Minority interest

Minority interest represents the portion of profit or loss and net assets in the subsidiaries not attributable to the Bank's shareholders.

#### (s) Redeemable preference shares

Preference shares which carry a mandatory coupon, and are redeemable at a fixed future date, are recognised as liabilities in the consolidated balance sheet, at amortised cost. The corresponding dividends on those shares are charged as interest expense in the consolidated statement of income.

#### (t) Dividend on ordinary shares

Dividend on ordinary shares are recognised as liability and deducted from equity when they are approved by the Bank's shareholders.

Dividends for the period that are approved after the balance sheet date are shown as an appropriation and reported in the consolidated statement of changes in equity, as an event after the balance sheet date.

#### (u) Employees' share purchase plan

The Group operates an employees' share purchase plan for certain eligible employees. The difference between the issue price and the fair value of the shares at the grant date is amortised over the vesting period in the consolidated statement of income with a corresponding effect to equity.

#### (v) Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Summary of significant accounting policies (continued)

#### (v) Financial guarantees (continued)

Financial guarantees are initially recognised in the consolidated financial statements at fair value, being the commission received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised commission and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

#### (w) Islamic banking

The activities of the Islamic branches are conducted in accordance with Islamic Shari'a principles, as approved by the Shari'a Supervisory Board. The Islamic branches' financial statements are prepared in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for The Islamic Financial Institutions (AAOIFI) and Central Bank of Bahrain regulations.

#### (x) Islamic financing

Revenues on Islamic financing transactions are recognised on accrual basis using the reducing installment method. Income on non performing financing accounts is suspended when it is not certain the branches will receive it.

#### (y) Unrestricted investment accounts' share of profit

The profit arrived at after taking into account all income and expenses at the end of financial year is distributed between unrestricted investment account holders and shareholders. The share of profit of the unrestricted account holders is calculated on the basis of their daily deposit balances over the year, after reducing the agreed and declared Mudaraba fee.

In the case of expenses, which arise out of issues relating to non compliance with Shari'a regulations, then such expenses are not to be borne by the unrestricted investment account holders.

## 4 INTEREST INCOME

	2008	2007
	US\$ '000	US\$ '000
Treasury bills and bonds	45,367	58,633
Deposits with banks and other financial institutions	142,688	280,587
Loans and advances	910,009	817,562
Non-trading investments	142,008	153,852
	<b>1,240,072</b>	1,310,634

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 5 INTEREST EXPENSE

	2008	2007
	US\$ '000	US\$ '000
Deposits from banks and other financial institutions	224,883	359,031
Customers' deposits	528,898	496,721
Term debts	49,311	85,703
Subordinated liabilities	33,875	41,061
	<b>836,967</b>	982,516

## 6 FEES AND COMMISSIONS - NET

	2008	2007
	US\$ '000	US\$ '000
Fees and commissions income		
– Retail and corporate banking	78,382	76,516
– Management, performance and brokerage fees	76,976	96,084
Fees and commissions expense	(4,728)	(15,075)
	<b>150,630</b>	157,525

Included in 'Management, performance and brokerage fees' is US\$ 23.9 million (2007: US\$ 32.0 million) of fee income relating to trust and other fiduciary activities.

## 7 TRADING INCOME - NET

	2008	2007
	US\$ '000	US\$ '000
Foreign exchange gains	42,895	29,437
(Loss) gain on trading securities	(19,200)	15,489
Others	1,201	(858)
	<b>24,896</b>	44,068

## 8 NET (LOSS) GAIN ON AVAILABLE-FOR-SALE INVESTMENTS

	2008	2007
	US\$ '000	US\$ '000
Net realised gain	147,473	54,724
(Less): impairment losses - net (note 11)	(159,864)	(29,762)
	<b>(12,391)</b>	24,962

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 9 CASH AND BALANCES WITH CENTRAL BANKS

	2008	2007
	US\$ '000	US\$ '000
Cash and balances with central banks, excluding mandatory reserve deposits (note 25)	157,082	72,206
Mandatory reserve deposits with central banks	235,169	70,384
	<b>392,251</b>	142,590

Mandatory reserve deposits are not available for use in the day-to-day operations.

## 10 LOANS AND ADVANCES

	2008		2007	
	US\$ '000	%	US\$ '000	%
<b>a) By industry sector</b>				
Consumer/personal	4,877,669	35.0	4,069,315	33.3
Real estate	3,336,675	24.0	2,903,992	23.8
Trading and manufacturing	3,044,852	21.9	2,718,877	22.3
Banks and other financial institutions	987,376	7.0	673,958	5.5
Construction	889,251	6.4	749,167	6.2
Government/public sector	245,686	1.8	175,761	1.4
Others	540,960	3.9	914,271	7.5
	<b>13,922,469</b>	<b>100.0</b>	12,205,341	100.0
(Less): Provision for loan losses (note 10(e))	(290,249)	(2.1)	(170,188)	(1.4)
	<b>13,632,220</b>	<b>97.9</b>	12,035,153	98.6

	2008		2007	
	US\$ '000	%	US\$ '000	%
<b>b) By geographic region</b>				
GCC countries	11,652,479	83.7	10,341,343	84.7
United Kingdom	758,540	5.4	1,069,959	8.8
Europe (excluding United Kingdom)	545,329	3.9	587,043	4.8
United States of America	2,480	0.0	12,175	0.1
Asia (excluding GCC countries)	83,087	0.6	90,847	0.7
Rest of the world (including Arab Republic of Egypt)	880,554	6.4	103,974	0.9
	<b>13,922,469</b>	<b>100.0</b>	12,205,341	100.0
(Less): Provision for loan losses (note 10(e))	(290,249)	(2.1)	(170,188)	(1.4)
	<b>13,632,220</b>	<b>97.9</b>	12,035,153	98.6

GCC countries comprise the members of the Gulf Co-operation Council being Kingdom of Bahrain, State of Kuwait, Sultanate of Oman, State of Qatar, Kingdom of Saudi Arabia and the United Arab Emirates.

Refer note 32(c) for disclosure of credit quality of loans and advances.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 10 LOANS AND ADVANCES (continued)

#### c) Age analysis of past due but not impaired loans and advances

	2008			Total US\$ '000
	Less than 30 days US\$ '000	Less than 60 days US\$ '000	61 to 90 days US\$ '000	
Loans and advances				
Retail	40,558	56,770	56,781	154,109
Corporate	21,988	82,812	56,579	161,379
	<b>62,546</b>	<b>139,582</b>	<b>113,360</b>	<b>315,488</b>

	2007			Total US\$ '000
	Less than 30 days US\$ '000	Less than 60 days US\$ '000	61 to 90 days US\$ '000	
Loans and advances				
Retail	35,744	26,911	17,874	80,529
Corporate	43,583	18,416	1,324	63,323
	79,327	45,327	19,198	143,852

The above past due loans and advances include those that are only past due by a few days. None of the above past due loans are considered to be impaired.

#### d) Individually impaired loans and advances

	2008			2007		
	Retail US\$ '000	Corporate US\$ '000	Total US\$ '000	Retail US\$ '000	Corporate US\$ '000	Total US\$ '000
Gross impaired loans	117,381	142,858	260,239	80,558	60,399	140,957
Specific impairment provision	(103,878)	(129,926)	(233,804)	(75,108)	(56,784)	(131,892)
	<b>13,503</b>	<b>12,932</b>	<b>26,435</b>	5,450	3,615	9,065
Impaired loan coverage	<b>88%</b>	<b>91%</b>	<b>90%</b>	93%	94%	94%

The fair value of collateral that the Group holds relating to loans individually determined to be impaired at 31 December 2008 amounts to US\$ 115.7 million (31 December 2007: US\$ 35.7 million). The collateral consists of securities, letters of guarantee and properties. Taking into consideration the related collateral valuations, the Group has an overall impaired loan coverage of 134% (2007: 119%).

The carrying amount of renegotiated loans as at 31 December 2008 is US\$ 27.6 million (31 December 2007: US\$ 19.1 million).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 10 LOANS AND ADVANCES (continued)

### e) Impairment allowance for loans and advances

A reconciliation of the allowance for impairment losses for loans and advances by class is as follows:

	2008			2007		
	Retail US\$ '000	Corporate US\$ '000	Total US\$ '000	Retail US\$ '000	Corporate US\$ '000	Total US\$ '000
At 1 January	85,080	85,108	170,188	57,112	77,354	134,466
Add/(Less):						
Arising on acquisition of subsidiary	-	30,808	30,808	-	-	-
Amounts written off during the year	(15,585)	(9,665)	(25,250)	(3,543)	(2,880)	(6,423)
Charge for the year	42,539	79,173	121,712	37,227	26,811	64,038
Recoveries during the year	(11,446)	(13,418)	(24,864)	(8,992)	(18,067)	(27,059)
Interest suspended during the year (net)	8,042	4,909	12,951	190	769	959
Exchange rate adjustments/other	23,200	(18,496)	4,704	3,086	1,121	4,207
At 31 December	131,830	158,419	290,249	85,080	85,108	170,188

### f) Provision for loan losses and contingencies - net

The charge for the year for provision for loan losses in the consolidated statement of income is determined as follows:

	2008 US\$ '000	2007 US\$ '000
Impairment charge for the year on loans and advances (note 10(e))	121,712	64,038
Recoveries from loans and advances during the year (including from loans written off) (note 10(e))	(24,864)	(39,650)
Net charge for contingencies	1,777	1,812
Provision for loan losses and contingencies - net	98,625	26,200

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 11 NON-TRADING INVESTMENTS

	2008			2007	
	Held-to-maturity US\$'000	Available-for-sale US\$'000	Loans and receivables US\$'000	Total US\$'000	Total US\$'000
<b>Quoted investments</b>					
GCC and US government bonds and debt securities	-	45,334	332,913	378,247	380,460
Other government bonds and debt securities	-	150,861	32,691	183,552	106,802
Floating rate notes and certificates of deposit:					
- issued by banks and other financial institutions	16,573	367,103	1,054,948	1,438,624	1,491,803
- issued by corporate bodies	-	93,896	523,690	617,586	620,114
Equity shares	-	137,491	-	137,491	395,004
	<b>16,573</b>	<b>794,685</b>	<b>1,944,242</b>	<b>2,755,500</b>	2,994,183
<b>Unquoted investments</b>					
Other government bonds and debt securities	-	-	-	-	15,718
Floating rate notes and certificates of deposit:					
- issued by banks and other financial institutions	-	167,633	57,693	225,326	223,511
- issued by corporate bodies	-	-	-	-	6,490
Equity shares at cost	-	73,156	-	73,156	16,143
Funds at net asset value	-	269,357	-	269,357	195,178
Other investments	-	118,475	-	118,475	118,497
	-	<b>628,621</b>	<b>57,693</b>	<b>686,314</b>	575,537
<b>Total</b>	<b>16,573</b>	<b>1,423,306</b>	<b>2,001,935</b>	<b>3,441,814</b>	3,569,720
(Less): Allowance for impairment				<b>(88,244)</b>	(44,443)
				<b>3,353,570</b>	3,525,277

Refer note 32(c) for disclosure of credit quality of non-trading investments.

Non trading investments, which were reclassified into loans and receivables, of US\$ 722 million (31 December 2007: US\$ 811 million) have been sold under agreements to repurchase against which the Group had borrowings of US\$ 604 million (31 December 2007: US\$ 789 million), included under "Deposits from banks and other financial institutions".

The movements in provision for impairment were as follows:

	2008 US\$ '000	2007 US\$ '000
At 1 January	44,443	14,812
Add/(Less):		
Arising on acquisition of subsidiaries	2,720	-
Charge for the year (note 8)	159,864	29,762
Amounts written off during the period	(131,121)	(242)
Exchange rate adjustments/other	12,338	111
At 31 December	<b>88,244</b>	44,443

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 11 NON-TRADING INVESTMENTS (continued)

The deterioration in the financial markets in the third quarter of 2008 has been viewed globally as a rare circumstance to have occurred in the financial sector. The IASB issued "Reclassification of Financial Assets: Amendments to IAS 39 – Recognition and Measurement and IFRS 7: Disclosures" which permits the reclassification of certain financial assets under such rare circumstances. Accordingly, the Group has performed the following reclassifications:

### (i) Financial assets reclassified into the "Loans and receivables" category from "Available-for-sale" category

	<u>2008</u>
	US\$ '000
Carrying value as at date of reclassification	1,991,712
Carrying value as at 31 December 2008	2,001,935
Fair value as at 31 December 2008	1,821,130
Fair value losses recognised in the cumulative changes in available-for-sale reserve upto date of reclassification	(108,527)
Fair value losses that would have been recognised in the cumulative changes in available-for-sale reserve had the non-trading investments not been reclassified	(180,805)

The Group earns interest income on these investments at an effective interest rate of 6.4% and the carrying values of these financial instruments reflect the cash flows expected to be recovered at the date of reclassification of these financial assets.

### (ii) Financial assets reclassified into the "Available-for-sale" category from "Trading securities" category

	<u>2008</u>
	US\$ '000
Carrying value as at date of reclassification	86,901
Carrying value and fair value as at 31 December 2008	79,881
Losses recognised in the consolidated statement of income upto the date of reclassification	(3,823)
Fair value losses recognised in the cumulative changes in available-for-sale reserve subsequent to reclassification	(7,020)

## 12 INVESTMENTS IN ASSOCIATES AND JOINT VENTURE

The principal associates and joint venture of the Group are:

### a) Associates

Name	Country of incorporation	Holding	
		<u>2008</u>	2007
Ahli Bank Q.S.C.	State of Qatar	40.0%	40.0%
Commercial Bank of Iraq P.S.C. (CBIQ)	Republic of Iraq	-	49.6%
Ahli United Bank (Egypt) S.A.E. (AUBE)	Arab Republic of Egypt	-	49.8%
AhliBank (Oman) S.A.O.G.	Sultanate of Oman	35.0%	35.0%

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 12 INVESTMENTS IN ASSOCIATES AND JOINT VENTURE (continued)

### a) Associates (continued)

AUBE and CBIQ, which were associates as at 31 December 2007, became subsidiaries of the Group with effect from 31 December 2008. Refer note 2 and note 13 for further details.

The summarised financial information of the Group's associates was as follows:

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
Assets	<b>6,172,919</b>	6,393,102
Liabilities	<b>5,399,011</b>	5,398,082
Revenues	<b>292,243</b>	212,798
Net profit for the year	<b>167,167</b>	123,325

### b) Joint Venture

Name	Country of incorporation	Holding	
		<b>2008</b>	2007
Legal & General Gulf B.S.C. (c)	Kingdom of Bahrain	<b>50.0%</b>	-

During the year, the Bank entered into a 50:50 joint venture agreement with Legal & General Middle East Limited, a subsidiary of Legal & General Group PLC to incorporate a regional life and health insurance company headquartered in the Kingdom of Bahrain. The joint venture has been incorporated with an authorised capital of US\$ 50 million of which US\$ 25 million is issued and paid-up. The joint venture company has obtained approval from the Central Bank of Bahrain vide its letter reference OG/409/2008 dated 15 December 2008 to commence insurance activities and has been incorporated under Commercial Registration certificate number 70934 dated 2 February 2009 issued by the Ministry of Industry and Commerce.

## 13 INVESTMENTS IN SUBSIDIARIES (PREVIOUSLY ASSOCIATES)

### a) Commercial Bank of Iraq P.S.C.

During the last quarter of 2008, the Bank increased its holding in the voting capital of CBIQ to 50% (2007:49.6%). As a result, CBIQ has become a subsidiary of the Bank and has been consolidated in the Group's consolidated financial statements with effect from 31 December 2008.

The acquisition has been accounted for using the purchase method of accounting, as required by IFRS 3: Business Combinations. The fair value of assets and liabilities of CBIQ and the goodwill arising from the acquisition are as follows:

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 13 INVESTMENTS IN SUBSIDIARIES (PREVIOUSLY ASSOCIATES) (continued)

### a) Commercial Bank of Iraq P.S.C. (continued)

	2008
	US\$ '000
<b>ASSETS</b>	
Cash and balances with Central Bank	21,495
Treasury bills and bonds	82,783
Deposits with banks and other financial institutions	24,474
Loans and advances	600
Non-trading investments	31,487
Premises and equipment	2,672
Other assets	9,359
	<b>172,870</b>
<b>LIABILITIES</b>	
Due to banks and other financial institutions	6,417
Customers' deposits	75,416
Other liabilities	29,819
Minority interest	30,592
	<b>142,244</b>
Net assets acquired	30,626
Goodwill	13,209
	<b>43,835</b>
Cost of combination	43,835
Less: Cash and balances with Central Bank acquired	(21,495)
<b>Net cost of combination</b>	<b>22,340</b>

The goodwill is attributable to the high potential profitability of the acquired business, access to banking opportunities in the Republic of Iraq and the significant synergies expected to arise. No acquisition provisions were created. The goodwill reported above is provisional and may be modified within a period of twelve months after the acquisition date, in accordance with IFRS 3 paragraph 62.

### b) Ahli United Bank, Egypt, S.A.E.

As a result of CBIQ becoming the Bank's subsidiary (note 13(a)), the Group's combined holding in the voting capital of AUBE, through the Bank and its subsidiaries, BKME and CBIQ, increased to 50.7% (2007: 49.8%). As a result, the Group acquired controlling interest in AUBE, thereby resulting in it becoming the Group's subsidiary and being consolidated in the Group's consolidated financial statements with effect from 31 December 2008.

The acquisition has been accounted for using the purchase method of accounting, as required by IFRS 3: Business combinations. The fair value of assets and liabilities of AUBE and the goodwill arising from the acquisition are as follows:

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 13 INVESTMENTS IN SUBSIDIARIES (PREVIOUSLY ASSOCIATES) (continued)

### b) Ahli United Bank, Egypt, S.A.E. (continued)

	<u>2008</u>
	US\$ '000
<b>ASSETS</b>	
Cash and balances with Central Bank	118,009
Trading securities	80,115
Treasury bills and bonds	767
Deposits with banks and other financial institutions	215,487
Loans and advances	696,161
Non-trading investments	144,915
Premises and equipment	37,527
Interest receivable	8,829
Other assets	9,648
	<u>1,311,458</u>
<b>LIABILITIES</b>	
Due to banks and other financial institutions	16,392
Customers' deposits	1,063,670
Interest payable	4,587
Other liabilities	41,608
Minority interest	98,858
	<u>1,225,115</u>
Net assets acquired	86,343
Goodwill	131,270
	<u>217,613</u>
Cost of combination	217,613
Less: Cash and balances with Central Bank acquired	<u>(118,009)</u>
<b>Net cost of combination</b>	<u>99,604</u>

The goodwill is attributable to the high potential profitability of the acquired business, access to banking opportunities in the Arab Republic of Egypt and the significant synergies expected to arise. No acquisition provisions were created. The goodwill reported above is provisional and may be modified within a period of twelve months after the acquisition date, in accordance with IFRS 3 paragraph 62.

If the above acquisitions had occurred on 1 January 2008, the impact on the Group's net operating income would have been higher by US\$ 51.5 million, while the impact on the net profit attributable to the shareholders would have been immaterial as these investments were equity accounted as associates upto 31 December 2008.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 14 PREMISES AND EQUIPMENT

The net book values of the Group's premises and equipment are:

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
Freehold land	<b>210,022</b>	161,289
Freehold buildings	<b>18,479</b>	12,557
Leasehold land and buildings	<b>51,181</b>	66,188
Capital work-in-progress	<b>54,454</b>	25,960
Others	<b>54,873</b>	26,467
	<b>389,009</b>	292,461

## 15 OTHER ASSETS

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
Tax assets (note 23)	<b>9,423</b>	540
Interest receivable	<b>173,494</b>	192,368
Derivative assets (note 29)	<b>143,098</b>	123,679
Prepayments and others	<b>191,856</b>	97,900
	<b>517,871</b>	414,487

## 16 GOODWILL AND OTHER INTANGIBLE ASSETS

	<b>2008</b>			2007		
	<b>Goodwill</b>	<b>Intangible</b>	<b>Total</b>	Goodwill	Intangible	Total
	<b>US\$'000</b>	<b>US\$'000</b>	<b>US\$'000</b>	US\$'000	US\$'000	US\$'000
At 1 January	<b>448,883</b>	<b>46,474</b>	<b>495,357</b>	388,716	43,625	432,341
Acquisitions during the period	<b>144,479</b>	-	<b>144,479</b>	38,967	-	38,967
Exchange rate adjustments	<b>(4,740)</b>	<b>(526)</b>	<b>(5,266)</b>	21,200	2,849	24,049
At 31 December	<b>588,622</b>	<b>45,948</b>	<b>634,570</b>	448,883	46,474	495,357

Additions to goodwill during the year relates to the Group's controlling interest acquired on 31 December 2008 in AUBE (50.7%) and CBIQ (50%). Refer note 13.

Goodwill acquired through business combinations has been allocated to the cash-generating units of the acquired entities for impairment testing purposes.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 16 GOODWILL AND OTHER INTANGIBLE ASSETS (continued)

The carrying amount of goodwill allocated to each of the cash-generating units as follows:

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
Retail banking	<b>205,741</b>	165,265
Corporate banking, treasury and investments	<b>255,937</b>	178,750
Private banking and wealth management	<b>126,944</b>	104,868
	<b>588,622</b>	448,883

### Key assumptions used in estimating recoverable amounts of cash-generating units

The recoverable amount of each cash-generating unit's goodwill is based on value-in-use calculations using cash flow projections from financial budgets approved by senior management, extrapolated for five year projections using nominal Gross Domestic Product growth rate in the respective GCC countries in which they operate. The discount rate applied to cash flow projections represent the cost of capital adjusted for appropriate risk premium for these business segments. The discount rate used in relation to the significant portion of the goodwill requiring impairment testing was 9.8%. The key assumptions used in the estimating recoverable amounts of cash generating units were sensitised to test the resilience of value-in-use calculations. On this basis, management believes that reasonable changes in the key assumptions used to determine the recoverable amount of the Group's cash-generating units will not result in an impairment.

## 17 CUSTOMERS' DEPOSITS

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
Current and call accounts	<b>2,432,304</b>	1,487,800
Saving accounts	<b>742,364</b>	619,026
Time deposits	<b>10,003,411</b>	8,674,088
	<b>13,178,079</b>	10,780,914

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 18 TERM DEBTS

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
Medium Term Syndicated Deposit (carrying interest rate of three-month LIBOR plus 0.325% per annum, repayable in October 2009)	<b>1,200,000</b>	1,200,000
Long Term Debts (carrying interest rate of six-month LIBOR plus 0.275% per annum, repayable in October 2012)	<b>150,000</b>	150,000
	<b>1,350,000</b>	1,350,000

The Medium Term Syndicated Deposit facility has been partially refinanced through a two year syndicated term loan facility of US\$ 800 million commencing from 30 October 2009 and expiring on 30 October 2011 at three month LIBOR plus 0.85% per annum.

## 19 OTHER LIABILITIES

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
Accruals	<b>110,662</b>	165,627
Interest payable	<b>198,381</b>	228,179
Derivative liabilities (note 29)	<b>357,078</b>	128,473
Other credit balances	<b>216,660</b>	171,290
	<b>882,781</b>	693,569

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 20 SUBORDINATED LIABILITIES

These borrowings are subordinated to the claims of all other creditors of the respective banks.

	2008	2007
	US\$ '000	US\$ '000
<b>(a) Ahli United Bank B.S.C.</b>		
– US Dollars – non-convertible portion (50%) of Class A Non-Cumulative Preference Shares carrying interest at 1.50% over twelve-month LIBOR, repayable on 1 January 2015, with an issuer option to redeem after 1 January 2010 subject to three months notice (also refer note 21 (e)).	225,000	225,000
– US Dollars – interest at three-month LIBOR plus a margin of 0.95% up to 2 December 2010 and margin of 1.45% thereafter, repayable on 2 December 2015 with an issuer option to redeem after 2 December 2010 subject to one month notice.	100,000	100,000
– Great Britain Pounds – interest at six-month LIBOR plus 1.00%, repayable in 2012.	29,131	40,070
– US Dollars- interest at six-month LIBOR plus a margin of 0.82%, repayable on 15 December 2016, convertible into ordinary shares at the holder's option at the rate of US\$ 1.24 per share between the third and sixth anniversary from the loan agreement dated 18 November 2006 (also refer note 24).	200,000	200,000
– US Dollars - interest at 6.5% p.a., repayable at 5 years and one day with an issuer option to extendable for a further period of 5 years and one day at 7% per annum.	50,000	-
<b>(b) Ahli United Bank (U.K.) PLC</b>		
– US Dollars – interest at three-month LIBOR plus ¾%, repayable in 2013.	2,267	-
– Great Britain Pounds - interest at six-month LIBOR plus ¾%, repayable in 2013.	2,340	-
– Great Britain Pounds - interest at six-month LIBOR plus ¾%, repayable in 2011.	1,532	2,108
– US Dollars - interest at six-month LIBOR plus ¾%, repayable in 2011.	1,485	1,485
– Great Britain Pounds - interest at six-month LIBOR plus ¾%, repayable at 5 years and one day notice.	6,004	11,478
– US Dollars - interest at three-month LIBOR plus ¾%, repayable at 5 years and one day notice.	5,817	8,083
	<b>623,576</b>	<b>588,224</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 21 SHARE CAPITAL

	2008	2007
	US\$ '000	US\$ '000
<b>(a) Authorised :</b>		
– Ordinary share capital 8,000 million shares of US\$ 0.25 each (2007: 8,000 million shares of US\$ 0.25 each) .	<b>2,000,000</b>	2,000,000
– Preference share capital 1,000 million (2007: 1,000 million) Class A preference shares of US\$ 0.25 each.	<b>250,000</b>	250,000
250 million (2007: 250 million) Non-Cumulative Fully Convertible Class B preference shares of US\$ 0.25 each.	<b>62,500</b>	62,500
<b>(b) Issued and fully paid:</b>		
– Ordinary share capital 4,506.3 million shares of US\$ 0.25 each ( 2007: 3,376.8 million shares of US \$ 0.25 each) During the year, the Bank issued 719.9 million ordinary shares of US\$ 0.25, each upon conversion of Class A and Class B preference shares and 409.6 million ordinary shares of US\$ 0.25 each as bonus issue (notes 21 (c) and (d)).	<b>1,126,561</b>	844,201
– Preference share capital 500 million Class A preference shares of US\$ 0.25 each (50% convertible portion) (note 21 (d) and (e)).	-	125,000
68.4 million Non-Cumulative Fully Convertible Class B preference shares of US\$ 0.25 each (2007 : 192 million Non-Cumulative Fully Convertible Class B preference shares) (note 21 (f)).	<b>17,128</b>	48,001

(c) The Annual General Assembly of Shareholders on 3 March 2008 approved a bonus share issue of 10% (1 ordinary share for every 10 shares held) (2007 : 10%) resulting in an increase in the ordinary share capital by US\$ 102.4 million (2007 : US\$ 68.3 million) comprising 409.6 million (2007 : 273.0 million) ordinary shares of US\$ 0.25 cents each. The convertible portion of all issued and outstanding Class B Preference Shares are automatically adjusted by these bonus share issues upon their conversion into ordinary shares under the terms of the respective issues.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 21 SHARE CAPITAL (continued)

### (d) Conversion of Class A preference shares

As per the terms of issue of the Class A preference shares, 577.5 million ordinary shares were issued, on 1 January 2008, upon conversion of 50% of Class A preference shares, including the bonus adjustment for the years 2005 and 2006.

(e) The remaining 50% of the Class A preference shares are redeemable in cash on 1 January 2015, or at an earlier date after 1 January 2010 if exercised by the Bank, at US\$ 0.45 per share. These preference shares not subject to conversion (recorded as subordinated liabilities) would receive preferential treatment over holders of ordinary shares and Class B preference shares, but shall be subordinated to all other liabilities of the Bank. The redeemable portion of the Class A preference shares amounting to US\$ 225 million (31 December 2007: US\$ 225 million) is included in subordinated liabilities (note 20(a)).

(f) An Employee Share Purchase Plan ("ESPP") was established in accordance with the Board of Directors' approval and the subsequent approval of the Extraordinary General Assembly of Shareholders meeting dated 5 October 2004 and further regulatory approvals obtained from:

- (i) Capital Markets Supervision Directorate of CBB vide their letters dated 2 September 2004, 9 November 2004 and 18 April 2005;
- (ii) Banking Supervision Directorate of CBB vide their letters dated 5 September 2004 and 17 April 2005; and
- (iii) Ministry of Commerce vide their letters dated 8 September 2004 and 9 April 2005.

Subsequent amendments were duly approved by the regulatory authorities.

As per the approved plan, the Non-Cumulative Fully Convertible Class B preference shares ("Class B preference shares") were authorised for issuance to the employees of the Bank and its subsidiary in UK, in five annual tranches over a five-year period commencing 1 January 2005 at prices determined by the Board of Directors within set parameters. The Class B Preference Shares are mandatorily convertible into an equivalent number of ordinary shares adjusted for any bonus share issues on the conversion date of each tranche.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 21 SHARE CAPITAL (continued)

The details of Class B preference shares issued, conversion dates of respective issues and the resultant conversion effect duly adjusted for bonus share issues for the years 2005, 2006 and 2007 are as follows:

Number of Class B preference shares issued :	Conversion date	Numbers in million	
		2008	2007
Tranche - I	1 January 2008	119.9	119.9
Tranche - II	1 January 2009	36.0	36.0
Tranche - III	1 January 2010	38.4	38.4
<b>Total Issue Class B preference shares - 31 December 2007</b>		<b>194.3</b>	194.3
Add: Bonus shares @ 5% for 2005 as approved at the Bank's Annual General Assembly of Shareholders' meeting held on 27 March 2006.		9.7	9.7
		<b>204.0</b>	204.0
Add: Bonus shares @ 10% for 2006 as approved at the Bank's Annual General Assembly of Shareholders' meeting held on 25 March 2007.		20.4	20.4
		<b>224.4</b>	224.4
Add: Rights issue conversion adjustment factor @ 2.834% as approved at the Bank's Extraordinary General Assembly of Shareholders' meeting held on 18 October 2007.		6.3	6.3
		<b>230.7</b>	230.7
Less: Conversion of Tranche I of Class B preference shares (refer (g) below).		(142.3)	-
		<b>88.4</b>	230.7
Add: Bonus shares @ 10% for 2007 as approved at the Bank's Annual General Assembly of Shareholders' meeting held on 3 March 2008.		8.8	-
<b>Total number of ordinary shares when converted</b>		<b>97.2</b>	230.7

### (g) Conversion of Tranche I of Class B preference shares

As per the terms of the issue of the Employee Share Purchase Plan (ESPP), upon conversion of Tranche-I of the Class B preference shares on 1 January 2008, 142.3 million ordinary shares were issued, including the bonus adjustment for the years 2005 and 2006 and the rights issue adjustment factor for 2007.

(h) Upon conversion of the remaining outstanding Class B Preference Shares, the resultant ordinary shares totaling to 97.2 million shares, including the effect of ordinary bonus share issues to 31 December 2007 will rank pari-passu with the ordinary shares in issue.

## 22 RESERVES

### a) Share premium

The share premium arising on the issue of ordinary and preference shares is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 22 RESERVES (continued)

### b) Capital reserve

As required by the Bahrain Commercial Companies Law, any profit on the sale of treasury stock is transferred to a capital reserve. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

### c) Statutory reserve

As required by the Bahrain Commercial Companies Law and the Bank's Articles of Association, 10% of the net profit is transferred to a statutory reserve on an annual basis. The Bank may resolve to discontinue such transfers when the reserve totals 50% of the paid up capital. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

### d) Property revaluation reserve

The revaluation reserve arising on revaluation of freehold land is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

### e) Foreign exchange translation reserve

It comprises of translation effects arising on consolidation of subsidiaries, non-monetary equity investments and investments in associates.

### f) Available-for-sale reserve

This reserve represents changes in fair value of available-for-sale investments.

### g) Cash flow hedge reserve

It represents the effective portion of gain or loss on the Group's cash flow hedging instruments.

### h) Employee share purchase plan reserve

The Group operates an employees' share purchase plan (ESPP) for certain eligible employees through the issuance of Non-Cumulative Fully Convertible Class B Preference Shares. The difference between the issue price and the fair value of the shares at the grant date is amortised over the vesting period in the consolidated statement of income with a corresponding effect to ESPP Reserve under consolidated statement of changes in equity. Upon conversion of these shares, the fair value reserve is transferred to share premium.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 22 RESERVES (continued)

### i) Movements in other reserves

	Cumulative changes in						
	Capital reserve	Property revaluation reserve	Foreign exchange translation reserve	Available- for-sale reserve	Cash flow hedge reserve	ESPP reserve	Total other reserves
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Balance at 1 January 2008	307	94,290	36,080	149,075	(14,585)	7,590	272,757
Currency translation adjustments	-	-	2,339	-	-	-	2,339
Share of changes in fair value reserve of associates	-	-	-	(22,731)	-	-	(22,731)
Net realised gain recycled to consolidated statement of income	-	-	-	(147,473)	-	-	(147,473)
Net realised gain on cash flow hedge recycled to consolidated statement of income	-	-	-	-	1,743	-	1,743
Net fair value movements during the period	-	-	-	(230,492)	-	-	(230,492)
Fair value amortisation of share based transaction (note 24)	-	-	-	-	-	4,730	4,730
Net unrealised loss on cash flow hedges	-	-	-	-	(72,810)	-	(72,810)
Conversion of preference shares (note 21(d))	-	-	-	-	-	(5,992)	(5,992)
Revaluation of freehold land	-	26,816	-	-	-	-	26,816
<b>Balance at 31 December 2008</b>	<b>307</b>	<b>121,106</b>	<b>38,419</b>	<b>(251,621)</b>	<b>(85,652)</b>	<b>6,328</b>	<b>(171,113)</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 22 RESERVES (continued)

#### i) Movements in other reserves (continued)

	Capital reserve	Property revaluation reserve	Foreign exchange translation reserve	Cumulative changes in			Total other reserves
				Available- for-sale reserve	Cash flow hedge reserve	ESPP reserve	
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Balance at 1 January 2007	307	-	(4,375)	133,695	1,418	2,394	133,439
Currency translation adjustments	-	-	40,455	-	-	-	40,455
Share of changes in fair value reserve of associates	-	-	-	10,427	-	-	10,427
Net realised gain recycled to consolidated statement of income	-	-	-	(54,724)	-	-	(54,724)
Net realised gain on cash flow hedge recycled to consolidated statement of income	-	-	-	-	252	-	252
Net fair value movements during the period	-	-	-	59,677	-	-	59,677
Fair value amortisation of share based transactions	-	-	-	-	-	5,196	5,196
Net unrealised loss on cash flow hedges	-	-	-	-	(16,255)	-	(16,255)
Conversion of preference shares (note 21(d))	-	-	-	-	-	-	-
Revaluation of freehold land	-	94,290	-	-	-	-	94,290
Balance at 31 December 2007	307	94,290	36,080	149,075	(14,585)	7,590	272,757

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 22 RESERVES (continued)

### i) Movements in other reserves (continued)

Net fair value movements during the year have arisen due to a decrease in valuations of the Group's investments in securities, particularly financial sector debt securities, as a result of the recent credit crisis and the resultant effect on global markets. The negative movements in the cash flow hedge reserve, during the year, are a result of decline in interest rates. These adverse movements are considered to be rare and temporary in nature and any impairment that are required has been provided for and recognised in the consolidated statement of income.

### j) Dividends paid and proposed

	2008 US\$ '000
<b>Proposed for approval at the forthcoming Annual General Assembly of Shareholders Meeting</b>	
Cash dividend on the Class B Preference shares @ US cents 4.7 per share	3,493
Cash dividend on the Ordinary shares @ US cents 2.5 per share	112,658
Bonus share issue	5%
	2007 US\$ '000
<b>Declared and paid during the year</b>	
Cash dividend on the Class A Preference shares @ US cents 3.1 per share (2007: US cents 2.9 per share)*	30,732
Cash dividend on the Class B Preference shares @ US cents 3.1 per share (2007: US cents 2.9 per share)	5,716
Cash dividend on the Ordinary shares @ US cents 3.5 per share (2007: US cents 3.5 per share)	105,780
Bonus share issue	10%

\* 50% relates to the subordinated liabilities portion recognised under interest expense.

## 23 TAXATION

	2008 US\$ '000	2007 US\$ '000
Consolidated balance sheet (note 15):		
- Current tax asset	9,315	540
- Deferred tax asset	108	-
	<b>9,423</b>	540
Consolidated statement of income		
- Current tax expense (credit) on foreign operations	(4,618)	12,354
- Deferred tax expense (credit) on foreign operations	1,331	-
	<b>(3,287)</b>	12,354

There is no taxation in the Kingdom of Bahrain. In view of the operations of the Group being subject to various tax jurisdictions and regulations, it is not practical to provide a reconciliation between the accounting and taxable profits together with the details of effective tax rates. Substantially all of the tax expense relates to AUBUK.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 24 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net profit for the year attributable to the Bank's ordinary equity shareholders less Class A and B preference share dividends, by the weighted average number of ordinary shares outstanding during the period.

Diluted earnings per share amounts are calculated by dividing the net profit attributable to the Bank's ordinary equity shareholders by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of Class A and Class B preference shares into ordinary shares.

The convertible subordinated debt issued (note 20(a)) is anti-dilutive for 2008 and 2007 and therefore ignored in calculating diluted earnings per share. The number of ordinary shares potentially issuable upon conversion of this debt amounts to 161.3 million shares as at 31 December 2008 (31 December 2007: 161.3 million).

The following reflects the income and share data used in basic and diluted earnings per share computations :

	2008	2007
	US\$ '000	US\$ '000
<b>Net profit for basic earnings per share computation</b>		
Net profit attributable to Bank's equity shareholders	255,723	296,317
(Less): Class A preference share dividend	-	(15,366)
(Less): Class B preference share dividend	(3,493)	(5,716)
Adjusted net profit attributable to Bank's ordinary equity shareholders for basic earnings per share	<b>252,230</b>	275,235
<b>Net profit for diluted earnings per share computation</b>		
Net profit attributable to Bank's equity shareholders before preference share dividend	255,723	296,317
Add: Staff costs - fair value amortisation of share based transactions	4,730	5,196
Adjusted net profit attributable to Bank's ordinary equity shareholders for diluted earnings per share	<b>260,453</b>	301,513
	<b>Number of shares</b>	
	<b>(in millions)</b>	
	2008	2007
Weighted average number of ordinary shares for basic earnings per share	4,506	3,325
Effect of dilution – Class A preference shares (note 21(e))	-	636
Effect of dilution – Class B preference shares (note 21(f))	91	252
Weighted average number of ordinary shares for diluted earnings per share	<b>4,597</b>	4,213

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 25 CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the consolidated statement of cash flows include the following balance sheet amounts:

	2008	2007
	US\$ '000	US\$ '000
Cash and balances with central banks, excluding mandatory reserve deposits (note 9)	157,082	72,206
Deposits with banks and other financial institutions - with an original maturity of three months or less	2,289,826	2,304,680
	<b>2,446,908</b>	<b>2,376,886</b>

## 26 RELATED PARTY TRANSACTIONS

The Group enters into transactions with major shareholders, associates, directors, senior management and companies which are controlled, jointly controlled or significantly influenced by such parties in the ordinary course of business at arm's length. All the loans and advances to related parties are performing and are free of any provision for possible loan losses.

The income, expense and the period end balances in respect of related parties included in the consolidated financial statements were as follows:

	2008			
	US\$ '000			
	Major shareholders	Associates	Directors and senior management	Total
Interest income	-	2,040	8,845	10,885
Interest expense	157,995	2,514	944	161,453
Fees and commissions	-	4,939	-	4,939
Deposits with banks and other financial institutions	25	88,514	-	88,539
Loans and advances	-	150,000	131,879	281,879
Deposits from banks and other financial institutions	-	21,934	-	21,934
Customers' deposits <sup>(a)</sup>	3,553,420	-	19,162	3,572,582
Subordinated liabilities	89,495	-	-	89,495
Commitments and contingent liabilities (notional)	-	1,073	-	1,073
Derivatives (notional)	-	152,899	26,136	179,035

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 26 RELATED PARTY TRANSACTIONS (continued)

	2007			Total
	US\$ '000			
	Major shareholders	Associates	Directors and senior management	
Interest income	2,503	3,650	7,404	13,557
Interest expense	162,232	176	2,386	164,794
Fees and commissions	-	3,400	-	3,400
Deposits with banks and other financial institutions	25	100,398	-	100,423
Loans and advances	-	-	114,448	114,448
Deposits from banks and other financial institutions	-	11,673	-	11,673
Customers' deposits <sup>(a)</sup>	2,572,224	-	40,744	2,612,968
Subordinated liabilities	52,411	-	-	52,411
Commitments and contingent liabilities (notional)	-	27	12,487	12,514
Derivatives (notional)	-	107,200	-	107,200

(a) Customers' deposits include deposits from GCC government-owned institutions totaling to US\$ 3,528 million (31 December 2007: US\$ 2,572 million).

The compensation of key management personnel of the Group included under staff costs was as follows:

	2008	2007
	US\$ '000	US\$ '000
Short term employee benefits	11,851	13,689
End of service benefits	2,140	847
Post employment benefits	118	200
Total benefits	14,109	14,736
Headcount	26	27

Included in short term employee benefits is the fair value amortisation charge relating to share based transactions of US\$ 2.9 million (2007: US\$ 2.8 million).

## 27 EMPLOYEE BENEFITS

### Defined benefits pension plan

AUBUK operates a funded defined benefits scheme for its employees who joined prior to 1 March 2001. The assets of the pension scheme are held independently of the Group's assets in a separate trustee administered fund.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 27 EMPLOYEE BENEFITS (continued)

### Defined benefits pension plan (continued)

The pension scheme is valued by independent actuaries periodically using the projected unit cost method. The latest actuarial valuation of AUB UK's pension scheme, carried out on 31 December 2008 revealed a deficit in the pension scheme's assets over its obligations as noted below. The principal assumptions used in the actuarial valuation were an expected investment return of 6.50% per annum (2007: 6.70% per annum) a future rate of salary progression of 3.00% per annum (2007: 3.30% per annum) future pension increases of 2.80% to 5.00% (2007: 3.20% to 5.00% per annum) and discount rate of 6.50% (2007: 5.80% per annum).

The overall expected rate of return on plan assets is determined based on best estimates of the fair value of the plan assets over the period of the plan.

The charge recognised in the consolidated statement of income was as follows:

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
Current service cost	<b>1,258</b>	1,643
Interest cost	<b>8,469</b>	8,026
(Less): Expected return on plan assets	<b>(8,289)</b>	(8,184)
Net actuarial losses recognised in the year	<b>742</b>	1,058
	<b>2,180</b>	2,543

The amounts recognised in the consolidated balance sheet were as follow:

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
Present value of scheme's obligations	<b>107,147</b>	158,447
(Less): Fair value of plan assets	<b>(82,023)</b>	(133,978)
	<b>25,124</b>	24,469
(Less): Unrecognised net actuarial losses	<b>(30,969)</b>	(27,467)
Asset in the consolidated balance sheet	<b>(5,845)</b>	(2,998)

The actual (loss) returns on plan assets were US\$ (23,684) thousand (2007: US\$ 7,311 thousand).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 27 EMPLOYEE BENEFITS (continued)

### Defined benefits pension plan (continued)

The movement in the (asset) liability recognised in the consolidated balance sheet during the year was as follows:

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
At 1 January	<b>(2,998)</b>	3,385
<u>Add/(Less):</u>		
Total expenses as stated above	<b>2,180</b>	2,543
Contributions by the Group	<b>(6,848)</b>	(8,996)
Exchange rate and other adjustments	<b>1,821</b>	70
At 31 December	<b>(5,845)</b>	(2,998)

The changes in the present value of the scheme's obligations were as follows:

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
At 1 January	<b>158,447</b>	149,012
<u>Add/(Less):</u>		
Interest cost	<b>8,469</b>	8,026
Current service cost	<b>1,258</b>	1,643
Actuarial loss	<b>(17,217)</b>	(254)
Benefits paid	<b>(2,759)</b>	(3,176)
Exchange rate and other adjustments	<b>(41,051)</b>	3,196
At 31 December	<b>107,147</b>	158,447

The changes in the fair value of the plan assets were as follows:

	<b>2008</b>	2007
	<b>US\$ '000</b>	US\$ '000
At 1 January	<b>133,978</b>	118,300
<u>Add/(Less):</u>		
Expected return	<b>8,289</b>	8,184
Contributions by the Group	<b>6,848</b>	8,996
Actuarial loss	<b>(31,973)</b>	(874)
Benefits paid	<b>(2,759)</b>	(3,176)
Exchange rate and other adjustments	<b>(32,360)</b>	2,548
At 31 December	<b>82,023</b>	133,978

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 27 EMPLOYEE BENEFITS (continued)

### Defined benefits pension plan (continued)

The major categories of plan assets as a percentage of the fair value of the total plan assets were as follows:

	<b>2008</b>	2007
	%	%
Equities	<b>69</b>	67
Government bonds	<b>13</b>	15
Corporate bonds	<b>17</b>	17
Others	<b>1</b>	1
Total	<b>100</b>	100

All bonds in the plan assets are investment grade and traded in an active market.

The present value of scheme's obligations, the fair value of plan assets and the deficit arising thereon along with the effect of differences between the previous actuarial assumptions and what has actually occurred (experience adjustments) for the years ended 31 December have been presented below:

	<b>2008</b>	2007	2006	2005	2004
	<b>US\$ '000</b>	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Present value of scheme's obligations	<b>107,147</b>	158,447	149,012	126,380	114,722
Fair value of plan assets	<b>(82,023)</b>	(133,978)	(118,300)	(94,600)	(87,489)
Deficit	<b>25,124</b>	24,469	30,712	31,780	27,233
Experience adjustments on:					
Plan liabilities	-	3,690	2,154	4,868	2,270
Plan assets	<b>25,096</b>	874	(1,615)	(10,187)	(3,374)

### Other defined benefit plans

The charge to the consolidated statement of income on account of end of service benefits for the year amounted to US\$ 6,323 thousand (2007: US\$ 6,417 thousand). There are no material differences between the carrying amount of the provision for end of service benefits and the amount arising from an actuarial computation thereof.

### Defined contribution plans

The Group contributed US\$ 5,299 thousand (2007: US\$ 3,886 thousand) during the year towards defined contribution plans. The Group's obligations are limited to the amounts contributed to various schemes.

## 28 MANAGED FUNDS

Funds administrated on behalf of customers to which the Group does not have legal title are not included in the consolidated balance sheet. The total market value of all such funds at 31 December 2008 was US\$ 5,233 million (31 December 2007: US\$ 8,352 million). The drop was primarily contributed by the sharp drops in international and regional sectors and real estate prices in the second half of the year.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 29 DERIVATIVES

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instruments, reference rates or indices.

Derivatives include financial options, futures and forwards, interest rate swaps and currency swaps, which create rights and obligations that have the effect of transferring between the parties of the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, a derivative financial instrument gives one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potential favourable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the term of the exchange are determined on inception of the derivative instruments, as prices in financial markets change those terms may become either favourable or unfavourable.

The table below shows the net fair values of derivative financial instruments together with the notional amounts. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at period-end and are neither indicative of the market risk nor credit risk.

	2008			2007		
	Notional	Derivative	Derivative	Notional	Derivative	Derivative
	amount	assets	liabilities	amount	assets	liabilities
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
<i>Derivatives held for trading:</i>						
Interest rate swaps	2,648,817	71,114	68,554	3,481,700	30,410	25,686
Forward foreign exchange contracts	3,735,890	48,746	50,883	2,733,093	64,531	55,393
Options	3,150,479	5,265	4,095	179,433	4,442	4,259
Interest rate futures	-	-	-	1,783,480	74	128
Credit derivatives	35,000	93	-	25,731	-	8
<i>Derivatives held as fair value hedges:</i>						
Interest rate swaps	1,444,941	11,516	143,933	1,460,839	9,905	27,664
Options	31,805	2,403	-	86,542	13,567	-
<i>Derivatives held as cash flow hedges:</i>						
Interest rate swaps	767,689	3,961	89,613	600,940	750	15,335
	<b>11,814,621</b>	<b>143,098</b>	<b>357,078</b>	<b>10,351,758</b>	<b>123,679</b>	<b>128,473</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 29 DERIVATIVES (continued)

### Cash flow hedges

The schedule of forecast principal balances on which the expected interest cash flows arise and their impact on the consolidated financial statements as at 31 December 2008 is as follows:

	3 months or less US\$'000	More than 3 months upto 1 year US\$'000	5 years or less but more than 1 year US\$'000	More than 5 years US\$'000	Total US\$'000
<b>At 31 December 2008</b>					
Cash inflows from assets	-	-	-	-	-
Cash outflows from liabilities	<b>7,446</b>	<b>15,408</b>	<b>140,921</b>	<b>92,169</b>	<b>255,944</b>
<b>At 31 December 2007</b>					
Cash inflows from assets	-	-	-	-	-
Cash outflows from liabilities	1,138	9,036	48,554	5,262	63,990

No hedge ineffectiveness on cash flow hedges was recognised in 2007 and 2008.

### Fair value hedges

Losses arising from fair value hedge instruments during 2008 were US\$ 114,459 thousand (2007 : US\$ 16,483 thousand) while the gains on the hedged items attributable to risk was US\$ 114,459 thousand (2007 : US\$ 16,483 thousand). These gains and losses are included in "Trading income-net" in the consolidated statement of income during 2007 and 2008.

### Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and interest rate futures are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. Forward rate agreements are effectively tailor-made interest rate futures which fix a forward rate of interest on a notional loan, for an agreed period of time starting on a specified future date.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 29 DERIVATIVES (continued)

### Derivatives held for trading purposes

Most of the Group's derivative trading activities relate to customer driven transactions as well as positioning and arbitrage. Positioning involves managing positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying and profiting from price differentials between markets or products.

### Derivatives held for hedging purposes

The Group has adopted a comprehensive system for the measurement and management of risk.

As part of its asset and liability management the Group uses derivatives for hedging purposes in order to reduce its exposure to currency and interest rate movements. This is achieved by hedging specific financial instruments and forecasted transactions, as well as strategic hedging against overall balance sheet exposures.

The Group uses options and currency swaps to hedge against specifically identified currency and equity risks. In addition, the Group uses interest rate swaps and forward rate agreements to hedge against the interest rate risk arising from specifically identified, or a portfolio of, fixed interest rate investments and loans. The Group also uses interest rate swaps to hedge against the cash flow risks arising on certain floating rate deposits. In all such cases the hedging relationship and objective, including details of the hedged item and hedging instrument, are formally documented and the transactions are accounted for as fair value hedges.

Hedging of interest rate risk is also carried out by monitoring the duration of assets and liabilities and entering into interest rate swaps to hedge net interest rate exposures. Since hedging of net positions does not qualify for special hedge accounting, related derivatives are accounted for the same way as trading instruments.

## 30 COMMITMENTS AND CONTINGENT LIABILITIES

### Credit-related commitments

Credit-related commitments include commitments to extend credit, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Group's customers.

Commitments to extend credit represent contractual commitments to make loans and revolving credits available and 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.

Standby letters of credit, guarantees and acceptances (standbys) commit the Group to make payments on behalf of customers contingent upon their failure to perform under the terms of the contract. Standbys would have market risk if issued or extended at a fixed rate of interest. However, these contracts are primarily made at floating rates.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 30 COMMITMENTS AND CONTINGENT LIABILITIES (continued)

### Credit-related commitments (continued)

The Group has the following credit related commitments:

	2008	2007
	US\$ '000	US\$ '000
Commitments on behalf of customers:		
Guarantees	1,880,235	1,101,614
Acceptances	65,670	79,216
Letters of credit	578,635	378,564
	<b>2,524,540</b>	1,559,394
Irrevocable commitments:		
Undrawn loan commitments	942,665	1,335,841

The Group's commitments in respect of non-cancellable operating leases were as follows:

	2008	2007
	US\$ '000	US\$ '000
Within one year	19	2,085
Within one to five years	387	634
Over five years	1,728	2,377
	<b>2,134</b>	5,096

## 31 SEGMENT INFORMATION

### Primary segment information

For management purposes the Group is organised into three major business segments:

Retail banking	principally handling individual customers' deposit and current accounts, providing consumer loans, residential mortgages, overdrafts, credit cards and fund transfer facilities.
Corporate banking, treasury and investments	principally handling loans and other credit facilities, and deposit and current accounts for corporate and institutional customers and providing money market, trading and treasury services, as well as management of the Group's funding.
Private banking and wealth management	principally servicing high net worth clients through a range of investment products, funds, credit facilities, trusts and alternative investments.

These segments are the basis on which the Group reports its primary segment information. Transactions between segments are conducted at approximate market rates on an arm's length basis. Interest is charged/credited to business segments based on a pool rate which approximates the cost of funds.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 31 SEGMENT INFORMATION (continued)

### Primary segment information (continued)

Segment information for the year ended **31 December 2008** is as follows:

	Retail banking	Corporate banking, treasury and investments	Private banking and wealth management	Total
	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Net interest and other income before share of profit from associates	198,199	337,897	62,982	599,078
	33.1%	56.4%	10.5%	100.0%
Share of profit from associates				66,455
<b>Operating income</b>				<b>665,533</b>
Profit before tax - excluding share of profit from associates	67,362	145,566	27,072	240,000
	28.0%	60.7%	11.3%	100.0%
Share of profit from associates				66,455
Add: Income tax credit				3,287
(Less): Net profit attributable to minority interest				(54,019)
Net profit attributable to the Bank's equity shareholders				255,723

Segment information as at **31 December 2008** is as follows:

	Retail banking	Corporate banking, treasury and investments	Private banking and wealth management	Total
	US\$ '000	US\$ '000	US\$ '000	US\$ '000
<b>Other information</b>				
Segment assets	3,332,992	16,520,737	1,821,081	21,674,810
Goodwill	205,741	255,937	126,944	588,622
Investments in associates and joint venture				534,916
Unallocated assets				784,379
Total assets				23,582,727
Segment liabilities	2,687,654	15,084,621	2,542,847	20,315,122
Unallocated liabilities				872,828
Total liabilities				21,187,950

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 31 SEGMENT INFORMATION (continued)

### Primary segment information (continued)

Segment information for the year ended 31 December 2007 is as follows:

	Retail banking	Corporate banking, treasury and investments	Private banking and wealth management	Total
	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Net interest and other income before share of profit of associates	189,325	305,750	84,794	579,869
	32.6%	52.8%	14.6%	100.0%
Share of profit from associates				57,134
Operating income				637,003
Profit before tax - excluding share of profit from associates	65,760	196,753	52,533	315,046
	20.9%	62.4%	16.7%	100.0%
Share of profit from associates				57,134
(Less): Income tax expense				(12,354)
(Less): Net profit attributable to minority interest				(63,509)
Net profit attributable to the Bank's equity shareholders				296,317

Segment information as on 31 December 2007 was as follows:

	Retail banking	Corporate banking, treasury and investments	Private banking and wealth management	Total
	US\$ '000	US\$ '000	US\$ '000	US\$ '000
<b>Other information</b>				
Segment assets	2,912,295	16,969,588	1,481,663	21,363,546
Goodwill	165,265	178,750	104,868	448,883
Investments in associates and joint venture				768,471
Unallocated assets				468,952
Total assets				23,049,852
Segment liabilities	2,253,769	15,483,743	2,288,015	20,025,527
Unallocated liabilities				376,204
Total liabilities				20,401,731

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 31 SEGMENT INFORMATION (continued)

### Secondary segment information

Although the management of the Group is based primarily on business segments, the Group operates in two geographic markets: the Gulf Co-operation Council (Kingdom of Bahrain, State of Kuwait, Sultanate of Oman, State of Qatar, Kingdom of Saudi Arabia and the United Arab Emirates), designated as regional, and the remainder (Europe, U.S.A., Asia and the rest of the world), is designated as international. The following table shows the distribution of the Group's operating income and total assets by geographical segment:

	Regional		International		Total	
	2008	2007	2008	2007	2008	2007
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Operating income	<b>653,682</b>	596,343	<b>11,851</b>	40,660	<b>665,533</b>	637,003
	<b>98.2%</b>	93.6%	<b>1.8%</b>	6.4%	<b>100.0%</b>	100.0%
Total assets	<b>17,121,640</b>	16,585,776	<b>6,461,087</b>	6,464,076	<b>23,582,727</b>	23,049,852
	<b>72.6%</b>	72.0%	<b>27.4%</b>	28.0%	<b>100.0%</b>	100.0%

## RISK MANAGEMENT

### 32 CREDIT RISK

Credit risk is the risk that one party to a financial instrument will fail to discharge a financial obligation and cause the other party to incur a financial loss. In the case of derivatives this is limited to positive fair values. The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties.

#### a) Concentration risk

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 manages its credit risk exposure so as to avoid over concentration to any sector or geographic location. It also obtains security where appropriate. Guidelines are in place regarding the acceptability of types of collateral and valuation parameters.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 32 CREDIT RISK (continued)

### a) Concentration risk (continued)

The principal collateral types are as follows:

- In the personal sector – mortgages over residential properties and assignments over salary income;
- In the commercial sector – charges over business assets such as premises, stock, receivables and corporate or bank guarantees;
- In the commercial real estate sector – charges over the properties being financed; and
- In the financial sector – charges over financial instruments, such as debt securities and equities.

The Group monitors the market value of collateral and requests additional collateral when necessary in accordance with the underlying agreement.

Details of the concentration of the loans and advances by industry sector and geographic region are disclosed in note 10.

Details of the industry sector analysis and the geographical distribution of the assets, liabilities and commitments on behalf of customers are set out in note 33.

### b) 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. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	<b>Gross maximum exposure 2008 US\$ '000</b>	Gross maximum exposure 2007 US\$ '000
Balances with central banks	<b>288,314</b>	118,355
Treasury bills and bonds	<b>1,236,997</b>	867,074
Deposits with banks and other financial institutions	<b>2,867,959</b>	4,396,781
Loans and advances	<b>13,632,220</b>	12,035,153
Non-trading investments	<b>2,755,091</b>	2,800,455
Other assets	<b>316,593</b>	316,586
<b>Total</b>	<b>21,097,174</b>	20,534,404
Contingent liabilities	<b>2,524,540</b>	1,559,394
Undrawn loan commitments	<b>942,665</b>	1,335,841
<b>Total credit related commitments</b>	<b>3,467,205</b>	2,895,235
<b>Total credit risk exposure</b>	<b>24,564,379</b>	23,429,639

Where financial instruments are recorded at fair value the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 32 CREDIT RISK (continued)

#### c) Credit quality per class of financial assets

The table below shows distribution of financial assets neither past due nor impaired.

	Neither past due nor impaired		
	High	Standard	Total
	standard grade	grade	
	US\$ '000	US\$ '000	US\$ '000
<b>At 31 December 2008</b>			
Balances with central banks	288,277	37	288,314
Treasury bills and bonds	1,154,214	82,783	1,236,997
Deposits with banks and other financial institutions	2,842,911	25,048	2,867,959
Loans and advances			
Retail	1,357,433	2,646,395	4,003,828
Corporate	7,055,785	2,287,129	9,342,914
Non trading investments			
Available-for-sale	725,531	99,295	824,826
Held to maturity	16,573	-	16,573
Loans and receivables	1,722,302	279,633	2,001,935
Other assets - derivatives	143,098	-	143,098

The table below shows distribution of financial assets neither past due nor impaired.

	Neither past due nor impaired		
	High	Standard	Total
	standard grade	grade	
	US\$ '000	US\$ '000	US\$ '000
<b>At 31 December 2007</b>			
Balances with central banks	118,355	-	118,355
Treasury bills and bonds	867,074	-	867,074
Deposits with banks and other financial institutions	4,248,562	148,219	4,396,781
Loans and advances			
Retail	717,442	2,767,351	3,484,793
Corporate	6,568,525	1,867,214	8,435,739
Non trading investments			
Available-for-sale	2,587,149	257,750	2,844,899
Other assets - derivatives	123,679	-	123,679

It is the Group's policy to maintain consistent internal risk ratings across the credit portfolio. The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the Group's internal credit rating system. This facilitates focused portfolio management of the inherent level of risk across all lines of business. The credit quality ratings given can be equated to the following risk rating grades:

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 32 CREDIT RISK (continued)

### c) Credit quality per class of financial assets

Credit quality rating	Risk rating	Definition
High standard	Risk rating 1 to 4	Undoubted through to good credit risk
Standard	Risk rating 5 to 6	Satisfactory through to adequate credit risk

The risk rating system is supported by a various financial analytics and qualitative market information for the measurement of counterparty risk.

There are no financial assets which are past due but not impaired other than those disclosed under note 10(c).

## 33 CONCENTRATION ANALYSIS

The distribution of assets, liabilities and commitments on behalf of customers by geographic region and industry sector was as follows:

	2008			2007		
	Assets US\$ '000	Liabilities US\$ '000	Commitments on behalf of customers US\$ '000	Assets US\$ '000	Liabilities US\$ '000	Commitments on behalf of customers US\$ '000
<b>Geographic region:</b>						
GCC countries	17,121,640	16,123,086	2,175,359	16,585,776	14,870,559	1,441,618
United Kingdom (UK)	2,018,530	218,290	13,534	2,890,226	743,819	20,751
Europe (excluding UK)	1,476,178	1,000,459	23,888	1,838,287	1,945,435	30,211
United States of America	747,462	389,743	21,235	538,388	356,392	36,600
Asia (excluding GCC)	590,230	2,038,333	23,106	490,814	1,725,194	9,334
Rest of the world (including Arab Republic of Egypt)	1,628,687	1,418,039	267,418	706,361	760,332	20,880
	<b>23,582,727</b>	<b>21,187,950</b>	<b>2,524,540</b>	23,049,852	20,401,731	1,559,394
<b>Industry sector:</b>						
Banks and other financial institutions	8,330,449	8,092,748	416,415	9,720,536	9,661,430	304,711
Consumer	4,689,289	4,677,417	41,783	3,996,099	3,852,940	43,447
Trading and manufacturing	3,330,186	1,330,071	592,101	2,856,752	1,404,035	477,201
Real estate	4,244,077	630,929	1,117,357	3,716,859	489,944	512,112
Government/public sector	1,102,274	3,869,785	9,082	698,133	3,222,590	1,040
Others	1,886,452	2,587,000	347,802	2,061,473	1,770,792	220,883
	<b>23,582,727</b>	<b>21,187,950</b>	<b>2,524,540</b>	23,049,852	20,401,731	1,559,394

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 34 MARKET RISK

Market risk is the risk of potential financial loss that may arise from adverse changes in the value of a financial instrument or portfolio of financial instruments due to movements in interest rates, foreign exchange rates, equity, commodity prices and derivatives. This risk arises from asset - liability mismatches, changes that occur in the yield curve, foreign exchange rates and changes in volatilities/implied volatilities in the market value of derivatives. The Group classifies exposures to market risk into either trading or non-trading portfolios. Given the Group's low risk strategy, aggregate market risk levels are considered low. The Group utilises Value-at-Risk (VaR) models to assist in estimating potential losses that may arise from adverse market movements in addition to non-quantitative risk management techniques. The market risk for the trading portfolio is managed and monitored on a VaR methodology which reflects the inter-dependency between risk variables. Non-trading portfolios are managed and monitored using stop loss limits and other sensitivity analyses.

### a. Market risk-trading

The Group calculates Historical Simulation VaR using a one day holding period at a confidence level of 95%, which takes into account the actual correlations observed historically between different markets and rates.

Since VaR is an integral part of the Group's market risk management, VaR limits have been established for all trading operations and exposures are reviewed daily against the limits by management. Actual outcomes are compared to the VaR model derived predictions on a regular basis as a means of validating the assumptions and parameters used in the VaR calculation.

The table below summarises the risk factor composition of the VaR including the correlative effects intrinsic to the trading book:

	Foreign exchange US\$ '000	Interest rate US\$ '000	Effects of correlation US\$ '000	Total US\$ '000
<b>2008 - 31 December</b>	<b>248</b>	<b>162</b>	<b>(1)</b>	<b>409</b>
2007 - 31 December	50	362	(77)	335

### b. Market risk-non-trading

#### Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments or the future profitability of the Group. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or reprice in a given period. The Group measures and manages interest rate risk by establishing levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Interest rate gaps on assets and liabilities are reviewed on a weekly basis and hedging strategies used to reduce the interest rate gaps to within the limits established by the Bank's Board of Directors.

The following table demonstrates the sensitivity of the Group's net interest income to a change in interest rates, with all other variables held constant. The sensitivity is based on the floating rate financial assets and financial liabilities held at 31 December 2008 including the effect of hedging instruments. Equity is not sensitive to changes in interest rates as there are no fixed rate instruments held in the available-for-sale portfolio.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 34 MARKET RISK (continued)

### b. Market risk-non-trading (continued)

#### Sensitivity analysis - interest rate risk

		2008	2007
		US\$ '000	US\$ '000
at 25 bps - increase (+)/decrease (-)	+/-	1,661	2,294
at 50 bps - increase (+)/decrease (-)	+/-	3,321	4,587

#### Currency risk

Currency risk is the risk that the functional currency value of a financial instrument will fluctuate due to changes in foreign exchange rates.

The risk management process manages the Group's exposure to fluctuations in foreign exchange rates (currency risk) through the asset and liability management process. It is the Group's policy to reduce its exposure to currency to acceptable levels as determined by the Board of Directors. The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

#### Sensitivity analysis - currency risk

All foreign currency exposures with the exception of strategic investments are captured as part of the trading book. The risk of the exposures are subject to quantification via a daily VaR calculation, the results of which are disclosed in note 34 (a).

The effect of foreign currency translation on the Group's strategic investments are reported under the "Foreign exchange translation reserve" under the note 22(i).

#### Equity price risk

Equity price risk arises from fluctuations in equity indices and prices. The Board has set limits on the amount and type of investments that may be accepted. This is monitored on an ongoing basis by the Group Investment Committee. The non-trading equity price risk exposure arises from the Group's investment portfolio.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 34 MARKET RISK (continued)

### b. Market risk-non-trading (continued)

The effect on equity valuations (as a result of a change in the fair value of equity investments held as available-for-sale) due to a reasonably possible change in equity indices, with all other variables held constant is as follows:

Market indices	Change in equity indices %	2008	2007
		Effect on equity US\$ '000	Effect on equity US\$ '000
Bahrain Stock Exchange	+10%	591	24
Doha Securities Market	+15%	876	1,037
Saudi Stock Exchange	+5%	326	81
Kuwait Stock Exchange	+10%	2,462	6,794
Abu Dhabi Stock Exchange	+10%	332	n/a

## 35 FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial instruments, with the exception of unquoted equity investments, approximate their carrying values.

The Group's primary medium and long-term financial liabilities are the term debts and subordinated liabilities. The fair values of these financial liabilities are not materially different from their carrying values, since these liabilities are repriced at intervals of three or six months, depending on the terms and conditions of the instrument and the resultant applicable margins approximate the current spreads that would apply for borrowings with similar maturities.

The fair value of unquoted equity investments cannot be determined with sufficient accuracy, as future cash flows are not determinable. The Group has unquoted equity investments carried at cost amounting to US\$ 73.2 million (31 December 2007: US\$ 16.1 million) where the impact of changes in equity prices will only be reflected when the investment is sold or deemed to be impaired, when the consolidated statement of income will be impacted; or when a material third party transaction in the investment gives a reliable indication of fair value which will be reflected in equity.

The Group intends to hold these securities until an opportunity to dispose them presents itself in the respective local markets.

Investments in associates include quoted equity investments of Ahli Bank Q.S.C. on the Doha Securities Market, and Ahli Bank (Oman) S.A.O.G. on the Muscat stock exchange. The table below shows the market value based on closing price as at 31 December 2008 and carrying value of these investments :

	2008	2007
	US\$ (million)	US\$ (million)
Market value	367	769
Carrying value	476	613

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 35 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Included under the previous year figure is the Group's holding in Ahli United Bank (Egypt) S.A.E. which was an associate as at 31 December 2007 and has subsequently become a subsidiary with effect from 31 December 2008. The market value of the Group's holding in AUBE as at 31 December 2007 was US\$ 199 million, while the carrying value relating to it was US\$ 155 million.

Impairment testing of the Group's investments in associates was carried out as required under IAS 28 and IAS 36 and the results showed no impairment.

## 36 LIQUIDITY RISK

Liquidity risk is the risk that an institution will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. To guard against this risk, management has diversified funding sources and assets are managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents and readily marketable securities.

The Group Asset and Liability Committee (GALCO) monitors the maturity profile on an overall basis with ongoing liquidity monitoring by the Group's treasury department.

The maturity profile of the assets and liabilities at **31 December 2008** given below reflects management's best estimates of the maturities of assets and liabilities that have been determined on the basis of the remaining period at the balance sheet date to the contractual maturity date, except in the case of customer deposits. The liquidity profile of customer deposits has been determined on the basis of the effective maturities indicated by the Group's deposit retention history.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 36 LIQUIDITY RISK (continued)

	US\$ '000						Total
	Up to one month	One month to three months	Over three months to one year	Over one year to five year	Over five years	Undated	
<b>ASSETS</b>							
Cash and balances with central banks	355,968	36,283	-	-	-	-	392,251
Treasury bills and bonds	79,235	314,538	710,072	133,152	-	-	1,236,997
Trading securities	3,620	18,978	-	766	-	-	23,364
Deposits with banks and other financial institutions	2,381,111	280,220	198,066	8,562	-	-	2,867,959
Loans and advances	2,106,536	1,956,177	2,132,707	4,183,693	3,253,107	-	13,632,220
Non-trading investments	103,866	230,904	406,110	1,200,386	1,412,304	-	3,353,570
Investments in associates and joint venture	-	-	-	-	-	534,916	534,916
Premises and equipment	-	-	-	-	-	389,009	389,009
Other assets	247,440	174,235	83,285	8,941	3,970	-	517,871
Goodwill and other intangible assets	-	-	-	-	-	634,570	634,570
<b>Total</b>	<b>5,277,776</b>	<b>3,011,335</b>	<b>3,530,240</b>	<b>5,535,500</b>	<b>4,669,381</b>	<b>1,558,495</b>	<b>23,582,727</b>
<b>LIABILITIES</b>							
Deposits from banks and other financial institutions	2,310,087	2,008,559	641,116	193,752	-	-	5,153,514
Customers' deposits	3,947,004	1,855,487	2,019,131	3,887,584	1,468,873	-	13,178,079
Term debts	-	-	400,000	950,000	-	-	1,350,000
Other liabilities	555,505	110,322	113,862	88,780	14,312	-	882,781
Subordinated liabilities	-	-	-	86,755	536,821	-	623,576
<b>Total</b>	<b>6,812,596</b>	<b>3,974,368</b>	<b>3,174,109</b>	<b>5,206,871</b>	<b>2,020,006</b>	<b>-</b>	<b>21,187,950</b>
Net liquidity gap	(1,534,820)	(963,033)	356,131	328,629	2,649,375	1,558,495	2,394,777

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 36 LIQUIDITY RISK (continued)

The maturity profile of the assets and liabilities at 31 December 2007 was as follows:

	US\$ '000						Total
	Up to one month	One month to three months	Over three months to one year	Over one year to five year	Over five years	Undated	
<b>ASSETS</b>							
Cash and balances with central banks	141,953	-	637	-	-	-	142,590
Treasury bills and bonds	32,553	126,016	455,445	179,534	73,526	-	867,074
Trading securities	44,592	67,609	-	-	-	-	112,201
Deposits with banks and other financial institutions	3,587,659	728,955	80,167	-	-	-	4,396,781
Loans and advances	1,308,228	1,948,682	2,446,979	2,865,404	3,465,860	-	12,035,153
Non-trading investments	530,396	149,600	222,949	1,422,892	1,199,440	-	3,525,277
Investments in associates and joint venture	-	-	-	-	-	768,471	768,471
Premises and equipment	-	-	-	-	-	292,461	292,461
Other assets	104,440	183,729	46,976	45,034	34,308	-	414,487
Goodwill and other intangible assets	-	-	-	-	-	495,357	495,357
<b>Total</b>	<b>5,749,821</b>	<b>3,204,591</b>	<b>3,253,153</b>	<b>4,512,864</b>	<b>4,773,134</b>	<b>1,556,289</b>	<b>23,049,852</b>
<b>LIABILITIES</b>							
Deposits from banks and other financial institutions	3,191,768	2,365,136	544,106	888,014	-	-	6,989,024
Customers' deposits	3,282,078	969,341	915,333	4,145,610	1,468,552	-	10,780,914
Term debts	-	-	-	1,350,000	-	-	1,350,000
Other liabilities	169,689	249,610	162,896	88,467	22,907	-	693,569
Subordinated liabilities	-	-	-	43,662	544,562	-	588,224
<b>Total</b>	<b>6,643,535</b>	<b>3,584,087</b>	<b>1,622,335</b>	<b>6,515,753</b>	<b>2,036,021</b>	<b>-</b>	<b>20,401,731</b>
Net liquidity gap	(893,714)	(379,496)	1,630,818	(2,002,889)	2,737,113	1,556,289	2,648,121

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 36 LIQUIDITY RISK (continued)

#### Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities based on contractual undiscounted repayment obligations.

	US\$ '000						Total
	Up to one month	One month to three months	Over three months to one year	Over one year to five year	Over five years	Undated	
<b>As at 31 December 2008</b>							
Deposits from banks and other financial institutions	2,289,461	2,019,675	651,760	239,018	-	-	5,199,914
Customers' deposits	7,262,921	3,143,222	2,498,449	403,181	239	-	13,308,012
Term debts	413	8,084	403,713	1,246,624	-	-	1,658,834
Subordinated liabilities	91	181	4,112	108,380	538,476	-	651,240
<b>Total</b>	<b>9,552,886</b>	<b>5,171,162</b>	<b>3,558,034</b>	<b>1,997,203</b>	<b>538,715</b>	<b>-</b>	<b>20,818,000</b>
Credit related commitments and contingencies	569,844	627,703	1,296,146	824,035	149,477	-	3,467,205
Derivatives - net outflow	(1,436)	(775)	(9,608)	(105,818)	(97,053)	-	(214,690)
<b>As at 31 December 2007</b>							
Deposits from banks and other financial institutions	3,783,049	2,481,759	570,935	497,903	-	-	7,333,646
Customers' deposits	7,092,384	2,218,196	1,871,202	139,658	1,545	-	11,322,985
Term debts	613	12,964	57,451	1,577,374	-	-	1,648,402
Subordinated liabilities	255	1,377	19,011	168,981	645,982	-	835,606
<b>Total</b>	<b>10,876,301</b>	<b>4,714,296</b>	<b>2,518,599</b>	<b>2,383,916</b>	<b>647,527</b>	<b>-</b>	<b>21,140,639</b>
Credit related commitments and contingencies	308,701	671,284	1,208,379	790,315	602,931	-	3,581,610
Derivatives - net outflow	(2,259)	1,490	8,177	(47,029)	4,951	-	(34,670)

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 37 CAPITAL ADEQUACY

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value. Capital adequacy for each of the group companies is also managed separately at its individual level.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

The risk asset ratio, calculated in accordance with the capital adequacy guidelines, under Basel II, approved by the Central Bank of Bahrain, for the Group, is disclosed under Pillar III Table 1, which is included in the annual report. The risk asset ratio is 13.8% under Basel - II in 2008 (2007: 13.6%).

## 38 DEPOSIT PROTECTION SCHEME

Certain customers' deposits of the Group are covered by deposit protection schemes established by the Central Bank of Bahrain and Financial Services Compensation Scheme, UK. The schemes apply to all non-bank private sector deposits subject to specific exclusions mainly relating to maximum deposit amounts, maximum total amount covered in one calendar year and maximum total amount of the Deposit Protection Board's financial resources. Eligible depositors are covered by the CBB to the extent of lower of 75% of the combined total of eligible deposits held by the depositor and BD 15,000. In the case of AUBUK, the entire amount of the customer deposit is covered under the Financial Services Compensation Scheme, subject to a maximum limit of GBP 50,000 per customer. No up-front contribution is currently required under the schemes and no liability is due unless any member bank of the Deposit Protection Scheme is unable to meet its depository obligations.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 39 ISLAMIC BANKING

The balance sheet and statement of income of the Bank's Islamic branches which are incorporated into the consolidated balance sheet and statement of income, are presented below:

#### Balance sheet as at 31 December

	2008	2007
	US\$ '000	US\$ '000
<b>ASSETS</b>		
Cash in hand	1,618	599
Due from banks	-	4,056
Receivable balances from islamic financing activities	95,836	17,916
Property, furniture and equipment	1,016	589
Other assets	150	-
<b>TOTAL ASSETS</b>	<b>98,620</b>	23,160
<b>LIABILITIES</b>		
Due to banks	25,085	3,578
Customers' deposits	3,616	3,674
Other liabilities	10,371	1,829
	<b>39,072</b>	9,081
Unrestricted investment accounts	44,297	414
	<b>83,369</b>	9,495
<b>EQUITY</b>		
Branch capital	13,963	13,963
Accumulated profit (loss)	1,586	(298)
Retained earnings	(298)	-
	<b>15,251</b>	13,665
<b>TOTAL LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY</b>	<b>98,620</b>	23,160

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 39 ISLAMIC BANKING (continued)

### Statement of income

	Year ended 2008	Six-month period ended 2007
	US\$ '000	US\$ '000
Net income from islamic financing activities	2,711	321
	<b>2,711</b>	321
Fees and commissions - net	605	42
<b>NET OPERATING INCOME</b>	<b>3,316</b>	363
Staff costs	369	262
Depreciation	289	3
Other operating expenses	154	393
<b>OPERATING EXPENSES</b>	<b>812</b>	658
<b>PROFIT (LOSS) OF UNRESTRICTED INVESTMENT ACCOUNT HOLDERS</b>	<b>2,504</b>	(295)
Less : Share of profit of unrestricted investment account holders	(918)	(3)
<b>NET PROFIT (LOSS) FOR THE YEAR / PERIOD</b>	<b>1,586</b>	(298)

# PILLAR III DISCLOSURES - BASEL II

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# PILLAR III DISCLOSURES - BASEL II

## INTRODUCTION TO THE CENTRAL BANK OF BAHRAIN'S BASEL II GUIDELINES

The Central Bank of Bahrain (CBB) Basel II Guidelines, based upon the BIS Revised Framework – 'International Convergence of Capital Measurement and Capital Standards', were introduced on 1 January 2008. Basel II is structured around three 'pillars': Pillar I - Minimum Capital Requirements; Pillar II – the Supervisory Review Process and the Internal Capital Adequacy Assessment Process (ICAAP); and Pillar III - Market Discipline.

### Group Structure

The public disclosures under this section have been prepared in accordance with the Central Bank of Bahrain ("CBB") Rules concerning Public Disclosure Module ("PD"), section PD-1: Annual Disclosure Requirements. The disclosures under this section are applicable to Ahli United Bank B.S.C. (the "Bank"), which is the parent Bank incorporated in Bahrain. The Bank operates under a retail banking license issued by the Central Bank of Bahrain. The Bank and its subsidiaries (as detailed under note 2 to the Consolidated Financial Statements) are collectively known as the Group.

### Pillar I – Minimum Capital Requirements

Pillar I deals with the basis for the computation of the regulatory capital ratio. It defines the various classes and the calculation of Risk Weighted Assets (RWAs) in respect of credit risk, market risk and operational risk, as well as deriving the regulatory capital base. The capital adequacy ratio is then calculated as the ratio of the Bank's regulatory capital to its total risk weighted assets. All Bahrain incorporated banks are currently required to maintain a minimum capital adequacy ratio of 12%. In addition, the Central Bank of Bahrain requires banks to maintain an additional 0.5% buffer above the minimum capital adequacy ratio.

The Group ensures that each subsidiary maintains sufficient capital levels for their respective legal and compliance purposes.

### Credit risk

Basel II provides three approaches to the calculation of credit risk regulatory capital. The Standardised approach which the Bank has adopted, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties, and groups other counterparties into broad categories and applies standardised risk weightings to these categories.

### Market risk

The Bank has adopted the Standardised approach for determining the market risk capital requirement.

### Operational risk

Under the basic indicator approach, which the Bank has adopted for operational risk, the regulatory capital requirement for operational risk is calculated by applying a co-efficient of 15 per cent to the average gross income for the preceding three financial years.

During 2009, we will be seeking CBB approval to move to the 'internal models' approach for the calculation of regulatory market risk and the Standardised approach for operational risk. Under the standardised approach, the regulatory capital requirement is calculated based on a range of coefficients, ranging between 12 and 18 per cent, applied to the average gross income for the preceding three financial years for each of the eight predefined business lines.

## PILLAR III DISCLOSURES - BASEL II

### **Pillar II – The Supervisory Review and Evaluation Process**

Pillar II involves the process of supervisory review of a financial institution's risk management framework and its capital adequacy.

Accordingly, this involves both, the Bank and its regulators taking a view on whether additional capital should be held against risks not covered in Pillar I. Part of the Pillar II process is the Internal Capital Adequacy Assessment Process (ICAAP) which is the Bank's self assessment of risks not captured by Pillar I.

As part of the CBB's Pillar II guidelines, each bank is required to be individually reviewed and assessed by the CBB with the intention of setting individual minimum capital adequacy ratios. The CBB is currently in the process of individually assessing the financial strength and risk management practices of each institution. Until finalised, we will be required to continue to maintain a 12 per cent minimum capital adequacy ratio.

### **Pillar III – Market Discipline**

The third pillar is related to market discipline and requires the Bank to publish detailed qualitative and quantitative information of its risk management and capital adequacy policies and processes to complement the first two pillars and the associated supervisory review process. The disclosures in this report are in addition to the disclosures set out in the audited consolidated financial statements of the Group for the year ended 31 December 2008.

### **PILLAR III QUANTITATIVE AND QUALITATIVE DISCLOSURES**

For the purpose of computing regulatory minimum capital requirements, the Group follows the rules as laid out under the CBB Rulebook module PCD: Prudential Consolidation and Deduction Requirements, PCD-1 & PCD-2 and the Capital Adequacy (CA) Module. Accordingly,

- a) All subsidiaries as per Note 2 to the audited consolidated financial statements are consolidated on a line by line basis in accordance with International Financial Reporting Standards. Minority interest arising on consolidation is reported as part of Tier 1 capital;
- b) Investments in associates as reported under Note 12 to the audited consolidated financial statements are pro-rata consolidated for the purpose of regulatory minimum capital requirements and capital deducted from Tier 1 and 2. The prorated capital is included under Tier 1 and Tier 2 respectively as aggregation,
- c) Goodwill is deducted from Tier 1 capital;
- d) Subordinated term debts, as reported under liabilities in the consolidated balance sheet, are reported as part of Tier 2 capital, subject to maximum thresholds and adjusted for remaining life;
- e) Unrealized gains arising from fair valuing equities is reported only to the extent of 45%;
- f) Property revaluation reserve is included under Tier 2 capital to the extent of 45%; and
- g) Collective impairment provisions to the extent of maximum threshold of 1.25% of total Credit Risk Weighted Assets is included under Tier 2 capital.

There are no restrictions on the transfer of funds or regulatory capital within the group and all investments are made fully complying with CBB approval instructions.

# PILLAR III DISCLOSURES - BASEL II

## 1. CAPITAL STRUCTURE

TABLE - 1

	Tier 1	Tier 2
	US\$ '000	US\$ '000
<b>A. NET AVAILABLE CAPITAL</b>		
Paid-up share capital	1,143,689	
Less : Loans against Employee Stock Purchase Plan Notes	(42,354)	
Reserves		
Share premium	540,029	
Capital reserve	307	
Statutory reserve	126,624	
Others	38,419	
Retained earnings	100,483	
Minority interest in the equity of subsidiaries	399,342	
Less : Goodwill	(588,622)	
Less : Unrealised gross losses arising from fair valuing equities	(24,564)	
Current year profit		255,723
Asset revaluation reserves- property, plant and equipment (45% only)		54,498
Unrealised gains arising from fair valuing equities (45% only)		10,383
Collective impairment provisions		129,945
Eligible subordinated term debt		605,468
<b>TOTAL CAPITAL BEFORE REGULATORY DEDUCTIONS</b>	<b>1,693,353</b>	<b>1,056,017</b>
Less : Regulatory deductions :		
Material holdings of equities	212,948	212,948
	1,480,405	843,069
Add : Proportionate aggregation	200,732	36,595
<b>NET AVAILABLE CAPITAL</b>	<b>1,681,137</b>	<b>879,664</b>
<b>TOTAL ELIGIBLE CAPITAL BASE (Tier 1 + Tier 2)</b>		<b>2,560,801</b>

The terms and conditions and main features of the capital instruments listed above as part of the Tier 1 and Tier 2 capital are explained in note 20 and note 21 to the consolidated financial statements of the Group for the year ended 31 December 2008.

## B. CAPITAL ADEQUACY RATIO

As at 31 December 2008, the capital adequacy ratio of the Group and significant subsidiaries were:

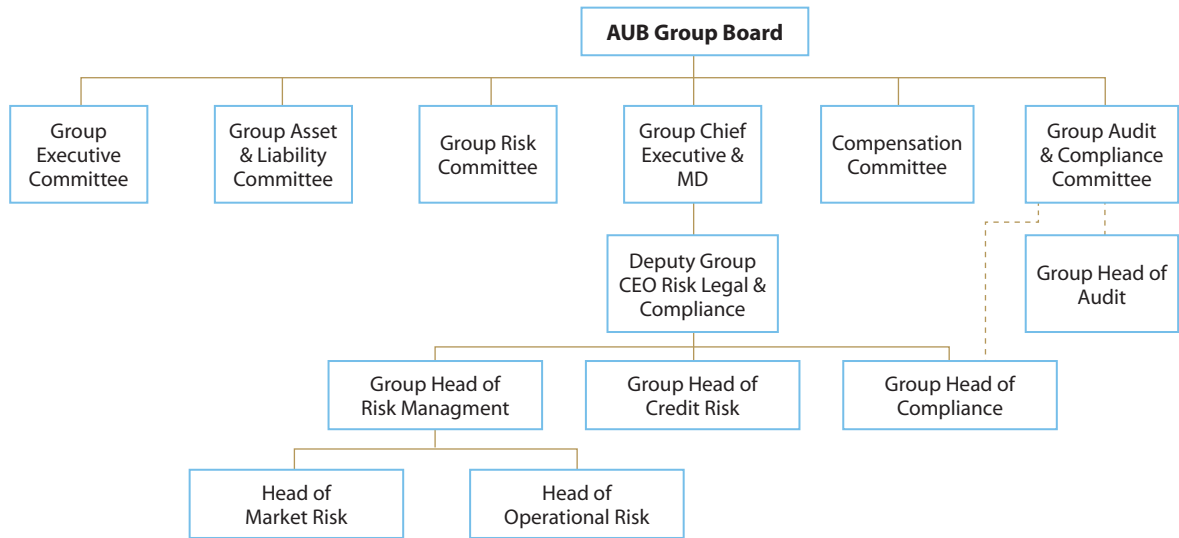
	Subsidiaries			
	Consolidated	The Bank of Kuwait and Middle East K.S.C. (BKME)	Ahli United Bank (U.K.) P.L.C. (AUB UK)	Ahli United Bank (Egypt) S.A.E. (AUBE)
Tier 1 - Capital Adequacy Ratio	9.0%	12.7%	14.3%	16.1%
Total - Capital Adequacy Ratio	13.8%	14.8%	15.6%	17.4%

## 2. GROUP RISK GOVERNANCE STRUCTURE

### Risk Governance

The AUB Group Board seeks to optimise the Bank’s performance by enabling the various group business units to realize the Group’s business strategy and meet agreed business performance targets by operating within the agreed capital and risk parameters and Group risk policy framework.

### AUB Group Risk Governance Structure



The Board approves the risk appetite and the Group Risk Committee monitors the Group’s risk profile against this appetite.

The Deputy Group CEO – Risk, Legal and Compliance under the delegated authority of the Group CEO & MD, supported by the Group Head of Risk Management and the Group Head of Credit Risk have responsibility for ensuring effective risk management and control. Within Group Risk Management specialist risk-type Heads and their teams are responsible for risk oversight and establishing appropriate risk control frameworks.

Internal Audit is responsible for the independent review of risk management and the Group’s risk control environment.

The Board and its Executive Committee receive quarterly risk updates including detailed Risk Asset Analysis reports.

The Board approves all risk policies as well as the the Group risk profile and control framework at least annually.

The Group Audit Committee considers the adequacy and effectiveness of the Group risk control framework and receives quarterly updates on any control issues, impairment provisions , regulatory and compliance related issues.

Systems and procedures are in place to identify, control and report on all major risks.

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from lending, trade finance and treasury activities. Credit risk also arises where assets are held in the form of debt securities, the value of which may fall.

The Group has policies and procedures in place to monitor and manage these risks and the Group Risk Management function provides high-level centralised oversight and management of credit risk. The specific responsibilities of Group Risk Management are to:

- Set credit policy, risk appetite for credit risk exposure to specific market sectors;
- Control exposures to sovereign entities, banks and other financial institutions and set risk ratings for individual exposures. Credit and settlement risk limits to counterparties in these sectors are approved and managed by Group Risk Management, to optimise the use of credit availability and avoid risk concentration;
- Control cross-border exposures, through the centralised setting of country limits with sub-limits by maturity and type of business;
- Manage large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography remain within internal and regulatory limits in relation to the group's capital base;
- Maintain the Bank's Internal Risk Rating framework;
- Manage watchlisted and criticised asset portfolio and recommend appropriate level of provisioning and write-offs;
- Report to the Group Risk Committee, Audit Committee and the Board of Directors on all relevant aspects of the Group's credit risk portfolio. Regular reports include detailed analysis of:
  - risk concentrations;
  - corporate and retail portfolio performance
  - specific higher-risk portfolio segments, e.g. real estate
  - individual large impaired accounts, and details of impairment charges
  - country limits, cross-border exposures.
- Specialised management and control of all non-performing assets;
- Manage and direct credit risk management systems initiatives; and
- Interface, for credit-related issues, with external parties including the Central Bank of Bahrain, rating agencies, investment analysts, etc.

All credit proposals are subjected to a through comprehensive risk assessment which examines the customer's financial condition and trading performance, nature of the business, quality of management and market position. In addition our internal risk rating model scores these quantitative and qualitative factors. The credit approval decision is then made and terms and conditions set. Exposure limits are based on the aggregate exposure to the counterparty and any connected entities across the AUB Group. All credit exposures are reviewed at least annually.

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT (continued)

#### Counterparty Exposure Classes

The CBB's capital adequacy framework for the standardised approach to credit risk sets the following counterparty exposure classes and the risk weightings to be applied to determine the risk weighted assets:

Exposure Class	Risk Weighting Criteria
Sovereign Portfolio	Exposures to governments of GCC member states and their central banks are zero % risk weighted. Other sovereign exposures denominated in the relevant domestic currency are also zero % risk weighted. All other sovereign exposures are risk weighted based on their external credit ratings;
Public Sector Entity [PSE] Portfolio	Bahrain PSEs and domestic currency claims on other PSEs [which are assigned a zero % risk weighting by their own national regulator] are assigned a zero % risk weighting. Other PSEs are risk weighted based on their external credit ratings;
Banks Portfolio	Exposures to banks are risk weighted based on their external credit ratings, with a preferential weighting given to short term exposures (i.e. with an original tenor of 3 months or less);
Investment Company Portfolio	Exposures to investment companies which are supervised by the CBB are treated in the same way as exposures to banks but without the preferential short term exposure weighting. Other exposures will be treated as a corporate exposure for risk weighting purposes.
Corporate Portfolio	Exposures to corporates are risk weighted based on their external credit rating. Unrated corporates are 100% risk weighted. A number of corporates owned by the Kingdom of Bahrain have been assigned a preferential zero % risk weighting.
Regulatory Retail Portfolio	Regulatory retail exposures are risk weighted at 75%.
Residential Property Portfolio	Exposures fully secured by first mortgages on owner occupied residential property are generally 75% risk weighted.
Commercial Property Portfolio	Exposures secured by mortgages on commercial real estate are subject to a minimum 100% risk weighting, except where the borrower has an external rating below BB- in which case the rating risk weighting applies.
Equities and Funds Investment Portfolio	Investments in listed equities carry a 100% risk weighting. Unlisted equities are 150% risk weighted.  Investments in rated instruments are risk weighted according to their external rating and treated as a corporate exposure. If not rated the investment is treated as an equity investment and risk weighted 100% for listed and 150% for others.
Past Due Portfolio	The unsecured portion of any exposure [other than a residential mortgage loan] that is past due for more than 90 days is:  150% risk weighted when specific provisions are less than 20% of the outstanding amount; and  100% risk weighted when specific provisions are greater than 20%.

# PILLAR III DISCLOSURES - BASEL II

## 3. CREDIT RISK MANAGEMENT (continued)

### External Rating Agencies

The Group uses the following external credit assessment institutions (ECAI's): Moody's; Standard & Poors and Fitch. The external rating of each ECAI is mapped to the prescribed internal risk rating that in turn produces standard risk weightings.

### Basel II Reporting of Credit Risk Exposures

As a result of the methodologies applied credit risk exposures presented under Basel II reporting differs in a number of respects from the exposures reported in the consolidated financial statements.

1. As per the CBB Basel II framework, off balance sheet exposures are converted, by applying a credit conversion factor (CCF), into direct credit exposure equivalents.
2. Under the Basel II capital adequacy framework eligible collateral is applied to reduce exposure.

### Credit Risk Mitigation

The Group's first priority when making loans is to establish the borrower's capacity to repay and not rely principally on security/collateral. Where the customer's financial standing is strong facilities may be granted on an unsecured basis, but when necessary collateral is an essential credit risk mitigant.

Acceptable forms of collateral are defined within the Group risk framework and conservative valuation parameters are also pre-set and regularly reviewed to reflect any changes in market conditions. Security structures and legal covenants are also subject to regular review to ensure that they continue to fulfill their intended purpose and remain in line with the CBB's prescribed minimum requirements set out in their capital adequacy regulations.

The principal collateral types are as follows:

- in the retail / personal sector, mortgages over residential properties, charges over investment portfolios, assignment of salaries;
- in the corporate / commercial sector, charges over business assets such as premises, stock and debtors, financial guarantees from acceptable third parties; and
- in the commercial real estate sector, charges over the properties being financed.

### Valuation of Collateral

The type and amount of collateral taken is based upon the credit risk assessment of the borrower. The market or fair value of collateral held is closely monitored and when necessary top-up requests are made or liquidation initiated as per the terms of the underlying credit agreements.

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT (continued)

#### Gross Credit Risk Exposures subject to Credit Risk Mitigants (CRM)

The following table details the Group gross credit risk exposures before the application of eligible Basel II credit risk mitigation techniques. The CBB's Basel II guidelines details which types of collateral and which issuers of guarantees are eligible for preferential risk weighting. The guidelines also specify the minimum collateral management processes and collateral documentation requirements necessary to achieve eligibility.

**TABLE - 2 GROSS CREDIT RISK EXPOSURES SUBJECT TO CREDIT RISK MITIGANTS (CRM)**

	<b>As at 31 December 2008</b>	<b>Average monthly balance</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Balances with central banks	288,314	171,152
Treasury bills and bonds	1,236,997	1,143,409
Deposits with banks and other financial institutions	2,867,959	4,804,925
Loans and advances	13,632,220	13,133,525
Non-trading investments	2,755,091	2,741,894
Other assets	324,892	345,215
<b>TOTAL FUNDED EXPOSURES</b>	<b>21,105,473</b>	<b>22,340,120</b>
Contingent liabilities	2,524,540	2,394,215
Undrawn loan commitments	942,665	584,278
<b>TOTAL UNFUNDED EXPOSURES</b>	<b>3,467,205</b>	<b>2,978,493</b>
<b>TOTAL CREDIT RISK EXPOSURE</b>	<b>24,572,678</b>	<b>25,318,613</b>

The gross credit exposures reported above are as per the consolidated balance sheet as reduced by exposures which do not carry credit risk.

Under the CBB Basel II Guidelines, banks may choose between two options when calculating credit risk mitigation capital relief. The simple approach which substitutes the risk weighting of the collateral for the risk weighting of the counterparty or the comprehensive approach whereby the exposure amount is adjusted by the actual value ascribed to the collateral. The Bank has selected to use the comprehensive method where collateral is in the form of cash or bonds or equities. The Bank uses a range of risk mitigation tools including collateral, guarantees, credit derivatives, netting agreements and financial covenants to reduce credit risk.

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT (continued)

**TABLE - 3 ELIGIBLE FINANCIAL COLLATERAL AND GUARANTEES**

	<b>Gross exposure</b>	<b>Eligible CRM</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Claims on sovereigns	2,172,670	5,000
Claims on public sector entities	712,015	160,177
Claims on banks	4,947,788	84,397
Claims on corporates	12,483,435	2,426,678
Regulatory retail exposures	2,436,183	55,217
Residential retail exposures	577,252	-
Equity	329,122	-
Investments in funds	269,357	-
Other exposures	1,205,466	3,474
<b>TOTAL</b>	<b>25,133,288</b>	<b>2,734,943</b>

The gross exposure in the above table represents the on and off balance sheet credit exposures before credit risk mitigation, determined in accordance with the CBB issued Pillar III guidelines. The off balance sheet exposures are computed using the relevant conversion factors.

**TABLE - 4 CREDIT RISK EXPOSURE POST CREDIT RISK MITIGATION AND CREDIT CONVERSION**

The following table details group credit exposures after applying risk mitigation.

	<b>US\$ '000</b>
Claims on sovereigns	109,153
Claims on Public Sector Entities	414,234
Claims on banks	1,653,893
Claims on corporates	9,608,670
Regulatory retail exposures	1,785,725
Residential retail exposures	202,038
Equity	424,938
Investments in funds	404,036
Other exposures	1,123,130
	15,725,817
Add : Proportionate aggregation	1,511,990
<b>TOTAL</b>	<b>17,237,807</b>
<b>TOTAL CREDIT RISK CAPITAL REQUIREMENT</b>	<b>2,068,537</b>

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT (continued)

**TABLE 5 - CAPITAL REQUIREMENT FOR CREDIT, MARKET AND OPERATIONAL RISKS**

	<b>Capital requirement US\$ '000</b>
Claims on sovereigns	13,098
Claims on public sector entities	49,708
Claims on banks	198,467
Claims on corporates	1,153,040
Regulatory retail exposures	214,287
Residential retail exposures	24,245
Equity	50,993
Investments in funds	48,484
Other exposures	134,776
	1,887,098
Add : Proportionate aggregation	181,439
	<b>2,068,537</b>
<b>TOTAL CREDIT RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH)</b>	<b>2,068,537</b>
<b>TOTAL MARKET RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH)</b>	<b>50,218</b>
<b>TOTAL OPERATIONAL RISK CAPITAL REQUIREMENT (BASIC INDICATOR APPROACH)</b>	<b>115,808</b>
<b>TOTAL</b>	<b>2,234,563</b>

#### **Concentration Risk**

Refer note 32(a) to the consolidated financial statements for definition and policies for management of concentration risk.

As per 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 per cent of the regulatory capital base. As at 31 December 2008 the Group had no single obligor exposures which exceeded 15 per cent of the Group's regulatory capital base (i.e. exceeded US\$ 384.1 million).

#### **Geographic Distribution of Gross Credit Exposures**

The geographic distribution of credit exposures is monitored on an ongoing basis by Group Risk Management and reported to the Board on a quarterly basis.

The following table details the Group's geographic distribution of gross credit exposures as at 31 December 2008.

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT (continued)

TABLE - 6 GEOGRAPHIC DISTRIBUTION OF GROSS CREDIT EXPOSURES

	GCC *	Europe (excluding United Kingdom)	United States of America	Asia (excluding GCC countries)	Rest of the world	Total
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Balances with central banks	170,237	30	-	-	118,047	288,314
Treasury bills and bonds	1,074,099	-	-	-	82,783	1,236,997
Deposits with banks and other financial institutions	1,088,152	792,957	534,798	295,773	55,815	100,464
Loans and advances	11,408,640	751,216	537,791	2,480	63,845	868,248
Non-trading investments	1,120,801	330,993	371,093	432,153	239,939	260,112
Other assets	247,605	66,868	1,591	-	-	8,828
<b>Total funded exposures</b>	<b>15,109,534</b>	<b>1,942,064</b>	<b>1,445,273</b>	<b>730,406</b>	<b>442,382</b>	<b>1,435,814</b>
Contingent liabilities	2,175,359	13,534	23,888	21,235	23,106	267,418
Undrawn loan commitments	758,652	72,960	100,746	5,010	4,385	912
<b>Total unfunded exposures</b>	<b>2,934,011</b>	<b>86,494</b>	<b>124,634</b>	<b>26,245</b>	<b>27,491</b>	<b>268,330</b>
<b>TOTAL</b>	<b>18,043,545</b>	<b>2,028,558</b>	<b>1,569,907</b>	<b>756,651</b>	<b>469,873</b>	<b>1,704,144</b>
	<b>73.5%</b>	<b>8.3%</b>	<b>6.4%</b>	<b>3.0%</b>	<b>1.9%</b>	<b>6.9%</b>
						<b>100.0%</b>

\* GCC countries are countries which are part of the Gulf Co-operation Council comprising Kingdom of Bahrain, State of Kuwait, Sultanate of Oman, State of Qatar, Kingdom of Saudi Arabia and the United Arab Emirates.

TABLE - 7 SECTORAL CLASSIFICATION OF GROSS CREDIT EXPOSURES

	Funded US\$ '000	Unfunded US\$ '000	Total US\$ '000	% US\$ '000
Banks and other financial institutions	7,092,942	590,290	7,683,232	31.3
Consumer/personal	4,688,128	283,118	4,971,246	20.2
Real estate	3,339,555	751,457	4,091,012	16.6
Trading and manufacturing	3,278,593	800,970	4,079,563	16.6
Construction	868,226	613,913	1,482,139	6.0
Government/public sector	1,102,194	18,793	1,120,987	4.7
Others	735,835	408,664	1,144,499	4.6
<b>TOTAL</b>	<b>21,105,473</b>	<b>3,467,205</b>	<b>24,572,678</b>	<b>100.0</b>
	<b>85.9%</b>	<b>14.1%</b>	<b>100.0%</b>	

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT (continued)

**TABLE - 8 RESIDUAL CONTRACTUAL MATURITY**

	Up to one month	One month to three months	Over three months to one year	Over one year to five years	Over five to ten years	Over ten to twenty years	Over twenty years	Total
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Balances with central banks	252,029	36,285	-	-	-	-	-	<b>288,314</b>
Treasury bills and bonds	79,235	314,538	710,072	133,152	-	-	-	<b>1,236,997</b>
Deposits with banks and other financial institutions	2,381,111	280,220	198,066	8,562	-	-	-	<b>2,867,959</b>
Loans and advances	2,106,536	1,956,178	2,132,707	4,183,693	2,226,040	918,630	108,437	<b>13,632,221</b>
Non-trading investments	21,368	93,701	404,917	1,028,075	732,013	186,103	288,913	<b>2,755,090</b>
Other assets	101,612	165,015	45,893	8,667	748	2,957	-	<b>324,892</b>
<b>Total funded exposures</b>	<b>4,941,891</b>	<b>2,845,937</b>	<b>3,491,655</b>	<b>5,362,149</b>	<b>2,958,801</b>	<b>1,107,690</b>	<b>397,350</b>	<b>21,105,473</b>
Contingent liabilities	59,960	568,564	1,116,672	680,437	98,907	-	-	<b>2,524,540</b>
Undrawn loan commitments	509,884	59,139	179,474	143,598	50,570	-	-	<b>942,665</b>
<b>Total unfunded exposures</b>	<b>569,844</b>	<b>627,703</b>	<b>1,296,146</b>	<b>824,035</b>	<b>149,477</b>	<b>-</b>	<b>-</b>	<b>3,467,205</b>
<b>TOTAL</b>	<b>5,511,735</b>	<b>3,473,640</b>	<b>4,787,801</b>	<b>6,186,184</b>	<b>3,108,278</b>	<b>1,107,690</b>	<b>397,350</b>	<b>24,572,678</b>

#### Impairment Provisions

The Group Risk Committee regularly evaluates the adequacy of the established allowances for impaired loans.

Two types of impairment allowance are in place:

#### Individually assessed impairment provisions

These are determined by evaluating the exposure to loss, case by case, on all individually significant accounts based upon the following factors:

- aggregate exposure to the customer;
- the viability of the customer's business model and its capacity to trade successfully out of financial difficulties, generating sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the extent of other creditors' commitments ranking ahead of, or pari passu with the Bank, and the likelihood of other creditors continuing to support the company;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession;

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT (continued)

- the likely dividend available on liquidation or bankruptcy;
- the likely costs involved in recovering amounts outstanding, and
- when available, the secondary market price of the debt.

Individually assessed impairment allowances are only reversed when there is reasonable and reliable evidence of a reduction in the established loss estimate.

#### Collectively assessed impairment provisions

Impairment is assessed on a collective basis in two circumstances:

#### Incurred but not yet identified impairment:

Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics. A collective loan loss allowance is calculated to reflect impairment losses incurred at the balance sheet date which will only be individually identified in the future.

The collective impairment provision is determined based upon:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, risk rating or product segment); and
- judgement as to whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

#### Homogeneous groups of loans

Collective impairment provision has been established in respect of homogeneous groups of loans such as unsecured retail lending products. Collectively assessed allowances are generally calculated quarterly and charges for new allowances, or reversals of existing allowances, are determined for each separately identified portfolio.

**TABLE - 9** SECTORAL BREAKDOWN OF IMPAIRED LOANS AND IMPAIRMENT PROVISION

	Impaired and past due loans	Specific Impairment	Net Specific Charge for the year ended 31 December 2008	Write off during the year ended 31 December 2008	Collective Impairment
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Consumer/personal	130,386	118,724	32,179	15,571	9,737
Trading and manufacturing	25,417	21,472	2,925	7,916	17,241
Real estate	73,884	70,270	16,235	1,763	19,403
Banks and other financial institutions	1,037	346	231	-	1,298
Construction	22,281	17,230	2,029	-	2,408
Others	7,234	5,762	1,669	-	6,358
<b>TOTAL</b>	<b>260,239</b>	<b>233,804</b>	<b>55,268</b>	<b>25,250</b>	<b>56,445</b>

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT (continued)

**TABLE - 10 GEOGRAPHICAL DISTRIBUTION OF IMPAIRMENT PROVISIONS FOR LOANS AND ADVANCES**

	GCC countries	United Kingdom	Europe (excluding United Kingdom)	United States of America	Asia (excluding GCC countries)	Rest of the world	Total
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Specific impairment provision	191,985	5,400	5,400	-	18,746	12,273	233,804
Collective impairment provision	51,854	1,924	2,138	-	496	33	56,445
<b>TOTAL</b>	<b>243,839</b>	<b>7,324</b>	<b>7,538</b>	<b>-</b>	<b>19,242</b>	<b>12,306</b>	<b>290,249</b>

**TABLE - 11 MOVEMENT IN IMPAIRMENT PROVISION FOR LOANS AND ADVANCES**

	RETAIL			CORPORATE			TOTAL	
	Specific	Collective	Total	Specific	Collective	Total	Specific	Collective
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Balance at 1 January 2008	75,107	9,973	<b>85,080</b>	56,785	28,323	<b>85,108</b>	131,892	<b>38,296</b>
Acquired from subsidiary	-	-	-	30,808	-	<b>30,808</b>	30,808	-
Amounts written off during the year	(15,585)	-	<b>(15,585)</b>	(9,665)	-	<b>(9,665)</b>	(25,250)	-
Net charge for the year	11,193	19,900	<b>31,093</b>	44,075	21,680	<b>65,755</b>	55,268	<b>41,580</b>
Interest suspended during the year (net)	8,042	-	<b>8,042</b>	4,909	-	<b>4,909</b>	12,951	-
Exchange rate adjustments / other movements	25,121	(1,921)	<b>23,200</b>	3,014	(21,510)	<b>(18,496)</b>	28,135	<b>(23,431)</b>
	<b>103,878</b>	<b>27,952</b>	<b>131,830</b>	<b>129,926</b>	<b>28,493</b>	<b>158,419</b>	<b>233,804</b>	<b>56,445</b>

#### Past Due and Impaired Credit Facilities

As per CBB guidelines, credit facilities are placed on non-accrual status and interest income suspended when either principal or interest is overdue by 90 days whereupon unpaid and accrued interest is reversed from income. Interest on non-accrual facilities is included in income only when received. Credit facilities classified as past due are assessed for impairment in accordance with IFRS guidelines. A specific provision is established where there is objective evidence that a credit facility is impaired.

Impaired credit facilities comprise those facilities where there is objective evidence that the Bank will not collect all amounts due, including both principal and interest. Objective evidence would include:

- a breach of contract, such as default or delinquency in interest or principal payments,
- the granting of a concession that, for economic or legal reasons relating to the borrower's financial difficulties, would not otherwise be considered,

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT (continued)

- indications that it is probable that the borrower will enter bankruptcy or other financial reorganisation,
- for equity securities classified as available-for-sale, a significant or prolonged decline in fair value below cost is considered in determining whether a security is impaired.

Refer to notes 10a to 10d and note 32c to the consolidated financial statements for the year ended 31 December 2008 for the distribution of the Loans and advances by quality.

Ratings 1 - 4 comprise of corporate facilities demonstrating financial condition, risk factors and capacity to repay that are good to excellent and retail borrowers where cash collateral [or equivalent such as pledged investment funds] has been provided.

Ratings 5 and 6 represents satisfactory risk and includes corporate facilities that require closer monitoring, and retail accounts which are maintained within generally applicable product parameters.

**TABLE - 12 PAST DUE LOANS - AGE ANALYSIS**

#### i) By Geographical area

	Three months to one year	One to three years	Over three years	Total
	US\$ '000	US\$ '000	US\$ '000	US\$ '000
GCC Countries	159,331	22,111	35,605	217,047
United Kingdom	8,468	343	-	8,811
Europe (excluding UK)	3,751	3,823	-	7,574
United States of America	-	-	117	117
Asia (excluding GCC countries)	-	11,795	416	12,211
Rest of the world	641	3,393	10,445	14,479
<b>TOTAL</b>	<b>172,191</b>	<b>41,465</b>	<b>46,583</b>	<b>260,239</b>
	<b>66.2%</b>	<b>15.9%</b>	<b>17.9%</b>	<b>100.0%</b>

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT (continued)

TABLE - 12 PAST DUE LOANS - AGE ANALYSIS (continued)

#### ii) By Sector

	Three months to one year	One to three years	Over three years	Total
	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Consumer/personal	92,378	16,632	21,376	<b>130,386</b>
Trading and manufacturing	12,060	2,053	11,304	<b>25,417</b>
Real estate	58,197	10,491	5,196	<b>73,884</b>
Banks and other financial institutions	932	-	105	<b>1,037</b>
Construction	9,460	4,673	8,148	<b>22,281</b>
Government/public sector	-	-	-	-
Others	1,068	215	5,951	<b>7,234</b>
<b>TOTAL</b>	<b>174,095</b>	<b>34,064</b>	<b>52,080</b>	<b>260,239</b>
	66.9%	13.1%	20.0%	<b>100.0%</b>

TABLE - 13 RESTRUCTURED CREDIT FACILITIES

	US\$ '000
Balance of any restructured credit facilities as at year end	27,559
Loans restructured during the year	5,980

The above restructurings did not have any significant impact on the present or future earnings and were primarily extensions of the loan tenor.

TABLE - 14 COUNTERPARTY CREDIT RISK IN DERIVATIVE TRANSACTIONS

#### i) Breakdown of the credit exposure

	Notional amount	Gross positive fair value	Credit conversion factor
	US\$ '000	US\$ '000	US\$ '000
Foreign exchange related	3,363,692	146,363	183,813
Interest rate related	4,861,447	149,641	383,366
Options	29,769	-	408
Derivatives credit exposure	<b>8,254,908</b>	<b>296,004</b>	<b>567,587</b>

Gross positive fair value represents the replacement cost of the derivatives

#### ii) Amounts of collateral

Nil

#### iii) Notional value of credit derivative exposures

Protection sold	30,000
Protection brought	5,000

## PILLAR III DISCLOSURES - BASEL II

### 3. CREDIT RISK MANAGEMENT (continued)

#### TABLE - 15 RELATED PARTY TRANSACTIONS

Refer note 26 to the consolidated financial statements of the Group for the year ended 31 December 2008.

### 4. MARKET RISK

Market risk is the risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and equity prices will reduce the Group's income or the value of its portfolios. The Group is also exposed to interest rate and potential foreign exchange risks arising from financial assets and liabilities not held for trading.

Market Risk Management, Measurement and Control Responsibilities

The Board approves the overall market risk appetite. Group Risk Management is responsible for the market risk control framework and sets a limit framework within the context of the approved market risk appetite.

The Group separates market risk exposures into either trading or non-trading portfolios. Trading portfolios include those positions arising from market-making, proprietary position-taking and other marked-to-market positions. Non-trading portfolios include positions that arise from the interest rate management of the Group's retail and commercial banking assets and liabilities, and financial assets designated as available-for-sale and held-to-maturity.

Each Group operating entity has an independent market risk function which is responsible for measuring market risk exposures in accordance with the Group Trading Book Policy and the Interest Rate Risk in the Banking Book Policy, and monitoring these exposures against prescribed limits.

Daily market risk reports are produced for the Bank's senior management covering the different risk categories. A more detailed market risk presentation is produced monthly and discussed at the Group Asset and Liability Committee.

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

- Value at Risk (VaR);
- Stress tests; and
- Annual earnings at risk.

#### Daily Value at Risk (VaR)

The Group VaR is an estimate of the potential loss which might arise from unfavourable market movements:

VaR Type	Sample Size	Holding Period	Confidence Interval	Frequency of Calculation
"Management" VaR	260 days	1 day	95%	Daily
"Regulatory" VaR	260 days	10 day	99%	Daily

## PILLAR III DISCLOSURES - BASEL II

### 4. MARKET RISK (continued)

Daily losses exceeding the VaR figure are likely to occur, on average, either once or five times in every 100 business days depending on the above VaR type methodology. The group routinely validates the accuracy of its VaR models by back testing the actual daily profit and loss results. The actual number of excesses over a given period can be used to gauge how well the models are performing.

Although a useful guide to risk, VaR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a 1-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a 1-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The VaR for the Group was as follows;

	<u>Average</u>	<u>Minimum</u>	<u>Maximum</u>
	US\$ '000	US\$ '000	US\$ '000
Total as at 31 December 2008	541	233	1,189

**TABLE - 16 CAPITAL REQUIREMENT FOR COMPONENTS OF MARKET RISK**

	<u>Capital requirement</u>	<u>Maximum value</u>	<u>Minimum value</u>
	US\$ '000	US\$ '000	US\$ '000
Interest rate risk	5,853	10,999	5,853
Equity position risk	5,607	38,542	5,607
Foreign exchange risk	33,422	35,217	33,422
Options	167	581	167
<b>TOTAL MARKET RISK CAPITAL REQUIREMENT BEFORE PROPORTIONATE AGGREGATION OF ASSOCIATES</b>	<b>45,049</b>		
Add : Proportionate aggregation	5,169	17,669	3,173
<b>TOTAL MARKET RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH)</b>	<b>50,218</b>		

## PILLAR III DISCLOSURES - BASEL II

### 4. MARKET RISK (continued)

#### Interest Rate Risk (non-trading)

Interest rate risk is the risk that the earnings or capital of the Group, or its ability to meet business objectives, will be adversely affected by movements in interest rates. Accepting this risk is a normal part of banking and can be an important source of profitability and shareholder value. Changes in interest rates can affect a bank's earnings by changing its net interest income and the level of other interest sensitive income and operating expenses. Changes in interest rates also affect the underlying value of the Group's assets, liabilities and off-balance sheet instruments because the present value of future cash flows and / or the cash flows themselves change when interest rates change. The Bank employs a risk management process that maintains interest rate risk within prudent levels.

The Board recognises that it has responsibility for understanding the nature and the level of interest rate risk taken by the Bank, and has defined a risk framework pertaining to the management of non trading Interest Rate Risk and has identified lines of authority and responsibility for managing interest rate risk exposures.

The Board has delegated the responsibility for the management of interest rate risk to the Group Asset and Liability Committee (GALCO). GALCO is responsible for setting and monitoring the interest rate risk strategy of the Group, for the implementation of the Interest Rate Risk framework and ensuring that the management process is in place to maintain interest rate risk within prudent levels.

GALCO reviews the Interest Rate Risk framework annually and submits recommendations for changes to the Executive Committee and Board as applicable.

The responsibility for the implementation of the Bank's interest rate risk policies resides with the Group Treasurer. An independent review of all interest exposure present in the Banking Book is undertaken by the Group Market Risk team and communicated to GALCO on a monthly basis.

Interest rate re-pricing reports are based on each product's contractual re-pricing characteristics overlaid where appropriate by behavioural adjustments. Behavioural adjustments are derived by an analysis of customer behaviour over time augmented by input from the business units.

Reports detailing the interest rate risk exposure of the Bank are reviewed by GALCO and the Board on a regular basis.

The following table summarises the repricing profiles of the Group's assets and liabilities as at 31 December 2008.

## PILLAR III DISCLOSURES - BASEL II

### 4. MARKET RISK (continued)

TABLE - 17 INTEREST RATE RISK

	Less than three months	Three months to one year	Over one year	Total
	US\$ '000	US\$ '000	US\$ '000	US\$ '000
<b>ASSETS</b>				
Treasury bills and bonds	393,773	710,071	133,153	1,236,997
Deposits with banks and other financial institutions	2,503,868	198,065	18,470	2,720,403
Loans and advances	7,834,701	1,365,880	4,217,997	13,418,578
Non-trading investments	630,702	406,817	2,046,682	3,084,201
	<b>11,363,044</b>	<b>2,680,833</b>	<b>6,416,302</b>	<b>20,460,179</b>
<b>LIABILITIES</b>				
Deposits from banks and other financial institutions	4,356,310	641,178	123,524	5,121,012
Customers' deposits	9,867,819	2,394,309	439,174	12,701,302
Term debt	1,200,000	150,000	-	1,350,000
Subordinated liabilities	119,445	279,131	225,000	623,576
	<b>15,543,574</b>	<b>3,464,618</b>	<b>787,698</b>	<b>19,795,890</b>
On - balance sheet gap	(4,180,530)	(783,785)	5,628,604	
Off - balance sheet gap	748,101	624,908	(1,373,009)	
Total interest sensitivity gap	(3,432,429)	(158,877)	4,255,595	
Cumulative interest sensitivity gap	<b>(3,432,429)</b>	<b>(3,591,306)</b>	<b>664,289</b>	

#### Interest rate risk sensitivity analysis

The Group's interest rate risk sensitivity is analysed in note 34b to the consolidated financial statements of the Group for the year ended 31 December 2008.

#### Equity Risk

Equity risk is the risk of changes in the fair value of an equity instrument. AUB Group is exposed to equity risk on non-trading equity positions that are primarily focused on the GCC stock markets. The Board has set limits on the amount and type of investments that may be made by the Bank. This is monitored on an ongoing basis by the Group Investment Committee with pre approved loss thresholds

A process of effective and prudent risk management is facilitated through the strategies used along with several key independent functions. These functions include Risk & Credit Control Unit, Market Risk, Operational Risk, Financial Control and Internal Audit. The effective management of risk is ensured by identifying, measuring and monitoring risks from a variety of perspectives.

## PILLAR III DISCLOSURES - BASEL II

### 4. MARKET RISK (continued)

#### Valuation and accounting policies:

- a) Equity investments held for strategic reasons - investments in associates and joint venture

Associated companies are companies in which the Group exerts significant influence but does not control, normally represented by an interest of between 20% and 50% in the voting capital. The Group classifies its investments as joint venture where it is a party to a contractual joint venture agreement. Investments in associated companies and joint ventures are accounted for using the equity method.

- b) Equity investments held for capital gains

After initial recognition, equity investments that are held as available-for-sale investments are remeasured at fair value. For investments in equity instruments, where a reasonable estimate of the fair value cannot be determined, the investment is carried at cost less impairment provision.

The fair value of equity instruments that are quoted in an active market is determined by reference to market bid prices respectively at the close of business on the balance sheet date. For equity investments that are not quoted in an active market, a reasonable estimate of the fair value is determined by reference to the current market value of another instruments that is substantially similar, or is determined using net present valuation techniques.

An assessment is made at each balance sheet date to determine whether there is any objective evidence that an equity instrument security may be impaired. For an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

Any impairment recognised is reflected directly as a write down of the financial asset. Impairment losses on equity investments are not reversed through the consolidated statement of income while any subsequent increase in their fair value are recognised directly in equity.

**TABLE - 18 EQUITY POSITION IN BANKING BOOK**

	Gross risk-weighted exposures	Capital requirement
	US\$ '000	US\$ '000
Listed	137,491	16,499
Unlisted	287,447	34,494
<b>TOTAL</b>	<b>424,938</b>	<b>50,993</b>

## 4. MARKET RISK (continued)

**TABLE - 19 GAINS ON EQUITY INSTRUMENTS**

	<u>US\$ '000</u>
Realised gains recognised in the statement of income	136,679
Unrealised (loss) gains recognised in the balance sheet:	
- Tier one (eligible portion)	(19,846)
- Tier two (eligible portion)	10,383

## 5. LIQUIDITY RISK AND FUNDING MANAGEMENT

Liquidity risk is the risk that the group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows. Funding risk arises when the necessary liquidity to fund illiquid asset positions cannot be obtained at the expected terms and when required.

The management of the group's liquidity and funding management is the responsibility of the Group Asset & Liability Committee under the chairmanship of the Senior Deputy Group Chief Executive Officer – Commercial Banking & Treasury supported by the Group Treasurer, and is responsible for ensuring that all foreseeable funding commitments, including deposit withdrawals, can be met when due, and that wholesale market access is co-ordinated and controlled.

The Group maintains a stable funding base comprising core retail and corporate customer deposits and institutional balances, augmented by wholesale funding and portfolios of highly liquid assets which are diversified by currency and maturity, in order to enable the group to respond quickly to any unforeseen liquidity requirements.

The Group subsidiaries and affiliates maintain a strong individual liquidity position and manage their liquidity profiles so that cash flows are balanced and funding obligations can be met when due.

Treasury limits are set by the Group Asset & Liability Committee (GALCO) and allocated as required across the various group entities. Specifically GALCO and the Group Treasurer are responsible for:

- projecting cash flows by major currency under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of debt maturities;
- managing contingent liquidity commitment exposures within predetermined caps;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans must identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises while minimising adverse long-term implications for the business.

## PILLAR III DISCLOSURES - BASEL II

### 5. LIQUIDITY RISK AND FUNDING MANAGEMENT (continued)

#### Maturity Analysis of Assets and Liabilities

A maturity analysis of cash flows payable by the Group under financial liabilities by remaining contractual maturities at the balance sheet date is shown in note 36 to the consolidated financial statements.

### 6. OPERATIONAL RISK

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events, whether intentional, unintentional or natural. It is an inherent risk faced by all businesses and covers a large number of operational risk events including business interruption and systems failures, internal and external fraud, employment practices and workplace safety, customer and business practices, transaction execution and process management, and damage to physical assets.

The Board acknowledges that it has ultimate responsibility for operational risk. Oversight rests with the Group Risk Committee, whilst day to day monitoring is carried out by the Group Operational Risk Committee. The Board has approved the operational risk framework and reviews it annually.

The operational risk management framework has been in place for a number of years and is ingrained in the Bank's processes. The Bank has developed a comprehensive 'operational risk self assessment (ORSA)' process.

### 7. IT RISK

All computer system developments and operations are centrally controlled and common systems are employed across the group wherever possible.

### 8. STRATEGIC RISK

The Board supported by Group Finance and the Strategic Development Unit manages strategic risk on an ongoing basis. The Board receives regular performance reports with details of strategic / regulatory issues as they arise.

### 9. LEGAL, COMPLIANCE, REGULATORY AND REPUTATIONAL RISKS

Protecting the reputation of the Group is of paramount importance and all management and staff are expected to apply the highest standards of business conduct and professional ethics at all times.

Regulatory and Reputational Risk is jointly managed by the Compliance, Risk Management, and Legal departments.

## PILLAR III DISCLOSURES - BASEL II

### 10. ENVIRONMENTAL RISK

The Bank recognises the importance of environmental and social issues within its risk framework, and has established an Environmental and Social Management System (ESMS) which details the policy, procedures and workflow that will be followed by the Bank and its subsidiaries / affiliates in respect of environmental risk.

The Bank continually endeavours to ensure effective environmental and social management practices in all its activities, products and services with a focus on the applicable national laws on environmental, health, safety and social issues.

As such the Bank will finance projects only when they are expected to be designed, built, operated and maintained in a manner consistent with the applicable national laws.

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