

Ahli United Bank B.S.C.
Pillar III Disclosures - Basel II
31 December 2014

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

The Central Bank of Bahrain (CBB) Basel II Guidelines, based upon the Bank of International Settlements (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 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 CBB. The Bank and its subsidiaries (as detailed under note 2 to the audited 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 adequacy ratio. It defines the calculation of Risk Weighted Assets (RWAs) for credit risk, market risk and operational risk, as well as the derivation of the regulatory capital base. The capital adequacy ratio is then calculated as the ratio of the Bank's regulatory capital to its total RWAs. All Bahrain incorporated banks are currently required to maintain a minimum capital adequacy ratio of 12%. In addition, the CBB 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.

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 Bank is currently required to maintain a 12 per cent minimum capital adequacy ratio at group level.

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 2014.

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 and 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 (IFRS). Non-controlling interest arising on consolidation is reported as part of Tier 1 capital;
- b) Investments in associates as reported under note 10 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 Credit Risk Weighted Assets are included under Tier 2 capital.

Ahli United Bank B.S.C.

Pillar III Disclosures - Basel II

31 December 2014

1. CAPITAL STRUCTURE

TABLE - 1

| A. NET AVAILABLE CAPITAL | US\$ '000 | |
|--|------------------|-------------------|
| | Tier 1 | Tier 2 |
| Paid-up share capital | 1,526,474 | |
| Less: Loans against Employee Stock Purchase Plan | (4,898) | |
| Reserves: | | |
| Share premium | 719,481 | |
| Capital reserve | 8,480 | |
| Statutory reserve | 295,814 | |
| Others | (168,948) | |
| Retained earnings | 520,533 | |
| Minority interest in the equity of subsidiaries | 439,345 | |
| Less: Goodwill | (476,410) | |
| Less: Unrealized gross losses arising from fair valuing equities | (684) | |
| Current year profit | | 482,529 |
| Asset revaluation reserve-property, plant and equipment (45% only) | | 16,663 |
| Unrealized gains arising from fair valuing equities (45% only) | | 7,780 |
| Collective impairment provisions | | 261,290 |
| Eligible subordinated term debt | | 277,026 |
| TOTAL CAPITAL BEFORE REGULATORY DEDUCTIONS | 2,859,187 | 1,045,288 |
| Less: Regulatory deductions: | | |
| Material holdings of equities | 144,157 | 144,157 |
| | 2,715,030 | 901,131 |
| Add: Proportionate aggregation | 208,011 | 25,383 |
| NET AVAILABLE CAPITAL | 2,923,041 | 926,514 |
| TOTAL ELIGIBLE CAPITAL BASE (Tier 1 + Tier 2) | | 3,849,555 |
| RISK WEIGHTED EXPOSURES | | |
| Credit Risk Weighted Exposures | | 22,269,256 |
| Market Risk Weighted Exposures | | 947,225 |
| Operational Risk Weighted Exposures | | 1,615,893 |
| TOTAL RISK WEIGHTED EXPOSURES | | 24,832,374 |
| Tier 1 - Capital Adequacy Ratio | | 11.8% |
| Total - Capital Adequacy Ratio | | 15.5% |

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 audited consolidated financial statements of the Group for the year ended 31 December 2014.

B. CAPITAL ADEQUACY RATIO

As at 31 December 2014, the capital adequacy ratio under Basel II of the Group's significant subsidiaries were:

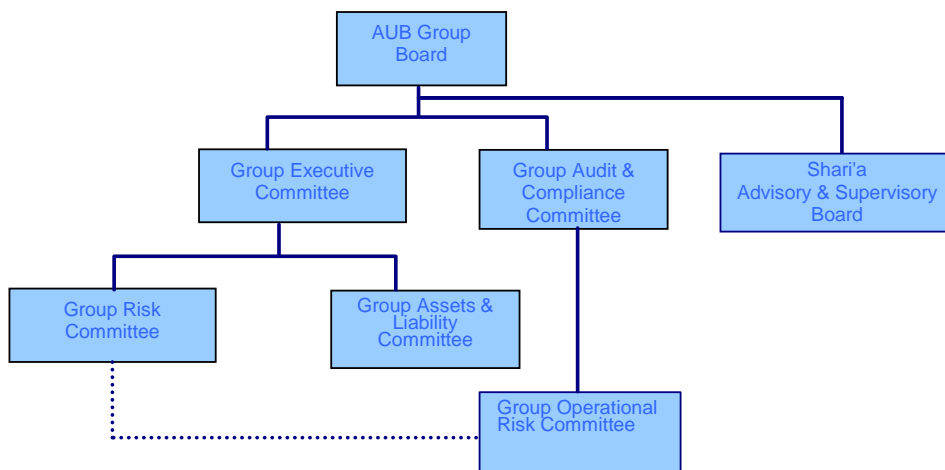
| | Subsidiaries | | |
|---------------------------------|---|--|--|
| | Ahli United Bank (U.K.) K.S.C.P. (AUBK) | Ahli United Bank (U.K.) P.L.C. (AUBUK) | Ahli United Bank (Egypt) S.A.E. (AUBE) |
| Tier 1 - Capital Adequacy Ratio | 17.0% | 15.7% | 11.0% |
| Total - Capital Adequacy Ratio | 18.7% | 19.5% | 12.4% |

2. GROUP RISK GOVERNANCE STRUCTURE

Risk Governance

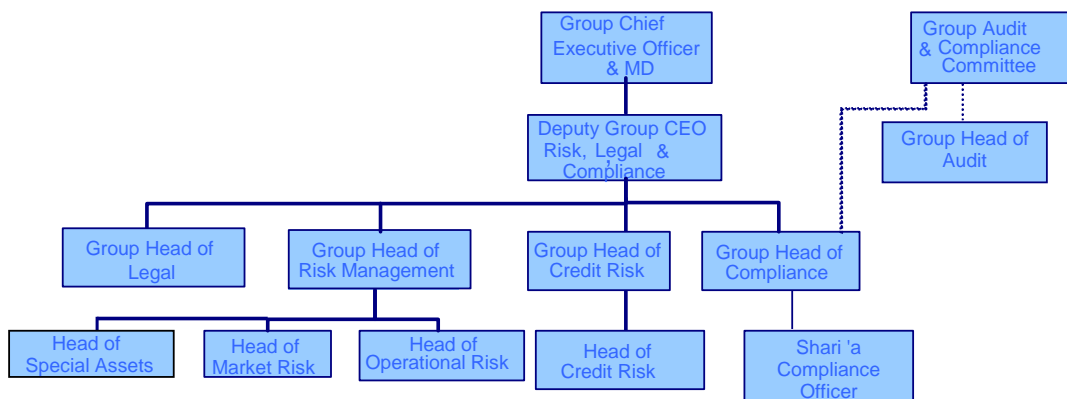
The Group Board seeks to optimise the Bank’s performance by enabling the various group business units to realize the Group’s business strategy and meet agreed business performance targets by operating within the agreed capital and risk parameters and Group risk policy framework.

AUB Group Risk Governance Structure



The above group committees are set up as part of the group risk governance structure. The terms of reference for these committees are approved by the Board. Group Audit & Compliance Committee also has oversight over Group Compliance Committee.

AUB Group Management Risk Governance Structure



The Board approves the risk parameters and the Group Risk Committee monitors the Group’s risk profile against these parameters.

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 has 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 exposures analysis reports.

The Board approves all risk policies as well as the Group risk framework on an annual basis.

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

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

3. CREDIT RISK MANAGEMENT

Credit risk is the risk of financial loss if a customer or counterparty fails to meet a financial 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 centralized oversight and management of credit risk. The specific responsibilities of Group Risk Management are to:

- Set credit policy and 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 optimize the use of credit availability and avoid risk concentration;
- Control cross-border exposures, through the centralized 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 Group's Internal Risk Rating framework;
- Manage watchlisted and criticised asset portfolios 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 CBB, rating agencies, investment analysts, etc.

All credit proposals are subjected to a thorough 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, AUB's 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.

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:

| <u>Exposure Class</u> | <u>Risk Weighting Criteria</u> |
|---|---|
| Sovereign Portfolio | Exposures to governments of GCC (refer table 4 for definition 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 | Eligible regulatory retail exposures are risk weighted at 75%. |
| Residential Property Portfolio | Exposures fully secured by first mortgages on owner occupied residential property are risk weighted between 35%-100% based on applicable regulatory guidance. |
| 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 90 days or more: 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%. |
| Holdings of Real Estate | All holdings (directly or indirectly) of real estate in the form of real estate companies, subsidiaries or associate companies or other arrangements such as trusts, funds or Real Estate Investment Trusts (REITs) are risk-weighted at 200%. Premises occupied by the bank are weighted at 100%. |
| Other Assets | All other assets not classified above are risk weighted at 100% |

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 mitigations.

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 personal sector – cash, mortgages over residential properties and assignments over salary income;
- in the commercial sector – cash, charges over business assets such as premises, inventories, receivables, debt securities and 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.

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 is initiated as per the terms of the underlying credit agreements.

Gross Credit Risk Exposures subject to Credit Risk Mitigations (CRM)

The following table details the Group's gross credit risk exposures before the application of eligible Basel II CRM techniques. The CBB's Basel II guidelines detail 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.

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TABLE - 2 GROSS CREDIT RISK EXPOSURES

| | <i>US\$ '000</i> | |
|--|---------------------------------------|--|
| | <i>As at 31 December 2014</i> | <i>Average monthly balance</i> |
| Balances with central banks | 526,277 | 640,520 |
| Treasury bills and deposits with central banks | 2,611,085 | 2,429,503 |
| Deposits with banks | 3,823,517 | 4,561,971 |
| Loans and advances | 18,464,536 | 17,638,101 |
| Non-trading investments | 5,393,329 | 5,293,731 |
| Interest receivable and other assets | 471,735 | 403,086 |
| TOTAL FUNDED EXPOSURES | 31,290,479 | 30,966,912 |
| Contingent liabilities | 3,087,397 | 3,034,629 |
| Undrawn loan commitments | 720,628 | 542,765 |
| TOTAL UNFUNDED EXPOSURES | 3,808,025 | 3,577,394 |
| TOTAL CREDIT RISK EXPOSURE | 35,098,504 | 34,544,306 |

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

TABLE - 3 RISK WEIGHTED EXPOSURES

| | <i>US\$ '000</i> | | | |
|--|---------------------------|--|--|--------------------------------|
| | <i>Gross exposure</i> | <i>Secured by eligible CRM</i> | <i>Risk weighted exposures after CRM</i> | <i>Capital requirement</i> |
| Claims on sovereigns | 4,756,078 | - | 138,056 | 16,567 |
| Claims on public sector entities | 639,546 | - | 593,092 | 71,171 |
| Claims on banks | 7,011,021 | 167,122 | 2,468,351 | 296,202 |
| Claims on corporates | 17,093,827 | 2,785,938 | 13,801,432 | 1,656,172 |
| Regulatory retail exposures | 1,922,271 | 122,889 | 1,349,536 | 161,944 |
| Residential retail exposures | 1,373,592 | - | 480,757 | 57,691 |
| Equity - Listed | 52,436 | - | 52,436 | 6,292 |
| Equity - Unlisted | 132,295 | - | 198,442 | 23,813 |
| Investments in funds | 168,167 | - | 233,730 | 28,048 |
| Other exposures | 1,383,856 | 63,170 | 1,587,364 | 190,484 |
| TOTAL | 34,533,089 | 3,139,119 | 20,903,196 | 2,508,384 |
| Add : Proportionate aggregation | | | 1,366,060 | 163,927 |
| TOTAL CREDIT RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH) | | | 22,269,256 | 2,672,311 |
| TOTAL MARKET RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH) | | | 947,225 | 113,667 |
| TOTAL OPERATIONAL RISK CAPITAL REQUIREMENT (BASIC INDICATOR APPROACH) | | | 1,615,893 | 193,907 |
| TOTAL | | | 24,832,374 | 2,979,885 |

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

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 Group has selected to use the comprehensive method where collateral is in the form of cash or bonds or equities. The Group uses a range of risk mitigation tools including collateral, guarantees, credit derivatives, netting agreements and financial covenants to reduce credit risk.

Concentration Risk

Refer note 31(a) to the audited 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 2014, the Group had no qualifying single obligor exposures in accordance with Central Bank of Bahrain guidelines which exceed 15 percent of the Group's regulatory capital base.

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 2014.

TABLE - 4 GEOGRAPHIC DISTRIBUTION OF GROSS CREDIT EXPOSURES

| | <i>US\$ '000</i> | | | | | | | | |
|---|-------------------------------|----------------------------|----------------------------------|---------------------------|--|---------------------------------------|---|------------------------------|-------------------|
| | <i>Kingdom of Bahrain</i> | <i>State of Kuwait</i> | <i>Other GCC countries *</i> | <i>United Kingdom</i> | <i>Europe (excluding United Kingdom)</i> | <i>Arab Republic of Egypt</i> | <i>Asia (excluding GCC countries)</i> | <i>Rest of the World</i> | <i>Total</i> |
| Balances with central banks | 155,124 | 28,848 | - | 1,213 | - | 290,417 | 50,675 | - | 526,277 |
| Treasury bills and deposits with central banks | 355,177 | 1,180,168 | - | 211,224 | - | 464,866 | 249,675 | 149,975 | 2,611,085 |
| Deposits with banks and other financial institutions | 81,987 | 972,124 | 831,336 | 358,680 | 730,871 | 52,923 | 300,288 | 495,308 | 3,823,517 |
| Loans and advances | 3,235,548 | 8,787,809 | 2,172,534 | 1,715,334 | 159,885 | 2,007,107 | 268,023 | 118,296 | 18,464,536 |
| Non-trading investments | 573,519 | - | 1,348,703 | 179,513 | 690,534 | 619,412 | 1,387,481 | 594,167 | 5,393,329 |
| Interest receivable and other assets | 225,992 | 40,059 | 1,793 | 74,202 | 73,878 | 46,874 | 1,653 | 7,284 | 471,735 |
| Total funded exposures | 4,627,347 | 11,009,008 | 4,354,366 | 2,540,166 | 1,655,168 | 3,481,599 | 2,257,795 | 1,365,030 | 31,290,479 |
| Contingent liabilities | 772,031 | 1,305,605 | 437,089 | 52,720 | 41,300 | 401,980 | 21,685 | 54,987 | 3,087,397 |
| Undrawn loan commitments | 66,416 | 132,301 | 198,273 | 83,722 | 16,655 | 217,123 | 2,333 | 3,805 | 720,628 |
| Total unfunded exposures | 838,447 | 1,437,906 | 635,362 | 136,442 | 57,955 | 619,103 | 24,018 | 58,792 | 3,808,025 |
| TOTAL | 5,465,794 | 12,446,914 | 4,989,728 | 2,676,608 | 1,713,123 | 4,100,702 | 2,281,813 | 1,423,822 | 35,098,504 |
| | 15.6% | 35.5% | 14.2% | 7.6% | 4.9% | 11.7% | 6.5% | 4.0% | 100.0% |

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

TABLE - 5 SECTORAL CLASSIFICATION OF GROSS CREDIT EXPOSURES

| | <i>US\$ '000</i> | | | <i>%</i> |
|--|-------------------|------------------|-------------------|--------------|
| | <i>Funded</i> | <i>Unfunded</i> | <i>Total</i> | |
| Balances with central banks | 3,137,362 | - | 3,137,362 | 8.9 |
| Banks and other financial institutions | 7,626,493 | 477,141 | 8,103,634 | 23.2 |
| Consumer/personal | 3,430,805 | 14,041 | 3,444,846 | 9.8 |
| Residential mortgage | 1,717,425 | 28,427 | 1,745,852 | 5.0 |
| Trading and manufacturing | 4,585,362 | 1,351,705 | 5,937,067 | 16.9 |
| Real estate | 4,644,398 | 146,325 | 4,790,723 | 13.6 |
| Services | 3,199,816 | 1,399,697 | 4,599,513 | 13.1 |
| Government/public sector | 2,704,465 | 235,939 | 2,940,404 | 8.4 |
| Others | 244,353 | 154,750 | 399,103 | 1.1 |
| TOTAL | 31,290,479 | 3,808,025 | 35,098,504 | 100.0 |
| | 89.2% | 10.8% | 100.0% | |

TABLE - 6 RESIDUAL CONTRACTUAL MATURITY OF GROSS CREDIT EXPOSURES

| | <i>US\$ '000</i> | | | | | | | <i>Total</i> |
|---|------------------------|----------------------------------|--------------------------------------|------------------------------------|-------------------------------|---------------------------------|--------------------------|-------------------|
| | <i>Up to one month</i> | <i>One month to three months</i> | <i>Over three months to one year</i> | <i>Over one year to five years</i> | <i>Over five to ten years</i> | <i>Over ten to twenty years</i> | <i>Over twenty years</i> | |
| Balances with central banks | 526,277 | - | - | - | - | - | - | 526,277 |
| Treasury bills and deposits with central banks | 861,979 | 722,302 | 1,026,804 | - | - | - | - | 2,611,085 |
| Deposits with banks and other financial institution | 3,053,904 | 400,514 | 225,392 | 143,707 | - | - | - | 3,823,517 |
| Loans and advances | 3,587,196 | 3,040,489 | 2,188,635 | 5,108,832 | 3,431,756 | 942,710 | 164,918 | 18,464,536 |
| Non-trading investments | 210,457 | 231,445 | 891,076 | 2,861,742 | 886,913 | 237,006 | 74,690 | 5,393,329 |
| Interest receivable and other assets | 64,156 | 162,985 | 132,069 | 71,396 | 41,129 | - | - | 471,735 |
| Total funded exposures | 8,303,969 | 4,557,735 | 4,463,976 | 8,185,677 | 4,359,798 | 1,179,716 | 239,608 | 31,290,479 |
| Contingent liabilities | 534,571 | 503,851 | 1,182,355 | 853,411 | 13,209 | - | - | 3,087,397 |
| Undrawn loan commitments | 90,920 | 110,190 | 378,329 | 130,137 | 11,052 | - | - | 720,628 |
| Total unfunded exposures | 625,491 | 614,041 | 1,560,684 | 983,548 | 24,261 | - | - | 3,808,025 |
| TOTAL | 8,929,460 | 5,171,776 | 6,024,660 | 9,169,225 | 4,384,059 | 1,179,716 | 239,608 | 35,098,504 |

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 mitigations) and likelihood of successful repossession;
- 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.

Collectively assessed impairment provisions

Impairment is assessed on a collective basis as follows:

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 potential impairment losses estimated at the balance sheet date which may 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
- judgment 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.

TABLE - 7 SECTORAL BREAKDOWN OF IMPAIRED LOANS AND IMPAIRMENT PROVISIONS

| | <i>US\$ '000</i> | | | | |
|--|--|--|---|---|--|
| | | | <i>*Net specific charge for the year ended 31 December 2014</i> | <i>Write off during the year ended 31 December 2014</i> | |
| | <i>Impaired and past due loans</i> | <i>Specific impairment provision</i> | | | <i>Collective impairment provision</i> |
| Consumer/personal | 87,092 | 84,268 | 86,480 | 71,646 | 55,624 |
| Trading and manufacturing | 113,473 | 106,051 | 80,686 | 74,640 | 66,482 |
| Real estate | 12,977 | 11,457 | 397 | 8,298 | 75,300 |
| Residential mortgage | 6,538 | 1,648 | 147 | - | 27,845 |
| Banks and other financial institutions | 33,868 | 32,341 | 9,157 | 15,413 | 16,343 |
| Services | 123,390 | 81,584 | 24,511 | 64,800 | 44,912 |
| Government/public sector | - | - | - | - | 4,293 |
| Others | 12,603 | 9,421 | 2,306 | 137 | 3,962 |
| TOTAL | 389,941 | 326,770 | 203,684 | 234,934 | 294,761 |

*Net specific charge for the year excludes recoveries from fully provided loans written off in prior years.

TABLE - 8 GEOGRAPHICAL DISTRIBUTION OF IMPAIRMENT PROVISIONS FOR LOANS AND ADVANCES

| | <i>US\$ '000</i> | | | | | | | | |
|---------------------------------|---------------------------|------------------------|----------------------------|-----------------------|--|-------------------------------|---------------------------------------|--------------------------|----------------|
| | <i>Kingdom of Bahrain</i> | <i>State of Kuwait</i> | <i>Other GCC countries</i> | <i>United Kingdom</i> | <i>Europe (excluding United Kingdom)</i> | <i>Arab Republic of Egypt</i> | <i>Asia (excluding GCC countries)</i> | <i>Rest of the world</i> | <i>Total</i> |
| Specific impairment provision | 55,965 | 216,652 | - | 570 | - | 45,032 | 8,551 | - | 326,770 |
| Collective impairment provision | 28,523 | 190,756 | 20,110 | 8,183 | 4,542 | 38,913 | 2,572 | 1,162 | 294,761 |
| TOTAL | 84,488 | 407,408 | 20,110 | 8,753 | 4,542 | 83,945 | 11,123 | 1,162 | 621,531 |

TABLE - 9 MOVEMENT IN IMPAIRMENT PROVISION FOR LOANS AND ADVANCES

| | <i>US\$ '000</i> | |
|---|------------------|-------------------|
| | <i>Specific</i> | <i>Collective</i> |
| Balance at 1 January 2014 | 353,091 | 284,634 |
| Amounts written off during the year | (234,934) | - |
| Net charge for the year* | 203,684 | 22,266 |
| Exchange rate adjustments / other movements | 4,929 | (12,139) |
| Balance at 31 December 2014 | 326,770 | 294,761 |

*Net specific charge for the year excludes recoveries from fully provided loans written off in prior years.

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,
- indications that it is probable that the borrower will enter bankruptcy or other financial reorganisation,

Refer to notes 8(a) to 8(d) and note 31(c) to the audited consolidated financial statements for the year ended 31 December 2014 for the distribution of the loans and advances portfolio by quality.

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

Ratings 5 - 7 represents satisfactory risk and includes corporate facilities that require closer monitoring, and retail accounts which are maintained within generally applicable product parameters.

TABLE - 10 PAST DUE AND IMPAIRED LOANS - AGE ANALYSIS

i) By Geographical area

| | <i>US\$ '000</i> | | | <i>Total</i> |
|--------------------------------|---------------------------------|---------------------------|-------------------------|----------------|
| | <i>Three months to one year</i> | <i>One to three years</i> | <i>Over three years</i> | |
| Kingdom of Bahrain | 8,783 | 46,692 | 7,413 | 62,888 |
| State of Kuwait | 189,707 | 33,928 | 45,514 | 269,149 |
| Other GCC Countries | - | - | - | - |
| United Kingdom | 1,900 | - | - | 1,900 |
| Arab Republic of Egypt | 18,252 | 11,753 | 17,569 | 47,574 |
| Asia (excluding GCC countries) | - | - | 8,430 | 8,430 |
| TOTAL | 218,642 | 92,373 | 78,926 | 389,941 |
| | 56.1% | 23.7% | 20.2% | 100.0% |

TABLE - 10 PAST DUE AND IMPAIRED LOANS - AGE ANALYSIS (continued)

ii) By Sector

| | <i>US\$ '000</i> | | | <i>Total</i> |
|--|---------------------------------|---------------------------|-------------------------|----------------|
| | <i>Three months to one year</i> | <i>One to three years</i> | <i>Over three years</i> | |
| Consumer/personal | 21,975 | 46,489 | 18,629 | 87,093 |
| Trading and manufacturing | 85,846 | 13,986 | 13,641 | 113,473 |
| Real estate | 1,900 | 5,439 | 5,638 | 12,977 |
| Residential mortgage | 3,766 | 2,773 | - | 6,539 |
| Banks and other financial institutions | 6,291 | 1,945 | 25,631 | 33,867 |
| Services | 97,775 | 21,585 | 4,030 | 123,390 |
| Others | 1,089 | 156 | 11,357 | 12,602 |
| TOTAL | 218,642 | 92,373 | 78,926 | 389,941 |
| | 56.1% | 23.7% | 20.2% | 100.0% |

TABLE - 11 RESTRUCTURED CREDIT FACILITIES

| | <i>US\$ '000</i> |
|--|------------------|
| Balance of any restructured credit facilities as at year end | 199,194 |
| Loans restructured during the year | 37,157 |

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

TABLE - 12 COUNTERPARTY CREDIT RISK IN DERIVATIVE TRANSACTIONS

i) Breakdown of the credit exposure

| | <i>US\$ '000</i> | | |
|------------------------------------|------------------------|----------------------------------|---------------------------------|
| | <i>Notional amount</i> | <i>Gross positive fair value</i> | <i>Credit conversion factor</i> |
| Foreign exchange related | 8,941,764 | 142,526 | 231,317 |
| Options & Interest rate related | 50,414,026 | 76,457 | 144,074 |
| Derivatives credit exposure | 59,355,790 | 218,983 | 375,391 |

Gross positive fair value represents the replacement cost of the derivatives.

| | |
|----------------------------------|----------------------------|
| ii) Amounts of collateral | <i>US\$ '000</i> 41,035 |
|----------------------------------|----------------------------|

TABLE - 13 RELATED PARTY TRANSACTIONS

Refer note 25 to the audited consolidated financial statements of the Group for the year ended 31 December 2014.

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.

Market Risk Management, Measurement and Control Responsibilities

The Board approves the overall market risk appetite and delegates responsibility for providing oversight on the Bank's market risk exposures and the sub allocation of Board limits to the Group Asset and Liability Committee (GALCO). Group Risk Management is responsible for the market risk control framework and for monitoring compliance with the GALCO limit framework.

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 foreign exchange/interest rate management of the Group's retail and commercial banking assets and liabilities, and financial assets designated as at amortised cost and fair value through other comprehensive income statement.

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.

Market risk reports covering Trading Book risk exposures and profit and loss are published daily to the Bank's senior management. A risk presentation covering both Trading and Banking Book is also compiled monthly and discussed at the GALCO.

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

- Value at Risk (VaR); and
- Stress tests
- Sensitivities and position size related metrics

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 | 1 day | 95% | Daily |
| "Regulatory" VaR | 260 | 10 day | 99% | Daily |

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 confidence interval employed in the VaR calculation (per the above). 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.

4. MARKET RISK (continued)

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 confidence level, by definition, does not take into account losses that might occur beyond the applied 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:

| | <i>US\$ '000</i> | | |
|-------------------|------------------|----------------|----------------|
| | <i>Average</i> | <i>Minimum</i> | <i>Maximum</i> |
| For the year 2014 | 826 | 310 | 1,768 |

TABLE - 14 CAPITAL REQUIREMENTS FOR COMPONENTS OF MARKET RISK

| | <i>US\$ '000</i> | | | |
|---|---|--------------------------------|--------------------------|--------------------------|
| | <i>Risk-weighted weighted exposures</i> | <i>Capital requirement</i> | <i>Maximum value</i> | <i>Minimum value</i> |
| Interest rate risk | 547,275 | 65,673 | 65,673 | 27,118 |
| Equity position risk | 18,265 | 2,192 | 22,525 | 2,192 |
| Foreign exchange risk | 204,245 | 24,509 | 24,509 | 8,750 |
| Options | 111,747 | 13,410 | 13,410 | 2,224 |
| TOTAL MARKET RISK CAPITAL REQUIREMENT BEFORE PROPORTIONATE AGGREGATION OF ASSOCIATES | 881,532 | 105,784 | | |
| Add : Proportionate aggregation | 65,693 | 7,883 | 9,398 | 7,883 |
| TOTAL MARKET RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH) | 947,225 | 113,667 | | |

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 practice 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 recognizes 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 Group Assets 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 behavioral adjustments. Behavioral adjustments are derived by an analysis of customer behavior 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 summarizes the re-pricing profiles of the Group's assets and liabilities as at 31 December 2014.

TABLE - 15 INTEREST RATE RISK

| | <i>US\$'000</i> | | | <i>Total</i> |
|--|---------------------------------------|---|--------------------------|-------------------|
| | <i>Less than three months</i> | <i>Three months to one year</i> | <i>Over one year</i> | |
| ASSETS | | | | |
| Treasury bills and deposits with central banks | 1,487,705 | 1,123,380 | - | 2,611,085 |
| Deposits with banks and other financial institutions | 3,249,760 | 349,804 | - | 3,599,564 |
| Loans and advances | 13,947,814 | 3,086,627 | 1,427,100 | 18,461,541 |
| Non-trading investments | 735,891 | 1,108,915 | 3,548,523 | 5,393,329 |
| | 19,421,170 | 5,668,726 | 4,975,623 | 30,065,519 |
| LIABILITIES | | | | |
| Deposits from banks and other financial institutions | 4,058,348 | 423,455 | - | 4,481,803 |
| Borrowings under repurchase agreements | 860,941 | 40,649 | - | 901,590 |
| Customers' deposits | 14,384,183 | 5,887,117 | 1,364,312 | 21,635,612 |
| Subordinated liabilities | 85,525 | 266,121 | - | 351,646 |
| | 19,388,997 | 6,617,342 | 1,364,312 | 27,370,651 |
| On balance sheet gap | 32,173 | (948,616) | 3,611,311 | |
| Off balance sheet gap | 3,266,425 | (214,748) | (3,051,677) | |
| Total interest sensitivity gap | 3,298,598 | (1,163,364) | 559,634 | |
| Cumulative interest sensitivity gap | 3,298,598 | 2,135,234 | 2,694,868 | |

Interest rate risk sensitivity analysis

The Group's interest rate risk sensitivity is analyzed in note 33(a) to the consolidated financial statements of the Group for the year ended 31 December 2014. Further, as noted in note 3.1 of the consolidated financial statements, since most of the assets and liabilities of the Group are carried at amortized cost, a movement of 200 bps will not materially impact the Group's assets, liabilities and capital.

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 Risk Committee with pre approved loss thresholds. The Bank's equity risk appetite is minimal.

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) Other equity investments

After initial recognition, equity 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 prices 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 using net present valuation techniques.

For accounting policies on equity instruments please refer to note 3.3(c) (v) of the consolidated financial statements.

TABLE - 16 GAINS ON EQUITY INSTRUMENTS

| | <u>US\$ '000</u> |
|--|------------------|
| Unrealized (loss) gains recognized in the balance sheet: | |
| - Tier one (eligible portion) | (684) |
| - Tier two (eligible portion) | 7,780 |

5. LIQUIDITY RISK AND FUNDING MANAGEMENT

Liquidity risk and funding management of the Group have been explained in note 35 of audited consolidated financial statements for the year ended 31 December 2014.

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 35 to the audited consolidated financial statements of the Group for the year ended 31 December 2014.

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. This definition includes legal risk, but excludes strategic and reputational risk. 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 culture and processes. The Bank has developed a comprehensive 'operational risk self assessment' (ORSA) process.

7. INFORMATION TECHNOLOGY RISK

All computer system developments and operations are centrally controlled and common standard business systems are deployed across the Group wherever possible. Information security is defined through a common 'AUB Group Information Security framework' and is executed through various information security processes and controls that support the framework. The Group follows an enterprise wide approach to business continuity to ensure that all identified critical operations, services and systems are recovered in time in the event of a disruption. The Business Continuity Policy is updated annually and the Disaster Recovery and Business Continuity capabilities are each tested at least once a year and critical systems data are continuously replicated at the disaster recovery site.

8. STRATEGIC RISK

The Board supported by Strategic Development Unit and the Group Finance 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 Legal, Compliance, Regulatory and Reputational Risks of the Group is of paramount importance and all management and staff are expected to apply highest standards of business conduct and professional ethics at all times.

The Board approved policies, including AUB Group Reputation Risk policy, Communications Policy, Personal Account Dealing Policy, Compliance Policy, Anti Money Laundering policy, Banking Integrity Policy and Code of Business conduct policy, prescribes the required standards of ethical behavior and personal conduct for all staff (including the Bank's Directors), and the Board exercises an oversight of these risks through various management functions, including Legal, Risk Management, Compliance, Human Resources and Internal Audit Department.

10. ENVIRONMENTAL RISK

The Bank recognizes the importance of environmental and social issues within its risk framework, and has established a Social and Environmental Management System (SEMS) 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 implement effective social and environmental management practices in all its activities, products and services with a focus on the applicable national laws on environmental, health, safety and social issues.

The Bank has adopted the Equator Principles (EP), a globally recognized benchmark for managing social and environmental risks in project finance. EP is an arrangement by financial institutions worldwide to adhere to the environmental, health and safety standards while financing projects.

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.