Ahli United Bank B.S.C.

Pillar III Disclosures - Basel II

31 December 2013

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 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 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 2013.

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.

1. CAPITAL STRUCTURE

TABLE - 1

A. NET AVAILABLE CAPITAL	US$ '000 Tier 1	Tier 2
Paid-up share capital	1,407,360	
Less: Loans against Employee Stock Purchase Plan Notes	(7,415)	
Reserves:		
Share premium	648,169	
Capital reserve	2,102	
Statutory reserve	237,877	
Others	(103,234)	
Retained earnings	326,277	
Minority interest in the equity of subsidiaries	416,279	
Less: Goodwill	(491,513)	
Less: Unrealized gross losses arising from fair valuing equities	(119)	
Current year profit		579,374
Asset revaluation reserve-property, plant and equipment (45% only)		16,424
Unrealized gains arising from fair valuing equities (45% only)		6,868
Collective impairment provisions		245,233
Eligible subordinated term debt		419,464
TOTAL CAPITAL BEFORE REGULATORY DEDUCTIONS	**2,435,783**	**1,267,363**
Less: Regulatory deductions:		
Material holdings of equities	115,947	115,947
	2,319,836	1,151,416
Add: Proportionate aggregation	159,203	30,540
NET AVAILABLE CAPITAL	**2,479,039**	**1,181,956**
TOTAL ELIGIBLE CAPITAL BASE (Tier 1 + Tier 2)		**3,660,995**
RISK WEIGHTED EXPOSURES		
Credit Risk Weighted Exposures		20,784,742
Market Risk Weighted Exposures		359,144
Operational Risk Weighted Exposures		1,504,823
TOTAL RISK WEIGHTED EXPOSURES		**22,648,709**
Tier 1 - Capital Adequacy Ratio		10.9%
Total - Capital Adequacy Ratio		**16.2%**

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 19 and note 20 to the audited consolidated financial statements of the Group for the year ended 31 December 2013.

B. CAPITAL ADEQUACY RATIO

As at 31 December 2013, the capital adequacy ratio of the Group's significant subsidiaries were:

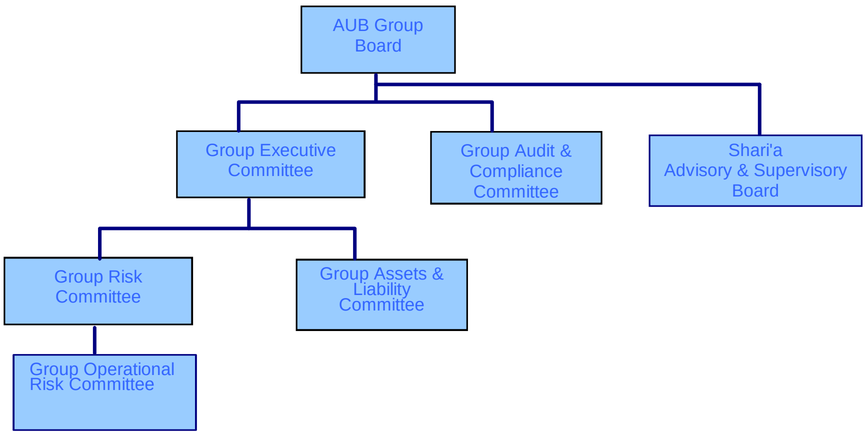
	Subsidiaries		
	Ahli United Bank K.S.C.P. (AUBK)	*Ahli United Bank (U.K.) P.L.C. (AUBUK)*	*Ahli United Bank (Egypt) S.A.E. (AUBE)*
Tier 1 - Capital Adequacy Ratio	17.3%	16.1%	11.9%
Total - Capital Adequacy Ratio	19.2%	17.5%	13.7%

2. GROUP RISK GOVERNANCE STRUCTURE

Risk Governance

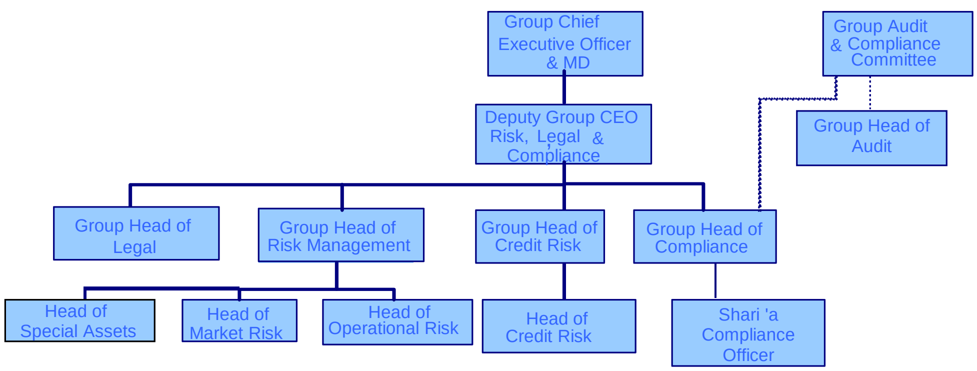
The Group Board seeks to optimise the Bank's performance by enabling the various group business units to realize the Group's business strategy and meet agreed business performance targets by operating within the agreed capital and risk parameters and Group risk policy framework.

AUB Group Board Risk Governance Structure



The above group committees are set up as part of the group board risk governance structure. The terms of reference for these committees are approved by the Board.

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 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 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 centralized 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 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 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.

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 (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 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.

TABLE - 2 GROSS CREDIT RISK EXPOSURES

	US$ '000	
	As at 31 December 2013	*Average monthly balance*
Balances with central banks	699,442	665,676
Treasury bills and deposits with central banks	2,587,534	2,234,460
Deposits with banks and other financial institutions	4,409,068	4,636,160
Loans and advances	17,305,682	16,344,817
Financial assets at fair value through profit or loss	15,262	20,450
Non-trading investments	5,049,055	4,769,673
Interest receivable and other assets	356,339	391,885
TOTAL FUNDED EXPOSURES	**30,422,382**	**29,063,121**
Contingent liabilities	2,896,112	2,847,435
Undrawn loan commitments	532,356	475,980
TOTAL UNFUNDED EXPOSURES	**3,428,468**	**3,323,415**
TOTAL CREDIT RISK EXPOSURE	**33,850,850**	**32,386,536**

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

	US$ '000			
	Gross exposure	*Secured by eligible CRM*	*Risk weighted exposures after CRM*	*Capital requirement*
Claims on sovereigns	5,048,664	-	97,621	11,714
Claims on public sector entities	844,076	1,288	677,700	81,324
Claims on banks	7,185,440	133,687	2,484,697	298,164
Claims on corporates	14,914,946	2,279,862	12,002,886	1,440,346
Regulatory retail exposures	1,822,290	68,338	1,315,464	157,856
Residential retail exposures	1,467,661	-	513,681	61,642
Equity	250,240	-	325,960	39,115
Investments in funds	186,711	-	256,487	30,778
Other exposures	1,737,626	52,678	1,944,174	233,301
TOTAL	**33,457,654**	**2,535,853**	**19,618,670**	**2,354,240**
Add : Proportionate aggregation			1,166,072	139,929
TOTAL CREDIT RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH)			**20,784,742**	**2,494,169**
TOTAL MARKET RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH)			**359,144**	**43,097**
TOTAL OPERATIONAL RISK CAPITAL REQUIREMENT (BASIC INDICATOR APPROACH)			**1,504,823**	**180,579**
TOTAL			**22,648,709**	**2,717,845**

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 2013, 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 2013.

TABLE - 4 GEOGRAPHIC DISTRIBUTION OF GROSS CREDIT EXPOSURES

	US$ ’000								
	Kingdom of Bahrain	***State of Kuwait***	***Other GCC countries ****	***United Kingdom***	***Europe (excluding United Kingdom)***	***Arab Republic of Egypt***	***Asia (excluding GCC countries)***	***Rest of the World***	***Total***
Balances with central banks	152,997	237,094	-	1,922	-	267,962	39,467	-	**699,442**
Treasury bills and deposits with central banks	410,884	1,338,778	-	288,420	-	373,274	176,178	-	**2,587,534**
Deposits with banks and other financial institutions	298,925	356,554	402,123	593,211	1,298,873	28,116	137,874	1,293,392	**4,409,068**
Loans and advances	3,200,273	7,980,672	1,960,885	1,916,899	156,393	1,798,742	197,730	94,088	**17,305,682**
Financial assets at fair value through profit or loss	-	-	-	-	-	-	10,279	4,983	**15,262**
Non-trading investments	507,832	-	1,695,789	267,967	713,555	557,627	628,254	678,031	**5,049,055**
Interest receivable and other assets	125,644	51,141	41,969	62,406	11,180	52,313	3,653	8,033	**356,339**
Total funded exposures	**4,696,555**	**9,964,239**	**4,100,766**	**3,130,825**	**2,180,001**	**3,078,034**	**1,193,435**	**2,078,527**	**30,422,382**
Contingent liabilities	566,255	1,069,520	603,061	6,445	33,044	545,815	32,037	39,935	**2,896,112**
Undrawn loan commitments	38,523	16,096	106,541	82,188	74,385	189,643	18,029	6,951	**532,356**
Total unfunded exposures	**604,778**	**1,085,616**	**709,602**	**88,633**	**107,429**	**735,458**	**50,066**	**46,886**	**3,428,468**
TOTAL	**5,301,333**	**11,049,855**	**4,810,368**	**3,219,458**	**2,287,430**	**3,813,492**	**1,243,501**	**2,125,413**	**33,850,850**
	15.7%	**32.6%**	**14.2%**	**9.5%**	**6.8%**	**11.3%**	**3.7%**	**6.2%**	**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

	US$ '000			
	Funded	***Unfunded***	***Total***	***%***
Balances with central banks	3,286,976	-	**3,286,976**	**9.7**
Banks and other financial institutions	7,573,853	587,326	**8,161,179**	**24.1**
Consumer/personal	3,644,407	20,297	**3,664,704**	**10.8**
Residential mortgage	1,864,406	93,714	**1,958,120**	**5.8**
Trading and manufacturing	4,280,875	1,077,156	**5,358,031**	**15.8**
Real estate	3,645,567	99,468	**3,745,035**	**11.1**
Services	3,270,111	1,098,653	**4,368,764**	**12.9**
Government/public sector	2,760,243	373,951	**3,134,194**	**9.3**
Others	95,944	77,903	**173,847**	**0.5**
TOTAL	**30,422,382**	**3,428,468**	**33,850,850**	**100.0**
	89.9%	**10.1%**	**100.0%**	

TABLE - 6 RESIDUAL CONTRACTUAL MATURITY OF GROSS CREDIT EXPOSURES

	US$ '000							
	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*
Balances with central banks	699,442	-	-	-	-	-	-	**699,442**
Treasury bills and deposits with central banks	1,254,018	734,762	598,754	-	-	-	-	**2,587,534**
Deposits with banks and other financial institutions	3,233,678	415,062	478,249	282,079	-	-	-	**4,409,068**
Loans and advances	2,859,073	3,223,990	1,904,411	4,724,232	3,506,406	918,251	169,319	**17,305,682**
Financial assets at fair through profit or loss	-	-	15,262	-	-	-	-	**15,262**
Non-trading investments	89,209	31,531	744,467	2,798,104	946,959	200,650	238,135	**5,049,055**
Interest receivable and other assets	49,534	102,473	88,984	59,953	55,395	-	-	**356,339**
Total funded exposures	**8,184,954**	**4,507,818**	**3,830,127**	**7,864,368**	**4,508,760**	**1,118,901**	**407,454**	**30,422,382**
Contingent liabilities	556,426	422,914	835,522	1,076,695	4,555	-	-	**2,896,112**
Undrawn loan commitments	13,852	16,667	332,899	153,503	15,435	-	-	**532,356**
Total unfunded exposures	**570,278**	**439,581**	**1,168,421**	**1,230,198**	**19,990**	**-**	**-**	**3,428,468**
TOTAL	**8,755,232**	**4,947,399**	**4,998,548**	**9,094,566**	**4,528,750**	**1,118,901**	**407,454**	**33,850,850**

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

	US$ '000				
	Impaired and past due loans	*Specific impairment provision*	*Net specific charge for the year ended 31 December 2013*	*Write off during the year ended 31 December 2013*	*Collective impairment provision*
Consumer/personal	101,740	86,479	16,548	62,518	59,052
Trading and manufacturing	104,014	92,591	26,465	3,271	62,264
Real estate	70,581	59,653	30,298	7,131	59,931
Residential mortgage	1,725	1,477	750	3,957	30,664
Banks and other financial institutions	65,260	58,245	30,478	-	12,987
Services	75,514	71,645	12,502	2,532	51,387
Government/public sector	-	-	-	-	6,173
Others	42,150	33,873	2,160	3,703	2,176
TOTAL	**460,984**	**403,963**	**119,201**	**83,112**	**284,634**

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

	US$ '000								
	Kingdom of Bahrain	*State of Kuwait*	*Other GCC countries*	*United Kingdom*	*Europe (excluding United Kingdom)*	*Arab Republic of Egypt*	*Asia (excluding GCC countries)*	*Rest of the world*	*Total*
Specific impairment provision	59,718	219,687	64,750	17,217	-	28,535	14,056	-	**403,963**
Collective impairment provision	33,075	181,266	18,814	10,167	5,036	33,365	1,957	954	**284,634**
TOTAL	**92,793**	**400,953**	**83,564**	**27,384**	**5,036**	**61,900**	**16,013**	**954**	**688,597**

TABLE - 9 MOVEMENT IN IMPAIRMENT PROVISION FOR LOANS AND ADVANCES

	US$ '000 TOTAL	
	Specific	*Collective*
Balance at 1 January 2013	**356,012**	**252,042**
Amounts written off during the year	**(83,112)**	**-**
Net charge for the year	**119,201**	**33,643**
Interest suspended during the year (net)	**11,126**	**-**
Exchange rate adjustments / other movements	**736**	**(1,051)**
Balance at 31 December 2013	**403,963**	**284,634**

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 2013 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

	US$ '000			
	Three months to one year	***One to three years***	***Over three years***	***Total***
Kingdom of Bahrain	54,504	13,624	3,623	**71,751**
State of Kuwait	122,987	70,562	56,046	**249,595**
Other GCC Countries	-	-	64,750	**64,750**
United Kingdom	14,986	13,088	-	**28,074**
Arab Republic of Egypt	7,500	6,337	18,986	**32,823**
Asia (excluding GCC countries)	-	-	13,991	**13,991**
TOTAL	**199,977**	**103,611**	**157,396**	**460,984**
	43.4%	**22.5%**	**34.1%**	**100.0%**

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

ii) By Sector

	US$ '000			
	Three months to one year	***One to three years***	***Over three years***	***Total***
Consumer/personal	73,114	-	28,626	**101,740**
Trading and manufacturing	69,780	7,196	27,037	**104,013**
Real estate	14,495	51,919	4,167	**70,581**
Residential mortgage	-	1,725	-	**1,725**
Banks and other financial institutions	38,669	26,592	-	**65,261**
Services	3,919	14,441	57,155	**75,515**
Others	-	1,738	40,411	**42,149**
TOTAL	**199,977**	**103,611**	**157,396**	**460,984**
	43.4%	**22.5%**	**34.1%**	**100.0%**

TABLE - 11 RESTRUCTURED CREDIT FACILITIES

	US$ '000
Balance of any restructured credit facilities as at year end	164,924
Loans restructured during the year	141,811

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

	US$ '000		
	Notional amount	***Gross positive fair value***	***Credit conversion factor***
Foreign exchange related	6,060,502	14,585	81,427
Interest rate related	9,424,287	90,112	121,604
Options	7,014,948	6,217	19,564
Derivatives credit exposure	**22,499,737**	**110,914**	**222,595**

Gross positive fair value represents the replacement cost of the derivatives

	US$ '000
ii) Amounts of collateral	1,770

TABLE - 13 RELATED PARTY TRANSACTIONS

Refer note 25 to the audited consolidated financial statements of the Group for the year ended 31 December 2013.

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 days	1 day	95%	Daily
“Regulatory” VaR	260 days	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

	US$ '000		
	Average	*Minimum*	*Maximum*
As at 31 December 2013	995	424	1,638

TABLE - 14 CAPITAL REQUIREMENT FOR COMPONENTS OF MARKET RISK

	US$ '000		
	Capital requirement	*Maximum*	*Minimum*
Interest rate risk	6,920	9,446	4,018
Equity position risk	19,018	19,018	19
Foreign exchange risk	4,516	47,431	4,516
Options	3,256	3,256	135
TOTAL MARKET RISK CAPITAL REQUIREMENT BEFORE PROPORTIONATE AGGREGATION OF ASSOCIATES	**33,710**		
Add : Proportionate aggregation	9,387	9,387	5,350
TOTAL MARKET RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH)	**43,097**		

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 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 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 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 2013.

TABLE - 15 INTEREST RATE RISK

	US$'000			
ASSETS	***Less than three months***	***Three months to one year***	***Over one year***	***Total***
Treasury bills and deposits with central banks	1,988,780	598,754	-	2,587,534
Deposits with banks and other financial institutions	3,574,275	478,247	-	4,052,522
Loans and advances	10,892,177	2,380,861	2,769,174	16,042,212
Financial assets at fair value through profit or loss	-	15,262	-	15,262
Non-trading investments	449,032	842,922	3,757,101	5,049,055
	16,904,264	**4,316,046**	**6,526,275**	**27,746,585**
LIABILITIES				
Deposits from banks and other financial institutions	3,875,563	359,559	-	4,235,122
Borrowings under repurchase agreements	1,215,258	15,204	40,649	1,271,111
Customers' deposits	13,485,949	5,304,543	2,136,080	20,926,572
Subordinated liabilities	277,205	365,000	-	642,205
	18,853,975	**6,044,306**	**2,176,729**	**27,075,010**
On balance sheet gap	(1,949,711)	(1,728,260)	4,349,546	
Off balance sheet gap	4,696,819	(99,770)	(4,597,049)	
Total interest sensitivity gap	2,747,108	(1,828,030)	(247,503)	
Cumulative interest sensitivity gap	**2,747,108**	**919,078**	**671,575**	

Interest rate risk sensitivity analysis

The Group's interest rate risk sensitivity is analysed in note 33(b) to the consolidated financial statements of the Group for the year ended 31 December 2013.

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 EQUITY POSITION IN BANKING BOOK

	US$ '000		
	Gross exposures	***Risk-weighted exposures***	***Capital requirement***
Listed	98,801	98,801	11,856
Unlisted	151,439	227,159	27,259
TOTAL	**250,240**	**325,960**	**39,115**

TABLE - 17 GAINS ON EQUITY INSTRUMENTS

	US$ '000
Unrealised (loss) gains recognised in the balance sheet:	
- Tier one (eligible portion)	(119)
- Tier two (eligible portion)	6,868

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 2013.

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 2013.

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 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 systems are employed across the Group wherever possible. Information security is defined through the 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 while the Disaster Recovery and Business Continuity capabilities are each tested twice per year and critical systems 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 recognises 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.