2012

ANNUAL REPORT

بنك الفجيرة الوطني
National Bank of Fujairah

His Highness Sheikh Khalifa Bin Zayed Al Nahyan
President of the UAE and Ruler of Abu Dhabi

His Highness Sheikh Mohammed Bin Rashid Al Maktoum
Vice President and Prime Minister of the UAE and Ruler of Dubai

His Highness Sheikh Hamad Bin Mohammed Al Sharqi
Member of the Supreme Council and Ruler of Fujairah

2012
ANNUAL REPORT

Fujairah Fort

The Fujairah emirate boasts scenic mountains, untouched beaches and spectacular waterfalls. All of this natural splendor, combined with Fujairah's rich heritage, makes it one of the major tourist destinations in the UAE.

The Bank for Business in the UAE, the Pride of Fujairah

Incorporated in 1982, the National Bank of Fujairah has a long established reputation for excellence in the areas of corporate and commercial banking, trade finance and treasury. More recently, we have expanded our range of services to include comprehensive personal banking options.

NBF's commitment to the economic development of the UAE and home emirate of Fujairah is evident through our support of industries ranging from oil and shipping to services, manufacturing, construction, education and healthcare. The Bank's firm financial footing is also well-recognised in the capital markets, where we are the partner-of-choice for leading global counterparties in regional syndications.

With our solid track record, strong cultural heritage, deep market insight and unwavering focus on service and innovation, we seek to develop lasting relationships with our customers as we help them leverage growth opportunities in the ever-changing marketplace.

Our Vision

As a bank born and bred in the UAE, we at NBF celebrate our cultural heritage by playing a proactive role in the development of the local community.

We believe in cultivating rewarding relationships with our customers by providing them with the very best in financial services, innovation and service delivery.

Similarly, we continuously strive towards the creation of a stimulating environment that allows our people to pursue their own personal and professional development.

Our Network

Head Office
Hamad Bin Abdullah Street
PO Box 887, Fujairah
Tel +971 9 222 4518
Fax +971 9 222 4516

Branch Locations

Fujairah

Fujairah
Hamad Bin Abdullah Street
PO Box 887
Tel +971 9 222 4513
Fax +971 9 222 9470

Dibba
Sheikh Mohammed Bin Hamad Street
PO Box 11700
Tel +971 9 244 3788
Fax +971 9 244 3785

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PO Box 11208
Tel +971 9 256 3999
Fax +971 9 256 3339

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Fax +971 9 236 0494

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Omar Bin Khattab Street,
Fish round about
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Fax +971 4 221 6831

Jebel Ali
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Next to Etisalat
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Al Salam Street
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Tel +971 2 612 5300
Fax +971 2 672 8362

Mussafah
Rashid Al Mazroui Building,
Bank Street, Mussafah Industrial Area
PO Box 786
Tel + 971 2 555 4414
Fax +971 2 555 1215

Al Ain
Sheikh Falah Bin Zayed Al Nahyan
Building, near clock intersection,
Main Road
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Tel + 971 3 764 8142
Fax +971 3 764 8156

Ajman

Ajman
Al Shorafa Tower,
Opposite to R Holding offices,
Sheikh Khalifa Bin Zayed Street
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Fax +971 6 525 5887

Chairman's Report

On behalf of the Board of Directors, I am pleased to present the Annual Report of the National Bank of Fujairah PSC and its subsidiary for the year ended 31 December 2012.

Continuing growth momentum contributed to record operating profit

The Bank continued its strong growth momentum and achieved a new record operating profit in 2012. Our operating profit grew by 21.6 per cent to AED 479.5 million, up from AED 394.3 million in 2011, driven by an ongoing focus on core business and efficiency. As a result, the Bank was able to outperform the industry for a third year running. The loan book grew by 16.1 per cent and deposits by 20.3 per cent despite the relatively low levels of growth in the general economy. Our cost to income ratio improved from 39.4 per cent to 36.9 per cent. Operating income grew by 16.7 per cent to AED 759.5 million and operating expenses increased by 9.2 per cent to AED 280.0 million.

Such a solid performance enabled us to remain resilient in spite of the ongoing credit stress in the market. To ensure that our growth remains steady, we continue to prudently provision for possible loan losses from the ongoing restructurings seen in 2012; loan provision charges for the year increased to AED 173.7 million compared to AED 113.3 million in 2011. The Bank's profit grew by a steady 8.9 per cent to AED 305.8 million, up from AED 280.9 million.

NBF continues to be well-capitalised for growth, with a capital adequacy ratio of 19.2 per cent and Tier 1 ratio of 12.3 per cent. Liquidity levels also remain strong, with an advances to deposits ratio of 82.8 per cent and liquid assets ratio of 22.7 per cent.

The Bank has enhanced its operating platform to better serve its customers. It introduced the NBF Direct online banking facility to retail customers, with an upgraded version for corporate clients scheduled for Q1 2013. We are deepening our physical infrastructure with new and refurbished branches and introducing additional functionalities to a growing network of ATMs. A number of new products have also been introduced, the latest of which is a series of insurance offerings. Our core banking system has also been successfully upgraded and a number of IT-based initiatives undertaken to further improve our service delivery across multiple channels.

The Bank's progressive performance is a reflection of its well-balanced strategy amid fast-changing times. It is also a reflection of the deep business relationships that the Bank is privileged to have enjoyed over the years and the high levels of trust that clients have placed on us; the accolades at the 2012 Banker Middle East Awards for NBF's trade finance, treasury management and commercial banking capabilities are a good indication of such customer support.

In view of the solid performance I, on behalf of the Board of Directors, am pleased to recommend a distribution of profits, in the form of cash dividends, of 10 per cent of the paid-up capital.

UAE - A unique case study of national cohesion offering unprecedented opportunities for sustained growth

The UAE economy has shown sustained resilience in the face of global and domestic challenges. Its well diversified economy, together with an established infrastructure, has enabled the nation to maintain its position as one of the leading emerging economies in the region.

We believe that NBF is in a good position to capitalise on the opportunities that exist in the UAE. Backed by our strong liquidity levels, prudent policies and a proactive management team, NBF will continue to improve its market position through an enhanced focus on service differentiation, product innovation and channel development. We will also continue to invest in new technology and enhance our operational capabilities so as to exceed customer expectations and improve shareholder returns.

The Bank remains committed to the growth of the UAE economy under the visionary and dynamic leadership of our President, His Highness Sheikh Khalifa Bin Zayed Al Nahyan, and our Vice President and Prime Minister of the UAE and Ruler of Dubai, His Highness Sheikh Mohammed Bin Rashid Al Maktoum. In particular, I would like to express my gratitude to His Highness Sheikh Hamad Bin Mohammed Al Sharqi, member of the Supreme Council and Ruler of Fujairah for his unwavering support and for being an inspiration for the Bank. I would also like to thank my fellow directors, management and staff of the Bank for their commitment and hard work.

Finally, I would like to thank the Bank's customers for their steadfast support throughout the years and assure them of the Bank's commitment to their success.

Saleh Bin Mohammed Al Sharqi

Directors' Report

1. Operating Environment

The global economic outlook continues to be marked by banking sectors in developed countries reeling from the effects of government austerity, structural imbalances in government finances, household deleveraging and the impact of industry-wide regulatory policy changes. Growth has now slowed in developed and emerging economies alike, with some of the countries still struggling with recessionary conditions.

In its recent ratings report, Moody's maintained a negative outlook for the UAE banking system, reflecting asset quality challenges, low provisioning coverage levels and structural weaknesses triggered by specific sizeable party-related exposures that will continue to undermine the performance of the entire banking system over the next year or more. These trends, coupled with impending regulatory changes, will continue to put pressure on net profits, with banks' aversion to lending resulting in further subdued growth.

Nonetheless, the UAE has shown signs of resilience. Its liberal policies, which enabled the country to earn "safe haven" status in the GCC, have also allowed it to benefit from the political transition in the region. A recovery has been seen in the real estate industry, while the tourism, services and trade sectors have also been performing strongly. Macro-economic indicators reflect the gradually improving trend.

Particulars	2010	2011	2012f	2013f	2014f	2015f
Real GDP growth, %	1.4	4.2	3.3	3.6	4.4	4.5
Inflation, %	0.9	0.9	2.3	3.5	2.7	5.5
Oil Price, $/b	83	107.52	107.05	99.10	96.15	95.20
Oil Volumes, 000bpd	2,665	2,919.7	2,948.9	2,978.4	3,008.2	3,015.0

Source: Business Monitor International, Q1 2013

2. Fujairah: On the path towards accelerated economic expansion

Against this backdrop, Fujairah is witnessing acceleration in economic expansion as its strategic location and investor friendly economic policies enhance its status as an attractive business destination. Encouraged by successes in recent years, the Government of Fujairah is developing a master plan that will provide the vision and framework for economic, social and government based projects over the next 30 years in the Emirate.

Fujairah is building on its status as the world's second largest fuel bunkering hub to become a leading centre for oil and petrochemicals trading, refining, storage and other marine industry activities. Its strategic importance has only intensified in light of Abu Dhabi's recent completion of a pipeline transporting crude oil to Fujairah for onward shipment to overseas buyers. A number of other infrastructure projects are also underway in Fujairah; these include a significant power and water treatment plant and a strategic storage facility to house imported grain.

The growth in the tourism and real estate sectors continues. Recently, a new Al Hilal City project, which will include residential, business and shopping facilities, has been announced. Fujairah Municipality has also completed the blueprint for a full-fledged labor village for more than 35,000 workers. Similarly, the Emirate's Ministry of Health has announced four new government hospitals to provide world class health care to the growing population.

In 2012, the Fujairah retail scene added another jewel to its crown with the launch of the Fujairah City Centre Mall. In addition, its manufacturing sector saw the opening of the United Textiles factory, the largest of its kind in the GCC and the Middle East, while the Fujairah International Airport started receiving flights from Abu Dhabi International Airport last year, with further expansion plans in the works.

As a national bank passionately committed to the future of the UAE, NBF is proud of the critical role that it plays in Fujairah's economic transformation.

Directors' Report (continued)

3. Financial Results

3.1 The Bank

NBF's performance is a reflection of proactive management and prudent policies focusing on long term sustainable results in the face of ongoing uncertainty in the operating environment. The Bank increased its market share for the third consecutive year by leveraging its solid liquidity and capital positions to outperform industry growth.

NBF set a new record in its operating profit reaching AED 479.5 million in 2012. This was up 21.6 per cent from AED 394.3 million in the previous year, an accomplishment made on the back of strong core business growth and efficient operations.

Operating income grew by 16.7 per cent to AED 759.5 million, compared to AED 650.8 million in 2011, reflecting growing business volumes and robust asset and liability management. Net interest income grew by 18.4 per cent to AED 504.9 million, compared to AED 426.5 million in 2011. Non-interest income rose to AED 254.6 million, 13.5 per cent higher than the AED 224.2 million in 2011, showing an increase primarily in trade business and credit growth. Exchange income, including derivative income, grew by 11.6 per cent to a record high of AED 55.8 million. A gain on investment income of AED 3.2 million was recorded in 2012, compared to AED 2.5 million for the corresponding period of 2011.

Operating expenses increased by 9.2 per cent to AED 280.0 million, a reflection of the Bank's ongoing commitment towards investing in new growth initiatives and its operating platform. However, the cost to income ratio improved to 36.9 per cent from 39.4 per cent in 2011, showing a focus on productivity, a disciplined approach to cost control and the benefits of investments in technology made in the last few years.

The Bank's strong operating performance helped it improve provision coverage for ongoing exposures currently undergoing restructuring in the market. The loan loss charge for the year was AED 173.7 million compared to AED 113.3 million in 2011. The Bank's non-performing loans and advances (NPL) ratio was reduced to 7.6 per cent from 10.9 per cent in 2011. Total provision coverage improved to 79.7 per cent in 2012 from 53.9 per cent in 2011, while specific provision coverage progressed to 51.3 per cent from 41.0 per cent over the same period.

NBF achieved a net profit of AED 305.8 million in 2012, up 8.9 per cent compared to AED 280.9 million the previous year.

The lending and deposit growth of 16.1 per cent and 20.3 per cent respectively reflect the strength of the Bank's customer relationships and its commitment to the development of the UAE economy. Total assets grew 17.6 per cent to AED 17.5 billion from AED 14.9 billion at end 2011. The return on average equity was 14.1 per cent (2011: 14.4 per cent) and return on average assets was 1.9 per cent (2011: 2.0 per cent).

Directors' Report (continued)

3.2 Segment Performance

Wholesale Banking

NBF's Wholesale Banking segment comprises corporate, commercial and financial institution businesses and represents 84.9 per cent of the Bank's operating income. The segment recorded a strong growth of 16.1 per cent in operating income to AED 644.5 million, up from AED 555.2 million in 2011. Growth in segment assets outpaced the industry average at AED 12,433.6 million, 13.5 per cent higher than 2011's AED 10,957.7 million.

The Bank's corporate banking business grew operating income by 11.7 per cent while commercial banking, comprising of small and medium-sized businesses, grew operating income by 26.7 per cent.

Trade finance comprises 27.4 per cent of the Bank's lending assets and 46.4 per cent operating income, is a principal driver of our corporate and commercial business.

NBF's expertise in trade finance and commercial banking was recognised as best in class at the 2012 Banker Middle East Awards, an annual event which acknowledges the best performing banks in the Middle East and North Africa.

Such results and industry accolades reflect the Bank's focus on enhancing marketing efforts and customer service. Our dedication to relationship management and personalised customer experience was further evidenced by the positive results from the Bank's customer satisfaction survey, an annual service benchmarking exercise conducted by an independent research agency featuring in-depth interviews with 500 clients across the business spectrum.

Retail Banking

NBF's long-established retail presence in the Fujairah region is currently undergoing expansion across the UAE in line with its diversification strategy. The Bank's retail base outside Fujairah grew by 69 per cent and comprises mainly affluent customers and employees of the Bank's corporate customers. A full suite of retail banking products and services has been introduced and Internet banking facility made available to personal banking customers. NBF's banking infrastructure and services are undergoing enhancement to increase its market share in the consumer banking business. Operating income from this segment increased by 14.5 per cent despite a number of regulatory changes, while deposit and loan growth grew progressively by 57.3 per cent and 46.3 per cent respectively.

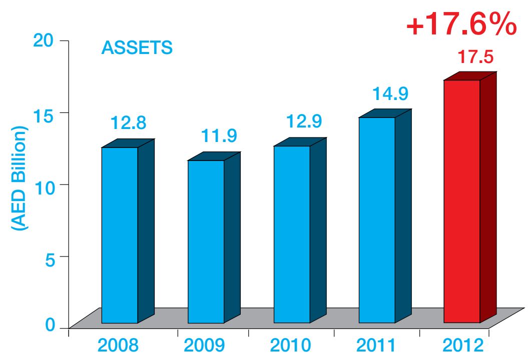
Treasury and Asset and Liability Management (ALM)

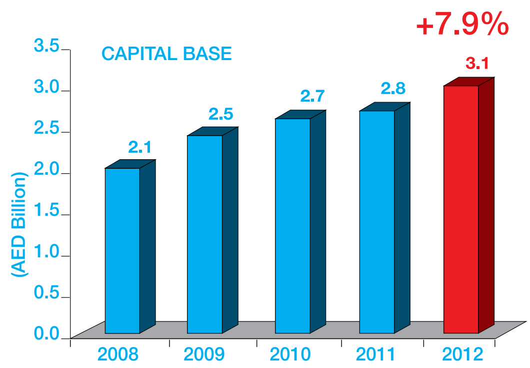
Our treasury business marked another year of success when it won "Best Treasury Management" at the Banker Middle East Awards last year. The business saw a growth in foreign exchange income of 11.6 per cent to a record AED 55.8 million (2011: 50.0 million). Sophisticated derivative transactions undertaken by the Bank last year also underscored the increasing importance of the Bank's treasury offerings to its continued growth.

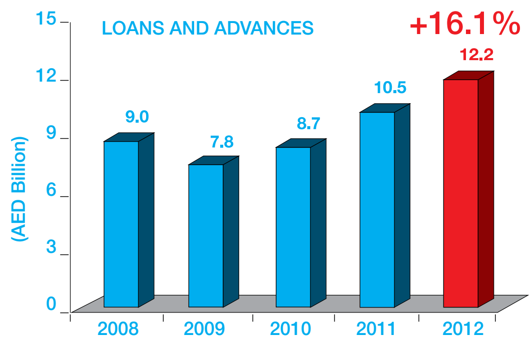
During the year, NBF was appointed onto the EIBOR panel by the Central Bank of the UAE, a further reflection of the high regard accorded by the industry to the Bank's treasury. NBF's enhanced focus on asset and liability management during the year also resulted in a strong net interest growth of 18.4 per cent (2011: 18.4 per cent).

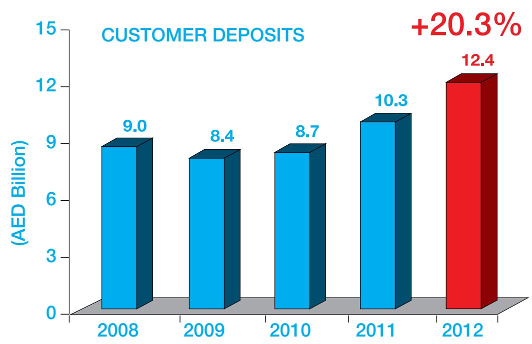
Directors' Report (continued)

3.3 NBF's Five Year Performance Scorecard









NBF's progression over the past five years is a reflection of its proactive and prudent response to the 2008 global financial crisis, followed by consolidation in 2009 and strong growth in the three years thereafter.

Assets:

17.5 b

2011: 14.9 b

Capital base:

3.1 b

2011: 2.8 b

Loans and advances:

12.2 b

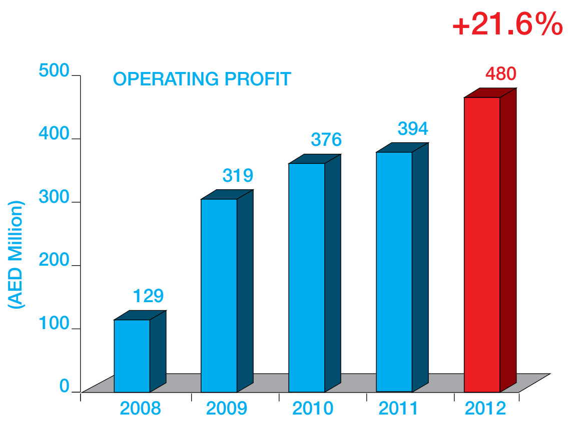
2011: 10.5 b

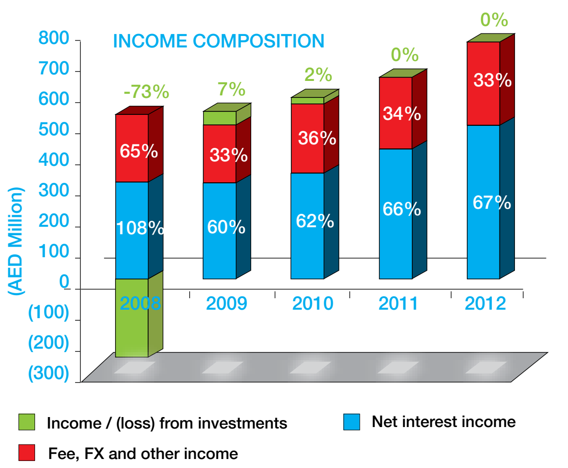
Customer deposits:

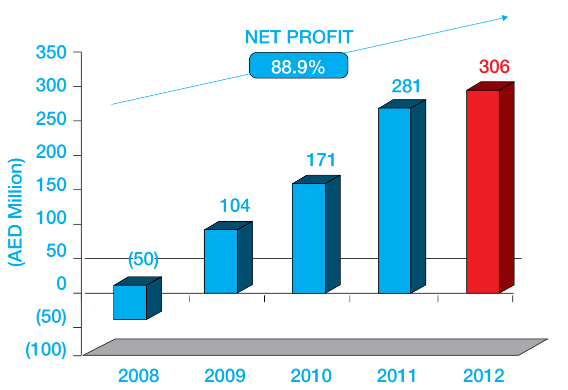
12.4 b

2011: 10.3 b

Directors' Report (continued)







NBF's track record for operating profit has been improving year on year on the back of impressive business performance and improvement in execution capabilities.

The quality of earnings has also been significantly enhanced by a growing share of stable, core business income. The Bank's improving net interest income is also a result of a sharper focus on asset and liability management.

Our net profit now results in a world class ROE of 13.5%.

Directors' Report (continued)

4. Operational Highlights

NBF's strong financial performance has been complemented by solid execution capabilities, which contributed to a number of operational achievements:

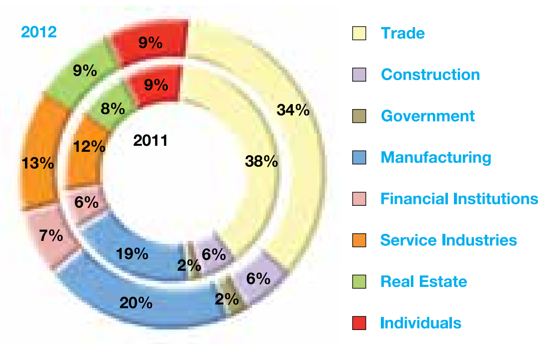
- A new Internet banking facility, NBF Direct, was successfully rolled out to our personal banking customers, and an upgraded service will be introduced to our corporate customers in Q1 2013
- NBF signed a Memorandum of Understanding with Wells Fargo Bank that will see us establishing a presence in Hong Kong to strengthen trade flows between the Middle East and Asia.
- NBF has filed an application with Dubai Financial Services Authority to establish its presence at Dubai International Financial Centre for an advisory service that would operate in tandem with its traditional banking business
- The results of the Bank's second customer satisfaction survey have shown an overall improvement across all service indicators. Our three Banker Middle East Awards in our key strengths in trade finance, commercial banking and treasury speak volumes of our customers' trust and support. Nonetheless, such progress compels us to work harder in order to improve our competitive advantage in our core areas of business
- NBF was recognised by Commerzbank for operational excellence in straight through processing of commercial payments for a second time in a row.
- Our Internal Audit department received an ISO certification in July for establishing a high standard of consistency and quality in the auditing of the Bank's activities.
- The Bank automated its credit process, creating an integrated platform that would allow it to refine and scale up all credit-related requirements - from origination to approval and subsequently the documentation and limit handling process, as and when required.
- The Bank's staff satisfaction and 360 degree surveys achieved 100% completion rates respectively. This is significantly higher than the industry norm and demonstrates the exceptional levels of employee engagement within the Bank. Such survey results will be put to good use in the management of the Bank's human resources.
- NBF unveiled an employee wellbeing programme in conjunction with AXA ICAS to improve staff work life balance. This service includes a free and confidential counselling service available to staff and their families and is the first of its kind for any local bank in the UAE. At the same time, a new human capital software system was also implemented to further automate HR processes for the benefit of staff.
- The Bank remains committed to the development of UAE's human capital. Its Emiratisation ratio was 40.7 per cent in 2012, an improvement from 40.4 per cent the year before and well above the industry average. NBF's career advancement and management trainee programmes (MTP) also underscore its continuing efforts towards cultivating talent in the local banking sector, with eight UAE Nationals recently graduating from the second intake of the Bank's MTP.
- As part of the Bank's on-going commitment to sustainable and environmentally friendly business practices, it established a corporate social responsibility (CSR) committee last year to spearhead community building efforts that are focused predominantly in the emirate of Fujairah. These included a financial donation to the Fujairah Higher Colleges of Technology for the purchase of laptops and i-Pads for needy Emirati students and sponsorship of the seafarers support group Angel Appeal. NBF staff also participated in a Ramadan gift donation drive for seamen stationed off the Eastern coasts of the UAE. Other initiatives included a donation of 940 kg of biodegradable plastic bags to the Fujairah Ministry of Health and the Bank's first-ever blood donation drive held in support of the Dubai Blood Donation Centre.

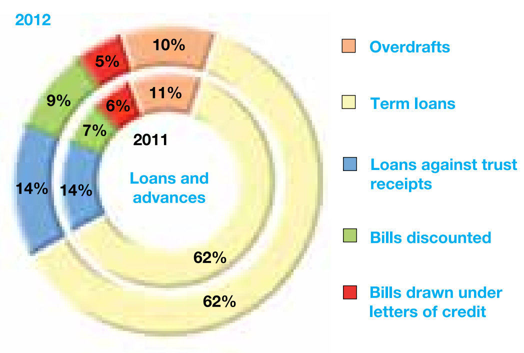
5. Risk Management

Risk management and corporate governance underpinned by transparency and fair business practices lies at the heart of everything we do, and are a key pre-requisite for good quality earnings, consistent results and shareholder confidence.

During the year, NBF adopted a more robust and granular approach towards the quantification of risk and measurement of associated capital. This was achieved through an augmentation of predictive accuracy rating models, institutionalisation of a risk-adjusted returns concept and adoption of an elaborate and effective ICAAP regime alongside a rigorous stress-testing framework.

- The Bank's financial stability is underpinned by its strong liquidity and capital adequacy ratios. International credit rating agency Capital Intelligence has maintained NBF's financial ratings, citing its good profitability and solid capital adequacy ratio. The Bank's Long Term Foreign Currency Rating (FCR) has been maintained at 'A-' since 2008, reflecting its prudent and proactive risk management practices and sound business model.
- The Bank continues to be solidly capitalised, as seen in its healthy capital adequacy ratio of 19.2 per cent and Tier 1 capital ratio of 12.3 per cent, both of which positions NBF strongly to meet evolving regulatory requirements. The Board approved NBF's three-year strategic plan, which included measures to keep the Bank's capital structure in line with its growth strategy and risk appetite.
- That the Bank manages its concentration risk from multiple perspectives is evident from its comprehensive array of products, customer segments and sectors:





- The Bank's credit concentration for its top 20 customers has also improved. From 32.2 per cent in 2009, it has gradually decreased to 29.5 per cent in 2011 and further reduced to 24.5 per cent in 2012.

Directors' Report (continued)

- The Bank has also significantly improved its liquidity risk profile over the last three years. The Bank's balance sheet is well-diversified and its liquidity is of a high quality; its advances-to-deposits ratio was 82.8 per cent (2011: 84.8 per cent) last year and liquid asset ratio 22.7 per cent over the same period (2011: 20.7 per cent). Similarly, the Bank has also improved the duration of its liabilities. It has implemented mark-to-market transfer pricing during the year which has resulted in more accurate reflections of market cost in the measurement of performance and risk-adjusted returns.
- The Bank has maintained prudent market risk limits and its trades are executed predominantly to support customer activities. NBF's investment portfolio is held with the principal objective of liquidity management in mind and comprises mostly of debt securities, with 88.1 per cent of the debt securities portfolio rated "BBB+" and above.
- The Bank is fully committed to protecting the UAE financial system from money laundering and terrorist financing. It has strengthened its anti-money laundering policy, procedures and system in line with the latest recommendations from FATF, the international anti-money laundering regulatory body. Annual learning programs have also been implemented to enable staff to stay at the vanguard of the Bank's compliance efforts.

The NBF Board and management are confident that the Bank is well-positioned to continue on its growth journey in the coming years. This can be achieved through an unwavering focus on enhancing the Bank's customer service and product proposition, adopting sound asset and liability management, embracing market best practices and practicing prudent risk management and good governance.

Easa Saleh Al Gurg, KCVO, CBE

Corporate Governance Report

The NBF Board and the management are committed to complying with the highest corporate governance standards and international best practices.

The Board of Directors' primary responsibility is to provide effective governance over the Bank's affairs for the benefit of its shareholders, and to balance the interests of its diverse constituencies, including its regulators, customers, employees, suppliers and the local communities in which it operates.

The Board plays a key role in the approval and oversight of the organisation's strategy, directional policies, risk appetites, senior appointments and supervision and remuneration of senior executives. The Bank has clearly defined the responsibilities of the Board of Directors, its corporate governance structure and delegated authorities so as to enable the effective and efficient implementation of all activities.

The Bank's corporate governance structure not only ensures that high levels of transparency and accountability are maintained, but also provides an appropriate functional independency and control environment from which to carry out its business activities. Also in place is a code of conduct and whistle blowing policy that encourages communication, transparency, issue escalation and fair business practices.

Finally, the Board has approved the Bank's formal disclosure policy and note two in our annual consolidated financial statements details NBF's compliance with all applicable laws and regulations. The annual consolidated financial statements are available on the Bank's website. For accounting policies, please refer to note three of the consolidated financial statements. Note four in our annual consolidated financial statements explains our financial risk management practices and can be referred to for further information on NBF's governance and risk management framework.

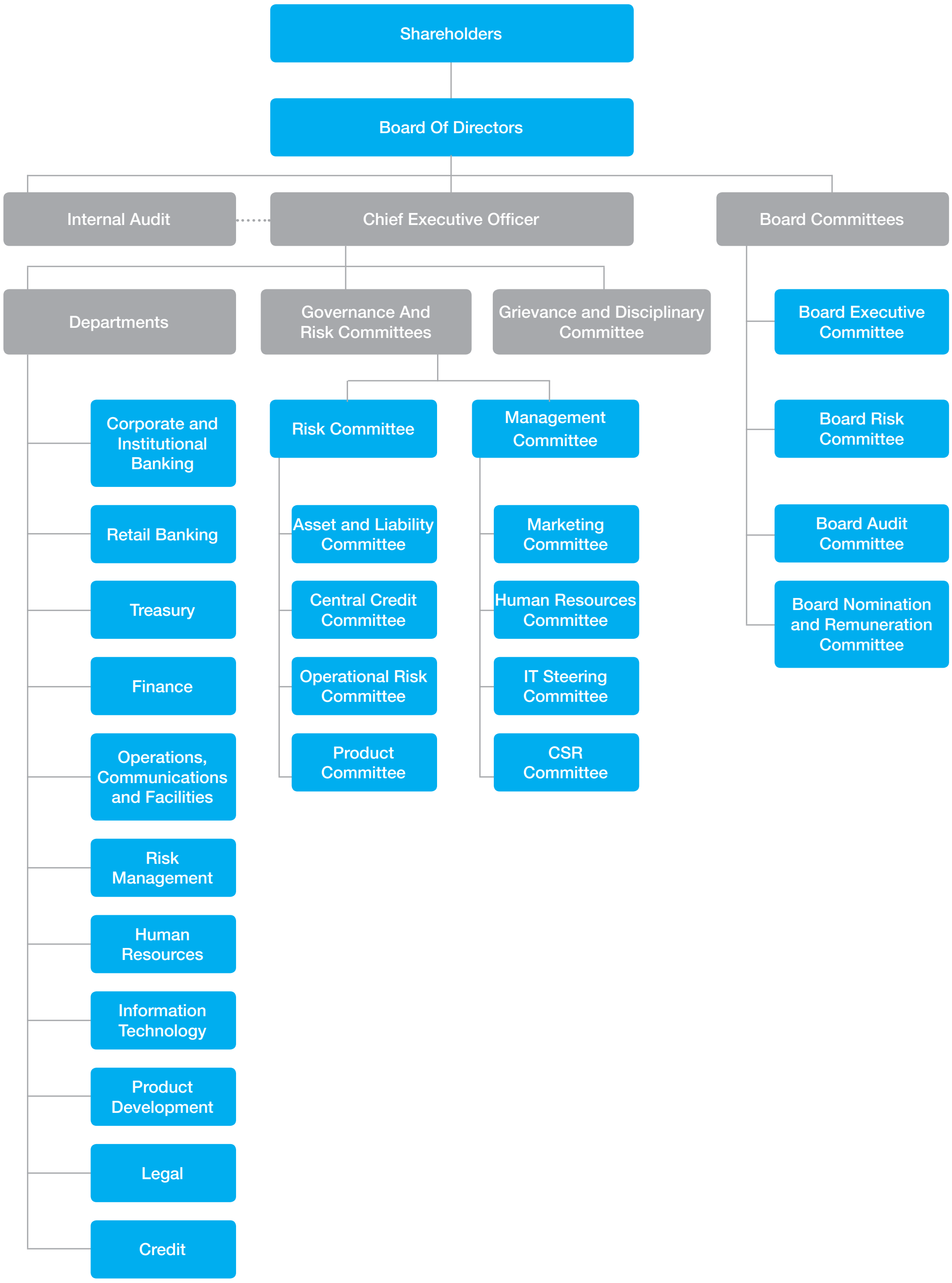
Corporate Governance Report (continued)

Organisation

The diagram below illustrates the high level organisation chart of the Bank. Management Committee and Risk Committee oversee and provide strategic direction to other committees. They also make recommendations to the Board and Board Committees.

Functional Reporting

Administrative Reporting



Corporate Governance Report (continued)

Shareholders

NBF's shareholders consist of:

Department of Industry and Economy - Government of Fujairah	39.42%
Easa Saleh Al Gurg Company LLC	19.45%
Investment Corporation of Dubai - Government of Dubai	9.78%
Al Fujairah Investment Company	5.22%
Citizens of the United Arab Emirates	26.13%

2012: During the year, *6,142,185 shares* representing 0.56% of the Bank's shares were traded.

The investor relations and external communications are managed through the Bank's Finance and Corporate Communications departments respectively:

Finance Department
Telephone: +971 9 2029210
Facsimile: +971 9 2229858
E-mail: nbfho@nbf.ae
Website: www.nbf.ae

Corporate Communications Department
Telephone: +971 4 5078351
Facsimile: +971 4 3975385

Corporate Governance Report (continued)

The Board of Directors

The Board has adopted a rolling agenda to ensure that its responsibilities are carried out on a periodic basis. In addition, the Board continues to focus on improving engagement and effectiveness by reviewing the Bank's governance structures, processes and information flow to and from the Board. Committees such as the Board Executive Committee, Board Risk Committee, Nomination and Remuneration Committee and Board Audit Committee which are established to assist the Board in carrying out its responsibilities.

The Board also regularly reviews the financial performance of the Bank and its individual business areas. It is also focused on setting the Bank's risk appetite, policies, enterprise governance, risk and control framework and three-year business strategy.

Appointment, retirement and re-election

All directors are required to seek re-election by shareholders every three years. The Board of Directors comprises eight members who were re-appointed on 27 March 2011 for a term of three years to fulfill its duties and responsibilities. The Chairman and all Directors are Non-Executive Directors. In 2012, no new Directors were appointed to the Bank. The formation of the Board of Directors is governed by the Federal Law No. 8 of 1984 (as amended).

All the directors declare their interests and directorships on an annual basis. Their dealings in the Bank's securities are also on full disclosure and at arm's length basis.

Details of the Board members' current terms of office and their external appointments are:

Board of Directors and their external appointments	**NBF, "the Bank"**
His Highness Sheikh Saleh Bin Mohammed Al Sharqi	Chairman
• *Chairman of Department of Industry & Economy, Government of Fujairah*	
• *Chairman of Fujairah Port Authority*	
• *Chairman of Fujairah Petroleum Company*	
• *Chairman of Fujairah National Group*	
His Excellency Easa Saleh Al Gurg, KCVO, CBE	Deputy Chairman
• *Chairman of Easa Saleh Al Gurg Group*	
• *Chairman of Al Gurg Fosroc LLC*	
• *Chairman of Arabian Explosives Company LLC*	
• *Chairman of Al Gurg Unilever LLC*	
• *Board Member of Siemens LLC*	
• *Member of the Board of Trustees – The Oxford Centre for Islamic Studies, UK*	
Dr. Sulaiman Mousa Al Jassim	Member
• *Vice President of Zayed University*	
• *Board Member in Al Fujairah National Insurance Company*	
• *Chairman of Al Jassim Trading Group*	
• *Chairman of Al Jassim Marble and Tile Factory*	
Mr. Hussain Mirza Al Sayegh	Member
• *Deputy Chairman of Oilfields Supply Center*	
• *Deputy Chairman of Al Nasr Leisure land*	
• *Director of Emirates National Oil Company*	
• *Director of Emirates National Bank of Dubai (ENBD)*	

Corporate Governance Report (continued)

Mr. Saif Sultan Al Salami	Member

- *Managing Director of Fujairah National Group*
- *Board Member of Al Fujairah National Insurance Company*
- *Managing Director of Fujairah Investment Company*

Mr. Nasser Ali Khamas	Member

- *Managing Director of Fujairah Cement Industries*
- *Chairman of Al-Ahli Group*

Mr. Mohammed Obaid Bin Majed	Member

- *Director General of Department of Industry & Economy, Government of Fujairah*
- *Chairman of Fujairah Building Industries*

Mr. Ali Ahmed Al Mehairi *Deputy General Director of Abu Dhabi National Hotels Company (subsequently resigned)*	Member *(subsequently resigned)*

Directors' interests in the Bank's shares:

Name (Board of Directors)	Shareholding at 1 Jan 2012	Shareholding at 31 Dec 2012	Change
Sheikh Saleh Bin Mohammed Al Sharqi	-	-	-
Easa Saleh Al Gurg, KCVO, CBE	-	-	-
Sulaiman Mousa Al Jassim	1,050,896	1,050,896	-
Hussain Mirza Al Sayegh	-	-	-
Saif Sultan Al Salami	-	-	-
Mohammed Obaid Majed	267,845	267,845	-
Nasser Ali Khamas	23,983	23,983	-
Ali Ahmed Al Mehairi *(subsequently resigned)*	-	-	-

Corporate Governance Report (continued)

Board Committees

The Board of Directors has overall responsibility for the establishment and oversight of the Group's enterprise risk management framework. The Board sets the overall risk appetite and strategy in consultation with the senior management and approves all policies and guidelines to manage the above mentioned risks. The Board has established the Board Committees to enhance the oversight mechanism in order to discharge its responsibilities effectively. Each Committee has a formal Charter approved by the Board of Directors. Similarly, note four in our annual consolidated financial statements may be referred for further information on Board Committees and Governance and Risk Committees.

In 2012, the Board of Directors met regularly and Directors received information about the activities of the Board Committees, Governance and Risk Committees, and developments in the Bank's business. The members and chairman of the Board's Committees are reviewed on a regular basis to ensure suitability and compliance with requirements. The table 'Board Committees' membership and meetings' below provides details of membership and meetings of the Board and Board Committees in 2012.

Board Committees' membership and meetings:

Name	Expiration of current term of office	Board	Board Executive Committee	Board Risk Committee	Board Audit Committee	Board Nomination & Remuneration Committee
Sheikh Saleh Bin Mohammed Al Sharqi	2014	C				C
Easa Saleh Al Gurg, KCVO, CBE	2014	M	C		C	M
Sulaiman Mousa Al Jassim	2014	M	M		M	
Hussain Mirza Al Sayegh	2014	M	M		M	
Saif Sultan Al Salami	2014	M	M	C	M	M
Mohammed Obaid Majed	2014	M	M	M	M	
Nasser Ali Khamas	2014	M	M			
Ali Ahmed Al Mehairi *(subsequently resigned)*	2014	M				
Vince Cook	CEO		M	M		
Adnan Anwar	CFO			M		
Prasant Sarkar	CRO			M		
Alan Maitland Smith	HOIA				M	
Total no. of meetings		*8*	*-*	*4*	*4*	*4*
Approvals by circulation		*2*	*18*	*-*	*2*	*-*

C : Chairman

M : Member

CEO : Chief Executive Officer

CFO : Chief Financial Officer

CRO : Chief Risk Officer

HOIA : Head of Internal Audit

Corporate Governance Report (continued)

Board of Directors – Remuneration and interests in the Bank's shares

The remuneration of the Board members consists only of the directors' attendance fee, which is a fixed amount for the year and paid annually after the Annual General Meeting. For 2012, the fee was AED 2.2 million, which was charged to the income statement, and is 0.72% of Net Profit attributed to shareholders of the Bank.

Board member remuneration paid during 2012 for year 2011	Director fees (AED per annum)
Chairman	400,000
Deputy Chairman	400,000
Director and Board Secretary	200,000 *(Per Person)*

Management

Vince Cook	Chief Executive Officer
Adnan Anwar	Chief Financial Officer
Sekhar T N	Chief Operations Officer
Prasant Sarkar	Chief Risk Officer
Das P B	Head of Wholesale & Institutional Banking
Sharif Mohd. Rafei	Head of Retail Banking and Fujairah Region
Mark Domenic Zanelli	Head of Treasury
Abdulla Aleter	Head of Human Resources

External Auditors

At the 2012 Annual General Meeting (AGM), PricewaterhouseCoopers (PWC) was appointed as the external auditor of the Bank, replacing KPMG, on the recommendation of the Board of Directors and the Board Audit Committee and approved by the shareholders at the AGM held on 18 March 2012. The fee for external audit work for the audit of the Bank and its subsidiary for the year ended 31 December 2012 was AED 500,000 (plus 5% out-of-pocket expenses).

In addition, the fee for other services rendered amounted to AED 1.17 million. All non-audit work is pre-approved by the Board Audit Committee and / or the Board.

PricewaterhouseCoopers,
Emaar Square, Building 4 Level 8
P.O. Box 11987, Dubai , United Arab Emirates
Telephone: 04-3043100
Facsimile: 04-3304100

Independent Auditor's Report

Independent auditor's report to the shareholders and directors of National Bank of Fujairah PSC

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of National Bank of Fujairah PSC ("the Bank") and its subsidiary ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2012, the consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

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

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

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

Opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2012, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirement

As required by the UAE Federal Law No. (8) of 1984, as amended, we report that:

(i) we have obtained all the information we considered necessary for the purpose of our audit;

(ii) the financial statements comply, in all material respects, with the applicable provisions of the UAE Federal Law No. (8) of 1984, as amended and the Articles of Association of the Bank;

(iii) the Bank has maintained proper books of account and the financial statements are in agreement therewith;

(iv) the financial information included in the Chairman's report and Directors' report is consistent with the books of account of the Bank; and

(v) nothing has come to our attention, which causes us to believe that the Bank has breached any of the applicable provisions of the UAE Federal Law No. (8) of 1984, as amended, or of its Articles of Association which would materially affect its activities or its financial position as at 31 December 2012.

Further, as required by the UAE Union Law No. (10) of 1980, as amended, we report that we have obtained all the information and explanations we considered necessary for the purpose of our audit.

PricewaterhouseCoopers
23 January 2013

Paul Suddaby
Registered Auditor Number 309
Dubai, United Arab Emirates

Consolidated statement of financial position

As at 31 December 2012

	Note	2012 AED'000	2011 AED'000
Assets			
Cash and balances with the UAE Central Bank	6	2,406,987	2,103,840
Due from banks and financial institutions	7	1,022,441	614,091
Loans and advances	8	12,196,008	10,505,260
Investments	11	778,832	583,898
Property and equipment and capital work-in-progress	12	90,514	87,050
Intangible assets	13	12,993	3,861
Other assets	14	1,036,841	1,015,364
Total assets		17,544,616	**14,913,364**
Liabilities			
Due to banks	15	617,079	540,212
Customer deposits	16	12,440,102	10,338,580
Term borrowings	15	1,153,551	918,250
Other liabilities	17	1,065,053	1,055,135
Total liabilities		15,275,785	**12,852,177**
Shareholders' equity			
Share capital	18	1,100,000	1,100,000
Statutory reserve	18	314,119	283,539
Special reserve	18	209,119	178,539
Available-for-sale revaluation reserve		3,396	(8,441)
Proposed dividends	18	110,000	110,000
Retained earnings		532,197	397,550
Total shareholders' equity		2,268,831	**2,061,187**
Total liabilities and shareholders' equity		17,544,616	**14,913,364**

These consolidated financial statements were approved and authorized for issue by the Board of Directors on 23 January 2013 and are signed on their behalf by:

Saleh Bin Mohammed Al Sharqi
Chairman

Easa Saleh Al Gurg, KCVO, CBE
Deputy Chairman

The notes on pages 23 to 73 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 17.

Consolidated statement of income

For the year ended 31 December 2012

	Note	2012 AED'000	2011 AED'000
Interest income	*19*	767,888	664,713
Interest expense	*20*	(262,995)	(238,179)
Net interest income		504,893	**426,534**
Net fees and commission income	*21*	181,517	163,562
Foreign exchange and derivatives income		55,829	50,015
Income from investments	*22*	3,178	2,461
Other operating income	*23*	14,065	8,179
Operating income		759,482	**650,751**
Operating expenses			
Employee benefits expense	*24*	(211,636)	(182,790)
Depreciation and amortization	*12, 13*	(13,486)	(16,528)
Other operating expenses		(54,846)	(57,179)
Total operating expenses		(279,968)	**(256,497)**
Operating profit		479,514	**394,254**
Net impairment losses	*10*	(173,707)	(113,329)
Net profit for the year		305,807	**280,925**
Earnings per share (basic and diluted)	*25*	AED 0.28	**AED 0.26**

Appropriations have been reflected in consolidated statement of changes in equity.
The notes on pages 23 to 73 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 17.

Consolidated statement of comprehensive income

For the year ended 31 December 2012

	2012 AED'000	2011 AED'000
Net profit for the year	305,807	280,925
Other comprehensive income:		
Change in available-for-sale investments:		
Net fair value gains on disposal of available-for-sale investments	(2,582)	(5,274)
Net changes in fair value of available-for-sale investments	9,511	1,302
Others	4,908	4,895
Net change in available-for-sale-investments	11,837	923
Total comprehensive income for the year	317,644	281,848

The notes on pages 23 to 73 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 17.

Consolidated statement of cash flows

For the year ended 31 December 2012

Operating activities	*Note*	2012	2011
		AED'000	AED'000
Net profit for the year		305,807	280,925
Adjustments for :			
Depreciation and amortization		13,486	16,528
Gain on disposal of property and equipment		-	(161)
Net impairment losses		173,707	113,329
Net fair value gains on disposal of investments		(3,746)	(5,285)
Net change in fair value of investments at fair value through profit and loss		568	2,824
Operating profit before working capital changes		489,822	408,160
Change in statutory reserve with the UAE Central Bank		(35,135)	(43,905)
Change in due from banks		50,000	(50,000)
Change in loans and advances		(1,864,455)	(1,901,895)
Change in other assets		(21,477)	13,603
Change in due to banks		64,836	(57,935)
Change in customer deposits		2,101,522	1,680,989
Change in other liabilities		9,918	(1,786)
Net cash generated from operating activities		795,031	47,231
Investing activities			
Purchase of property and equipment			
and capital work-in-progress		(26,082)	(10,191)
Proceeds from sale of property and equipment		-	161
Purchase of investments		(477,588)	(535,270)
Proceeds from sale of investments		297,669	633,118
Net cash (used in) / generated from investing activities		(206,001)	87,818
Financing activities			
Change in term borrowings		235,301	10,145
Cash dividends		(110,000)	(68,200)
Net cash generated from / (used in) financing activities		125,301	(58,055)
Net change in cash and cash equivalents		714,331	76,994
Cash and cash equivalents at beginning of the year		1,764,742	1,687,748
Cash and cash equivalents at end of the year	*27*	2,479,073	1,764,742

The notes on pages 23 to 73 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 17.

Consolidated statement of changes in equity

For the year ended 31 December 2012

	Share capital	Statutory reserve	Special reserve	Retained earnings	Available-for-sale revaluation reserve	Proposed dividends	Total
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
At 1 January 2011	1,100,000	255,447	150,447	282,809	(9,364)	68,200	1,847,539
Total comprehensive income for the year	-	-	-	280,925	923	-	281,848
Proposed dividends	-	-	-	(110,000)	-	110,000	-
Transfer to reserves	-	28,092	28,092	(56,184)	-	-	-
2010 cash dividends paid	-	-	-	-	-	(68,200)	(68,200)
At 31 December 2011	**1,100,000**	**283,539**	**178,539**	**397,550**	**(8,441)**	**110,000**	**2,061,187**
At 1 January 2012	**1,100,000**	**283,539**	**178,539**	**397,550**	**(8,441)**	**110,000**	**2,061,187**
Total comprehensive income for the year	**-**	**-**	**-**	**305,807**	**11,837**	**-**	**317,644**
Proposed dividends	**-**	**-**	**-**	**(110,000)**	**-**	**110,000**	**-**
Transfer to reserves	**-**	**30,580**	**30,580**	**(61,160)**	**-**	**-**	**-**
2011 cash dividends paid	**-**	**-**	**-**	**-**	**-**	**(110,000)**	**(110,000)**
At 31 December 2012	**1,100,000**	**314,119**	**209,119**	**532,197**	**3,396**	**110,000**	**2,268,831**

The notes on pages 23 to 73 form an integral part of these consolidated financial statements.
The report of the independent auditors is set out on page 17.

Notes to the consolidated financial statements

For the year ended 31 December 2012

1. Legal status and activities

National Bank of Fujairah (''the Bank") is a Public Shareholding Company registered under the laws of the United Arab Emirates. The Bank operates under a banking license issued on 29 August 1984 by the Central Bank of the United Arab Emirates ('the UAE Central Bank') and commenced operations on 20 September 1984. The shares of the Bank were listed on Abu Dhabi Securities Exchange (ADX) on 23 October 2005.

The principal activity of the Bank is commercial banking which is carried out from its fourteen branches in Fujairah, Abu Dhabi, Dubai, Sharjah, Dibba, Jebel Ali, Musaffah, Masafi, Qidfah, Deira, Ajman, Tawian, Al-Ain and Fujairah City Centre.

The Bank has one fully owned subsidiary company, NBF Financial Services FZC which was established in December 2004 with limited liability status in the Fujairah Free Trade Zone to provide support services to the Bank.

The consolidated financial statements comprise the Bank and its subsidiary (together referred to as "the Group").

The registered address of the Group is Hamad Bin Abdullah Street, P. O. Box 887, Fujairah, United Arab Emirates.

2. Disclosure policy

The Group has established a disclosure policy to ensure compliance with all applicable laws and regulations concerning disclosure of material non public information, including International Financial Reporting Standards (IFRS), the rules of the UAE Central Bank and its Basel II Pillar 3 guidelines and the listing requirements of the Securities and Commodities Authority (SCA) and ADX.

The following are the key features of the Group's disclosure policy concerning disclosure of financial information:

(a) Materiality thresholds

Information is considered material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions and/or any material information that might affect the share price. The Group, in order to ensure adequate disclosure lays down a materiality threshold, so that no material information is omitted or misstated.

(b) Frequency and medium of disclosure

The condensed consolidated interim financial information is prepared and presented on a quarterly basis while complete consolidated financial statements are prepared and presented on an annual basis in compliance with the requirements of IFRS, Basel II Pillar 3 and other guidelines from the UAE Central Bank. Disclosures of material non-public financial information are made by the Finance Department of the Group through the following mediums:

- Sending quarterly reviewed and annual audited consolidated financial statements, along with Management Discussion Analysis or Directors' report and any other price sensitive information to ADX and SCA;
- Hosting quarterly and annual consolidated financial statements on the Group's website;

Notes to the consolidated financial statements (continued)

2. Disclosure policy (continued)

(b) Frequency and medium of disclosure (continued)

- Publication of annual audited consolidated financial statements in both Arabic and English newspapers after the approval in the Annual General Meeting (AGM);
- Management analysis in Arabic and English newspapers in a manner that ensures wide dissemination; and
- Publication of annual report.

In addition, the Group's Corporate Communication Department discloses and disseminates information through press releases and media coverage.

3. Summary of significant accounting policies

(a) Basis of preparation

The consolidated financial statements have been prepared in accordance with IFRS as issued by the International Accounting Standards Board (IASB), interpretations issued by International Financial Reporting Interpretations Committee (IFRIC) and applicable requirements of laws of the United Arab Emirates.

Along with these consolidated financial statements, the Group has presented Basel II Pillar 3 disclosures in accordance with the guidelines issued by the UAE Central Bank. The adoption of Basel II Pillar 3 guidelines has impacted the type and amount of disclosures made in these consolidated financial statements, but had no impact on the reported profits or financial position of the Group. In accordance with the requirements of Basel II, the Group has provided full comparative information.

Standards that are effective for the Group's accounting period beginning on 1 January 2012

There are no new standards and amendments to published standards or International Financial Reporting Interpretations Committee (IFRIC) interpretations that are effective for the first time for the financial year beginning on 1 January 2012 that would be expected to have a material impact on the consolidated financial statements of the Group.

The following relevant new standards and amendments to published standards have been issued but are not effective for the Group's accounting period beginning 1 January 2012 and have not been early adopted by the Group:

- IFRS - 9, 'Financial instruments' (effective 1 January 2015), addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of International Accounting Standard (IAS) 39 – 'Financial Instruments: Recognition and Measurement' that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch.

  The Group is yet to assess IFRS 9's full impact and intends to adopt IFRS 9 no later than the accounting period beginning on 1 January 2015. The Group will also consider the impact of the remaining phases of IFRS 9 when completed by the IASB.

3. Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

- IFRS - 10 'Consolidated financial statements' (effective 1 January 2013). This standard builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements. The standard provides additional guidance to assist in determining control where this is difficult to assess.
- IFRS - 13, 'Fair value measurement' (effective 1 January 2013). This standard aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP.
- IAS - 27 (revised 2011) 'Separate financial statements' (effective 1 January 2013). This standard includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10.

The Group has assessed the impact of the above new standards and amendments to published standards and has concluded that they will not have a significant impact on the Group's financial statements.

(b) Basis of measurement

The consolidated financial statements are prepared under the historical cost convention as modified by the revaluation of the following financial assets:

- derivative financial instruments are measured at fair value;
- financial instruments at fair value through profit or loss are measured at fair value; and
- available-for-sale financial assets are measured at fair value.

(c) Functional and presentation currency

Items included in the consolidated financial statements of the Group are measured and presented in United Arab Emirates Dirham ("AED") which is the functional currency of the Group, rounded to the nearest thousand.

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and have been applied consistently by Group entities.

(d) Basis of consolidation

Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. The Group also assesses existence of control where it does not have more than 50 per cent of the voting power but is able to govern the financial and operating policies by virtue of de-facto control.

De-facto control may arise in circumstances where the size of the Group's voting rights relative to the size and dispersion of holdings of other shareholders give the Group the power to govern the financial and operating policies.

Notes to the consolidated financial statements (continued)

3. Summary of significant accounting policies (continued)

(d) Basis of consolidation (continued)

Subsidiaries (continued)

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases. The financial statements of the subsidiary are included in the consolidated financial statements from the date the control commences until the date that control ceases.

Transactions eliminated on consolidation

Inter-company transactions, balances, income and expenses on transactions between Group companies are eliminated. Profits and losses resulting from intercompany transactions that are recognized in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(e) Financial instruments

Classification

A financial instrument is any contract that gives rise to both a financial asset for the Group and a financial liability or equity instrument of another party. All assets and liabilities in the consolidated statement of financial position are financial instruments, except property and equipment, capital work-in-progress, intangible assets, prepayments, advance receipts and shareholders' equity.

Financial assets are categorized as follows:

Financial assets at fair value through profit or loss (FVPL): This category has two sub-categories: financial assets held-for-trading, and those designated to be fair valued through profit or loss at inception. The Group has designated financial assets at fair value through profit or loss when the assets are managed, evaluated and reported internally on a fair value basis. Derivatives are also categorized as held for trading unless they are designated as hedges.

Loans and receivables are non-derivative financial assets with fixed and determinable payments that are not quoted in an active market.

Held-to-maturity (HTM) assets are non-derivative financial assets with fixed or determinable payments and fixed maturities, where the Group has the positive intent and ability to hold to maturity. Where the Group sells other than an insignificant amount of held-to-maturity assets, the entire category would be re-classified as available-for-sale.

Available-for-sale (AFS) assets are those non-derivative financial assets that are designated as available-for-sale or not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

Initial recognition

Regular purchases and sales of financial assets are recognized on the trade-date, the date on which the Group commits to purchase or sell the asset. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the consolidated statement of income. Loans and advances are recognized when cash is advanced to the borrowers.

Notes to the consolidated financial statements (continued)

3. Summary of significant accounting policies (continued)

(e) Financial instruments (continued)

Derecognition

Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are subsequently carried at amortized cost using the effective interest method. A financial liability is derecognized when it is extinguished.

Measurement

A financial asset or financial liability is initially measured at fair value plus (for an item not subsequently measured at fair value through profit or loss) transaction costs that are directly attributable to its acquisition or issue.

Subsequent to initial recognition, all financial instruments to be fair valued through profit or loss and available-for-sale assets are measured at fair value, except any instrument that does not have a reliably measurable fair value, in which case financial instruments are measured as set out in the fair value measurement principles below.

All held-to-maturity financial instruments and loans and advances for which the fair value has not been hedged are measured at amortised cost less impairment losses.

Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment. Premiums and discounts including initial transaction costs are included in the carrying amount of the related instrument.

Fair value measurement principles

Fair value is the amount for which an asset could be exchanged, or liabilities settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the fair value of a financial instrument is based on quoted market prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis. If a quoted market price is not available or if a market for a financial instrument is not active, the fair value is determined by using valuation techniques. Valuation techniques include net present value techniques, discounted cash flow methods, comparison to similar instruments for which market observable prices exist. For investments under management with external fund managers, fair value is provided by the external fund managers, and is determined based on the market value of underlying investments of each fund. In all other cases, the instruments are measured at acquisition cost, including transaction cost, less impairment losses, if any.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market-related rate at the date of consolidated statement of financial position for an instrument with similar terms and conditions.

3. Summary of significant accounting policies (continued)

(e) Financial instruments (continued)

Fair value measurement principles (continued)

Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group and the counterparty, where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties; to the extent that the Group believes a third-party market participant would take them into account in pricing a transaction.

The fair value of derivatives that are not exchange traded is estimated at the amount that the Group would receive or pay to terminate the contract at the date of consolidated statement of financial position, taking into account current market conditions and the current creditworthiness of the counterparty.

Fair value hierarchy

The Group measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: Quoted market price (unadjusted) in an active market for an identical instrument. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry, group, pricing service or regulatory agency, and those prices represent actual and regularly recurring market transactions on an arm's length basis.
- Level 2: Valuation techniques based on observable input, either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Pursuant to disclosure requirements of IFRS 7 Financial Instruments: Disclosures, the Group has disclosed the respective information under note 5.2.

Gains and losses on subsequent measurement

Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the consolidated statement of income in the period in which they arise.

Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised in other comprehensive income, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in other comprehensive income is reclassified to the consolidated statement of income. In case where the available-for-sale investments with fixed maturity are reclassified to held-to-maturity investments, the fair value gain or loss till the date of the reclassification is held in equity and are amortised to consolidated statement of income over the remaining life of the held-to-maturity investments using the effective interest rate method.

Notes to the consolidated financial statements (continued)

3. Summary of significant accounting policies (continued)

(e) Financial instruments (continued)

Impairment

Financial assets are reviewed at each reporting date to determine whether there is objective evidence of impairment. If any such evidence exists, the asset's recoverable amount is estimated. Impairment loss is the difference between the net carrying value of an asset and its recoverable amount. Any such impairment loss is recognised in the consolidated statement of income. The recoverable amount of loans and advances is calculated as the present value of the expected future cash flows, discounted at the instrument's original effective interest rate. Short-term (up to one year maturity) balances are not discounted.

The Group considers evidence of impairment for loans and advances and held-to-maturity investment securities at both a specific asset and collective level. All individually significant loans and advances and held-to-maturity investment securities are assessed for specific impairment. All individually significant loans and advances and held-to-maturity investment securities found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar risk characteristics.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the write down, the write down or allowance is reversed through the consolidated statement of income.

In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale investments, the cumulative loss is measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in consolidated statement of income, and is removed from consolidated statement of other comprehensive income and recognised in the consolidated statement of income.

Impairment losses recognized in the consolidated statement of income on equity instruments are not reversed through the consolidated statement of income and are reversed through the cumulative changes in fair value under equity.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in consolidated statement of income, the impairment loss is reversed, with the amount of the reversal recognized in consolidated statement of income.

(f) Derivatives

Recognition and fair valuation

Derivative financial instruments are initially recognised at fair value which is normally the transaction price. Subsequent to their initial recognition, derivative financial instruments are stated at fair value. Fair values are generally obtained by reference to quoted market prices, discounted cash flow models and pricing models, as appropriate.

Derivative financial instruments with positive market values (unrealised gains) are included in assets, and derivative financial instruments with negative market values (unrealised losses) are included in liabilities.

Notes to the consolidated financial statements (continued)

3. Summary of significant accounting policies (continued)

(f) Derivatives (continued)

Recognition and fair valuation (continued)

Derivatives may be embedded in another contractual arrangement (a “host contract”). The Group accounts for such embedded derivatives at fair value separately from the host contract when the host contract is not itself carried at fair value through profit or loss, and the characteristics of the embedded derivative are not clearly related to the host contract.

Gain and losses on subsequent measurement

Gains or losses on the re-measurement of both the hedging instruments and the hedged items are recognised in the consolidated statement of income.

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the consolidated statement of income, along with changes in the fair value of the assets, liabilities or group thereof that are attributable to the hedged risk.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in the hedging reserve in other comprehensive income. Any gain or loss in fair value relating to an ineffective portion is recognized immediately in the consolidated statement of income.

(g) Key accounting estimates and judgments

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may therefore differ resulting in future changes in these estimates. These disclosures supplement the commentary on financial risk management set out in note 4. In particular, considerable management’s judgment is required in the following:

Impairment losses on loans and advances and held-to-maturity and available-for-sale investments

The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management’s best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgments about a counter party’s financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function. Judgment is also exercised while reviewing factors indicating and determining the objective evidence of impairment in respect of loans and advances and held-to-maturity and available-for-sale investments.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of loans and advances and held-to-maturity investment securities with similar credit risk characteristics when there is objective evidence to suggest that the portfolio contains impaired loans and advances and held-to-maturity investment securities, but the individual impaired items cannot be identified. In assessing the need for collective impairment allowances, management considers factors such as credit quality, portfolio size, concentrations and economic factors.

Notes to the consolidated financial statements (continued)

3. Summary of significant accounting policies (continued)

(g) Key accounting estimates and judgments (continued)

Held-to-maturity investments

The Group follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgment. In making this judgment, the Group evaluates its intention and ability to hold such investments to maturity.

(h) Due from banks and financial institutions

Amount due from banks and financial institutions are initially recognized at fair value and measured subsequently at amortised cost using the effective interest method. Impairment of amount due from banks and financial institutions is assessed as outlined in the accounting policy of financial instruments.

(i) Property and equipment, capital work-in-progress and depreciation

Property and equipment are stated at cost less accumulated depreciation and impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of replacing an item of property and equipment is recognised in the carrying value of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably.

Depreciation is charged to the consolidated statement of income on a straight line basis over the estimated useful lives of property and equipment. Freehold land is not depreciated.

Where the carrying value of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount. Gains and losses on disposal are recognized in the consolidated statement of income. The estimated useful lives for various types of assets are as follows:

Buildings	20 to 30 years
Leasehold improvements	Over the period of lease
Furniture, EDP and other equipment	4 years
Motor vehicles	3 years

Useful life and the depreciation method are re-assessed at each reporting date.

Capital work-in-progress is stated at cost and is transferred to the appropriate asset category when it is brought into use and is depreciated in accordance with the Group's accounting policy.

(j) Intangible assets

Intangible assets represent software acquired by the Group which is stated at cost less accumulated amortisation and impairment losses, if any. Cost of the software represents the costs incurred to acquire and bring to use the specific software.

Amortisation is recognised in the consolidated statement of income on a straight-line basis over the estimated useful life of the software, from the date it is available for use. The useful life of software is estimated to be five years.

(k) Government grants

Land granted by Government of Fujairah is recorded at nominal value.

Notes to the consolidated financial statements (continued)

3. Summary of significant accounting policies (continued)

(l) Due to banks, term borrowings and customer deposits

Due to banks, term borrowings and customer deposits are initially measured at fair value plus directly attributable transaction costs. Subsequently, these are measured at amortised cost using the effective interest method except where the Group chooses to carry the liabilities at fair value through the consolidated statement of income. Amortised cost is calculated by taking into account any discount or premium on settlement.

(m) Provisions

A provision is recognised if as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability.

(n) Guarantees

Guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment or provide agreed service when due in accordance with the terms of a debt.

Guarantees are initially recognized at their fair value, and the initial fair value is amortised over the life of the guarantee.

The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Guarantees are included within other liabilities.

(o) Employee terminal benefits

Provision is made for employee terminal benefits payable under UAE labour law and is calculated as the liability that would arise if the employment of all expatriate staff was terminated at the reporting date. The Group pays its contributions in respect of UAE citizens under UAE pension and social security law and no further liability exists.

(p) Interest income and expense

Interest income and expense for all interest bearing financial instruments are recognised in the consolidated statement of income on an accruals basis using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that discounts estimated future cash receipts and payments earned or paid on a financial asset or a liability through its expected life or, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

When calculating effective interest rates, the Group estimates cash flows considering all contractual terms of the financial instruments excluding future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset to the carrying amount as reduced by any allowance for impairment and is not recognised as interest income.

Notes to the consolidated financial statements (continued)

3. Summary of significant accounting policies (continued)

(q) Net fees and commission income

Fees and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income earned and expense incurred from the provision of services are recognised as revenue and expense, as and when the services are rendered.

(r) Income from investments

Income from investments at fair value through profit or loss, which arises from gains and losses resulting from disposal and from the fair valuation of such investments, are recognized in the consolidated statement of income.

(s) Dividend income

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

(t) Cash and cash equivalents

For the purposes of the consolidated statement of cash flow, cash and cash equivalents comprise cash on hand and balances with the UAE Central Bank (excluding statutory reserve) and other balances due from and due to banks maturing within three months. Cash and cash equivalents are carried at amortised cost in the consolidated statement of financial position.

(u) Foreign currencies

Foreign currency transactions are recorded at the rate of exchange ruling at the value date of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into AED at the rate of exchange ruling at the reporting date. Any resultant gains and losses are recognised in the consolidated statement of income.

Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at the date of the transaction. Forward foreign exchange contracts are translated into AED at the mid market rate of exchange applicable to their maturities ruling at the reporting date. Any resultant gains and losses are taken to income.

(v) Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, whose operating results are reviewed regularly by the management committees, as discussed in note 4, and Chief Executive Officer (together referred to as the "Chief Operating Decision Maker" or "CODM") to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

(w) Offsetting

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position when, and only when, the Group has a legally enforceable right to set off the recognized amounts and it intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRSs / IASs, or when gains and losses arise from a group of similar transactions such as in the Group's trading activity.

Notes to the consolidated financial statements (continued)

3. Summary of significant accounting policies (continued)

(x) Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Group by the weighted average number of ordinary shares outstanding during the year. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares.

(y) Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. The reduction in carrying amount is recognised in the consolidated statement of income.

(z) Operating leases

Leases of assets under which the lessor effectively retains all the risks and rewards of ownership are classified as operating leases. Payments made under operating leases are recognised in the consolidated statement of income on a straight-line basis over the term of the lease.

4. Financial risk management

(a) Introduction

Risk is inherent in the Group's activities and is managed through a process of ongoing identification, measurement, mitigation, reporting and monitoring. The Group's exposure can be broadly categorized into the following risks:

- Credit risk
- Liquidity risk
- Market risk
- Operational risk

The Group has been enhancing its risk management environment and relevant projects are in various stages of completion and implementation of the Economic Capital and Basel II IRB approach is also in progress. The Group is committed to the implementation of best practices and governance standards. The roles and responsibilities of existing governance committees have been explained in note 4 (b).

(b) Governance and risk management framework

This note presents broad information about the Group's objectives, policies and processes for identifying, measuring, reporting and mitigating the above mentioned risks and the Group's management of capital. This note also covers enhanced disclosures relating to Pillar 3 (Market Discipline) of Basel II.

The Board of Directors has overall responsibility for the establishment and oversight of the Group's enterprise risk management framework. The Board sets the overall risk appetite and strategy in consultation with the senior management and approves all governance committee charters, policies and guidelines to manage the above mentioned risks. The Board has established following committees to enhance the oversight mechanism to carry out its responsibilities effectively.

Board Executive Committee: consists of six members of the Board and the Chief Executive Officer (CEO), to assist them in the credit and investment approval process in line with the Board delegated authorities.

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(b) Governance and risk management framework (continued)

***Board Risk Committee**:* consists of two Board members, CEO, Chief Risk Officer (CRO) and Chief Financial Officer (CFO) to assist the Board in fulfilling its oversight responsibilities in respect of the risks inherent in the businesses of the Group and the control processes with respect to such risks, the risk profile of the Group, and the risk management, compliance and control activities of the Group. The responsibilities of the Committee include, but not limited to the following:

- Review the Group's Enterprise Risk Management and Internal Control Framework;
- Review risk appetite of the Group and establish risk policies for implementation;
- Review credit risk rating system;
- Review policies for Asset and Liability management;
- Review financial and other risk exposures and the steps management has taken to identify, measure, monitor, control and report such exposures including and without limitation review of credit, market, fiduciary, liquidity, reputation, insurance, operational (including fraud, business continuity, information security and legal) and strategic risks;
- Review appropriate transaction or trading limits;
- Review reports and significant findings from the Risk Management Division, Risk Committee of the Management and from the regulatory agencies relating to risk issues and management response;
- Review ICAAP submission to the UAE Central Bank;
- Review Basel II implementation and economic capital allocation methodology;
- Review Basel III, liquidity and leverage review methodology;
- Monitor the Group's compliance with legal and regulatory obligations; and
- Review major disclosure documentation prior to the issue to the market.

***Board Audit Committee**:* steered by the Deputy Chairman of the Board receives and considers reports and recommendations from the Head of Internal Audit and the external auditors and make recommendations to the Board in respect of the financial reporting, systems of internal control and both internal and external audit processes of the Group. The responsibilities of the Committee include, but are not restricted to the following:

- Confirm and assure the independence of the Internal Auditors;
- Review with the Head of Internal Audit and the External Auditor the scope, plan, coordination and effectiveness of internal and external audit efforts;
- Oversight of the preparation of the financial statements including a review of the interim and year end accounts to monitor that such accounts have been prepared in accordance with proper accounting principles and recommend them for adoption by the Board;
- Review the Group's Internal Control Systems for effectiveness; and
- Review all Internal Audit reports concerning any investigation or significant fraud that occurs at the Group.

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(b) Governance and risk management framework (continued)

Board Nomination and Remuneration Committee: comprises the Board's Chairman, the Board's Deputy Chairman and a Board member. The responsibilities of the Committee include, but are not restricted to the following:

- Make recommendations to the Board concerning the appointment, reappointment and succession planning of the Directors except for the position of the Chairman;
- Consider appointment, termination and succession planning for the CEO and deemed as required, other senior Management positions in the Group;
- Review the remuneration policy for the Board and the CEO position and determine their terms of service. The CEO and the full Board will determine and review the Group's Human Resources policy and remuneration levels for the Group;
- Review the structure, size and composition required of the Board and make recommendations to the Board with regard to any changes;
- Evaluate the balance of skills, knowledge and experience on the Board; and
- Review the performance of the Board, and work with the members of the Board to develop recommendations to the Board for any performance adjustments deemed advisable.

In order to discharge its responsibilities effectively, the Board has established the Management Committee (MANCOM), Risk Committee (RC), Marketing Committee (MC), Human Resources Committee (HRC), Corporate Social Responsibility Committee (CSRC), IT Steering Committee (ITSC), Asset and Liability Committee (ALCO), Central Credit Committee (CCC), Operational Risk Committee (ORC), Product Committee (PC) and Grievance and Disciplinary Committee (GDC). These committees oversee and direct the implementation of the day-to-day activities of the Group in line with the guidelines set by the Board. These committees comprise key officers, who convene frequently to appraise the Group's risk profile and various risk issues. The Group's policies and procedures are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, to monitor risks and adherence to limits, and to ensure effective escalation and reporting. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered.

The Management Committee (MANCOM), steered by the CEO, is responsible for the development and monitoring of execution plan of the Group's strategy approved by the Board, implementation of corporate governance, performance measurement and monitoring, deciding on staff related matters, policies and any other administrative matters other than risk matters. It oversees and provides direction to MC, HRC, ITSC and CSRC.

The Risk Committee (RC) steered by the CEO is responsible to develop and recommend to the Board and the Board Risk Committee, the Group's risk appetite, develop and review the Group's risk policies and ICAAP (Internal Capital Adequacy Assessment Process), recommend allocations of regulatory and economic capital to portfolio segments and business lines, approve scenarios for stress testing for all risk categories and evaluate potential changes to market conditions. Further, the Committee reviews significant financial or other risks and the steps management has taken to monitor, control and report such risks, including, but without limitation to, review of credit, market, fiduciary, liquidity, reputation, operational, compliance, legal, fraud and strategic risks. It obtains assurance that significant risks are being measured, monitored, evaluated, and appropriately escalated through periodic updates, risk reporting, and key risk indicator reviews from ALCO, CCC, ORC and PC.

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(b) Governance and risk management framework (continued)

The Asset and Liability Committee (ALCO) steered by the CFO is responsible for directing asset and liability growth and allocations in order to achieve the Group's strategic goals. It monitors the Group's liquidity and market risks and the Group's risk profile in the context of economic developments and market fluctuations, to ensure that the Group's ongoing activities are compatible with the risk appetite approved by the Board. The Committee is also responsible for developing and establishing ALCO metrics and MIS for review, measurement, monitoring and control of all market and liquidity risks and stress testing.

The Central Credit Committee (CCC) steered by the Head of Credit is responsible for credit decisions for the Group's lending portfolio, setting country and other high level Group risk limits, oversee portfolio reviews with particular focus on quality, dealing with impaired assets and re-grading of credit facilities. The Committee is also responsible for developing and establishing credit risk metrics and MIS for review, measurement, monitoring and control of all credit risks, stress testing and making recommendation to the CRO for reviews of credit risk policies, enhancement of credit risk reporting and processing.

The Operational Risk Committee (ORC) steered by the Head of Operational Risk and Compliance is responsible for independently assessing and monitoring the operational risks of the Group against the Group's operational risk management policies, internal control framework and operational risk appetite as approved by the Board. It is responsible to review operational procedures, adequacy of the internal control systems, develop and establish operation risk metrics and MIS for review, measurement, monitor and control of operational risks. Further, it is also responsible for the implementation of the Business Continuity Plan (BCP) and Disaster Recovery Programme (DR), review of anti-money laundering unit reports and adequacy of compliance with relevant laws, regulations and license conditions. The Committee also reviews reports from internal, external and Central Bank audits and monitors progress on actions initiated to address all operational risks covered by these reports.

The Product Committee (PC) steered by the CRO is responsible to review and approve all risks, designs, pricing, financials, product risk ratings, processes for distribution, product control and MIS processes of proposed new products and services. It ensures that the products and services fall within the risk appetite and the Group's strategic plans. It is responsible for monitoring the Group's competitiveness in product positioning and developments in technology that could have an impact on risk profile and profitability of products and services.

The Marketing Committee (MC) steered by the CEO is responsible for challenging marketing strategies or plans proposed by the Business Segments and recommending to the MC the changes for improving marketing and selling activities. It co-ordinates and monitors the support and resources required, new product and channels development and pricing strategies. It oversees plans for developing business with the Group's key customers and monitors progress together with setting customer service standards.

The Human Resources Committee (HRC) steered by the CEO is responsible for ensuring internal equity of compensation and overall evaluation of jobs for consistent and accurate assessment. It is responsible for grade and compensation structure together with benchmarking in line with the market conditions. In order to achieve its objectives, the Committee reviews the organization design and changes / improvements to the rewards and benefits structure and discusses future human resources planning, policies and procedure guidelines.

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(b) Governance and risk management framework (continued)

The IT Steering Committee (ITSC) steered by the CEO is responsible to provide direction to the Group's key initiatives and assist in the alignment of IT spend with business needs. It is responsible for providing oversight on IT projects and direction on technology dependent projects including prioritization and resource alignment.

The Corporate Social Responsibility Committee (CSRC) steered by the Head of Internal Audit is responsible for the oversight of environmental management, community initiatives and communication of CSR initiatives within and outside the Group.

The Grievance and Disciplinary Committee (GDC) steered by Head of Internal Audit is empowered by the Bank's MANCOM to act impartially when dealing with staff grievances and disciplinary cases in accordance with Group rules, policies and UAE laws.

Enterprise-wide Risk Management and Internal Control Framework: The Board set the risk appetite, policies and the enterprise-wide risk management and internal control framework. The principal responsibility for the execution and implementation of policies and procedures and internal controls rests with respective functions and departments in accordance with the approved framework. An independent Risk Management function carries out the oversight through independent review and approval of procedures, spot checks to assess adequacy of internal controls and meeting of compliance requirements, operational risk management, credit review and middle office activities for market and liquidity risks.

The Group follows the whistle blowing policy where staff can independently raise matters to the CEO, the Head of Internal Audit or the Board Secretary. The Group through the GDC comprising Head of Internal Audit, Head of Human Resources and Head of Legal, and reporting to the CEO promotes transparent and fair dealings among staff.

The role of the Internal Audit Function within the Group is to provide independent and objective assurance that the process for identifying, evaluating and managing significant risks faced by the Group is appropriate and effectively applied. In addition, it also provides an independent check on the compliance with laws and regulations and measuring compliance with the Group's policies and procedures. Additionally, Internal Audit provides consulting services which are advisory in nature, and are generally performed at the specific request of the Senior Management. It is led by the Head of Internal Audit who reports to the Board of Directors, with administrative reporting to the CEO. To perform its role effectively, Internal Audit has organizational independence from management, to enable unrestricted evaluation of management activities and personnel.

(c) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's loans and advances to customers and banks and investments.

The Group is mainly engaged in wholesale business which comprises the majority of loans and advances of the Group. The wholesale business comprises corporate, small and medium enterprise and financial institution businesses where credit is assessed based on specific guidelines. The Group also carries out retail banking and a range of products and services are available to customers across the UAE.

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(c) Credit risk (continued)

Management of credit risk

Independent Credit Department is responsible for review, recommending and approving underwriting proposals and together with Risk Management Division is responsible for managing credit risk and formulation of credit policies in line with strategic objectives, risk appetite, business growth, regulatory requirements and risk management standards. An independent loan review function is responsible for loan review, on a post fact and sample basis, to assess compliance with underwriting approvals according to the policies and review the underwriting standards of the Group. Independent departments are responsible for documentation and collateral management and custody.

The credit risk management framework includes:

- Risk appetite and policy setting;
- An authorization structure and limits for the approval and renewal of credit facilities;
- Review and assessment of credit risk in line with credit policies and within the authorization and limit structure. Renewals of facilities are subject to the same review process;
- Diversification and limiting concentrations of exposure to counterparties, geographies, industries and asset classes;
- Reviewing compliance, on an ongoing basis, with agreed exposure limits relating to counterparties, industries, countries and products and reviewing limits in accordance with the risk management strategy and market trends;
- Remedial management and recoveries; and
- Stress testing

Concentration risk

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political, or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentration of risk, Group risk policies and procedures include specific guidelines to ensure maintenance of diversified portfolios through a series of country, counterparty, industry, sector and product limits.

Credit exposures to individual customers or customer groups are controlled through a tiered hierarchy of delegated approval authorities. Approval is required from the UAE Central Bank for any planned exposure to single counterparty / group exceeding 7 percent of the regulatory capital base and for a commercial public sector entity / group counterparty(ies) exceeding 25 percent of the regulatory capital base. The combined exposure to these large borrowers shall not exceed 800% of the regulatory capital base. The Group has adhered to these requirements.

The Group monitors concentrations of credit risk by industry, sector and geographic location. The Group has further defined portfolio caps for its specialized businesses like Marine Finance and Precious Metal Unit.

The following tables illustrate the sectoral, geographical and currency wise analysis of loans and advances. Information about other areas from where credit risk arises has been included in the respective notes.

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(c) Credit risk (continued)

Sector analysis

An analysis of sector concentrations of credit risk arising out of loans and advances at 31 December 2012 and 2011 is shown below:

2012	Loans and advances							
	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded)	Past due but not impaired	
							Upto 90 days	Above 90 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Trade	4,423,504	1,377,053	5,800,557	65,616	62,038	18,633	21,206	-
Construction	769,235	2,934,448	3,703,683	11,182	6,386	-	26,203	-
Government	303,242	5,107	308,349	-	-	-	-	-
Manufacturing	2,572,067	559,604	3,131,671	154,633	129,744	6,892	23,584	-
Financial institutions	894,717	88,087	982,804	237,739	96,677	-	380	-
Service industries	1,640,548	222,044	1,862,592	329,585	97,775	1,038	2,523	-
Real estate	1,203,986	-	1,203,986	18,840	13,566	-	681	-
Individuals	1,179,393	16,254	1,195,647	174,163	102,439	8,678	1,704	-
Gross amount	12,986,692	5,202,597	18,189,289	991,758	508,625	35,241	76,281	-

In addition to the specific provision, the Group holds AED 282.06 million (2011: AED 156.08 million) as collective provisions.

2011	Loans and advances							
	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded)	Past due but not impaired	
							Upto 90 days	Above 90 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Trade	4,198,849	1,203,044	5,401,893	76,107	69,187	13,685	89,712	-
Construction	714,071	2,901,648	3,615,719	6,438	6,411	11,266	21,710	-
Government	260,739	5,845	266,584	-	-	-	-	-
Manufacturing	2,111,387	531,877	2,643,264	166,407	132,962	37,303	37,686	-
Financial institutions	618,358	153,096	771,454	54,224	27,112	55,095	-	-
Service industries	1,319,267	197,579	1,516,846	693,205	112,148	33	11,674	-
Real estate	886,409	-	886,409	19,532	14,261	-	2,537	-
Individuals	1,048,398	16,892	1,065,290	194,125	134,058	1,794	11,940	-
Gross amount	**11,157,478**	**5,009,981**	**16,167,459**	**1,210,038**	**496,139**	**119,176**	**175,259**	**-**

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(c) Credit risk (continued)

Geographic location analysis

Based on the location of the borrower, an analysis of geographic concentrations of credit risk arising out of loans and advances at 31 December 2012 and 2011 is shown below:

2012	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded)	Past due but not impaired Upto 90 days	Past due but not impaired Above 90 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Within UAE	12,566,027	5,166,021	17,732,048	828,019	421,961	35,241	75,901	-
GCC countries	188,493	7,016	195,509	163,739	86,664	-	-	-
Other	232,172	29,560	261,732	-	-	-	380	-
Total	12,986,692	5,202,597	18,189,289	991,758	508,625	35,241	76,281	-

2011	Funded	Unfunded	Gross exposure	Impaired loans	Specific provision	Write-off (funded)	Past due but not impaired Upto 90 days	Past due but not impaired Above 90 days
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Within UAE	10,919,788	4,889,759	15,809,547	1,155,814	469,027	27,351	174,526	-
GCC countries	180,642	80,126	260,768	54,224	27,112	91,825	-	-
Other	57,048	40,096	97,144	-	-	-	733	-
Total	**11,157,478**	**5,009,981**	**16,167,459**	**1,210,038**	**496,139**	**119,176**	**175,259**	**-**

Currency wise analysis

The Group's credit exposure by currency type is as follows:

	2012			2011		
	Funded AED'000	Unfunded AED'000	Gross exposure AED'000	Funded AED'000	Unfunded AED'000	Gross exposure AED'000
AED	10,907,147	3,666,769	14,573,916	9,369,053	3,741,623	13,110,676
USD	1,603,611	1,300,704	2,904,315	1,115,979	1,113,334	2,229,313
EURO	35,381	137,929	173,310	41,147	87,713	128,860
GBP	-	5,530	5,530	-	3,987	3,987
XAU	382,789	-	382,789	474,297	-	474,297
Others	57,764	91,665	149,429	157,002	63,324	220,326
TOTAL	12,986,692	5,202,597	18,189,289	**11,157,478**	**5,009,981**	**16,167,459**

4. Financial risk management (continued)

(c) Credit risk (continued)

Settlement risk

The Group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of counterparty to honour its obligations to deliver cash, securities or other assets as contractually due. Any delays in settlement are rare and are monitored and quantified as part of the Group's Credit Risk Management.

For certain types of transactions, the Group mitigates this risk by conducting settlements through a settlement / clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval / limit monitoring process. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals in accordance with the approved credit framework.

Risk mitigation, collateral and credit enhancements

The Group manages credit exposure by obtaining security where appropriate, and in certain cases, the Group may also close out transactions or assign them to other counterparties to mitigate credit risk.

The amount and type of collateral depends on assessments of the credit risk of the counterparty. The types of collateral mainly include cash, guarantees, pledge over listed shares and mortgage and liens over properties or other securities over assets. Pledged interests over vehicles, ships and equipment are also obtained. Collateral generally is not held against non-trading investments and due from banks.

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

Estimates of fair value are generally assessed on a periodic basis in accordance with the respective credit policies. An estimate of fair value of collateral and other security enhancements held against the loan portfolio is shown below:

Notes to the consolidated financial statements (continued)

4. **Financial risk management (continued)**

(c) **Credit risk (continued)**

Risk mitigation, collateral and credit enhancements (continued)

Particulars	Loans and Advances		Collaterals	
	2012	2011	2012	2011
	AED'000	AED'000	AED'000	AED'000
Individually impaired				
Pledged deposits	24,932	34,664	3,602	5,071
Debt / Equity securities	121,056	109,428	88,092	85,286
Property	152,225	103,461	133,959	54,723
Others	693,545	962,485	20,000	20,000
Gross amount	991,758	1,210,038	245,653	165,080
Impairment loss	(508,625)	(496,139)	-	-
Carrying amount	483,133	713,899	245,653	165,080
Past due but not impaired				
Pledged deposits	42,650	74,014	10,541	15,823
Debt / Equity securities	233	844	233	844
Property	14,599	50,882	11,383	50,433
Others	18,799	49,519	-	-
Gross amount	76,281	175,259	22,157	67,100
Impairment loss	-	-	-	-
Carrying amount	76,281	175,259	22,157	67,100
Neither past due nor impaired				
Pledged deposits	3,932,073	3,441,099	973,409	1,000,861
Debt / Equity securities	145,859	257,423	77,274	156,032
Property	1,752,993	1,334,000	1,380,417	1,193,966
Others	6,087,728	4,739,659	-	-
Gross amount	11,918,653	9,772,181	2,431,100	2,350,859
Collective impairment provision	(282,059)	(156,079)	-	-
Carrying amount	11,636,594	9,616,102	2,431,100	2,350,859
Total	12,196,008	10,505,260	2,698,910	2,583,039
Renegotiated exposure	1,077,859	692,965	370,695	341,669
Contingent liabilities				
Pledged deposits	2,673,349	2,623,996	385,671	448,906
Others	2,529,248	2,385,985	131,768	120,662
Total	5,202,597	5,009,981	517,439	569,568

4. Financial risk management (continued)

(c) Credit risk (continued)

Risk mitigation, collateral and credit enhancements (continued)

Past due but not impaired portfolio ageing is as follows:

	2012 AED'000	2011 AED'000
Less than 1 month	50,635	99,231
1 month to 3 months	25,646	76,028
3 months to 6 months	-	-
Total	76,281	**175,259**

Credit quality

The credit quality of the loans and advances portfolio is managed by the Group using internal credit ratings comprising 22 grades. The risk rating system is used as a credit risk management tool whereby any risks taken on the Group's books are rated against a set of predetermined standards which also complies with the UAE Central Bank guidelines.

The Group's Credit Risk Rating Methodology follows the categorization of credit risk assets under the following risk classification / grading system:

Risk Grade	2012 AED'000	2011 AED'000
Neither past due nor impaired / Past due but not impaired (RR 1-19)		
Grades 1-18: Performing or normal	11,338,673	9,680,699
Grade 19: Other Loans Especially Mentioned (OLEM)	656,261	266,741
	11,994,934	**9,947,440**
Individually impaired (RR 20-22)		
Grade 20: Sub-standard	358,141	664,724
Grade 21: Doubtful	208,196	101,167
Grade 22: Loss	425,421	444,147
	991,758	**1,210,038**
Total	12,986,692	**11,157,478**

Impaired loans and advances

Impaired loans are those financial assets where it is probable that the Group will be unable to collect all principal and interest due according to the contractual terms of the loan agreements.

Past due but not impaired loans

Loans and advances are recognized as past due but not impaired where contractual interest or principal payments are past due but the Group believes that the assets are not impaired on the basis of the level of security / collateral available and / or the stage of collection of amounts owed to the Group.

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(c) Credit risk (continued)

Loans with renegotiated terms

Loans with renegotiated terms are loans that have been rescheduled / restructured due to deterioration in the borrower's financial position and where the Group has made concessions that it would not otherwise consider. These loans are not delinquent; however, impairment is recognized in accordance with IAS 39 to represent the benefits foregone by the Group. The impairment recognized will be gradually unwound to the consolidated statement of income in a manner that corresponds to the performance of the account in line with the restructuring terms.

Allowances for impairment

On a monthly basis, the Group establishes an allowance for impairment losses that represents its estimate of losses in the loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for groups of homogenous assets in respect of losses that may have been incurred but have not been identified on loans subject to individual assessment for impairment. The methods of assessment of allowances for impairment have been summarized in note 4.

Write-off policy

The Group writes off loan balances (and any related allowances for impairment losses) when it has generally exhausted all possible efforts for collection and determines that the loans are no longer collectible.

(d) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Management of liquidity risk

The Group's approach to managing liquidity is to maintain, as far as possible, sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or putting the Group's reputation at risk.

Treasury is entrusted with the responsibility of ensuring compliance with both statutory liquidity requirements and internal risk limits. All liquidity risk management policies and procedures are subject to review and approval by ALCO, RC, Board Risk Committee and the Board.

The Group maintains a portfolio of short-term liquid assets, largely made up of investment grade marketable securities and UAE Central Bank certificates of deposit, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained both under normal conditions and simulated stress scenarios. **13.03%** (2011: 16.22%) of the Group's deposits are pledged against customer loans and advances and contingencies and commitments.

The Group uses advances to deposits ratio of 1:1 as stipulated by the UAE Central Bank as one of the key risk indicators and monitors this on a regular basis. The Group uses more prudent internal advances to deposits ratio measure of 0.9:1 as a trigger point for action planning. During the year, the advances to deposits ratio was as follows:

	2012	2011
December 31	**0.83:1**	0.85:1
Minimum	**0.82:1**	0.80:1
Average	**0.86:1**	0.86:1
Maximum	**0.89:1**	0.93:1

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(d) Liquidity risk (continued)

Management of liquidity risk (continued)

The Group manages its concentration of deposits by continuing to widen the customer base and setting in place caps on individual size and varying maturities.

Liquidity risk appetite is prudently and proactively reviewed taking into consideration the market events and relevant risk management standards. Adherence to the longer stress period is being achieved through reliance on both higher quality and adequate level of liquid assets. The Group monitors 4 week stress test under two scenarios of local market crisis and one / two notch downgrade in line with its liquidity risk appetite. There is an enhanced focus on liability diversification and improving duration to manage liquidity gaps effectively.

The table below shows the undiscounted cash flows of the Group's financial assets and liabilities and commitments on the basis of their earliest possible contractual maturity and / or expected date of settlement or realization. The amounts set out below may not necessarily represent actual cash flows. For example, demand deposits from customers are expected to maintain a stable balance and term deposits are often rolled over on maturity. Loans and advances are partly of revolving nature. Cash and balances with the UAE Central Bank include certificate of deposits which are readily convertible into cash under repurchase arrangements with the UAE Central Bank. Investments include available-for-sale investments which can be redeemed before their contractual maturity.

At 31 December 2012	Less than 1 month AED'000	1 month to 3 months AED'000	Over 3 months to 6 months AED'000	Over 6 months to 1 year AED'0000	Over 1 year to 5 years AED'000	Over 5 years AED'000	Total AED'000
Cash and balances with the UAE Central Bank	1,133,209	200,570	601,994	475,879	-	-	2,411,652
Due from banks and financial institutions	875,119	147,775	-	-	-	-	1,022,894
Loans and advances	2,642,197	2,947,871	1,341,524	869,498	4,067,115	1,616,717	13,484,922
Investments	777	152,015	229,139	120,029	239,593	64,408	805,961
Other assets	317,967	374,328	215,125	7,262	6,990	-	921,672
Total financial assets	4,969,269	3,822,559	2,387,782	1,472,668	4,313,698	1,681,125	18,647,101
At 31 December 2012							
Due to banks	206,675	346,108	64,906	-	-	-	617,689
Customer deposits	4,457,872	2,776,916	1,262,979	1,852,759	1,168,109	1,461,712	12,980,347
Term borrowings	751	5,176	5,927	118,631	1,063,434	-	1,193,919
Other liabilities	298,914	431,578	215,125	7,262	6,990	-	959,869
Total financial liabilities	4,964,212	3,559,778	1,548,937	1,978,652	2,238,533	1,461,712	15,751,824
On Balance Sheet Gap	5,057	262,781	838,845	(505,984)	2,075,165	219,413	
Cumulative Gap	5,057	267,838	1,106,683	600,699	2,675,864	2,895,277	
At 31 December 2011							
Financial Assets	4,621,988	2,564,304	1,901,076	1,234,587	4,249,506	1,434,160	16,005,621
Financial Liabilities	5,635,987	2,427,096	835,133	879,683	2,935,185	471,558	13,184,642
On Balance Sheet Gap	(1,013,999)	137,208	1,065,943	354,904	1,314,321	962,602	
Cumulative Gap	(1,013,999)	(876,791)	189,152	544,056	1,858,377	2,820,979	

Notes to the consolidated financial statements (continued)

4. **Financial risk management (continued)**

(d) **Liquidity risk (continued)**

Management of liquidity risk (continued)

The table below incorporates guarantees, letters of credit and notional amounts of derivative financial instruments, entered into by the Group, outstanding at the date of consolidated statement of financial position, analyzed by the earliest period these can be called. The notional amount is the value of the derivative's underlying asset and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicators of either the market risk or the credit risk. The amounts set out below do not represent expected cash flows.

	Less than 1 month AED'000	1 month to 3 months AED'000	Over 3 months to 6 months AED'000	Over 6 months to 1 year AED'000	Over 1 year to 5 years AED'000	Over 5 years AED'000	Total AED'000
At 31 December 2012							
Guarantees	4,027,299	-	-	-	-	-	4,027,299
Letters of credit	173,981	597,552	282,497	116,015	5,253	-	1,175,298
Forward foreign exchange contracts	1,064,266	425,592	672,481	113,751	69,569	-	2,345,659
Currency options	-	-	-	1,485,346	-	-	1,485,346
Interest rate swaps	9,347	12,437	12,294	24,588	473,288	-	531,954
Swaptions	-	-	-	-	183,650	-	183,650
	5,274,893	1,035,581	967,272	1,739,700	731,760	-	9,749,206
At 31 December 2011							
Guarantees	3,949,910	-	-	-	-	-	3,949,910
Letters of credit	162,517	637,507	203,869	54,709	1,469	-	1,060,071
Forward foreign exchange contracts	2,449,828	739,031	393,808	226,647	-	-	3,809,314
Currency options	91,872	244,270	38,928	187,666	-	-	562,736
Interest rate swaps	3,105	45,384	9,315	17,797	537,714	-	613,315
Interest rate future options	-	91,825	183,650	91,825	-	-	367,300
	6,657,232	**1,758,017**	**829,570**	**578,644**	**539,183**	**-**	**10,362,646**

The positive / negative fair values of derivative financial instruments, entered into by the Group, at the reporting date are depicted below:

	2012		2011	
	Positive fair value AED'000	Negative fairvalue AED'000	Positive fair value AED'000	Negative fair value AED'000
Derivatives				
Forward foreign exchange contracts	13,683	11,580	29,138	23,725
Currency options	3,630	3,630	20,210	20,210
Interest rate swaps	10,850	13,111	14,666	14,034
Interest rate future options	-	-	21	15
Swaptions	3,121	3,121	-	-
	31,284	31,442	64,035	57,984

4. Financial risk management (continued)

(e) Market risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates, commodity prices and credit spreads will affect the Group's income or the value of its holdings of financial instruments.

Management of market risks

The Group distinguishes its exposure to market risk between trading and non-trading portfolios. The Group manages market risk positions within the risk management limits set out by the Board. Overall responsibility for monitoring market risk is vested in ALCO.

Credit risk arising on investments is managed independently by the RC and CCC but reported as a component of market risk exposure for reporting purposes.

Investment price risk

The risk originates primarily from the investment portfolio of the Group which is managed on a fair value basis. The Group manages the risk through diversification of investments in terms of counterparty, industry and country. The Group monitors and reviews portfolio performance on a monthly basis.

ALCO reviews sensitivity of investment price volatility on annualized income. The stop loss limit of 20% is followed unless ALCO and RC believe a different level is appropriate, when Board approval is obtained.

The table below shows the impact of decline in fair value of investments by 10% on net income and equity for 2012 and 2011:

	Assumed level of change %	Impact on net income and equity 2012 AED '000	Impact on net income and equity 2011 AED '000
Investments carried at fair value			
through the income statement			
Reference benchmarks:			
Fair value of managed funds	10%	2,768	3,777

	Assumed level of change %	Impact on equity 2012 AED '000	Impact on equity 2011 AED '000
Available for sale investments			
Reference benchmarks:			
Quoted debt securities	10%	40,984	21,893
Investments in listed equity	10%	63	52

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(e) Market risk (continued)

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates and arises from financial instruments denominated in a foreign currency. The Board of Directors has set limits on positions by currencies which are closely monitored. Exceptions, if any, are only allowed by seeking prior approval of ALCO and RC supported by a business case and ratification by the Board. During the year, the Group complied with the open position limits and exception approval process.

The Group carries out sensitivity analysis on the basis of 5% shift in exchange rate and analyzes their impact on annualized exchange income. ALCO reviews currency limits based on these sensitivities.

The UAE currency is pegged to the US Dollar and this is considered while setting the limits and analyzing the sensitivity impact.

At 31 December, the Group's open positions and potential impact of a shift in exchange rate on the statement of income are as follows:

Currency	**USD**	**EUR**	**Others**
Open position			
2012 (AED in 000's)	**91,252**	**(1,459)**	**4,945**
2011 (AED in 000's)	107,316	494	(3,465)
Assumed change in exchange rates	5%	5%	5%
Impact on exchange income from increase in exchange rates:			
2012 (AED in 000's)	**4,563**	**(73)**	**247**
2011 (AED in 000's)	5,366	25	(173)
Impact on exchange income from decrease in exchange rates:			
2012 (AED in 000's)	**(4,563)**	**73**	**(247)**
2011 (AED in 000's)	(5,366)	(25)	173

At 31 December 2012, the impact on exchange income due to change in exchange rate by 5% is **±8.5%** (2011: ±10.4%). Excluding the impact of US$ open position, the impact is **±0.3%** (2011: ±0.3%).

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(e) Market risk (continued)

Interest rate risk

The principal risk to which financial assets and liabilities are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates.

The Group's treasury manages interest rate risk principally through monitoring interest rate gaps and matching the interest re-pricing profile of financial assets and liabilities. The Group's long term financial assets and liabilities are priced on a floating rate basis, which tracks the changes in market interest rates. Retail personal loans are priced on a fixed rate basis and constitute **4.89%** (2011: 4.62%) of the total loan portfolio. The pricing of these loans reflect the fixed rate nature of the product and are generally priced at higher spread.

The Group also carries out sensitivity analysis on the net interest income for one year assuming changes (whether increase or decrease) in interest rates. An analysis of the Group's sensitivity to an increase or decrease in market interest rates based on the financial assets and financial liabilities, denominated in various currencies, held at 31 December, assuming no asymmetrical movement in yield curves and a constant statement of financial position, is as follows:

Currency	AED	USD	EUR	Others	Total
Assumed change in interest rates	±200 bps	±200 bps	±200 bps	±200 bps	±200 bps
Impact on net interest income from increase in interest rates:					
2012 (AED in 000's)	**35,000**	**-**	**-**	**2,000**	**37,000**
2011 (AED in 000's)	24,000	(4,000)	1,000	2,000	23,000
Impact on net interest income from decrease in interest rates:					
2012 (AED in 000's)	**(42,000)**	**-**	**-**	**(2,000)**	**(44,000)**
2011 (AED in 000's)	(42,000)	2,000	(1,000)	(7,000)	(48,000)

The results of the shift analysis are reviewed monthly by ALCO, who along with MC has the overall responsibility for managing pricing policy. An impact of 5% or higher on total shareholders' equity is followed as a trigger event based on which an action plan is agreed. At 31 December 2012, the impact of 200 bps shift analysis on net interest is **+7.3% / -8.7%** (2011: +5.4% / -11.3%) and regulatory capital is **+1.2% / -1.4%** (2011: +0.81% / -1.70%).

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(e) Market risk (continued)

The Group's interest rate gap position on financial assets and liabilities based on the earlier of contractual re-pricing or maturity date is as follows:

At 31 December 2012	Less than 1 month AED'000	1 month to 3 months AED'000	Over 3 months to 6 months AED'000	Over 6 months to 1 year AED'000	Over 1 to 5 years AED'000	Over 5 years AED'000	Non-interest bearing items AED'000	Total AED'000
Cash and balances with the UAE Central Bank	250,000	200,000	600,000	475,000	-	-	881,987	2,406,987
Due from banks and financial institutions	773,566	147,500	-	-	-	-	101,375	1,022,441
Loans and advances	4,230,056	5,135,953	1,737,567	138,615	587,338	163,647	202,832	12,196,008
Investments	99,330	371,434	110,870	51,095	55,032	62,760	28,311	778,832
Other assets	-	-	-	-	-	-	1,010,256	1,010,256
Total financial assets	5,352,952	5,854,887	2,448,437	664,710	642,370	226,407	2,224,761	17,414,524
Due to banks	422,282	102,877	64,836	-	-	-	27,084	617,079
Customer deposits	2,260,442	3,717,299	1,239,990	1,752,030	151,069	1,030,033	2,289,239	12,440,102
Term borrowings	1,046,805	-	-	106,746	-	-	-	1,153,551
Other liabilities	-	-	-	-	-	-	1,020,829	1,020,829
Total financial liabilities	3,729,529	3,820,176	1,304,826	1,858,776	151,069	1,030,033	3,337,152	15,231,561
Interest rate sensitivity gap								
On-balance Sheet	1,623,423	2,034,711	1,143,611	(1,194,066)	491,301	(803,626)	(1,112,391)	
Off-balance Sheet	2,826	386,256	12,292	24,588	105,992	-	-	
Cumulative	1,626,249	4,047,216	5,203,119	4,033,641	4,630,934	3,827,308	2,714,917	
At 31 December 2011								
Cumulative interest rate sensitivity gap	(215,691)	2,957,017	3,647,812	3,135,126	3,046,383	3,531,752	2,598,947	

Interest rate yields

The average earning on placements and balances with banks was 0.51% *(2011:* 0.61%*)*, on loans and advances was 5.98% *(2011:* 6.08%*)* and on investments was 2.41% *(2011:* 2.91%*)*. The average cost of customer deposits was 2.05% *(2011:* 2.19%*)* and of bank borrowings was 1.85% *(2011:* 1.84%*)*.

4. Financial risk management (continued)

(f) Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Group's processes, personnel, technology and infrastructure and from external factors other than credit, market and liquidity risks, such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Group's operations and are faced by all business entities. Potential loss may be in the form of financial loss or other damages, for example loss of reputation and public confidence that will impact the Group's credibility and ability to do business.

The Group's objective in managing operational risk is to balance avoidance of financial losses and damage to the Group's reputation with overall cost effectiveness.

The Group has defined policies and procedures which are followed to manage operational risk through the ORC forum. Compliance with Group standards is supported by a programme of periodic risk and internal control assessments and reviews undertaken by Internal Audit and Operational Risk and Compliance. The results of reviews are discussed with the businesses and functional units to which they relate and regular reports are provided to the RC, Board Risk Committee and the Board.

(g) Management of capital

The Group's lead regulator, the UAE Central Bank, sets and monitors regulatory capital requirements. The requirements of capital for subsidiary, NBF Financial Services FZC, are determined by the Free Zone Authority of Fujairah.

The Group's objectives and strategy when managing capital are:

- To maintain adequate level and achieve an optimum structure for the Group's capital commensurate to its strategy, risk profile and relative positioning in the market
- To ensure compliance with the regulatory requirements
- To plan for replacement of Tier 2 capital and the Group's liquidity management
- To efficiently allocate capital to various businesses leading to enhanced shareholder value
- To ensure effective internal organisation and processes and to assess and manage material risks on an ongoing basis
- To provide for any unforeseen losses

The Group's capital management is carried out centrally and determines the level of risk-weighted assets growth and the optimal amount and mix of capital required to support planned business growth.

The Group and its subsidiary have complied with all externally imposed capital requirements throughout the year.

In implementing capital requirements, the Group calculates its capital adequacy ratio in accordance with the guidelines issued by the UAE Central Bank dated 17 November 2009. The UAE Central Bank introduced the implementation of Basel II with Standardized Approach which the Group follows while at the same time developing risk management measurement tools and robust practices to become Basel II Foundation Internal Rating Based Approach (FIRB) compliant bank. The UAE Central Bank places considerable emphasis on the Internal Capital Adequacy Assessment Planning (ICAAP) and the Group is developing and implementing economic capital model to comply with the UAE Central Bank requirements.

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(g) Management of capital (continued)

The Group's regulatory capital adequacy ratio is set by the Central Bank which is 12 % analyzed in two tiers, of which Tier 1 capital adequacy ratio must not be less than 8%. The Group has complied with its capital adequacy ratio calculation in accordance with Basel II Standardized Approach for credit, market and operational risks.

The Group's regulatory capital is analyzed into two tiers:

- Tier 1 capital, which includes ordinary share capital and retained earnings (excluding current year profit); and
- Tier 2 capital, which includes fair value reserves relating to unrealized gains / losses on investments classified as available-for-sale, collective impairment provision and subordinated facilities. The following limits have been applied for Tier 2 capital:
  - Total tier 2 capital shall not exceed 67% of tier 1 capital;
  - Subordinated liabilities shall not exceed 50% of total tier 1 capital; and
  - Collective impairment provision shall not exceed 1.25% of total risk weighted assets.

	31 December 2012 AED'000	31 December 2011 AED'000
Tier 1 Capital		
Share capital	1,100,000	1,100,000
Statutory reserve	283,539	255,447
Special reserve	178,539	150,447
Retained earnings	397,550	282,809
Total Tier 1	1,959,628	**1,788,703**
Tier 2 Capital		
Available-for-sale revaluation reserve	3,396	(8,441)
Subordinated facilities (note 16.1 & 16.2)	914,083	894,352
Collective impairment provision	178,583	156,079
Total Tier 2	1,096,062	**1,041,990**
Deductions from Tier 1 and Tier 2 Capital		
Investments in unconsolidated subsidiaries	-	-
Total capital base (a)	3,055,690	**2,830,693**

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(g) Management of capital (continued)

Risk weighted assets

	31 December 2012 Risk weighted equivalent AED'000	31 December 2011 Risk weighted equivalent AED'000
Credit risk	15,169,519	13,359,472
Market risk	3,628	5,029
Operational risk	728,918	573,503
Total risk weighted assets (b)	15,902,065	13,938,004
Capital adequacy ratio (a) / (b) - %	19.22	20.31

The Group has prepared an ICAAP document and submitted to the Central Bank for the years ended December 2010 and December 2011. The Group's ICAAP report includes assessment and review of the following keeping in mind a forward-looking approach:

- Risk management framework to assess, measure, monitor and control all the material elements of risks;
- Risk profile and business strategy;
- Capital required to cover all material risks;
- Stress testing risks to assess capital requirement under stressed conditions; and
- Capital planning and budgeting.

Apart from credit, market and operational risk covered in Pillar I, the ICAAP report covers other material risks like liquidity risk, concentration risk, interest rate risk in banking book, strategic risk, residual risk, reputational risk, etc. The ICAAP report also covers stress testing framework for credit, market, liquidity and interest rate risk on banking book. The Pillar II CAR for the year ended 31 December 2012 was 17.73% (2011: 18.41%).

Risk weights for credit risk

The Group has a diversified funded and unfunded credit portfolio. The exposures are classified as per the approach mentioned under the Central Bank of UAE Basel II Capital Adequacy Framework covering the Standardized Approach for credit risk. The descriptions of the counterparty classes along with the risk weights used to derive the risk weighted assets are as follows:

Claims on sovereigns

These pertain to exposures to governments and their central banks. Claims on central banks and sovereigns are risk weighted in accordance with their ratings from acceptable ECAIs, except that, for all GCC sovereigns a 0% weight has been applied.

Claims on public sector entities (PSEs)

Domestic currency claims on GCC non-commercial PSE are treated as claims on GCC sovereign if their Central Bank or monetary authority treats them as such. Foreign currency claims on GCC PSE are treated one grade less favourable than its sovereign i.e. 20% risk weight are applied.

Claims on other foreign non-commercial PSE are treated one grade less favourable than its sovereign. Claims on commercial PSE are treated as claims on corporate.

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(g) Management of capital (continued)

Risk weights for credit risk (continued)

Claims on multilateral development banks (MDBs)

All MDBs are risk weighted in accordance with the respective credit rating except for those members listed in the World Bank Group which are risk weighted at 0%.

Claims on banks

Claims on banks are risk weighted based on the ratings assigned to them by external rating agencies, however, short term claims denominated in local currency are assigned more favourable risk weighting.

Claims on corporate portfolio

Claims on corporate are risk weighted in accordance with ratings from acceptable ECAIs. Risk weightings for unrated corporate claims are assigned at 100%.

Claims on regulatory retail exposures

Retail claims that are included in the regulatory retail portfolio are assigned risk weights of 75%, if it meets the criteria mentioned in the Central Bank of UAE Basel II guidelines. Claims which do not meet the criteria are assigned risk weights of 100%.

Claims secured by residential property

A preferential risk weight of 35% is applied on claims that do not exceed AED 10 million and are secured by residential property with LTV of up to 85%. Other claims secured on residential property are risk weighted at 100%.

Claims secured by commercial property

100% risk weight is applied on claims secured by commercial property.

Past due exposures

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

- 150% risk weight where specific provisions are less than 20% of the outstanding amount of the loan; and
- 100% risk weight where specific provisions are equal to or greater than 20% of the outstanding amount of the loan.

Equity portfolios

Equity in banking book is risk weighted at 150%.

Other exposures

These are risk weighted at 100%.

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(g) Management of capital (continued)

Risk weights for credit risk (continued)

Credit risk and risk weights

2012 (AED'000)	On balance sheet Gross outstanding	Off balance sheet Net exposure after CCF	Credit risk mitigation (CRM) Exposure before CRM	CRM	After CRM	Risk-weighted assets
Claims on sovereigns	2,714,488	1,021	2,715,509	-	2,715,509	-
Claims on public sector entities	928,502	43,595	972,097	140,572	831,525	831,525
Claims on banks	2,081,748	56,581	2,138,329	-	2,138,329	692,391
Claims on corporates	8,264,342	3,746,274	12,010,616	1,175,406	10,835,210	10,835,210
Regulatory retail exposures	966,398	11,351	977,749	26,501	951,248	951,248
Residential retail portfolio	567,987	-	567,987	10,346	557,641	557,641
Commercial real estate	622,825	-	622,825	-	622,825	622,825
Past due exposures	1,167,091	18,825	513,801	54,761	459,040	459,139
Higher-risk categories	28,311	-	28,311	-	28,311	42,467
Other exposures	277,553	-	277,553	-	277,553	177,073
Total	17,619,245	3,877,647	20,824,777	1,407,586	19,417,191	15,169,519

2011 (AED'000)	On balance sheet Gross outstanding	Off balance sheet Net exposure after CCF	Credit risk mitigation (CRM) Exposure before CRM	CRM	After CRM	Risk-weighted assets
Claims on sovereigns	2,295,609	1,169	2,296,778	-	2,296,778	-
Claims on public sector entities	280,982	766	281,748	7,000	274,748	274,748
Claims on banks	953,370	175,607	1,128,977	-	1,128,977	361,467
Claims on corporates	7,933,997	3,572,154	11,506,151	1,195,550	10,310,601	10,182,912
Regulatory retail exposures	870,192	13,321	883,513	70,064	813,449	813,382
Residential retail portfolio	371,487	-	371,487	12,853	358,634	358,634
Commercial real estate	499,228	-	499,228	-	499,228	499,228
Past due exposures	1,320,976	3,382	717,373	45,916	671,457	671,457
Higher-risk categories	38,289	-	38,289	-	38,289	57,434
Other exposures	212,285	-	212,285	-	212,285	140,210
Total	**14,776,415**	**3,766,399**	**17,935,829**	**1,331,383**	**16,604,446**	**13,359,472**

Notes to the consolidated financial statements (continued)

4. Financial risk management (continued)

(g) Management of capital (continued)

Credit risk and risk weights (continued)

The Group uses the following external credit assessment institutions (ECAIs): Standards & Poor, Moody's and Fitch. The external rating of ECAI is mapped to the prescribed credit quality assessment scale that in turn produces standard risk weightings. The Group uses Credit Risk Mitigation techniques (CRM) whereby only cash and bank guarantees are used in calculation of Pillar I Capital requirements.

Market risk and risk weights

The Group's capital charge, in respect of market risk in accordance with the Standardized methodology, is as follows:

	2012	2011
	AED'000	AED'000
Interest rate risk		
- Specific interest rate risk	-	-
- General interest rate risk	-	-
Equity position risk	-	-
Foreign exchange risk	435	603
Option risk	-	-
Total market risk capital charge	435	603
Market risk – risk weighted assets	3,628	5,029

In line with Basel II Accord, investments designated as fair value through profit or loss form part of the banking book rather than the trading book. Accordingly, the designated investment portfolio has been covered under credit risk.

Capital charge against option risk is nil (2011: nil), as all currency options are covered through back-to-back transactions with the respective counter parties.

Operational risk and risk weights

Capital requirement for operational risk is calculated using the Standardized Approach. The total capital charge is calculated by multiplying the specified eight business line's three (3) - year average net interest and net non-interest income by a percentage (beta) assigned to each of the business lines. The beta factors range from 12% to 18%, as specified in the Basel II Accord.

5. Financial assets and liabilities

5.1 Classification

The fair values and carrying values of the financial assets and liabilities at 31 December are shown below:

2012	At fair value through profit or loss AED'000	At fair value through equity AED'000	Held-to-maturity AED'000	Loans and advances AED'000	Other amortised cost AED'000	Carrying amount AED'000
Financial assets						
Cash and balances with the UAE Central Bank	-	-	-	-	2,406,987	2,406,987
Due from banks and financial institutions	-	-	-	-	1,022,441	1,022,441
Loans and advances	-	-	-	12,196,008	-	12,196,008
Investments	27,682	410,464	340,686	-	-	778,832
Other assets	-	-	-	-	1,010,256	1,010,256
Total financial assets	27,682	410,464	340,686	12,196,008	4,439,684	17,414,524
Financial liabilities						
Due to banks	-	-	-	-	617,079	617,079
Customer deposits	9,489	-	-	-	12,430,613	12,440,102
Term borrowings		-	-	-	1,153,551	1,153,551
Other liabilities					1,020,829	1,020,829
Total financial liabilities	9,489	-	-	-	15,222,072	15,231,561

2011	At fair value through profit or loss AED'000	At fair value through equity AED'000	Held-to-maturity AED'000	Loans and advances AED'000	Other amortised cost AED'000	Carrying amount AED'000
Financial assets						
Cash and balances with the UAE Central Bank	-	-	-	-	2,103,840	2,103,840
Due from banks and financial institutions	-	-	-	-	614,091	614,091
Loans and advances	-	-	-	10,505,260	-	10,505,260
Investments	37,766	219,455	326,677	-	-	583,898
Other assets	-	-	-	-	991,588	991,588
Total financial assets	**37,766**	**219,455**	**326,677**	**10,505,260**	**3,709,519**	**14,798,677**
Financial liabilities						
Due to banks	-	-	-	-	540,212	540,212
Customer deposits	39,173	-	-	-	10,299,407	10,338,580
Term borrowings	-	-	-	-	918,250	918,250
Other liabilities	-	-	-	-	1,016,003	1,016,003
Total financial liabilities	**39,173**	**-**	**-**	**-**	**12,773,872**	**12,813,045**

Notes to the consolidated financial statements (continued)

5. Financial assets and liabilities (continued)

5.2 Fair value measurement – fair value hierarchy:

2012	Level 1	Level 2	Level 3
	AED'000	AED'000	AED'000
On balance sheet items			
Investments			
- Debt securities	409,835	-	-
- Other investments	629	27,682	-
Customer deposits	-	9,489	-
Off balance sheet items - derivatives			
Forward foreign exchange contracts	-	2,345,659	-
Currency options	-	1,485,346	-
Interest rate swaps	-	531,954	-
Swaptions	-	183,650	-

2011	Level 1	Level 2	Level 3
	AED'000	AED'000	AED'000
On balance sheet items			
Investments			
- Debt securities	218,931	-	-
- Other investments	524	37,766	-
Customer deposits	-	39,173	-
Off balance sheet items - derivatives			
Forward foreign exchange contracts	-	3,809,314	-
Currency options	-	562,736	-
Interest rate swaps	-	613,315	-
Interest rate future options	-	367,300	-

During the year, there were no transfers between Level 1 and Level 2 of the fair value hierarchy above. Further, there has been no change in the valuation techniques in relation to valuation of financial instruments, as discussed in note 3, during the year.

Notes to the consolidated financial statements (continued)

6. Cash and balances with the UAE Central Bank

	2012 AED'000	2011 AED'000
Cash on hand (note 27)	100,480	72,074
Certificates of deposit (CDs) with the UAE Central Bank	1,525,000	1,525,000
Other balances with the UAE Central Bank (note 6.1)	781,507	506,766
	2,406,987	2,103,840

6.1 Other balances with the UAE Central Bank include regulatory cash reserve deposits of AED 398.1 million (2011: AED 363.0 million).

7. Due from banks and financial institutions

	2012 AED'000	2011 AED'000
7.1 By type		
Placements	921,067	544,666
Current accounts	101,374	69,425
	1,022,441	614,091
7.2 By geographical area		
Within UAE	662,246	413,961
GCC countries	79,187	77,833
Others	281,008	122,297
	1,022,441	614,091
7.3 *The currency wise analysis is set out below*:		
AED	558,185	334,399
USD	321,376	178,514
EURO	49,501	53,931
GBP	28,942	20,424
Others	64,437	26,823
	1,022,441	614,091

Notes to the consolidated financial statements (continued)

8. Loans and advances

	2012 AED'000	2011 AED'000
8.1 Loans and advances by type:		
Overdrafts	1,317,162	1,220,654
Term loans	8,110,586	6,961,523
Loans against trust receipts	1,852,710	1,578,965
Bills discounted	1,101,314	765,735
Bills drawn under letters of credit	604,920	630,601
	12,986,692	11,157,478
Allowance for impairment losses (note 10)	(790,684)	(652,218)
Net loans and advances	12,196,008	10,505,260

9. Contingent liabilities and commitments

Contingent liabilities represent credit related commitments under letters of credit and guarantees which are designed to meet the requirements of the Group's customers towards third parties. Commitments represent contractually binding commitments to extend credit and other capital expenditure commitments of the Group which are undrawn at the date of consolidated statement of financial position.

	2012 AED'000	2011 AED'000
Contingent liabilities:		
- Letters of credit covering movement of goods	1,175,298	1,060,071
- Financial guarantees and other direct credit substitutes	477,809	391,897
- Bid bonds, performance bonds and other transaction related contingencies	3,549,490	3,558,013
	5,202,597	5,009,981
Commitments:		
- Undrawn commitments – credit related	11,076,002	8,301,885
- Others	35,818	22,955
	11,111,820	8,324,840
	16,314,417	13,334,821

These contingent liabilities and commitments represent unfunded credit risk and related fees and accruals for probable losses are recognised in the consolidated statement of financial position until the commitments and contingent liabilities are either fulfilled or expired. Many of the contingent liabilities and commitments will expire without being funded in whole or in part. Therefore, the amounts do not necessarily represent expected future cash flows.

Notes to the consolidated financial statements (continued)

10. Allowance for impairment losses on loans and advances

	2012	2011
Movement in allowances for impairment losses	AED'000	AED'000
Balance at 1 January	652,218	658,065
Net allowance for impairment losses	173,707	113,329
Written-off during the year	(35,241)	(119,176)
Balance at 31 December	790,684	652,218

11. Investments

	2012	2011
	AED'000	AED'000
Investments at fair value through profit or loss (FVPL) (note 11.1)	27,682	37,766
Available-for-sale (AFS)		
Debt securities (note 11.2)	409,835	218,931
Other investments	629	524
	410,464	219,455
Held-to-maturity (HTM)		
Debt securities (note 11.2)	340,686	326,677
	778,832	583,898

11.1 Investments at FVPL include various funds whose fair values are based on the net asset values provided by the fund managers.

11.2 Debt securities aggregating **AED 750.5 million** (2011: AED 545.6 million) represent the Group's investments in bonds and notes which are quoted on recognized exchanges and prices are available on internationally recognized platforms of Reuters and Bloomberg and are liquid in normal market conditions. Debt securities portfolio includes floating rate securities amounting to **AED 581.6 million** (2011: AED 489.9 million).

11.3 The counterparty dispersion of the investment portfolio is set out below:

	2012	2011
	AED'000	AED'000
Government	104,565	88,317
Banks and financial institutions	593,013	387,531
Others	81,254	108,050
	778,832	583,898

Notes to the consolidated financial statements (continued)

11. Investments (continued)

11.4 An analysis of investments based on external credit ratings is as follows:

2012	Debt securities AED'000	Other investments AED'000	Total AED'000
AA	14,909	-	14,909
AA-	18,682	-	18,682
A+	47,851	-	47,851
A	386,500	-	386,500
A-	24,360	-	24,360
BBB+	168,532	-	168,532
BBB	26,735	-	26,735
BBB-	12,497	629	13,126
Unrated	50,455	27,682	78,137
	750,521	28,311	778,832

2011	Debt securities AED'000	Other investments AED'000	Total AED'000
AA-	96,932	-	96,932
A+	156,856	-	156,856
A	209,884	-	209,884
A-	12,176	-	12,176
BBB+	7,279	-	7,279
BB+	22,018	-	22,018
BB	-	524	524
Unrated	40,463	37,766	78,229
	545,608	38,290	583,898

11.5 The geographic dispersion of the investment portfolio is as follows:

	2012 AED'000	2011 AED'000
Within UAE	493,756	449,877
GCC Countries	14,909	7,279
Others	270,167	126,742
	778,832	583,898

Notes to the consolidated financial statements (continued)

11. Investments (continued)

11.6 The currency wise analysis of the investment portfolio is set out below:

	2012 AED'000	2011 AED'000
AED	451,556	445,627
USD	215,973	68,658
EURO	111,303	69,613
	778,832	583,898

12. Property and equipment

AED'000	Freehold land	Buildings & leasehold improvements	Motor vehicles, furniture, EDP & other equipment	Total
Cost				
At 1 January 2011	**14,066**	**104,261**	**46,492**	**164,819**
Additions	-	4,032	3,348	7,380
Disposals	-	-	(580)	(580)
At 31 December 2011	**14,066**	**108,293**	**49,260**	**171,619**
At 1 January 2012	14,066	108,293	49,260	171,619
Additions	-	5,677	4,551	10,228
Disposals	-	-	-	-
At 31 December 2012	14,066	113,970	53,811	181,847
Depreciation				
At 1 January 2011	**-**	**40,134**	**38,456**	**78,590**
Charge for the year	-	5,409	5,970	11,379
On disposals	-	-	(580)	(580)
At 31 December 2011	**-**	**45,543**	**43,846**	**89,389**
At 1 January 2012	-	45,543	43,846	89,389
Charge for the year	-	4,622	3,937	8,559
On disposals	-	-	-	-
At 31 December 2012	-	50,165	47,783	97,948
Net book value				
At 31 December 2012	14,066	63,805	6,028	83,899
At 31 December 2011	**14,066**	**62,750**	**5,414**	**82,230**

The buildings in Fujairah, Dibba, Masafi, Qidfa and Tawian are constructed on land granted to the Group by the Government of Fujairah. The land is shown at a nominal value of AED 1 each (2011: AED 1 each).

Notes to the consolidated financial statements (continued)

12. Property and equipment (continued)

12.1 Capital work-in-progress

	2012	2011
	AED'000	AED'000
Premises and equipment (note 12.2)	1,322	53
Intangible assets (note 12.3)	5,293	4,767
	6,615	4,820

12.2 Premises and equipment costs were incurred in respect of the Group's ATM enhancement and credit card infrastructure projects. (2011: Premises and equipment costs were incurred in respect of the Group's buildings in Dubai and Fujairah for facilities management).

12.3 The cost of intangible assets is in respect of the purchase of software and directly attributable costs relating to the implementation of Internet Banking. (2011: The cost of intangible assets is in respect of the purchase of software and directly attributable costs relating to the implementation of Credit Automated Work Flow System and Internet Banking).

13. Intangible assets

	2012	2011
	AED'000	AED'000
Cost		
At 1 January	26,854	26,854
Additions	14,059	-
At 31 December	40,913	26,854
Amortization		
At 1 January	22,993	17,844
Charge for the year	4,927	5,149
At 31 December	27,920	22,993
Net book value	12,993	3,861

The cost of intangible assets comprises the cost of the Group's version upgrade of the core banking software, license cost including customization cost, and directly attributable implementation costs of the project necessarily incurred to bring the software to the state of use. It also includes purchase of software and directly attributable costs relating to the implementation of Credit Automated Work Flow System, Human Resources System and Internet Banking and other software purchases. The cost is being amortised over the estimated useful life of 5 years.

Notes to the consolidated financial statements (continued)

14. Other assets

	2012	2011
	AED'000	AED'000
Accrued interest	88,584	65,941
Prepayments and deposits	10,404	8,900
Customer liabilities for acceptances	879,544	900,012
Others	58,309	40,511
	1,036,841	1,015,364

15. Due to banks and term borrowings

	2012	2011
	AED'000	AED'000
By type:		
Club term loan facility (note 15.1)	863,155	863,155
Bilateral borrowing (note 15.2)	290,396	55,095
	1,153,551	918,250
Short-term borrowings	617,079	540,212
	1,770,630	1,458,462
By geographical area:		
Within UAE	353,135	197,109
GCC Countries	183,650	7,349
Others	1,233,845	1,254,004
	1,770,630	1,458,462

15.1 On 24 June 2011, the Group arranged a club term loan facility of AED 863.2 million (USD 235 million) through a syndicate of banks. The facility carries a floating rate which is the aggregate of margin plus LIBOR and is repayable in full on 12 June 2014.

Under the terms of the agreement, the Group is required to maintain a minimum capital adequacy ratio calculated on the basis of Basel II Accord as applicable in the UAE; to maintain a minimum tangible net worth of USD 425 million; and to maintain its ratio of impaired loans to total funded gross loans, which shall not be greater than ten (10%) percent at any time, subject to the exclusion of certain facilities as stipulated in the agreement. The respective conditions stipulated above have been complied with, as at the reporting date.

15.2 During 2012, the Group has arranged three term loan facilities through banks amounting to AED 290.4 million. The facilities carry interest rate which is the aggregate of margin and LIBOR. As per the terms of the agreements, one facility extends to 1 year, second 2 years and the third 3 years after the disbursement date.

Notes to the consolidated financial statements (continued)

16. Customer deposits

	2012	2011
	AED'000	AED'000
By type:		
Demand and margin deposits	2,749,291	2,117,244
Saving deposits	52,289	33,309
Fixed term and notice deposits	8,595,918	7,145,423
Subordinated debt (note 16.1 & 16.2)	1,042,604	1,042,604
	12,440,102	10,338,580
By geographical area:		
Within UAE	11,883,520	9,804,409
Others	606,582	534,171
	12,440,102	10,338,580

16.1 The Group received deposits aggregating to AED 643 million in 2008 from the Ministry of Finance of the UAE. On 31 December 2009, the Group entered into an agreement with UAE Ministry of Finance, through which these deposits are now subordinate to equity subject to certain conditions as set out in the agreement and included in Tier 2 capital. As per the terms of the conversion and subordination agreement and subject to certain conditions to be adhered to, the tenure of the loan extends to 7 years from the date of conversion and is payable in full on maturity with an early repayment option. The loan carries stepped up pricing over the tenure, with interest payable quarterly.

16.2 On 19 August 2008, the Group arranged a term subordinated loan facility with a finance company amounting to AED 400 million. The facility carries interest rate which is the aggregate of margin and EIBOR, payable quarterly commencing from 19 November 2008. As per the terms of the facility, the full principal amount of the facility is to be repaid on 19 August 2018. The Central Bank has approved the facility to be considered as Tier 2 capital for regulatory purposes.

17. Other liabilities

	2012	2011
	AED'000	AED'000
Accrued interest	60,960	32,854
Employee terminal and other long term benefits	26,820	23,525
Accrued expenses	53,691	45,274
Directors' attendance fees	2,200	2,200
Liabilities under acceptances	879,544	900,012
Others	41,838	51,270
	1,065,053	1,055,135

Notes to the consolidated financial statements (continued)

18. Shareholders' equity

18.1 *Share capital*

	2012 AED'000	2011 AED'000
Authorised, issued and fully paid:		
1,100,000,000 shares of AED 1 each (2011: 1,100,000,000 shares of AED 1 each)	1,100,000	1,100,000

The Board of Directors proposed a cash dividend of 10% (2011: 10%) of the share capital for the year ended 31 December 2012.

18.2 *Statutory and special reserve*

In accordance with the Bank's Articles of Association, the provisions of Article 82 of Union Law No. 10 of 1980 and Article 192 of Federal Law No. 8 of 1984 (as amended), 10% of the profit for the year shall be transferred to a statutory reserve which is not distributable. Additionally, in accordance with the Bank's Articles of Association, another 10% of the profit for the year shall be transferred to a special reserve which is to be used for purposes to be determined by the ordinary general meeting upon the proposal of the Board of Directors.

19. Interest income

	2012 AED'000	2011 AED'000
Loans and advances	741,567	633,356
Due from banks including the UAE Central Bank CDs	10,733	12,365
Investments	15,588	18,992
	767,888	664,713

20. Interest expense

	2012 AED'000	2011 AED'000
Due to banks including term borrowings	31,885	27,872
Customer deposits	231,110	210,307
	262,995	238,179

21. Net fees and commission income

	2012 AED'000	2011 AED'000
Fees and commission income		
Letters of credit	61,288	58,151
Letters of guarantee	40,591	36,931
Lending fees	66,453	58,191
Asset management and investment services	102	157
Commission on transfers	15,746	12,371
Others	925	1,044
Total fees and commission income	185,105	166,845
Fees and commission expense		
Brokerage expense	246	253
Card related charges	3,342	3,030
Total fees and commission expense	3,588	3,283
Net fees and commission income	181,517	163,562

Notes to the consolidated financial statements (continued)

22. Income from investments

	2012	2011
	AED'000	AED'000
Net fair value gains on investments	3,165	2,452
Dividend income	13	9
	3,178	2,461

23. Other operating income

	2012	2011
	AED'000	AED'000
Rental income	1,270	1,071
Rebates	3,187	3,168
Other miscellaneous income	9,608	3,940
	14,065	8,179

24. Employee benefits expense

Employee benefits expense includes employee bonus of **AED 27,479 thousand** (2011: AED 21,065 thousand). The number of employees at 31 December 2012 was **607** (including **513** relating to the Bank) of which **209** (relating to the Bank) were UAE nationals (2011: 576 (including 500 relating to the Bank) of which 202 (relating to the Bank) were UAE nationals).

25. Earnings per share

The calculation of earnings per share is based on earnings of **AED 305,807 thousand** (2011: AED 280,925 thousand) divided by the weighted average number of shares of **1,100,000 thousand** (2011: 1,100,000 thousand shares) outstanding during the year.

Notes to the consolidated financial statements (continued)

26. Related parties

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In the case of the Group, related parties, as defined in the International Accounting Standard No. 24, include major shareholders of the Group, directors and officers of the Group and companies of which they are principal owners and key management personnel. Banking transactions are entered into with related parties on agreed terms and conditions approved by the Board of Directors. The significant transactions included in the consolidated financial statements are as follows:

	31 December 2012 AED'000	Average balance during 2012 AED'000	31 December 2011 AED'000	Average balance during 2011 AED'000
Statement of financial position items				
Loans and advances	971,587	907,729	822,765	928,383
Customer deposits	3,311,737	3,117,011	2,696,494	2,539,588
Investments	40,446	40,236	40,463	40,277
Letters of credit	47,313	59,109	69,261	68,328
Financial guarantees and other direct credit substitutes	9,727	15,142	16,653	16,796
Transaction related contingencies	101,889	112,588	108,731	125,943
Acceptances	76,649	54,581	49,125	219,602
Statement of income items				
Interest income	39,438		43,270	
Interest expense	86,601		76,842	
Other income	6,317		7,980	
Key management compensation				
Salaries and other short-term benefits	13,672		14,298	
Employee terminal and other long-term benefits	403		319	
Directors' attendance fees	2,200		2,200	

No provisions for impairment have been recognized in respect of loans given to related parties (2011: Nil).

The loans given to related parties amounting to **AED 971.6 million** (2011: AED 822.8 million) have been secured against collateral amounting to **AED 149.7 million** (2011: AED 144.0 million).

Notes to the consolidated financial statements (continued)

27. Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise the following balances from the date of acquisition:

	2012	2011
	AED'000	AED'000
Cash on hand	100,480	72,074
Balances with the UAE Central Bank (note 27.1)	1,908,395	1,668,789
Due from banks with less than three months maturity	1,022,441	564,091
	3,031,316	2,304,954
Due to banks with less than three months maturity	(552,243)	(540,212)
	2,479,073	1,764,742

27.1 Balances with the UAE Central Bank include certificates of deposit which are negotiable with the UAE Central Bank.

28. Segmental reporting

The Group uses business segments for presenting its segment information in line with the Group's management and internal reporting structure. The Group's operations are confined mainly in the UAE.

Business segments pay and receive interest, to and from Treasury on an arm's length basis to reflect allocation of capital and funding costs.

Business segments

The Group conducts its activity through the following clearly defined business segments:

Wholesale banking

The segment offers a range of products and services including credit and trade finance products, and services to large sized and small to medium size corporate customers through separate units and to financial institutions, and accepts deposits. The segment also offers transactional services to small-sized businesses.

Retail banking

The segment offers a range of products and services to individuals and high net worth individuals including personal and mortgage loans, credit cards, other transactions and balances, and accepts their deposits.

Treasury, Asset and Liability Management (ALM) and others

The segment undertakes the Group's asset and liability management centrally and is responsible for optimum utilization of resources in productive assets and management of exchange and interest positions within the limits and guidelines set by management and approved by the Board.

Treasury also offers various foreign exchange and derivative products to customers and is entrusted with the responsibility of managing the Group's investment portfolio together with Asset and Liability Committee. The Group's capital and investment in subsidiary is recognised under this segment.

The Group has central shared services which include Operations, Risk Management, Human Resources, Finance, Information Technology, Product Development, Legal, Credit and Internal Audit. The shared services cost is allocated to business segments based on transaction and relevant drivers.

Notes to the consolidated financial statements (continued)

28. Segmental reporting (continued)

The segment analysis based on business segments is set out below:

2012	Wholesale banking AED'000	Retail banking AED'000	Treasury, ALM and Others AED'000	Consolidated AED'000
Segment revenue	644,478	54,191	60,813	759,482
Segment operating cost	(174,068)	(92,696)	(13,204)	(279,968)
Net impairment losses	(195,832)	22,125	-	(173,707)
Net profit / (loss)	274,578	(16,380)	47,609	305,807
Segment assets	12,433,647	784,002	4,326,967	17,544,616
Segment liabilities	11,796,838	992,165	2,486,782	15,275,785
Capital expenditure	-	-	24,287	24,287

2011	Wholesale banking AED'000	Retail banking AED'000	Treasury, ALM and others AED'000	Consolidated AED'000
Segment revenue	555,233	47,306	48,212	650,751
Segment operating cost	(157,303)	(85,093)	(14,101)	(256,497)
Net impairment losses	(106,895)	(6,434)	-	(113,329)
Net profit / (loss)	**291,035**	**(44,221)**	**34,111**	**280,925**
Segment assets	10,957,666	536,068	3,419,630	**14,913,364**
Segment liabilities	9,773,531	630,778	2,447,868	**12,852,177**
Capital expenditure	-	-	7,380	**7,380**

Notes to the consolidated financial statements (continued)

28. Segmental reporting (continued)

An analysis based on revenues derived by products and services is set out below:

Revenues derived by products and services	2012	2011
	AED'000	AED'000
Interest income on loans and advances		
Overdrafts	79,080	78,067
Term loans	411,615	341,750
Loans against trust receipts	134,389	106,641
Bills discounted	63,251	55,899
Bills drawn under letters of credit	53,232	50,999
	741,567	633,356
Fees and commission income		
Letters of credit	61,288	58,151
Letters of guarantee	40,591	36,931
Lending fees	66,453	58,191
Asset management and investment services	102	157
Commission on transfers	15,746	12,371
Others	925	1,044
	185,105	166,845