بنك اليوباف العربي الدولي ش.م.ب. (م)

ALUBAF ARAB INTERNATIONAL BANK B.S.C (C)

ANNUAL REPORT 2008

Business, more than any other occupation, is a continual bridging of present experience with future opportunities; an instinctive exercise in advancing with foresight.

inspired by Henry R. Luce

Alubaf Bank successfully completes its first fully operational year and looks to the future with refreshed perspectives, renewed vigour and progressive ambitions,. Having resumed its journey onto the financial shores of business, Alubaf Bank is set to re-establish its name as a wholesale bank whose operations encompass Treasury, Trade finance and Lending. More importantly, the bank seeks to leverage not just its wealth of experience in the industry but its unique, strategically positioned location in Bahrain which would act as a bridge onto a wider spread clientele of North Africa and Middle East. A spiraling galaxy of opportunities lie ahead waiting to be seized as the bank seeks to exploit this crucial geographical asset to enable it to keep an eye on emerging investment trends that would help consolidate its position further as another leading bank from the region and a force to reckon with.

CONTENTS

Registered Office
ALUBAF Arab International Bank BSC©, Wind Tower, 2nd Floor, Diplomatic area, P.O. Box 11529, Manama, Kingdom of Bahrain
Tel: +973 17517722, Tele fax: + 973 17540094

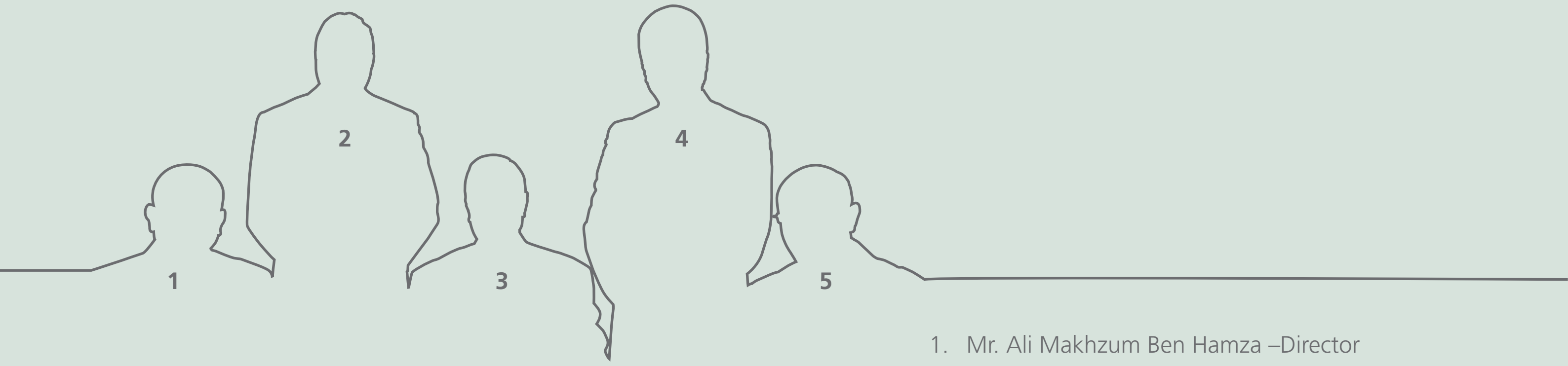
ALUBAF Arab International Bank BSC© is a wholesale bank registered in the Kingdom of Bahrain, ALUBAF reactivated its business in the region effective December 2007, ALUBAF's operations include Treasury, Trade finance and Lending.

VISION

ALUBAF visualizes to be a premier wholesale bank in providing effective banking solutions and bridge the gap between North Africa and Middle East.

MISSION

To augment shareholder value with prudent financial management and to entrench a disciplined risk and cost management culture and be a premier provider of Trade finance.



1. Mr. Ali Makhzum Ben Hamza –Director
2. Mr. Ahmed I Rajab –General Manager
3. Dr. Mohamed Abdulla Bait Elmal –Director
4. Mr. Suleiman Esa Al Azzabi –Director
5. Mr. Saifullah Asaad Moosa Salim –Director

BOARD OF DIRECTORS

Mr. Mohamed Najib Hmida Eljamal - Chairman

BA in Accounting, with over 30 years of International Banking experience.

Additionally, a Board member of :

- ARESBANK, Madrid, Spain
- Arab Bank for Investment and Foreign Trade, Abudhabi, UAE
- Arab International Bank, Cairo, Egypt

Also,

- General Manager, Libyan Foreign Bank, Libya
- Consultant , Arab Turkish Bank, Istanbul, Turkey

Formerly, a Board member of :

- British Arab Commercial Bank, London, UK

Dr. Mohamed Abdulla Bait Elmal –Director

DBA in Accounting with over 30 years of experience in Finance and Banking.

Additionally, a Board member of :

- and Chairman, Libyan Foreign Bank, Libya
- British Arab Commercial Bank, London, UK

Formerly,

- Head of Auditor General, Libya
- Minister of Finance, Libya

Mr. Suleiman Esa Al Azzabi –Director

Masters in Banking and Finance, with 20 years of experience.

Additionally, a Board member of :

- Arab Financial Services, Bahrain
- A&T Financial Leasing company-Turkey

Also,

- General Manager, Foreign Exchange & Financial Services Co.-Libya
- Committee member, Leasing Law-Libya

Mr. Saifullah Asaad Moosa Salim –Director

BA in Accounting, with over 25 years of Banking experience

- Manager, International Finance Department, Libyan Foreign Bank, Libya

Formerly,

- A Board member of ALUBAF International Bank, Tunis

Mr. Ali Makhzum Ben Hamza –Director

BA in Statistics, with over 25 years of Banking experience

- Deputy Manager, Treasury Department, Libyan Foreign Bank, Libya

THE BOARD OF DIRECTOR'S STATEMENT

On behalf of the Board of Directors of ALUBAF Arab International Bank B.S.C©, it gives me great pleasure in presenting our Annual Report and Audited Financial Statements for the year ended 31 December 2008.

The year 2008 was the first full operational year for ALUBAF Bahrain since its reactivation, where, the bank commenced its various banking activities in International trade finance, Loans and Credit, in addition to, its Treasury services. It is believed that, the bank succeeded to restore its identity among the other working banks in the Kingdom of Bahrain.

Nevertheless, such achievement would have not taken place without the strong support received from its major shareholder, the Libyan Foreign Bank, Tripoli. This support has been proved by increasing the Bank's Capital by USD 50 million at the end of June 2008, thus bringing the total paid up capital to USD 100 million and has laid the foundation in providing a significant boost to the business activities.

Despite the International financial crisis at all frontiers and levels, which pushed the global interest rates to its lowest levels and narrowing the scope of the active financial products, the Bank succeeded to achieve a reasonable net profit of USD 8,160,000, which is considered a real accomplishment in the light of the negative outlook for 2008. Consequently, USD 816,000 has been transferred to statutory reserve.

It is gratifying to note that in the first year of reactivation of business activity, the Bank managed to record a total assets of USD 513 million, maintaining comfortable financial ratios.

"In the first year of reactivation of business activity, the Bank managed to record a total assets of USD 513 million."

The Global economic meltdown witnessed in 2008 will continue to leave its deleterious effect on the banking sector, employment and the global growth during 2009. The collapse of the international equity markets and the consequent volatility in the global financial markets, has clearly reduced the potential for growth in world's output, trade and investment in 2009. The negative consequences of the deterioration that has taken place during 2008 cannot be accurately assessed until the developed countries agree on consistent and standardized criteria to evaluate the related unprecedented damage since the second world war.

In the midst of a global financial turmoil, ALUBAF Bahrain, along with its peers, in the global market is not expected to be away from turbulence, forcing ALUBAF Bahrain to adopt a conservative approach in planning and drafting its budget for 2009, to mitigate and avoid the unforeseen market risk. Therefore, a business consultant was appointed in 2008 with an aim to build a strategic road map for 2009, in order to, improve productivity and adding innovative products, which, shall ensure sustainable growth. Meanwhile, the Bank will maintain utilizing the best practice approach to enhance its operation and improve productivity. The bank would capitalize on its sound start to generate lucrative return out of its successful operations, which represents the Trade finance and commercial business especially between Arab countries and the rest of the world, which is anticipated in generating lucrative operational income during 2009.

Once again on behalf of the Board of Directors and Shareholders, I would like to thank the Bahrain Ministry of Industry and Commerce and the Central Bank of Bahrain for their support, guidance and unstinting efforts during the turbulent year, which ensured the financial stability for the working banks in the Kingdom of Bahrain. Also, we would like to express our gratitude especially to Libyan Foreign Bank and all our correspondent banks for their cooperation, and the entire staff for their hard work, loyalty and achievement.

Mohammed Najeeb Al Jamal
Chairman

MESSAGE FROM GENERAL MANAGER

The year 2008 earmarked a turning point in the history of ALUBAF Arab International bank. During 2008 the bank embarked its reactivation of business operations leaving behind a decade of silence with a renewed organization program and a fresh strategic thrust. 2008 was a year of accomplishments for ALUBAF. The bank moved forward, strived vigorously to build, ensure and grow towards achieving its overall goal amid the global financial crisis. The Bank made significant stride and progress in 2008:

- Infused additional Capital to strengthen its balance sheet
- Reconstituted its Board of Directors for a sound corporate governance
- Formulated a clear business plan and strategy
- Recruited quality executive management team
- Accomplished regulatory compliance
- Realized significant good earnings and
- Enhanced banks position within the regional and international banking industry.

With enormous pride and delight I can say that our decision to reactivate the business activities of the bank, is proved right and reflects the rational business strategy that produced fruits through the outstanding closing results of 2008.

ALUBAF BUSINESS STRATEGY

Our renewed strategy is clear,

- to attain sustainable growth in providing innovative banking solutions
- to act as a bridge for the international banking requirements of North Africa with Middle East and the rest of the world
- to become a premier provider of Trade Finance business.

"The profit generated in 2008 stood at $ 8.16 million in comparison to $ 4 million in 2007."

ALUBAF`s core aim is to render reliable services to exporters and importers alike, where they can really count on. Such mission has been inspired from the market driving forces and current financial crisis, which has shaped ALUBAF's business plan. Entertaining Trade Finance business in such market condition is to be considered a very smart strategy for a bank, to just run its engine, in order, to ensure maximum security and optimization of its capital. In light of such a strategy, the bank ensures to maximize the efficiency of a wide range of related services provided along with Letters of credit , on confirmation, discounting and back to back Letters of credit.

We have successfully increased the volume of business and revenues in Trade Finance through developing strong and long term business relationship with major banks and customers.

OPERATIONAL ACHIEVEMENTS

In the very first year of reactivation of business activity, ALUBAF's assets has been increased to $ 513 million in 2008 from $ 44 million (last year) , signifying an increase of twelve times over last year and the profit generated in 2008 stood at $ 8.16 million in comparison to $ 4 million in 2007.

Our successful infusion of additional capital to increase the paid up capital to $ 100 million from $ 50 million, strengthened and propelled the revival activities. We monitor the capital adequacy ratio, which is maintained well above regulatory norms . We successfully established banking relationships with all major financial institutions in the MENA / Central Africa regions. The Bank, significantly increased its clientele for current accounts, which offers excellent and exclusive service to the account holders by our dedicated staff.

ORGANISATIONAL DEVELOPMENTS

TREASURY SERVICES

Despite the challenging financial climate in 2008, our Treasury team took a lead role in optimally managing the Bank`s liquidity through the interbank market and investing excess liquidity in a very prudent and safe way thus contributing a good source of revenue for the bank.

We are looking forward for a prosperous 2009 in Treasury services, as we have developed excellent banking relationship with various banks in the MENA region and we are broadening our range of products and services which are developed by a very highly capable and skilled staff.

CREDIT AND MARKETING

Our Credit and Marketing team, is the key, in focusing new business and establishing banking / client relationship. We are very proud to say that in a very short period of time, we recorded good earnings from quality short term assets.

MESSAGE FROM GENERAL MANAGER

We are participants in most of the major syndicated lending's and have a large customer current accounts balances which are a milestone in our quality Balance Sheet.

Credit management also played a vital role in monitoring and controlling the various stages of credit process in order to maintain a high quality credit portfolio in line with the policies of Risk Management.

RISK MANAGEMENT AND COMPLIANCE

Risk management team performs an independent process of identifying, assessing , monitoring, controlling and reporting risk. The Board of Directors is responsible for the best practice management and risk oversight. Board of Directors oversees the definition of risk appetite, risk tolerance standards and risk process standards to be kept in place. The bank has implemented the Basle II and the capital adequacy is monitored as per the regulatory Central Bank of Bahrain requirements.

Compliance of Anti money laundering and know your customer procedures are very strictly adhered to as per the guidelines of our Regulatory authority and required review by auditors is conducted.

HUMAN RESOURCES

2008 being our first year of revival of operations, the Human Resources team was instrumental in recognizing and bringing in quality staff. In a short time frame, HR has implemented several key programs in the areas of job restructuring, job evaluation and compensation patterns. We envisage to introduce various new innovative methods in 2009, for development of staff skills which is imperative in this competitive field.

CORPORATE GOVERNANCE

The bank recognized the vital role of a sound Corporate governance that can influence , control and play an integral part of fairness, transparency and accountability.

The Bank reconstituted its Board of Directors, developed an effective management framework based on best corporate governance principles. The Bank's supervisory and execution function are organized to achieve its primary goal and objectives. The Board of Directors are responsible for the Bank's overall policy, strategy and supervision of executive management, while, the executive management is responsible for day to day execution of business. The Bank's corporate auditors conducts final audits and quarterly reviews of financials to ensure regulatory compliance.

FUTURE GROWTH

ALUBAF is now looking beyond 2008 and ensures to deliver high class banking services in the field of Money market , Trade Finance and improving the Banks financial position to achieve another remarkable performance in 2009, in pursuit of its corporate goal, by, constantly emphasizing on improvement and prudent management.

CONCLUSION

Finally, I would like to thank the Bahrain government, Central Bank of Bahrain, shareholders and customers for their support. I also extend my thanks to all my colleagues for their relentless efforts in achieving our goals and results.

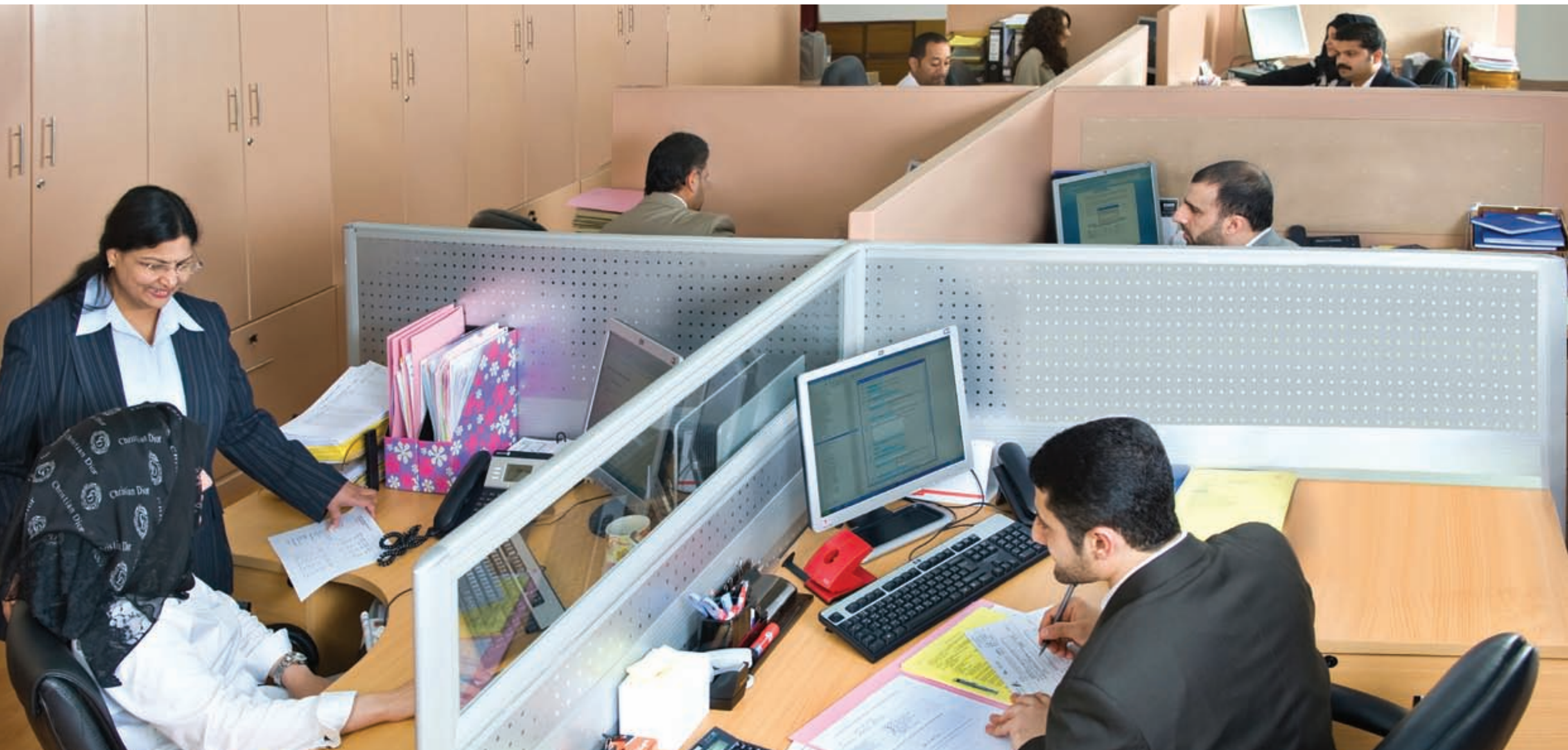
A Rajab

Ahmed I Rajab
General Manager

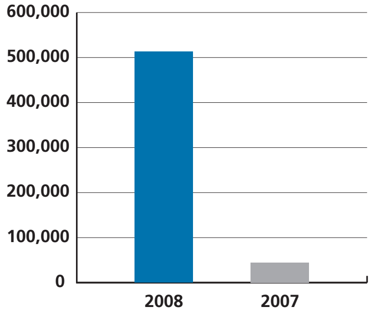
FINANCIAL HIGHLIGHTS

YEAR ENDED 31 DECEMBER

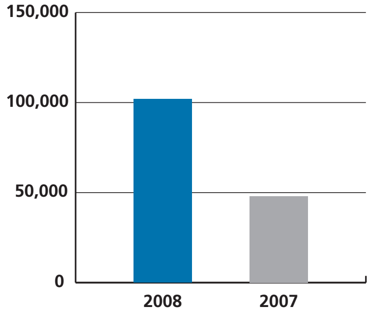
	2008 US $ '000s	2007 US $ '000s
Net Profit	8,160	4,033
Total assets	513,156	44,481
Total loans	81,847	36,663
Total liabilities	410,644	129
Total equity	102,512	44,352
ROAA - Return on average assets (%)	3%	9%
ROAE - Return on average equity (%)	11%	10%
Cost to income	16%	10%
Capital adequacy ratio	44%	–
Equity/ Assets ratio	20%	–



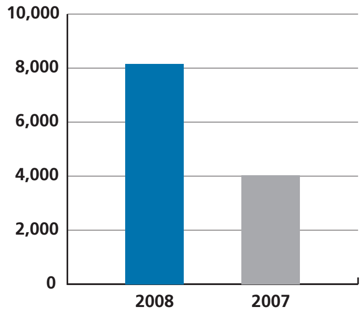
Total Assets US$ '000s



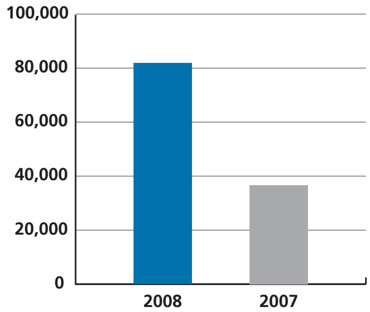
Shareholder's funds US$ '000s



Net Profit US$ '000s



Total loans US$ '000s



ERNST & YOUNG

P.O. Box 140
14th Floor - The Tower
Bahrain Commercial Complex
Manama, Kingdom of Bahrain
Tel: +973 1753 5455 Fax: +973 1753 5405
manama@bh.ey.com
www.ey.com/me
C.R. No. 6700

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF ALUBAF ARAB INTERNATIONAL BANK B.S.C.

We have audited the accompanying financial statements of ALUBAF Arab International Bank B.S.C. © ("the Bank"),which comprise the balance sheet as at 31 December 2008 and the statements of income, cash flows and changes in equity for the year then ended, and summary of significant accounting policies and other explanatory notes.

Board of Directors' Responsibility for the Financial Statements

The Board of Directors is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial reporting standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error: selecting and applying appropriate accounting policies: and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 financial statements in order to design audit procedures that are appropriate for 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 the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the 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 financial statements present fairly, in all material respects, the financial position of the bank as of 31st December 2008 and its financial performance and its cash flows for the year then ended in accordance with International Financial reporting standards.

Other Regulatory Matters

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

Ernst + Young

24 February 2009
Manama, Kingdom of Bahrain

FINANCIAL STATEMENTS

BALANCE SHEET

AT 31 DECEMBER 2008

	Note	2008 US$ '000	2007 US$ '000
ASSETS			
Cash and balances with banks and the Central Bank of Bahrain	3	3,870	365
Deposits with banks and other financial institutions		418,981	5,597
Investment held for trading	4	49	151
Loans and advances	5	81,847	36,663
Land, property and equipment	6	4,423	180
Interest receivable		3,929	1,469
Other assets		57	56
TOTAL ASSETS		513,156	44,481
LIABILITIES AND EQUITY			
LIABILITIES			
Deposits from banks and other financial institutions		372,814	–
Due to banks		34,176	–
Interest payable		1,645	20
Other liabilities	7	2,009	109
Total liabilities		410,644	129
EQUITY			
Share capital	8	100,000	50,000
Statutory reserve	8	1,830	1,014
Retained earnings/(accumulated losses)		682	(6,662)
Total equity		102,512	44,352
TOTAL LIABILITIES AND EQUITY		513,156	44,481

General Manager

Chairman

The attached notes 1 to 13 from part of these financial statements.

STATEMENT OF INCOME

YEAR ENDED 31 DECEMBER 2008

	2008 US$ '000	2007 US$ '000
Interest income	9,278	3,418
Interest expense	(3,916)	–
Net interest income	5,362	3,418
Fee and commission income	1,059	–
Dividend income	–	5
Changes in fair value of investments held for trading	3,331	1,040
Foreign exchange loss	(8)	(3)
Other income	25	–
OPERATING PROFIT	9,769	4,460
Staff costs	(861)	(119)
Depreciation	(85)	(6)
Other operating expenses	(663)	(302)
OPERATING EXPENSES	(1,609)	(427)
PROFIT FOR THE YEAR	8,160	4,033

The attached notes 1 to 13 from part of these financial statements.

STATEMENT OF CASH FLOWS

YEAR ENDED 31 DECEMBER 2008

	2008 US$ '000	2007 US$ '000
OPERATING ACTIVITIES		
Profit for the year	8,160	4,033
Adjustments for:		
Depreciation	85	6
Changes in fair value of investments held for trading	(3,331)	(1,040)
Interest income on reclassification of asset	(189)	-
Dividend income	-	(5)
Operating profit before changes in operating assets and liabilities	4,725	2,994
Changes in operating assets and liabilities:		
Loans and advances	(41,562)	-
Deposits with banks and other financial institutions	(413,384)	(3,145)
Interest receivable	(2,460)	
Other assets	(1)	-
Deposits from banks and other financial institutions	372,814	-
Due to banks	34,176	-
Interest payable	1,625	20
Other liabilities	1,900	(5)
Net cash used in operating activities	(42,167)	(136)
INVESTING ACTIVITIES		
Purchase of land, property and equipment	(4,328)	(186)
Dividend income	-	5
Net cash used in investing activities	(4,328)	(181)
FINANCING ACTIVITY		
Issue of share capital	50,000	-
Net cash from financing activity	50,000	-
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,505	(317)
Cash and cash equivalents at 1 January	365	682
CASH AND CASH EQUIVALENTS AT 31 DECEMBER (NOTE 3)	3,870	365

The attached notes 1 to 13 from part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

YEAR ENDED 31 DECEMBER 2008

	Share capital US$ '000	Statutory reserve US$ '000	Accumulated /losses retained earnings US$ '000	Total US$ '000
Balance as of 31 December 2006	50,000	611	(10,292)	40,319
Profit for the year – 2007	–	–	4,033	4,033
Transfer to statutory reserve (note 8)	–	403	(403)	–
Balance as of 31 December 2007	50,000	1,014	(6,662)	44,352
Increase in share capital (note 8)	50,000	–	–	50,000
Profit for the year – 2008	–	–	8,160	8,160
Transfer to statutory reserve (note 8)	–	816	(816)	–
Balance as of 31 December 2008	100,000	1,830	682	102,512

The attached notes 1 to 13 from part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

AT 31 DECEMBER 2008

1 ACTIVITIES

ALUBAF Arab International Bank B.S.C. (c) («the Bank») is a closed Bahraini joint stock company incorporated in the Kingdom of Bahrain and registered with the Ministry of Industry and Commerce under Commercial Registration (CR) number 12819. The Bank operates under a wholesale banking licence issued by the Central Bank of Bahrain under the new integrated licensing framework.The Bank's registered office is at the Wind Tower Building, 2nd Floor, Diplomatic Area, P O Box 11529, Manama, Kingdom of Bahrain.

The Bank is majority owned by Libyan Foreign Bank, a bank registered in Libya.(note 8)

The financial statements for the year ended 31 December 2008 were authorised for issue in accordance with a resolution of the directors on 24 February 2009.

2 SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

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

Basis of preparation

The financial statements are prepared under the historical cost convention, as modified for measurement at fair value of investments held for trading.

The financial statements are presented in US Dollars which is the Bank's functional currency, and all values are rounded to the nearest thousand (US Dollar thousand) except where otherwise indicated.

The accounting policies are consistent with those used in previous year.

New standards and interpretations issued but not effective

The following standard has been issued but not effective:

IAS 1 - Presentation of financial statements (revised)

The application of IAS 1 (revised) which will be effective for the year ending 31 December 2009 will result in amendments to the presentation of the consolidated financial statements.

The application of above standard will result in amendments to the presentation of the financial statements when it becomes effective.

In October 2008, the International Accounting Standard Board [IASB] issued amendments to IAS 39,»Financial Instruments; Recognition and Measurement» and IFRS 7 «Financial instruments: Disclosures», titled «Reclassification of Financial assets» from the held for trading category to loans and advances category in particular circumstances.

The amendment to IFRS 7 introduce additional disclosure requirements if an entity has reclassified financial assets in accordance with IAS 39 amendments. The amendments are effective retrospectively from 1 July 2008.

2 SIGNIFICANT ACCOUNTING POLICIES continued

Investments held for trading

These investments are initially recorded at cost and subsequently remeasured at fair value with any gains and losses arising from changes in fair values being included in the statement of income in the period in which they arise. However the acquisition expense are expensed when acquired. Interest earned and dividends received are included in interest income and dividend income respectively.

Loans and advances

Loans and advances are stated at cost less any amounts written off and provision for impairment.

Deposits

All money market and customer deposits are carried at amortised cost, less amounts repaid.

Revenue recognition

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

(i) Interest income

Interest income and fees which are considered an integral part of the effective yield of a financial asset, are recognised using the effective yield method, unless collectability is in doubt. The recognition of interest income is suspended when the loans become impaired, such as when overdue by more than 90 days. Notional interest is recognised on impaired loans and other financial assets based on the rate used to discount future cash flows to their net present value.

(ii) Fee and commission income

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

(iii) Dividend income

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

Foreign currencies

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

Monetary assets and liabilities denominated in foreign currencies are re-translated into US Dollars at the rate of exchange prevailing at the balance sheet date. Any gains or losses are reflected in the statement of income.

Cash and cash equivalents

Cash and cash equivalents comprise cash, balances with banks and mandatory deposit with Central Bank of Bahrain.

2 SIGNIFICANT ACCOUNTING POLICIES continued

Provisions

Provisions are recognised when the Bank has a present obligation (legal and constructive) arising from a past event, and costs to settle the obligation are both probable and able to be reliably measured.

Land, property and equipment

Property and equipment are stated at cost less accumulated depreciation and any impairment in value. Land is not depreciated.

Estimated useful life of property and equipment other than land is three years.

Depreciation is provided on a straight-line basis over the estimated useful lives of three years.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset is included in the statement of income in the year the asset is derecognised.

Fair values

For investments actively traded in organised financial markets, fair value is determined by reference to quoted market bid prices at the close of business on the balance sheet date.

The fair value of interest-bearing financial assets and liabilities is estimated based on discounted cash flows using current market rates for financial instruments with similar terms and risk characteristics.

Trade and settlement date accounting

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

Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and the Bank intends to settle on a net basis.

Impairment and uncollectability of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the net present value of future anticipated cash flows, is recognised in the statement of income.

2 SIGNIFICANT ACCOUNTING POLICIES continued

Estimation uncertainty

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

The Bank's management exercises considerable judgment in the estimation of the amount and timing of future cash flows when determining the level of provision required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

3 CASH AND BALANCES WITH BANKS AND THE CENTRAL BANK OF BAHRAIN

	2008 US$ '000	2007 US$ '000
Cash and mandatory reserve deposit with the Central Bank of Bahrain	67	53
Money at call and short notice	3,803	312
	3,870	365

Cash and cash equivalents included in the statement of cash flows represent the money at call and short notice presented above.

4 INVESTMENT HELD FOR TRADING

This comprises equity shares of Arab Banking Corporation B.S.C. held by the Bank for US$ 49 thousand (2007: US$ 151 thousand).

As more fully explained in note 5, the Bank has reclassified US$ 40.2 million (2007:US$36.7 million) from "investment held for trading" to "loans and advances" in accordance with the amendment to IAS 39 and IFRS 7 issued by IASB in October 2008.

5 LOANS AND ADVANCES

Loans and advances are stated net of provisions for loan losses and interest in suspense.

	2008 US$ 000	2007 US$ 000
Sovereign loans	47,163	36,664
Commercial loans	34,684	–
Past due obligations	–	8,767
	81,847	45,431
Less: Provision for loan losses and interest in suspense	–	(8,767)
	81,847	36,664

Movements in the provision for loan losses were as follows:

	2008 US$ '000	2007 US$ '000
At 1 January	8,767	8,767
Written off during the year	(8,767)	–
At 31 December	–	8,767

The Bank has reclassified investments in Iraq note with a carrying value of US $ 40.2 million, effective 1 July 2008 from 'trading investment' to 'loans and advances' pursuant to the amendment to IAS 39 and IFRS 7 issued by IASB in October 2008 and considering the current global financial crisis as a rare circumstance in the financial sector.

	2008 US$ '000
Carrying value as at 1July 2008 the date of reclassification	40,096
Carrying value as at 31 December 2008	40,285
Fair value as at 31 December 2008	30,209
Loss in the statement of income if the financial asset is not reclassified to loans and advances as on 31 December 2008	10,076

The Bank earns an effective interest rate of 8.89% and expects to recover US $40.2 million on Iraq notes which were reclassified.

6 LAND, PROPERTY AND EQUIPMENT

	Freehold land US$ '000	Furniture, equipment and motor vehicles US$ '000	Total US$ '000
Cost			
At 31 December 2007	–	186	186
Additions during the year	4,232	96	4,328
At 31 December 2008	4,232	282	4,514
Depreciation			
At 31 December 2007	–	6	6
Depreciation for the year	–	85	85
At 31 December 2008	–	91	91
Net book value			
At 31 December 2008	4,232	191	4,423
At 31 December 2007	–	180	180

Significant amount of purchases in property and equipment were made towards the end of 31 December 2007 and during 2008.

7 OTHER LIABILITIES

	2008 US$ '000	2007 US$ '000
Accrued expenses	247	109
Unearned income/fee	114	–
Advance received on Letter of credit	1,648	–
	2,009	109

NOTES TO THE FINANCIAL STATEMENTS

AT 31 DECEMBER 2008

8 SHARE CAPITAL

The Bank has increased its share capital during the year by US$ 50 million, being an increase of 1 million shares of US$ 50 each in accordance with the resolution approved at the Extra Ordinary General Meeting held on 26 June 2008. Libyan Foreign Bank, Tripoli increased its current stake from 95.12% to 97.11% by contributing the additional US$ 50 million.

	2008 US$ '000	2007 US$ '000
Authorised:		
4,000,000 shares of US$ 50 each	200,000	200,000
Issued and fully paid:		
2,000,000 shares of US$ 50 each		
(2007: 1,000,000 shares of US$ 50 each)	100,000	50,000

Shareholders

	2008		2007	
	Percentage (%) holding	US$ '000	Percentage (%) holding	US$ '000
Libyan Foreign Bank	97.11	97,105	95.12	47,557
Central Bank of Egypt	1.43	1,429	2.86	1,429
Bank of Jordan Limited	0.56	561	1.12	561
Yemen Bank for Reconstruction and Development	0.56	561	0.56	281
National Bank of Yemen	0.34	344	0.34	172
	100.00	100,000	100.00	50,000

Statutory reserve

As required by the Bahrain Commercial Companies Law and the Bank's articles of association, a statutory reserve has been created by transfer of 10% of its annual profit. The Bank may resolve to discontinue such transfers when the reserve totals 50% of the paid up capital. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

9 COMMITMENTS AND CONTINGENT LIABILITIES

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

	2008 US$ '000	2007 US$ '000
Within one year	59	59
Within one to five years	160	219
	219	278

	2008 US$ '000	2007 US$ '000
Letters of guarantee	19	–
Letters of credit - maturing within 12 months	50,990	–
	51,009	–

10 RISK MANAGEMENT

10.1 Credit risk

Credit risk is the risk that a customer or counterparty will fail to meet a commitment, resulting in financial loss to the Bank. Such risk arises from lending, treasury and other activities undertaken by the Bank. Credit risk is actively monitored in accordance with the credit policies which clearly define delegated lending authorities, and procedures. The Bank manages its credit risk by monitoring concentration of exposures by geographic location and adhering to approved limits formulated. The Bank limits its risk on Off Balance sheet items with adequate collateral.

a. Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the balance sheet. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Gross maximum exposure 2008 US$ '000	Gross maximum exposure 2007 US$ '000
Cash and balances with banks and the Central Bank of Bahrain	3,857	365
Deposits with banks and other financial institutions	418,981	5,597
Loans and advances	81,847	36,663
Interest receivable	3,929	1,469
Total funded credit risk exposure	508,614	44,094
Unfunded exposure on contingent liabilities	51,009	–
Total credit risk exposure	559,623	44,094

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

10 RISK MANAGEMENT continued

b. Credit quality per class of financial assets

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

	Neither past due nor impaired			
	High standard grade US$ '000	Standard grade US$ '000	Watch list US$ '000	Total US$ '000
At 31 December 2008				
Cash and balances with banks and the Central Bank of Bahrain	3,870	–	–	3,870
Deposits with banks and other financial institutions	282,221	136,760	–	418,981
Loans and advances	2,653	79,194	–	81,847
Interest receivable	1,725	2,204	–	3,929
Total funded exposures	290,469	218,158	–	508,627
Contingent liabilities	–	51,009	–	51,009
Total unfunded exposures	–	51,009	–	51,009
Total exposures	290,469	269,167	–	559,636

	Neither past due nor impaired			
	High standard grade US$ '000	Standard grade US$ '000	Watch list US$ '000	Total US$ '000
At 31 December 2007				
Cash and balances with banks and the Central Bank of Bahrain	365	–	–	365
Deposits with banks and other financial institutions	–	5,597	–	5,597
Loans and advances	–	36,663	–	36,663
Interest receivable	–	1,469	–	1,469
	365	43,729	–	44,094
Contingent liabilities	–	–	–	–
Total unfunded exposures	–	–	–	–
Total of funded and unfunded exposures	365	43,729	–	44,094

Definition

(i) High standard-Undoubted through to good credit risk

(ii) Standard-Satisfactory through to adequate credit risk

(iii) Watch list-Watch list credit risk

NOTES TO THE FINANCIAL STATEMENTS

AT 31 DECEMBER 2008

10 RISK MANAGEMENT continued

c. Concentration of maximum exposure to credit risk

The geographical distribution of assets are as given below:

At 31 December 2008

ASSETS	Bahrain US$ '000	Other GCC countries US$ '000	Other Middle east & African countries US$ '000	Europe US$ '000	Rest of the world US$ '000	Total US$ '000
Cash and balances with banks and the Central Bank of Bahrain	155	359	68	1,497	1,791	3,870
Deposits with banks and financial institutions	250,319	62,394	65,000	36,268	5,000	418,981
Loans and advances	2,653	7,250	61,444	5,500	5,000	81,847
Interest receivable	1,680	147	1,999	7	96	3,929
Total funded exposures	254,807	70,150	128,511	43,272	11,887	508,627
Contingent liabilities	–	19	50,990	–	–	51,009
Total unfunded exposures	–	19	50,990	–	–	51,009
Total exposures	254,807	70,169	179,501	43,272	11,887	559,636

At 31 December 2007

ASSETS	Bahrain US$ '000	Other GCC countries US$ '000	Other Middle east & African countries US$ '000	Europe US$ '000	Rest of the world US$ '000	Total US$ '000
Cash and balances with banks and the Central Bank of Bahrain	325	–	7	33	–	365
Deposits with banks and financial institutions	–	–	5,597	–	–	5,597
Loans and advances	–	–	36,663	–	–	36,663
Interest receivable	–	–	1,469	–	–	1,469
Total funded exposures	325	–	43,736	33	–	44,094
Contingent liabilities	–	–	–	–	–	–
Total unfunded exposures	–	–	–	–	–	–
Total exposures	325	–	43,736	33	–	44,094

10 RISK MANAGEMENT continued

Sectoral classification of gross credit exposures

At 31 December 2008

ASSETS	Sovereign US$ '000	Banks & financial institutions US$ '000	Commercial & business US$ '000	Others US$ '000	Total US$ '000
Cash and balances with banks and Central Bank of Bahrain	–	3,870	–	–	3,870
Deposits with banks and other financial institutions	–	418,981	–	–	418,981
Loans and advances	47,163	–	34,684	–	81,847
Interest receivable	–	3,929	–		3,929
Total funded exposures	47,163	426,780	34,684	–	508,627
Contingent liabilities	–	51,009	–	–	51,009
Total unfunded exposures	–	51,009	–	–	51,009
Total of funded and unfunded exposures	47,163	477,789	34,684	–	559,636

At 31 December 2007

ASSETS	Sovereign US$ '000	Banks & financial institutions US$ '000	Commercial & business US$ '000	Others US$ '000	Total US$ '000
Cash and balances with banks and Central Bank of Bahrain	–	365	–	–	365
Deposits with banks and other financial institutions	–	5,597	–	–	5,597
Loans and advances	36,663	–	–	–	36,663
Interest receivable	–	1,469	–	–	1,469
Total funded exposures	36,663	7,431	–	–	44,094
Total of funded and unfunded exposures	36,663	7,431	–	–	44,094

10 RISK MANAGEMENT continued

10.2 Market risk

Market risk is the risk of potential financial loss that may arise from adverse changes in the value of a financial instrument or portfolio of financial instruments due to movements in interest rates, foreign exchange rates and equity. This risk arises from asset - liability mismatches, changes that occur in the yield curve and foreign exchange rates. Given the Bank's low risk strategy, aggregate market risk levels are considered very low.

10.2.1 Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature of reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through a number of means. The Bank's interest rate sensitivity position as of 31 December, is as follows:

Sensitivity analysis - interest rate risk

	Impact on statement of income	
	2008 US$ '000	2007 US$ '000
US Dollar		
at 25 bps increase/decrease	(+)(–)196	107

10.2.2 Currency risk

Currency risk arise from the movement of the rate of exchange over a period of time. The Bank's currency risk is limited to Euro denominated assets and liabilities, further other G.C.C currencies are pegged to US Dollars. The Bank limits this risk by monitoring positions on a regular basis. Thus, the Bank's exposure to currency risk is minimal and insignificant.

10 RISK MANAGEMENT continued

10.3 Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. During 2008 and 2007, the management depended on its own capital and assets were managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents and deposits with banks.

The maturity profile of the assets and liabilities at 31 December 2008 given below reflects the management's best estimates of the maturities of assets and liabilities that have been determined on the basis of the remaining period at the balance sheet date.

	Upto 1 Year						
At 31 December 2008	Upto 1 month US$ '000	1 to 3 months US$ '000	3 to 12 months US$ '000	Total US$ '000	More than 1 Year US$ '000	No specific maturity US$ '000	Total US$ '000
ASSETS							
Cash and balances with banks and the Central Bank of Bahrain	3,803	–	–	3,803	–	67	3,870
Deposits with banks and other financial institutions	409,731	9,250	–	418,981	–	–	418,981
Investment held for trading	–	–	–		–	49	49
Loans and advances	–	3,983	15,466	19,449	62,398	–	81,847
Land, property and equipment	–	–	–		–	4,423	4,423
Interest receivable	3,374	177	314	3,865	64	–	3,929
Other assets	–	–	–	–	57	–	57
Total assets	416,908	13,410	15,780	446,098	62,519	4,539	513,156
LIABILITIES							
Deposits from banks and other financial institutions	363,769	9,045	–	372,814	–	–	372,814
Due to banks	34,176	–	–	34,176	–	–	34,176
Interest payable	1,645	–	–	1,645	–	–	1,645
Other liabilities	1,799	–	–	1,799	114	96	2,009
Total liabilities	401,389	9,045	–	410,434	114	96	410,644
Net liquidity gap	15,519	4,365	15,780	35,664	62,405	4,443	102,512
Cumulative liquidity gap	15,519	19,884	35,664	–	98,069	102,512	–

NOTES TO THE FINANCIAL STATEMENTS

AT 31 DECEMBER 2008

10 RISK MANAGEMENT continued

	Upto 1 Year						
At 31 December 2007	Upto 1 month US$ '000	1 to 3 months US$ '000	3 to 12 months US$ '000	Total US$ '000	More than 1 Year US$ '000	No specific maturity US$ '000	Total US$ '000
ASSETS							
Cash and balances with banks and the Central Bank of Bahrain	312	–	–	312	–	53	365
Deposits with banks and other financial institutions	–	5,597	–	5,597	–	–	5,597
Investment held for trading	–	–	–		151	–	151
Loans and advances	–	–	–	–	36,663	–	36,663
Land and fixed assets	–	–	–	–	–	180	180
Interest receivable	1469	–	–	1,469	–	–	1,469
Other assets	56	–	–	56	–	–	56
Total assets	1,837	5,597	–	7,434	36,814	233	44,481
LIABILITIES							
Interest payable	–	–	–	–	–	20	20
Other liabilities	–	–	–	–	–	109	109
Total liabilities	–	–	–	–	–	129	129
Net liquidity gap	1,837	5,597	–	7,434	36,814	104	44,352
Cumulative liquidity gap	1,837	7,434	7,434	–	44,248	44,352	–

The maturity profile of the financial liabilities as at 31 December 2008 based on contractual undiscounted repayment obligations is as follows:

	Upto 1 year						
At 31 December 2008	Upto 1 month US$ '000	1 to 3 months US$ '000	3 to 12 months US$ '000	Total US$ '000	No fixed maturity US$	Over 5 years US$ '000	Total US$ '000
LIABILITIES							
Deposits with banks and financial institutions	363,969	9,045	–	373,014	–	–	373,014
Due to banks	34,176	–	–	34,176	–	–	34,176
Total financial liabilities	398,145	–	–	407,190	–	–	407,190

The Bank did not have financial liabilities as at 31 December 2007 and hence no disclosure of comparatives is applicable.

11 FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of the Bank>s financial instruments are not materially different from their carrying values at the balance sheet date except as disclosed to note 5 discussed above.

12 TRANSACTIONS WITH RELATED PARTIES

Related parties represent associated companies, shareholders, directors and key management personnel of the Bank, and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Bank's management.

Libyan Foreign Bank, Tripoli is the only related party the Bank had transactions with during the year 2008 and 2007.

Transactions with related parties included in the statement of income and balance sheet are as follows:

	2008 US$ '000	2007 US$ '000
Statement of income		
Interest income	116	3,418
Interest expense	1,248	–
Balance sheet		
Cash and balances with banks and the Central Bank of Bahrain	60	–
Deposits with banks and other financial institutions	–	5,597
Deposits from banks and other financial institutions	168,521	–

Compensation paid to the Board of Directors and key management personnel:

	2008 US$ 000	2007 US$ 000
Short term benefits*	284	98
End of term benefits	11	5
	295	103

* Includes fee paid to Board of Directors during the year US $ 152 thousand (2007: US $ 44 thousand).

NOTES TO THE FINANCIAL STATEMENTS

AT 31 DECEMBER 2008

13 CAPITAL ADEQUACY

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities.

The risk asset ratio, calculated in accordance with the capital adequacy guidelines, under Basel II, approved by the Central Bank of Bahrain.

	2008 US$ 000
Capital base:	
Tier 1 capital	102,512
Tier 2 capital	–
Total capital base (a)	102,512
Risk weighted assets (b)	234,466
Capital adequacy (a/b * 100)	43.72%
Minimum requirement	12.00%

BASEL II PILLAR III DISCLOSURES

31 DECEMBER 2008

TABLE OF CONTENTS

BASEL II PILLAR III DISCLOSURES

AT 31 DECEMBER 2008

1. INTRODUCTION

Central Bank of Bahrain, the regulating body for Banks and Financial Institutions in the Kingdom of Bahrain, provides a common framework for the implementation of Basel II accord.

The Basel II framework is based on three pillars:

- Pillar I defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk. The requirement of capital has to be covered by own regulatory funds.
- Pillar II addresses the Bank's internal processes for assessing overall capital adequacy in relation to risks (ICAAP). Pillar II also introduces the Supervisory review and Evaluation Process (SREP), which assesses the internal capital adequacy.
- Pillar III complements the other two pillars and focuses on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy.

This document gathers together all the elements of the disclosure required under Pillar III and complies with the public disclosure module of CBB, in order to enhance corporate governance and financial transparency. This disclosure report is in addition to the financial statements presented in accordance with International Financial Reporting Standards (IFRS).

2. CORPORATE STRUCTURE

ALUBAF Arab International Bank B.S.C. (c) ("the Bank") is a closed Bahraini joint stock company incorporated in the Kingdom of Bahrain and registered with the Ministry of Industry and Commerce under Commercial Registration (CR) number 12819. The Bank operates under a wholesale banking license issued by the Central Bank of Bahrain under the new integrated licensing frame work. The Bank's registered office is at Wind Tower Building, 2nd Floor, Diplomatic Area, P O Box 11529, Manama, Kingdom of Bahrain.

The Bank is majority owned by Libyan Foreign Bank (Shareholding 97.11%), a bank registered in Libya.

3. CAPITAL STRUCTURE

The Bank's capital base comprise of Tier I Capital, which includes share capital, statutory reserve and retained earnings.

The issued and paid up share capital of the Bank was US $ 100 million as at 31 December, 2008 comprising of 2 million shares of US$ 50 each.

3. CAPITAL STRUCTURE continued

Break down of Capital Base

	US$ '000s
Tier I	
Share capital	100,000
Statutory reserve	1,830
Retained earnings	682
Tier I Capital base	102,512
Less: Regulatory deductions	–
Net Available Capital Base	102,512

The Bank had increased its paid up capital during the year in June 2008 by US$ 50 million i.e., by 100% of the previous year 2007 paid up capital. This increase in capital contributed in reactivating the business in the region and widening the business activities, which contributed a net profit for the year of US$8,160 thousand and enabled to wipe off the accumulated losses of previous years. The net retained earnings after set off of accumulated losses and transfer to statutory reserve amounts to US$ 682 thousand. However there is no dividend proposed for the year 2008.

4. CAPITAL ADEQUACY RATIO (CAR)

The purpose of capital management at the Bank is to ensure the efficient utilization of capital in relation to business requirements and growth, risk profile and shareholders' returns and expectations.

The Bank manages its capital structure and makes adjustments in the light of changes in economic conditions and risk characteristics of its activities. In order to augment its capital resources, at an Extra Ordinary General meeting of the shareholders held on 26 June 2008, the shareholders of the Bank approved and increased it's paid up share capital from US$ 50 million to US$ 100 million.

Capital adequacy ratio calculation:

	US$ '000s
Tier I Capital Base	102,512
Risk weighted assets (RWA)	
Credit risk	230,025
Market risk	125
Operational risk	4,316
	234,446
Capital adequacy ratio	43.72%

The Bank's capital adequacy ratio of 43.72% is well above the minimum regulatory requirement of 12%.

5. PROFILE OF RISK-WEIGHTED ASSETS AND CAPITAL CHARGE

The Bank has adopted the standardized approach for Credit risk and market risk and the Basic indicator approach for Operational risk for regulatory reporting purposes. The Bank's risk weighted capital requirement for credit, market and operational risks are given below:

5.1 Credit risk

Definition of exposure classes per Standard Portfolio

The Bank has funded and unfunded credit portfolio. The exposures are classified as per the Standard portfolio approach mentioned under the CBB's Basel II capital adequacy framework covering the 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:

(a) Claims on sovereigns

These pertain to exposures to governments and their central banks. Claims on Bahrain are risk weighted at 0%. While claims on other sovereigns, denominated in a non-relevant currency and unrated are assigned a risk weight of 100%.

(b) Claims on banks

Claims on Banks are risk weighted based on the ratings assigned to them by external rating agencies, however, short term claims on locally incorporated banks and claims maturing within three months and denominated in Bahrain Dinars or US Dollars are risk weighted at 20%. Other claims on banks, which are in foreign currency, are risk weighted using standard risk weights ranging from 20% to 100%. All unrated claims on banks are assigned a risk weight of 50%.

(c) Claims on corporate portfolio

Claims on corporate portfolio are risk weighted based on external credit ratings and are assigned a risk weight of 100% for unrated corporate portfolio.

(d) Equity portfolios

Investments in listed equities are risk weighted at 100%.

(e) Other exposures

These are risk weighted at 100%.

5. PROFILE OF RISK-WEIGHTED ASSETS AND CAPITAL CHARGE continued

Credit exposure and risk weighted assets

US$ '000s	Gross exposure	Funded exposure	Unfunded exposure	Cash collateral	Risk weighted	Capital charge
Cash	14	14	-	-	-	-
Claims on Sovereigns	47,216	47,216	-	-	44,510	5,341
Claims on Banks	455,420	445,218	10,202	10,198	164,807	19,777
Claims on Corporate	12,250	12,250	-	-	12,250	1,470
Equity Portfolio	49	49	-	-	49	6
Other Exposures	8,409	8,409	-	-	8,409	1,009
	523,358	513,156	10,202	10,198	230,025	27,603

Gross credit exposure before credit risk mitigation

US$ '000s	Gross Credit exposure	Average Monthly balance
Cash	14	3
Claims from Sovereigns	47,216	44,283
Claims from Banks	455,420	171,825
Claims on Corporate	12,250	7,500
Equity Portfolio	49	71
Other exposures	8,409	5,178
Total Funded exposure	523,358	228,860
Unfunded exposures	10,202	4,683

Average monthly balance represents the average of the sum of twelve month end balance for the year ended 31 December 2008.

5. PROFILE OF RISK-WEIGHTED ASSETS AND CAPITAL CHARGE continued

5.2 Market risk

Foreign exchange positions constitute the market risk for capital charge. The Bank's capital charge in respect of market risk in accordance with the standardised methodology is as follows:

US$ '000s	Risk Weighted Assets	Capital Charge
Foreign exchange risk	125	10
	125	10

5.3 Operational risk

In accordance with the Basic indicator approach, the total capital charge in respect of operational risk was US$ 518 thousand on operational risk weighted exposure of US$ 4,316 thousand. This operational risk weighted exposure is computed using the Basic indicator approach, where a fixed percentage (Alpha), which is 15% of the average previous three year annual gross income, is multiplied by 12.5 operational capital charge; years with positive gross income are counted for computation of capital charge. This computation is as per CBB Capital adequacy rulebook.

6 RISK MANAGEMENT

Risk is inherent in the Banks business activities and is managed through a process of on- going identification, measurement, controlling and monitoring. The Bank is exposed primarily to credit risk and to a limited extent to market and operational risk.

The Board of Directors is responsible for the best practice management and risk oversight. Board of Directors oversees the definition of risk appetite, risk tolerance standards and risk process standards to be kept in place. At the second level, the senior management is responsible for credit decisions on lending portfolio, setting country limits and interbank limits and general credit policy matters, which are reviewed and approved by the Board of Directors. Executive management is responsible for the identification and evaluation on a continuous basis of all significant risks to the business and implementation of appropriate internal controls to minimize them. This is done through the senior management reporting timely to Board of Directors for their decision making and implementation.

6.1 Credit risk concentrations and thresholds

The first level of protection against undue credit risk is through country and industry threshold limits, together with individual borrower threshold limits. Single name concentrations are monitored on an individual basis. Under the CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's approval for any planned exposure to a single counterparty or group of connected counterparties exceeding 15% of the regulatory capital base.

6 RISK MANAGEMENT continued

As at 31 December 2008, the Bank's exposures in excess of 15% of the obligor limits to individual counterparties are shown below:

US$ '000s	On balance sheet Exposure	Off balance sheet Exposure	Total Exposure
Counterparty A*	18,042	Nil	18,042
Counterparty B	40,285	Nil	40,285
Counterparty C*	65,000	Nil	65,000

* These are interbank deposits maturing within 6 months from 31 December 2008.

Risk mitigation – collateral

The amount and type of collateral depends on an assignment of the credit risk of the counterparty. The types of collateral mainly include cash collaterals in relation to credit related contingent items.

The amount and type of collateral depends on an assignment of credit risk of the counterparty. The types of collateral mainly include cash collaterals in relation to credit related contingent items, which is liquidated on maturity/expiry date.

6.2 Geographical distribution of exposures is summarized below:

US$ '000s	Gross credit exposure	Funded exposure	Unfunded exposure
Bahrain	254,807	254,807	-
Other GCC Countries	70,169	70,150	19
Other Middle East & Africa	179,501	128,511	50,990
Europe	43,272	43,272	-
Rest of the world	11,887	11,887	-
	559,636	508,627	51,009

6.3 Industrial sector analysis of exposures is summarized below:

US$ '000s	Gross credit exposure	Funded exposure	Unfunded exposure
Sovereign	47,163	47,163	-
Banks & financial institutions	477,789	426,780	51,009
Commercial & business	34,684	34,684	-
	559,636	508,627	51,009

6 RISK MANAGEMENT continued

6.4 Exposure by external credit rating

The Bank uses external credit ratings from Standard & Poors, Moodys and Fitch ratings, which are accredited External Credit Assessment Institutions (ECAI's). The Bank assigns the risk weights through the mapping process provided by CBB to the rating grades. The Bank uses the highest risk weight associated, in case of two or more eligible ECAI's are chosen. The breakdown of the Bank's exposure into rated and unrated categories is as follows:

US$ '000s	Net credit exposure	Rated exposure	Unrated exposure
Cash	14	–	14
Claims on sovereigns	47,216	2,706	44,510
Claims on banks	444,041	314,096	129,945
Claims on corporate	12,250	–	12,250
Equity portfolio	49	–	49
Other exposures	8,409	–	8,409
	511,979	**316,802**	**195,177**

6.5 Maturity analysis of funded exposures

Residual contractual maturities of the Bank's exposures are as follows:

US$ '000s	Within 1 Month	1-3 Months	3-12 Months	Total within 1 year	1-5 years	More than 15 years	Undated	Total
Cash	-	-	-	-	-	-	14	14
Claims on Sovereigns	-	2,653	-	2,653	4,225	40,285	53	47,216
Claims on Banks	413,534	10,580	13,216	437,330	7,888	-	-	445,218
Claims on Corporate	-	-	2,250	2,250	10,000	-	-	12,250
Equity Portfolio	-	-	-	-	-	-	49	49
Other exposures	3,374	177	314	3,865	121	-	4,423	8,409
	416,908	13,410	15,780	446,098	22,234	40,285	4,539	513,156

6.6 Maturity analysis of unfunded exposures

Credit Exposure after applying CCF

US$ '000s	Notional principal	Within 1 Month	Months 1-3	Months 3-12	Total within 1 year
Claims on Banks- Contingent items	51,009	3,577	2,281	4,344	10,202
Less: Cash collateral	-	-	-	-	(10,198)
Net Credit exposure	-	3,577	2,281	4,344	4

6 RISK MANAGEMENT continued

Credit-related contingent items:

Credit related contingent items comprise letters of credit confirmations, acceptance and guarantees. For credit-related contingent items, the nominal value is converted to an exposure through the application of a credit conversion factor (CCF). The CCF applied is at 20% to convert off balance sheet notional amounts into an equivalent on balance sheet exposure.

6.7 Impairment of assets

The Bank makes an assessment at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, an impairment loss is recognized in the statement of income.

Evidence of impairment may include indications that a borrower is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that the borrower will enter bankruptcy or other financial re-organisation and where, observable data indicates, that there is a measurable decrease in the estimated future cash flows such as changes in arrears or economic conditions that correlate with defaults.

There were no impairment of exposures for the year ended 31 December 2008, hence, there were no related specific provisions.

6.8 Market Risk

Market risk is the risk of potential financial loss that may arise from adverse changes in the value of a financial instrument or portfolio of financial instruments due to movements in interest rates, foreign exchange rates and equity prices. This risk arises from asset - liability mismatches, changes that occur in the yield curve and foreign exchange rates. Given the Bank's low risk strategy, aggregate market risk levels are considered very low.

Interest rate risk on the Banking book arises from the possibility that changes in interest rates will affect the value of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through basis point value approach, which measures changes in economic value resulting from changes in interest rates. The Bank's interest rate sensitivity position as of 31 December, 2008 for a change in 200 Basis points will result in an increase or decrease on statement of income by +/(-) US$ 1,560 thousand.

Currency risk arises from the movement of the rate of exchange over a period of time. The Banks currency risk is limited to Euro denominated assets and liabilities, as Bahrain Dinars and GCC Currencies (except Kuwaiti Dinars) are pegged to US Dollars. The Bank limits this risk by monitoring positions on a regular basis. Thus, the Banks exposure to currency risk is minimal and insignificant.

Liquidity risk is the risk that the Bank will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. During 2008, the Bank depended mainly on its own capital and assets were managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents and deposits with banks.

6 RISK MANAGEMENT continued

6.9 Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes or systems, or from external events. Operational risk is inherent in all business activities and can never be eliminated entirely, however shareholder value can be preserved and enhanced by managing, mitigating and, in some cases, insuring against operational risk. To achieve this goal, the Bank intends to make operational risk transparent throughout the enterprise, to which end processes are being developed to provide for regular reporting of relevant operational risk management information to senior management and the Board of Directors.

Operational functions of booking, recording and monitoring of transactions are carried by staff that are independent of the individuals initiating the transactions. Each business line including Operations, Information Technology, Human Resources, Compliance and Financial Control – is further responsible for employing the aforementioned framework processes and control programmes to manage its operational risk within the guidelines established by the Bank policy, and to develop internal procedures that comply with these policies.

6.10 Capital management :

Internal Capital Adequacy Assessment Process (ICAAP)

The Bank's capital management aims to maintain an optimum level of capital to enable it to pursue the Bank's corporate strategies whilst meeting regulatory ratio requirements.

Comprehensive assessment of economic capital, i.e., credit, market and operational risks and processes relating to other risks such as liquidity, is made, reviewed and monitored regularly. The Bank's capital adequacy ratio of 43.72% is well above the regulatory requirement and provides a healthy cushion against any stress conditions.

Supervisory Review and Evaluation Process (SREP):

Central Bank of Bahrain (CBB) is the regulator for the Bank and sets the minimum capital requirement. CBB requires the Bank to maintain a 12% minimum ratio of total capital to risk weighted assets, taking into account both on balance sheet and off balance sheet exposures. The Bank maintains a strong and healthy capital adequacy ratio.

7 OTHER DISCLOSURES

7.1 Related Party transactions

Related party represents major shareholders, directors, key management personnel and entities significantly influenced by such parties. Pricing policies are at arm's length and approved by executive management and Board of Directors.

US$ '000s	31 December 2008
Exposures to related parties:	–
Liabilities to related parties: Connected deposits	168,521

7.2 Impaired loans and relative provision: There were no impaired loans and provisions required for the year ended 31 December 2008.

7.3 Restructured facilities: There were no restructured facilities made during the year 31 December 2008.

7.4 Assets sold under recourse agreements: The Bank did not enter into any recourse agreements during the year ended 31 December 2008.

7.5 Equity Positions in the Banking book: None

CORPORATE DIRECTORY

General Management

Ahmed I. Rajab
General Manager
Tel: 17517750

Human Resources and Administrations

Saeed A. Nabi Hussain
Head of HR and Administrations
Tel: 17517728

Credit and Marketing

Ayoob Al-Araibi
Head of Credit and Marketing
Tel: 17517721

Treasury

Mahmood A. Ameer Radhi
Treasury Manager
Tel: 17517723

Operations

Suresh T. Vaidyanathan
Head of Operations
Tel: 17517720

Finance

K.R. Usha
Finance Manager
Tel: 17517734

Trade Finance:

Hassan A.Rahman
Assistant Manager
Tel: 17517752

Jaffar Hussain
Assistant Manager
Tel: 17517730