2012

ABU DHABI COMMERCIAL BANK P.J.S.C

PILLAR 3 DISCLOSURES

31 December, 2012

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1. Overview

The Bank complies with the Basel II framework which has been implemented in the UAE through the Central Bank of UAE guidelines issued in November 2009. Basel II is structured around three 'pillars' which are outlined below:

Pillar I deals with maintenance of regulatory capital calculated for three major components of risk that a bank faces: credit risk, operational risk, and market risk. Other risks are not considered fully quantifiable at this stage;

Pillar II allows banks and supervisors to take a view on whether the bank should hold additional capital to cover the three Pillar 1 risk types, or to cover other risks. A Bank's own internal models and assessments support this process. The second pillar deals with the regulatory response to the first pillar, giving regulators much improved 'tools' over those available to them under Basel I. It also provides a framework for dealing with all the other risks a bank may face, such as systemic risk, concentration risk, strategic risk, reputational risk, liquidity risk and legal risk, which the accord combines under the title of residual risk. It gives banks power to review their risk management systems. Internal Capital Adequacy Assessment Process (ICAAP) is the result of Pillar II of the Basel II accord.

Pillar III covers external communication of risk and capital information by banks as specified in the Basel rules. The aim of pillar 3 is to allow market discipline to operate by requiring institutions to disclose details on the scope of application, capital, risk exposures, risk assessment processes and the capital adequacy of the institution. It must be consistent with how the senior management including the board assess and manage the risks of the institution.

Banks are required to disclose all their material risks as part of the pillar 3 framework. All material information required by pillar 3 is included in the Pillar 3 Disclosures.

Basel II also provides for different approaches to calculating capital requirements.

Standardised Approach - Similar to the Basel I framework, but with a more detailed classification of asset types to enable better risk sensitivity. The risk weights used to assess requirements against credit exposures are consistent across the industry.

Internal Ratings Based approach (IRB) – under this approach the risk weights are derived from the bank's internal models. The IRB approach is further sub-divided into two alternative applications, Advanced and Foundation:

Foundation IRB (FIRB) – Under this approach the banks are allowed to develop their own model to estimate the PD (probability of default) for individual clients or groups of clients and use supervisory values for LGD (loss given default) and EAD (exposure at default) estimates. Banks can use this approach only subject to approval from their local regulators.

Advanced IRB (AIRB) – Under this approach the banks are allowed to develop their own model to quantify required capital for credit risk. Probability of Default / Loss Given Default and Exposure At Default can be determined using the Bank's internal models. Banks can use this approach only subject to approval from their local regulators.

2. ADCB's Approach to Pillar I

Credit Risk – The standardised Approach is currently being used by the Bank in calculating its capital requirements for Credit Risk. This approach allows the use of external ratings from designated credit rating agencies, wherever available, in determining the appropriate risk weights. The risk weights are determined by the asset class and the external rating of the counterparty. The net exposure incorporates off balance sheet exposures after applying the credit conversion factors (CCF) and credit risk mitigation (CRM) factors.

Market Risk - For the regulatory market risk capital requirement, the Bank uses the standardised approach.

Operational Risk - The Bank uses the standardised approach for computing capital requirement for operational risk.

3. Credit Risk and Credit Risk Mitigation (Standardised Approach)

All credit exposures under the standardised approach of Basel II are assessed according to the counterparty classifications and against the External Credit Assessment Institution (ECAI) ratings as notified in the Capital Adequacy Standards issued by the Central Bank of UAE in November 2009 (the 'guidelines'):

Central Banks & Sovereigns - Claims on Central Banks and Sovereigns in the Gulf Co-operation Council countries (GCC) have a 0% risk weighting. Other central banks and sovereigns exposures are risk weighted in line with paragraphs 53 to 56 of the Basel II Accord which requires risk weights to be assigned according to the credit assessment of the sovereigns as below:

Credit Assessment	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk Weight	0%	20%	50%	100%	150%	100%

Further, at national discretion, a lower risk weight may be applied to banks' exposures to sovereigns (or central banks) if denominated in domestic currency and funded in that currency. Where this discretion is exercised, other national supervisory authorities may also permit their banks to apply the same risk weight to domestic currency exposures to this sovereign (or central bank) funded in that currency.

For the purpose of risk weighting claims on sovereigns, supervisors may recognise the country risk scores assigned by Export Credit Agencies (ECAs). To qualify, an ECA must publish its risk scores and subscribe to the OECD agreed methodology. Banks may choose to use the risk scores published by individual ECAs that are recognised by their supervisor, or the consensus risk scores of ECAs participating in the "Arrangement on Officially Supported Export Credits". The OECD agreed methodology establishes eight risk score categories associated with minimum export insurance premiums. These ECA risk scores will correspond to risk weight categories as detailed below:

ECA Score	0 - 1	2	3	4 - 6	7
Risk Weight	0%	20%	50%	100%	150%

3. Credit Risk and Credit Risk Mitigation (Standardised Approach)(continued)

Public Sector Entities (PSE) - Claims on Public Sector Enterprises (PSEs) in the GCC, in their local currency, are risk weighted at 0% if treated as a PSE by the local regulator. Foreign currency claims on a GCC PSE are weighted at one grade less favourable, being 20%. All other PSE (i.e. non GCC) are risk weighted at one grade less favourable than their sovereigns.

Multilateral Development Banks (MDB) - Provisions of the Basel II Accord (paragraph 59) apply which requires that the risk weights applied to claims on MDBs will generally be based on external credit assessments as set out under option 2 for claims on banks but without the possibility of using the preferential treatment for short-term claims. A 0% risk weight will be applied to claims on highly rated MDBs that fulfill to the Basel Committee's satisfaction the criteria provided below. The Basel Committee will continue to evaluate eligibility on a case-by-case basis. The eligibility criteria for MDBs risk weighted at 0% are:

- very high quality long-term issuer ratings, i.e. a majority of an MDB's external assessments must be AAA;
- shareholder structure is comprised of a significant proportion of sovereigns with long-term issuer credit assessments of AA- or better, or the majority of the MDB's fund-raising are in the form of paid-in equity/capital and there is little or no leverage;
- strong shareholder support demonstrated by the amount of paid-in capital contributed by the shareholders; the amount of further capital the MDBs have the right to call, if required, to repay their liabilities; and continued capital contributions and new pledges from sovereign shareholders;
- adequate level of capital and liquidity (a case-by-case approach is necessary in order to assess whether each MDB's capital and liquidity are adequate); and
- strict statutory lending requirements and conservative financial policies, which would include among other conditions a structured approval process, internal creditworthiness and risk concentration limits (per country, sector, and individual exposure and credit category), large exposures approval by the board or a committee of the board, fixed repayment schedules, effective monitoring of use of proceeds, status review process, and rigorous assessment of risk and provisioning to loan loss reserve.

Banks – As per the Central Bank of UAE guidelines the Bank has adopted risk weightings specified in Option 2 of paragraph 63 of the Basel II Accord, as follows:

Credit Assessment	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk Weight	20%	50%	50%	100%	150%	50%
Risk Weight Short Term Claim	20%	20%	20%	50%	150%	20%

Securities Firms - Where these entities are regulated as banks, they are treated as per the above process for banks. If they are not regulated as banks, corporate treatment is applied as noted below.

3. Credit Risk and Credit Risk Mitigation (Standardised Approach)(continued)

Corporate - Risk weightings for corporates rated by approved External Credit Assessment Institutions (ECAIs) are applied as per paragraph 66 of the Basel II Accord, as follows:

Credit Assessment	AAA to AA-	A+ to A-	BBB+ to BB-	Below BB-	Unrated
Risk Weight	20%	50%	100%	150%	100%

Unrated corporate exposures must be risk weighted at 100%. CBUAE may, at its sole discretion, require a higher risk weighting for some corporates as advised to banks directly where appropriate.

Regulatory Retail Portfolios - A 75% risk weighting is applied for exposures classified as retail. For this classification, the following four Basel II criteria are required:

- Orientation – Exposure to a person or persons, or small business.
- Product – Eligible products included are credit cards, revolving credit, personal lending and small business products. Mortgage products are excluded as these are treated separately.
- Granularity –No exposure to any one counterparty is to exceed 0.20% of the total retail portfolio being evaluated.
- Value – Maximum aggregated exposure to one counterparty does not exceed the value of AED 2,000,000.

Claims Secured by Residential Property - A 35% risk weighting is applied to exposures secured by residential property where (i) Loan to Value (LTV) ratio is less than 85%; and (ii) the exposure does not exceed AED 10 million.

If the above LTV and Exposure cap criteria cannot be definitively established, then the applicable Risk Weighting for the counterparty type is applied.

Past Due Loans - 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 when specific provisions are less than 20% of the outstanding amount of the loan
- 100% risk weight when specific provisions are 20% and above of the outstanding amount of the loan

High Risk & Other Assets - Paragraphs 79 through 81 of the Basel II Accord read with July 2009 Enhancements paper applies for treatment of these exposures.

Off - Balance Sheet

Off-balance sheet items under the standardised approach (Para 82 to 87 of Basel II Accord) are converted into credit exposure equivalents through the use of credit conversion factors in a similar manner to Basel I.

3. Credit Risk and Credit Risk Mitigation (Standardised Approach)(continued)

Credit Conversion Factor of 100%

- All direct credit substitutes, including general guarantees of indebtedness and all guarantee type instruments, such as standby letters of credit and acceptances, backing the financial obligations of other parties
- Credit derivatives such as credit default swaps where bank provides credit protection
- Sale and repurchase agreements and asset sales with recourse, where the credit risk remains with the bank
- Forward asset purchases, forward deposits and commitments for the unpaid portion of partly-paid shares and securities which represent commitments with certain draw-downs

Credit Conversion Factor of 50%

- Transaction-related contingent items e.g. performance bonds, bid bonds warranties and standby letters of credit related to particular transactions
- Underwriting commitments under note issuance and revolving underwriting facilities (after deduction for own holdings of notes underwritten)
- Other commitments -Not unconditionally cancellable with an original maturity exceeding one year

Credit Conversion Factor of 20%

- Other commitments not unconditionally cancellable with an original maturity of one year or less
- Short-term self-liquidating trade-related contingent items e.g. documentary credits collateralised by underlying shipments.

Credit Conversion Factor of 0%

- Any commitment that is unconditionally cancellable

Credit Risk Mitigation

Only the following Credit Risk Mitigation techniques are considered as effective credit risk reduction for Pillar 1 calculation purposes:

- Netting – Applicable only with legally enforceable netting agreements in place.
- Collateral – Eligible collaterals
- Guarantees & Credit Derivatives – These tools are only used to mitigate credit risk provided they are direct, explicit, irrevocable and unconditional.

4. Future Development

The regulation and supervision of financial institutions continues to undergo significant change in response to the global financial crisis.

In December 2010, the Basel Committee issued final rules in two documents: A global regulatory framework for more resilient banks and banking systems and International framework for liquidity risk measurement, standards and monitoring, which together are commonly referred to as 'Basel III'. Basel III will require banks to hold 4.5% of common equity (up from 2% in Basel II) and 6% of Tier I capital (up from 4% in Basel II) of risk-weighted assets (RWA). Basel III also introduces additional capital buffers, (i) a mandatory capital conservation buffer of 2.5% and (ii) a discretionary countercyclical buffer, which allows national regulators to require up to another 2.5% of capital during periods of high credit growth. In addition, Basel III introduces a minimum 3% leverage ratio and two required liquidity ratios. The Liquidity Coverage Ratio requires a bank to hold sufficient high-quality liquid assets to cover its total net cash flows over 30 days; the Net Stable Funding Ratio requires the available amount of stable funding to exceed the required amount of stable funding over a one-year period of extended stress.

Impact on ADCB

ADCB's current capital levels are already significantly higher than the new Basel III requirements. At the end of 2012, the capital ratio and the tier I ratio of the Bank were 23.05% and 17.47% respectively with core tier I capital at 14.4%. Additionally, the composition of the Bank's capital is of high quality and is equity based with lesser reliance on tier 2 capital supply i.e. hybrid instruments. Further, The UAE Central Bank has set total capital adequacy ratio of 12 per cent and tier 1 capital adequacy ratio (equity capital and disclosed reserves as per cent of total assets) of eight per cent which are already higher than the target 2019 ratios of six per cent and eight per cent set by Basel III.

ADCB meets both the LCR and NSFR set by Basel III as of date. Two notable proposals made by the Basel Committee are that banks need to maintain a leverage ratio of 3% of total assets to constrain aggregate size relative to capital base. However, the proposal is subject observation between 2013 to 2017 before it becomes mandatory in 2018 post final adjustments. Further, a new minimum standard for liquidity coverage ratio (LCR) has been introduced to promote the short-term resilience of a bank's liquidity profile along with introduction of Net Stable Funding Ratio (NSFR) to ensure a sustainable maturity structure of assets and liabilities. These liquidity ratios are also subject to an observation period. ADCB meets both the LCR and NSFR set by Basel as of date.

5. Comparison with the Annual Accounts 2012

The Pillar 3 disclosures have been prepared in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with International Financial Reporting Standards ('IFRS's). Therefore, some information in the Pillar 3 disclosures are not directly comparable with the financial information in the Annual Accounts 2012. This is most pronounced for the credit risk disclosures, where credit exposure is defined as the maximum loss the Bank has estimated under specified Basel II parameters. This differs from similar information in the Annual Accounts, which is mainly reported as at the balance sheet date and, therefore, does not reflect the likelihood of future drawings of committed credit lines. Further, the off balance sheet exposures are post credit conversion factor and may not reflect the actual off balance sheet exposures reported in the annual accounts.

6. Presentation of Risk Data

The disclosures are based on the Bank's assets in terms of gross exposures, capital requirements and Risk Weighted Assets (RWA). For the purpose of these disclosures, credit exposure is defined as the extent to which the Bank may be exposed to counterparty risk in the event of, and at the time of, that counterparty's default or through the decline in value of an asset.

Where this document discloses credit exposures or capital requirements or RWA, the Bank has followed the scope and application of its Pillar I capital adequacy calculations in accordance to guidelines of Basel II accord as published by the Central Bank, UAE in November 2009. . Where figures for impairment or losses are disclosed within this document, the Bank has followed the IFRS definitions used in the Annual Report. Throughout this report, tables show credit exposures or capital requirements or RWA split into various exposure classes.

Basis of Consolidation

In this report, the Bank's pillar 3 disclosures are presented on a consolidated basis for the year ended 31 December 2012.The consolidation basis used is the same as that used for regulatory capital adequacy.

7. Verification

The Pillar 3 Disclosures 2012 have been appropriately verified internally, but have not been audited by the Bank's external auditor.

8. Risk Management

Ultimate responsibility for setting out risk appetite and for the effective mangement of risk rests with the Board. This is managed through a number of Board level committees; namely Board Risk & Credit Committee (BRCC) and Board Audit & Compliance Committee (BACC), which ensures that risk taking authority and policies are cascaded down from the Board to the appropriate business units.

The Management Executive Committee (MEC) has primary responsibility for implementing, overseeing and taking ownership for the enforcement of risk strategy and internal control directives laid down by the Board and Board Committees.

The Management level committees also actively manage risk particularly the Assets and Liabilities Management Committee; Management Risk & Credit Committee and Management Recoveries Committee. The Risk Management function headed by the Bank's Chief Risk Officer reports independently to the Board, BRCC, BACC and the Chief Executive Officer. The risk function is independent of the origination, trading and sales function to ensure balance in risk reward decision is not compromised and to ensure transparency of decisions in accordance with laid down standards and policies. The risk function exercises control over credit, market, short-term liquidity, operational and compliance risk.

8. Risk Management (continued)

The Audit & Compliance Committee provides assistance to the Board to fulfill its duties to ensure and oversee the Bank's financial statements, independence and performance of the Bank's external and internal auditors, compliance with legal and regulatory requirements and internal policies and internal control over financial reporting.

The Internal Audit Group (IAG) aims to apply a systematic and disciplined approach to evaluating and improving the effectiveness of ADCB's risk management, control and governance processes. The IAG reports directly to the BACC. The IAG consists of a team of auditors, whose tasks are, among other things, to evaluate the quality of ADCB's lending portfolio, controls in operational processes and the integrity of ADCB's information systems and databases. The IAG auditors, alongside the compliance department, also ensure that transactions undertaken by ADCB are conducted in compliance with applicable legal and regulatory requirements, and in accordance with ADCB's internal procedures, thereby minimising the risk of fraudulent, improper or illegal practices.

9. Capital Adequacy and Capital Management

Capital management process

Capital Risk is the risk that the Bank has inadequate capital resources to: ensure capital requirements set by the Central Bank of United Arab Emirates; to safeguard the Bank's ability to continue as a going concern and increase the returns for the shareholders; and to maintain a strong capital base to support the development of its business.

The Bank's objectives when managing capital, which is a broader concept than 'equity' shown under the statement of financial position, are:

- To comply with the capital requirements set by the Central Bank of United Arab Emirates;
- To safeguard the Bank's ability to continue as a going concern and increase the returns for the shareholders; and
- To maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored on a regular basis by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and the Central Bank of United Arab Emirates. The required information is filed with the regulators on a monthly (Basel 1) and quarterly (Basel II) basis.

The U.A.E. Central Bank vide its circular No. 27/2009 dated November 17, 2009 informed all the Banks operating in the U.A.E. to implement Standardised approach of Basel II from the date of the circular. For credit and market risk, the Central Bank has previously issued draft guideline for implementation of Standardised approach and Banks are expected to comply and report under pillar 2 – Internal Capital Adequacy Assessment Process (ICAAP) requirements by March 2010. For operational risk, the Central Bank has given Banks the option to use the Basic Indicators approach or the Standardised approach and the Bank has chosen to use the Standardised approach. ADCB complies with all reporting requirements as provided in the Central Bank circulars/guidelines.

9. Capital Adequacy and Capital Management (continued)

ADCB's capital management is driven by long/short term strategies and organisational requirements with due consideration to the regulatory, economic and commercial environment in which the Bank operates.

The Bank seeks to optimise returns on capital and it has always been the objective to maintain a strong capital base to support business development and to meet regulatory capital requirements at all times.

Capital supply

As per Basel II requirement, capital should comprise of the following:

Tier 1 capital - includes paid-up share capital, published reserves (including post-tax retained earnings), share premium, legal reserves, general reserves, hybrid Tier 1 Instruments (with prior approval from Central Bank), minority interests in the equity of subsidiaries less than wholly-owned.

Deductions must be made from Tier 1 core capital as per the the Basel/ Central Bank of UAE rules and includes goodwill and other intangibles at net book value, adjustments for the cumulative effect of foreign currency translation, own shares held - at net book value taking account of any provisions made against the acquisition value, current year loss/retained losses, shortfall in provisions, other deductions to be determined by Central Bank of UAE.

Tier 2 capital - includes general provisions, undisclosed reserves, asset revaluation reserves/cumulative changes in fair value, hybrid (debt/equity) capital instruments and subordinated term loans.

Tier 3 capital –Subject to prior approval from the CBUAE, banks may employ a third tier of capital (Tier 3), consisting of short term subordinated debt as defined in paragraph 49(xiv) of Basel II, for the sole purpose of meeting a proportion of the capital requirements for market risks, subject to the conditions in paragraph 49(xiii) and 49(xiv). Currently, the Bank does not hold any Tier 3 capital.

Securitised Assets

Exposures to securitised assets that are rated B+ and below (long term), below A3/P3 (short term), or are un-rated are deducted from the capital base.Where deductions of investments are made pursuant to this part on scope of application, the deductions will be 50% from Tier 1 and 50% from Tier 2 capital

Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degree of risk associated with different activities. In such cases the capital requirements may be flexed to reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the

9. Capital Adequacy and Capital Management (continued)

minimum required for regulatory purposes. The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation by the Bank Risk & Credit Committee and Finance and is subject to review by the ALCO as appropriate

Tier 1 capital comprises the following resources:

- Ordinary shareholders' funds, which include the cumulative proceeds from the issuance of ordinary shares at their nominal value. These instruments confer a share of ownership in the bank, and carry no obligations;
- Statutory & Legal Reserves:
  - Statutory reserve - As required by Article 255 of U.A.E. Federal Commercial Companies Law No. 8 of 1984 (as amended), 10% of the net profit for the year is transferred to the statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve equals 50% of the nominal value of the paid up share capital.
  - Legal reserve - In accordance with the Article 82 of Union Law No 10 of 1980 and Article 84 of the Memorandum and Articles of Association of the Bank, 10% of the net profit for the year is transferred to the legal reserve. The Bank may resolve to discontinue such annual transfers when the reserve equals 50% of the nominal value of the paid up share capital. The legal reserve is not available for distribution.
- General reserve & Contingency Reserves:
  - General Reserves - In accordance with Article 84 of the Memorandum and Articles of Association of the Bank, a further percentage of net profit for the year may require to be transferred to the general reserve based on the recommendation of the Board of Directors. The Bank may resolve to discontinue such annual transfers when the reserve equals 25% of the nominal value of the paid up share capital. This reserve may only be used for the purposes recommended by the Board of Directors and approved by the shareholders.
  - Contingency reserve - The contingency reserve is established to cover unforeseen future risks or contingencies which may arise from general banking risks.
- Employees' incentive plan shares - The Bank grants equity-settled share-based payments to employees. These shares acquired by ACB LTIP (IOM) Limited for ADCB's employees are treated as treasury shares and are deducted from capital;
- Foreign Currency Translation Reserves - The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations as well as from the translation of liabilities and gains and losses on derivatives that hedge the Bank's net investment in foreign operations.
- Retained earnings, - which represent the cumulative profits not distributed to shareholders, and other eligible reserves;
- Non-controlling interest in equity of subsidiaries;
- Capital Notes - The Notes are non-voting, non-cumulative perpetual securities for which there is no fixed redemption date, and are callable by the Issuer subject to certain conditions; and

Deductions from Tier 1 resources include intangible assets, 50% of investments in associates and securitization exposures.

9. Capital Adequacy and Capital Management (continued)

Tier 2 capital comprises the following resources:

- Collective impairment on loans and advances (limited to 1.25% on RWA);
- Cumulative changes in fair value - The cumulative changes in fair values includes the cumulative net change in the fair value of available for sale investments measured at fair value through other comprehensive income. However, it is limited to 45% if the balance is positive. But if the balance is negative, the entire balance is adjusted in Tier 1 capital; and
- Long term borrowings.

Deductions from Tier 2 resources include 50% of investments in associates and securitization exposures.

Regulatory Capital Requirements

The table below presents the minimum regulatory capital requirements, calculated as 12% per cent of RWA based on the approaches described above in section 2.

	2012		2011	
	Capital Charge (AED '000)	**Capital Ratio**	Capital Charge (AED '000)	Capital Ratio
Capital Requirements				
1 Credit Risk				
Standardised approach	**15,373,615**		15,564,746	
2 Market Risk				
Standardised approach	**449,945**		252,452	
3 Operational Risk				
Standardised approach	**783,193**		696,616	
Total Capital Requirements	**16,606,754**		16,513,814	
Capital Ratio				
1 Total for the Bank		**23.05%**		22.51%
2 Tier 1 for the Bank		**17.47%**		15.90%
3 Total for each significant Bank subsidiary		**N/A**		N/A

10. Credit Risk Management

Credit risk is the risk that when, one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

Risk Management is intended to be proactive and reasoned. All types of credit risk are identified, objectively assessed, and, where this is the appropriate response, actively managed. The aim is to anticipate, and where possible, minimize/mitigate risks rather than dealing with their consequences. However, for some key areas where the likelihood of a risk occurring is relatively small, but the impact on the Bank is high, the risk may be covered by setting up specialized units, e.g., Business Intelligence Unit, operational & Compliance Risk Unit, etc. This allows the Bank to contain the negative effect of unlikely events that might occur.

The Bank endeavours to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties and continually assessing the creditworthiness of counterparties. In addition to monitoring credit limits, the Bank manages the credit exposure relating to its trading activities by entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances and limiting the duration of exposure. In certain cases, the Bank may also close out transactions or assign them to other counterparties to mitigate credit risk.

Organisational Framework

The risk structure of the Bank is clearly established with well defined roles and responsiblities as explained in section 8.

The committees responsible for managing credit risk are Management Risk & Credit Committee and Management Recoveries Committee. ADCB risk management practices and strategies are an integral part of business planning and budgeting process. All risk management areas are centralised under the Credit and Risk Group.

The Board Risk and Credit Committee (BRCC) is responsible for sanctioning high value credits and formulation of credit policies and processes in line with growth, risk management and strategic objectives. In addition, the Bank manages the credit exposure by obtaining security where appropriate and limiting the duration of exposure. Credit risk in respect of derivative financial instruments is limited to those with positive fair values.

Regular audits of business units and the Bank's credit processes are undertaken by the Internal Audit and Compliance Division.

ADCB's maximum exposure to credit risk before credit risk mitigants

The following table presents the maximum exposure at 31st December 2012 and 2011 to credit risk of balance sheet and off-balance sheet financial instruments, before taking account of any credit risk mitigants and after allowance for impairment and netting where appropriate.

The maximum exposure to credit risk for on balance sheet items is their carrying value. For financial guarantees granted recorded off balance sheet, the maximum exposure to credit risk is the maximum amount that ADCB would have to pay if the guarantees were to be called upon. For loan and

10. Credit Risk Management (continued)

other credit related commitments that are irrevocable over the life of the respective facilities, the maximum exposure to credit risk is the full amount of the committed facilities.

The analysis of credit risk under this section includes only financial assets subject to credit risk. They exclude other financial assets, mainly equity securities held in the trading portfolio or available for sale assets, as well as non-financial assets. The nominal value of off-balance sheet credit related instruments is also shown, where appropriate.

Whilst the Bank's maximum exposure to credit risk is the carrying value of the assets or, in the case of off-balance sheet items, the amount guaranteed, committed, or endorsed, in most cases the likely exposure is far less due to collateral held, and other credit risk mitigants and other actions taken to manage the Bank's exposure.

The following tables detail the Bank's gross and net credit risk exposure before and after the effect of credit risk mitigation, broken down by the relevant exposure class against the relevant economic activities, currency, maturity and geography. The amount of the undrawn facility included is dependent on the product type and the credit conversion factors applied to them.

11. Gross Credit Risk Exposure

Gross Credit Risk Exposure - Standardised Approach of Basel II (Asset Class)

2012

AED ' 000

	On Balance Sheet	Off Balance Sheet	Credit Risk Mitigation (CRM)				
Asset Class	**Gross Outstanding**	**Net Exposure After Credit Conversion Factors (CCF)**	**Total Gross Exposure**	**Exposure Before CRM**	**CRM**	**Exposure Post CRM**	**Risk Weighted Assets**
Claims on Sovereigns	**15,782,516**	**375,548**	**16,158,064**	**16,158,064**	**-**	**16,158,064**	**85,188**
Claims on Non-Central Government Public Sector Entities (PSEs)	**29,965,947**	**1,682,260**	**31,648,207**	**30,887,202**	**1,129,932**	**29,757,270**	**18,012,927**
Claims on Multilateral Development Banks	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Claims on Banks	**24,515,960**	**6,475,064**	**30,991,024**	**30,973,998**	**2,713,668**	**28,260,330**	**13,264,404**
Claims on Securities Firms	**2,719,940**	**600,857**	**3,320,797**	**3,050,797**	**66,621**	**2,984,176**	**2,899,825**
Claims on Corporates	**33,103,540**	**13,849,745**	**46,953,284**	**46,810,628**	**9,783,830**	**37,026,799**	**37,029,687**
Claims included in the Regulatory Retail Portfolio	**19,717,172**	**473,820**	**20,190,992**	**20,045,190**	**4,301,159**	**15,744,031**	**12,541,373**
Claims secured by Residential Property	**4,357,609**	**265,177**	**4,622,786**	**4,619,988**	**7,801**	**4,612,187**	**2,045,084**
Claims secured by Commercial Real Estate	**36,101,269**	**-**	**36,101,269**	**35,823,477**	**664,052**	**35,159,425**	**35,159,344**
Past Due Loans	**7,427,056**	**-**	**7,427,056**	**4,034,370**	**865,098**	**3,169,271**	**3,866,403**
Items belonging to High Risk Categories	**276,804**	**-**	**276,804**	**276,804**	**-**	**276,804**	**415,207**
Other Assets	**9,263,458**	**-**	**9,263,458**	**9,263,458**	**-**	**9,263,458**	**2,794,018**
Claims on Securitised Assets	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Credit Derivatives (Banks selling protection)	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total Credit Risk	**183,231,270**	**23,722,471**	**206,953,741**	**201,943,976**	**19,532,160**	**182,411,816**	**128,113,458**

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	On Balance Sheet	Off Balance Sheet	Credit Risk Mitigation (CRM)				
	Gross outstanding	Net Exposure After Credit Conversion Factors (CCF)	Total Gross Exposure	Exposure Before CRM	CRM	Exposure Post CRM	Risk Weighted Assets
Claims on Sovereigns	13,333,805	22,668	13,356,473	13,333,805	-	13,333,805	32,961
Claims on Non-Central Government Public Sector Entities (PSEs)	28,974,469	2,044,430	31,018,899	29,701,097	1,039,125	28,661,972	17,103,077
Claims on Multilateral Development Banks	-	-	-	-	-	-	-
Claims on Banks	26,679,729	5,250,469	31,930,198	31,717,186	1,655,642	30,061,544	9,251,562
Claims on Securities Firms	2,904,186	1,883,831	4,788,017	3,982,936	571,233	3,411,703	3,408,767
Claims on Corporates	37,167,909	16,795,313	53,963,222	55,174,179	15,772,204	39,401,976	37,437,566
Claims included in the Regulatory Retail Portfolio	18,403,533	789,159	19,192,692	18,591,680	73,595	18,518,084	16,893,329
Claims secured by Residential Property	4,242,232	-	4,242,232	4,507,331	1,013	4,506,318	3,823,097
Claims secured by Commercial Real Estate	34,260,241	-	34,260,241	34,260,240	167,764	34,092,476	34,092,373
Past Due Loans	6,725,862	-	6,725,862	3,615,941	442,819	3,173,122	4,668,957
Items belonging to High Risk Categories	-	-	-	-	-	-	-
Other Assets	8,675,095	-	8,675,095	8,675,095	-	8,675,095	2,990,007
Claims on Securitised Assets	22,590	-	22,590	22,590	-	22,590	4,518
Credit Derivatives (Banks selling protection)	-	-	-	-	-	-	-
Total Credit Risk	181,389,652	26,785,870	208,175,522	203,582,079	19,723,394	183,858,685	129,706,214

11. Gross Credit Risk Exposure (continued)

Gross Credit Risk Exposure as Per Standardised Approach of Basel II (Rated/Unrated)

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Asset Class	Gross Credit Exposure					
	Rated	**Unrated**	**Total Gross Exposure**	**Exposure Before CRM**	**Exposure Post CRM**	**RWA Post CRM**
Claims on Sovereigns	**16,158,064**	**-**	**16,158,064**	**16,158,064**	**16,158,064**	**85,188**
Claims on Non-Central Government Public Sector Entities (PSEs)	**16,286,841**	**15,361,365**	**31,648,207**	**30,887,202**	**29,757,270**	**18,012,927**
Claims on Multilateral Development Banks	**-**	**-**	**-**	**-**	**-**	**-**
Claims on Banks	**28,838,090**	**2,152,934**	**30,991,024**	**30,973,998**	**28,260,330**	**13,264,404**
Claims on Securities Firms	**888,443**	**2,432,354**	**3,320,797**	**3,050,797**	**2,984,176**	**2,899,825**
Claims on Corporates	**478,454**	**46,474,830**	**46,953,284**	**46,810,628**	**37,026,799**	**37,029,687**
Claims included in the Regulatory Retail Portfolio	**-**	**20,190,992**	**20,190,992**	**20,045,190**	**15,744,031**	**12,541,373**
Claims secured by Residential Property	**-**	**4,622,786**	**4,622,786**	**4,619,988**	**4,612,187**	**2,045,084**
Claims secured by Commercial Real Estate	**-**	**36,101,269**	**36,101,269**	**35,823,477**	**35,159,425**	**35,159,344**
Past Due Loans	**-**	**7,427,056**	**7,427,056**	**4,034,370**	**3,169,271**	**3,866,403**
Items belonging to High Risk Categories	**-**	**276,804**	**276,804**	**276,804**	**276,804**	**415,207**
Other Assets	**-**	**9,263,458**	**9,263,458**	**9,263,458**	**9,263,458**	**2,794,018**
Claims on Securitised Assets	**-**	**-**	**-**	**-**	**-**	**-**
Credit Derivatives (Banks selling protection)	**-**	**-**	**-**	**-**	**-**	**-**
Total	**62,649,892**	**144,303,849**	**206,953,741**	**201,943,976**	**182,411,816**	**128,113,458**

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	Gross Credit Exposure					
	Rated	Unrated	Total Gross Exposure	Exposure Before CRM	Exposure Post CRM	RWA Post CRM
Claims on Sovereigns	13,333,805	-	13,333,805	13,333,805	13,333,805	32,960
Claims on Non-Central Government Public Sector Entities (PSEs)	15,289,562	14,433,402	29,722,964	23,997,905	22,958,780	11,399,885
Claims on Multilateral Development Banks	-	-	-	-	-	-
Claims on Banks	30,093,408	1,633,094	31,726,501	31,717,186	30,061,544	9,251,562
Claims on Securities Firms	848,526	3,233,409	4,081,936	3,982,936	3,411,703	3,408,767
Claims on Corporates	3,709,898	52,794,522	56,504,420	91,677,124	75,904,922	73,940,513
Claims included in the Regulatory Retail Portfolio	-	18,614,762	18,614,762	12,642,616	12,569,020	10,944,265
Claims secured by Residential Property	-	4,507,346	4,507,346	4,507,331	4,506,318	3,823,097
Claims secured by Commercial Real Estate	-	34,260,241	34,260,241	9,409,550	9,241,786	9,241,683
Past Due Loans	-	6,725,862	6,725,862	3,615,941	3,173,122	4,668,957
Items belonging to High Risk Categories	-	-	-	-	-	-
Other Assets	-	8,675,095	8,675,095	8,675,095	8,675,095	2,990,007
Claims on Securitised Assets	22,590	-	22,590	22,590	22,590	4,518
Credit Derivatives (Banks selling protection)	-	-	-	-	-	-
Total	63,297,789	144,877,734	208,175,522	203,582,079	183,858,685	129,706,214

11. Gross Credit Risk Exposure (continued)

Gross Credit Risk Exposure by Currency

2012

AED ' 000

Currency	Loans	Investment Securities	Other Assets	Total Funded	Commitments	OTC Derivatives	Other Off Balance Sheet exposures	Total Non-Funded	Total
AED	114,970,797	858,076	19,029,636	134,858,509	1,228,711	2,556,983	4,511,434	8,297,127	143,155,636
USD	12,431,945	16,822,719	13,069,828	42,324,492	331,555	4,423,025	7,933,631	12,688,211	55,012,703
EUR	41,302	535,964	2,313,092	2,890,359	-	239,592	625,855	865,447	3,755,806
CHF	-	-	26,151	26,151	-	137,164	43	137,208	163,359
GBP	425	-	381,998	382,423	-	39,997	12,262	52,259	434,682
MYR	-	-	17,063	17,063	-	136,155	-	136,155	153,218
Other	2,214,547	290,112	4,163,030	6,667,689	-	128,499	1,417,565	1,546,064	8,213,753
Add: Interest in Suspense	802,628	-	-	802,628	-	-	-	-	802,628
Less: Acceptances	-	-	(4,738,044)	(4,738,044)	-	-	-	-	(4,738,044)
Total	**130,461,644**	**18,506,871**	**34,262,755**	**183,231,270**	**1,560,266**	**7,661,415**	**14,500,790**	**23,722,471**	**206,953,741**

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AED ' 000

	Loans	Investment Securities	Other Assets	Total Funded	Commitments	OTC Derivatives	Other Off Balance Sheet exposures	Total Non-Funded	Grand Total
AED	113,311,017	447,506	19,715,540	133,474,063	1,050,266	1,582,884	4,678,605	7,311,755	140,785,818
USD	14,305,494	13,707,215	21,336,348	49,349,057	2,329,489	3,883,886	11,250,037	17,463,412	66,812,469
EUR	9,530	486,309	1,333,654	1,829,493	29,078	38,422	455,245	522,745	2,352,238
CHF	-	-	20,543	20,543	-	46,805	378	47,183	67,726
GBP	21,067	-	395,365	416,432	380	69,727	99,359	169,466	585,898
MYR	-	-	16,831	16,831	-	73,533	-	73,533	90,364
Other	2,819,505	223,262	1,071,686	4,114,453	4,362	233,177	960,237	1,197,776	5,312,229
Add: Interest in Suspense	940,603	-	-	940,603	-	-	-	-	940,603
Less: Acceptances	-	-	(8,771,823)	(8,771,823)	-	-	-	-	(8,771,823)
Total	131,407,216	14,864,292	35,118,144	181,389,652	3,413,575	5,928,434	17,443,861	26,785,870	208,175,522

11.Gross Credit Risk Exposure (continued)

Gross Credit Exposure by Geography

2012

AED '000

	Loans	Investment Securities	Other Assets	Total Funded	Commitments	OTC Derivatives	Other Off Balance Sheet exposures	Total Non-Funded	Total
Domestic (U.A.E.)	124,707,901	8,555,934	26,945,957	160,209,792	1,447,606	3,247,302	12,364,445	17,059,353	177,269,145
Other GCC countries	2,400,188	2,173,274	4,567,098	9,140,560	98,483	2,613	515,525	616,621	9,757,180
Other Arab countries	134,724	-	21,008	155,732	-	-	33,694	33,694	189,426
Asia	1,082,622	1,278,835	1,276,078	3,637,535	79	144,160	379,319	523,558	4,161,093
Europe	124,361	3,303,639	5,644,265	9,072,265	565	3,070,191	673,165	3,743,921	12,816,185
U.S.A.	210	2,903,035	336,186	3,239,431	13,533	1,135,391	482,378	1,631,303	4,870,734
Rest of the world	1,209,010	292,154	210,207	1,711,371	-	61,758	52,264	114,022	1,825,393
Add: Interest in suspense	802,628	-	-	802,628	-	-	-	-	802,628
Less: Acceptances		-	(4,738,044)	(4,738,044)	-	-	-	-	(4,738,044)
Total	**130,461,644**	**18,506,871**	**34,262,755**	**183,231,270**	**1,560,266**	**7,661,415**	**14,500,790**	**23,722,471**	**206,953,741**

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	Loans	Investmet Securities	Other Assets	Total Funded	Commitments	OTC Derivatives	Other Off Balance Sheet exposures	Total Non-Funded	Total
Domestic (U.A.E.)	125,184,905	6,973,634	32,622,542	164,781,081	2,069,995	3,208,929	14,392,098	19,671,022	184,452,103
Other GCC countries	2,235,385	1,999,370	2,683,156	6,917,911	-	13,928	297,779	311,707	7,229,618
Other Arab countries	9,145	-	14,178	23,323	70,666	154	127,200	198,020	221,343
Asia	1,108,616	1,213,864	1,231,026	3,553,506	1,257,143	145,748	244,044	1,646,935	5,200,441
Europe	366,814	2,317,999	5,503,841	8,188,654	-	1,979,559	1,232,011	3,211,570	11,400,224
U.S.A.	9,474	2,264,246	1,806,669	4,080,389	-	459,178	1,122,243	1,581,421	5,661,810
Rest of the world	1,552,274	95,179	28,555	1,676,008	15,771	120,938	28,486	165,195	1,841,203
Add: Interest in suspense	940,603	-	-	940,603	-	-	-	-	940,603
Less: Acceptances	-	-	(8,771,823)	(8,771,823)	-	-	-	-	(8,771,823)
Total	131,407,216	14,864,292	35,118,144	181,389,652	3,413,575	5,928,434	17,443,861	26,785,870	208,175,522

11. Gross Credit Risk Exposure (continued)

Gross Credit Exposure by Residual Maturity

2012

AED ' 000

	Loans	Investment Securities	Other Assets	Total Funded	Commitments	OTC Derivatives	Other Off Balance Sheet exposures	Total Non-Funded	Total
Less than 3 months	17,813,742	417,348	27,909,578	46,140,668	114,001	538,651	4,034,970	4,687,621	50,828,289
3 months to less than 6 months	5,615,131	768,592	2,937,860	9,321,583	308,664	180,080	1,929,743	2,418,488	11,740,071
6 months to less than 1 year	8,945,923	254,422	2,205,592	11,405,937	140,201	979,312	742,502	1,862,015	13,267,952
1 year to 3 years	15,367,342	11,120,669	677,968	27,165,979	748,350	1,158,492	7,541,891	9,448,733	36,614,712
Over 3 years	81,916,878	5,945,840	5,269,801	93,132,519	249,051	4,804,879	251,684	5,305,614	98,438,133
Add: Interest in Suspense	802,628	-	-	802,628	-	-	-	-	802,628
Less: Acceptances	-	-	(4,738,044)	(4,738,044)	-	-	-	-	(4,738,044)
Total	**130,461,644**	**18,506,871**	**34,262,755**	**183,231,270**	**1,560,266**	**7,661,415**	**14,500,790**	**23,722,471**	**206,953,741**

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	Loans	Investment Securities	Other Assets	Total Funded	Commitments	OTC Derivatives	Other Off Balance Sheet exposures	Total Non-Funded	Total
Less than 3 months	24,712,917	248,205	27,756,663	52,717,785	888,844	257,878	1,120,680	2,267,402	54,985,187
3 months to less than 6 months	4,111,680	36,946	1,044,741	5,193,367	654,675	162,338	1,227,728	2,044,741	7,238,108
6 months to less than 1 year	16,439,592	678,800	8,428,013	25,546,405	463,671	60,876	7,463,057	7,987,604	33,534,009
1 year to 3 years	15,874,485	5,189,068	1,360,418	22,423,971	659,378	2,562,129	1,194,000	4,415,507	26,839,478
Over 3 years	69,327,939	8,711,273	5,300,132	83,339,344	747,007	2,885,213	6,438,396	10,070,616	93,409,960
Add: Interest in Suspense	940,603	-	-	940,603	-	-	-	-	940,603
Less: Acceptances	-	-	(8,771,823)	(8,771,823)	-	-	-	-	(8,771,823)
Total	131,407,216	14,864,292	35,118,144	181,389,652	3,413,575	5,928,434	17,443,861	26,785,870	208,175,522

11. Gross Credit Risk Exposure (continued)

Gross Credit Exposure by Economic Sector

2012

AED '000

	Loans	Investment Securities	Other Exposure	Total Funded	Commitments	OTC Derivatives	Other Off Balance Sheet exposures	Total Non-Funded	Total
Agriculture	10,803	-		10,803	-	-	670	670	11,473
Energy	10,286,569	1,092,268	483,872	11,862,710	98,054	791,312	65,568	954,934	12,817,644
Trading	1,023,047	253,713	268,588	1,545,348	-	247,040	656,914	903,954	2,449,302
Development & construction	20,272,997	2,054,569	757,034	23,084,600	463,264	2,277	4,451,252	4,916,793	28,001,394
Real Estate investment	30,587,620	-	677,731	31,265,351	-	-	11	11	31,265,362
Transport	1,755,513	626,383	435,976	2,817,871	-	2	108,537	108,539	2,926,411
Government	3,149,773	5,135,933	9,447,782	17,733,488	-	89,159	191,237	280,396	18,013,885
Financial institutions	9,696,574	9,274,502	19,422,695	38,393,771	212,764	5,874,178	2,080,445	8,167,387	46,561,158
Manufacturing	1,512,171	-	298,497	1,810,668	-	10,523	450,028	460,552	2,271,220
Services	21,536,017	69,503	7,020,488	28,626,008	350,662	538,940	6,294,934	7,184,536	35,810,544
Personal - Retail	17,632,372	-	178,332	17,810,704	435,522	107,982	200,272	743,776	18,554,481
Personal collaterised	12,195,559	-	9,802	12,205,361	-	-	922	922	12,206,284
Add: Interest in suspense	802,628	-		802,628	-	-	-	-	802,628
Less: Acceptances			(4,738,044)	(4,738,044)	-	-	-	-	(4,738,044)
Total	**130,461,644**	**18,506,871**	**34,262,755**	**183,231,270**	**1,560,266**	**7,661,415**	**14,500,790**	**23,722,471**	**206,953,741**

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	Loans	Investment Securities	Other Exposure	Total Funded	Commitments	OTC Derivatives	Other Off Balance Sheet exposures	Total Non-Funded	Total
Agriculture	9,084	-		9,084	-	-	436	436	9,520
Energy	11,227,074	828,069	426,041	12,481,185	48,624	694,215	63,546	806,385	13,287,570
Trading	862,053	-	837,519	1,699,572	19,792	-	1,302,534	1,322,326	3,021,898
Development & construction	28,805,049	1,869,640	341,145	31,015,833	222,045	8,573	3,233,053	3,463,671	34,479,504
Real Estate investment	19,907,821	-	396,912	20,304,733	-	-	11	11	20,304,744
Transport	1,878,609	556,594	108,141	2,543,344	-	154	121,378	121,532	2,664,876
Government	2,855,458	4,184,455	6,890,382	13,930,294	-	88,446	22,320	110,766	14,041,060
Financial institutions	8,997,131	7,354,896	24,356,830	40,708,858	581,039	4,292,419	3,714,889	8,588,347	49,297,205
Manufacturing	2,248,426	-	144,113	2,392,539	-	11,166	381,573	392,739	2,785,278
Services	20,161,581	70,637	10,039,809	30,272,027	1,327,096	531,399	8,355,297	10,213,792	40,485,819
Personal - Retail	16,953,276	-	349,075	17,302,351	33	50,234	247,800	298,067	17,600,419
Personal collaterised	16,561,051	-		16,561,051	1,214,946	251,829	1,025	1,467,800	18,028,851
Add: Interest in suspense	940,603	-		940,603	-	-	-	-	940,603
Less: Acceptances	-	-	(8,771,823)	(8,771,823)	-	-	-	-	(8,771,823)
Total	131,407,216	14,864,292	35,118,144	181,389,652	3,413,575	5,928,434	17,443,862	26,785,871	208,175,523

12. Credit Risk Measurement and Mitigation Policies

Loans and advances to customers is the main source of credit risk for the Bank although ADCB can also be exposed to other forms of credit risk through, for example, loans to banks, loan commitments and debt securities. The Bank's risk management policies and processes are designed to identify and analyse risk, to set appropriate risk appetite, limits and controls, and to monitor the risks and adherence to limits by means of reliable and timely data. The Bank assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparties.

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate.

Collateral

The Bank holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, fixed deposits and guarantees. Estimates of fair value of the collateral including shares are updated on a regular basis. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. The principal collateral types for loans and advances are:

- Cash and marketable securities
- Mortgages over residential and commercial properties;
- Charges over business assets such as premises, inventory and accounts receivable;
- Charges over financial instruments such as debt securities and equities; and
- Guarantees.

Derivatives

The Bank maintains strict control limits on net open derivative positions (i.e. the difference between purchase and sale contracts), by both amount and term. At any time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Bank (i.e. positive fair value of assets), which in relation to derivatives is a small fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements.

Collateral or other security is not usually obtained for credit risk exposures on these instruments, except where the Bank requires margin deposits from counterparties.

12. Credit Risk Measurement and Mitigation Policies (continued)

Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty to cover the aggregate of all settlement risks arising from the Bank's market transactions on any single day.

Master netting arrangements

The Bank further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of statement of financial position assets and liabilities, as transactions are usually settled on a gross basis.

However, the credit risk associated with favourable contracts is reduced by a master netting arrangement to the extent that if a default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Bank's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a year, as it is affected by each transaction subject to the arrangement.

Credit Risk Mitigants as per Basel II eligibility

	2012		2011	
	Gross Credit Exposures	**Risk Weighted Assets**	Gross Credit Exposures	Risk Weighted Assets
Gross Exposure Prior to Credit Risk Mitigation	**201,943,976**	**145,074,002**	208,175,522	147,914,776
Less: Exposure covered by on-balance sheet netting	**(2,956,794)**	**(1,257,695)**	(1,664,606)	(1,066,957)
Less: Exposures covered by Eligible Financial Collateral	**(16,575,366)**	**(15,702,849)**	(18,058,789)	(17,141,605)
Less: Exposures covered by Guarantees				
Less: Exposures covered by Credit Derivatives				
Net exposures after Credit Risk Mitigation	**182,411,816**	**128,113,458**	188,452,127	129,706,214

13. Portfolio Monitoring & Identifying Credit Risk Loans

Credit Risk Management is actively involved in identifying and monitoring credit risk loans. It monitors the portfolio through system generated MIS and periodic reviews giving due consideration to industry/general economic trends, market feed back, and media reports.

Within the retail portfolios comprising of homogeneous assets, statistical techniques are deployed to monitor potential weaknesses on a portfolio basis. The approach is consistent with the Bank's policy of raising a specific impairment allowance as soon as objective evidence of impairment is identified. Retail accounts are classified according to specified categories of arrears status (days past due buckets), which reflects the level of contractual payments which are overdue on a loan.

13. Portfolio Monitoring & Identifying Credit Risk Loans (continued)

The probability of default increases with the number of contractual payments missed, thus raising the associated impairment requirement. In the event, where a decision is taken to write off a loan, the account is moved to legal recovery function. However, in certain cases, an account may be charged off directly from a performing status, such as in the case of insolvency or death.

In the Wholesale Banking portfolio, the Bank will more frequently participate in debt restructuring agreements as part of the business support process. Debt restructuring agreements may include actions to facilitate recovery of the principal and interest outstanding and may include rate negotiation, relaxing payment schedules, etc.

Identification and measurement of impairment

At each reporting date the Bank assesses whether there is objective evidence that financial assets carried at amortised cost are impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a Bank of assets such as adverse changes in the payment status of borrowers or issuers in the Bank, or economic conditions that correlate with defaults in the Bank.

The Bank considers evidence of impairment for loans and advances and investment securities measured at amortised costs at both a specific asset and collective level.

Individually assessed loans and advances

Impairment losses for individually assessed loans are determined by an evaluation of objective evidence related to each exposure on a case-by-case basis. This procedure is applied to all classified corporate, commercial, high net worth individual loans, bank loans and advances which are individually significant accounts or are not subject to a portfolio-based-approach. Specific factors considered by management when determining allowance for impairment on individual loans and advances which are significant includes the Bank’s aggregate exposure to the customer, viability of the customer’s business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations, the amount and timing of expected receipts and recoveries, likely dividend available on liquidation or bankruptcy, extent of other creditors’ commitments ranking ahead of, or pari passu with the Bank, likelihood of other creditors continuing to support the company, realisable value of security (or other credit mitigants) and likelihood of successful repossession, and likely deduction of any costs involved in recovery of amounts outstanding.

The amount of impairment loss is measured as the difference between the loan’s carrying amount and the present value of estimated future cash flows excluding future credit losses but including amounts recoverable from guarantees and collateral, discounted at the loan’s original effective

13. Portfolio Monitoring & Identifying Credit Risk Loans (continued)

Individually assessed loans and advances (continued)

interest rate, when it became delinquent under the contract. The amount of the loss is recognised using an allowance account and is included in the consolidated income statement line impairment allowances.

The Bank's policy requires regular review of the level of impairment allowances on individual facilities, regular valuation of the collateral and consideration of its enforceability. Impaired loans continue to be classified as impaired unless they are fully current and the collection of scheduled interest and principal is considered probable.

Impairment is assessed on a collective basis in two circumstances:

- to cover losses which may have been incurred but have not yet been identified on loans subject to individual assessment; and
- for homogenous groups of loans that are not considered individually significant

The following factors are considered by management when determining allowance for impairment for such loans:

Retail loans – All the unsecured loans falling under similar overdue category are assumed to carry similar credit risk and allowance for impairment is taken on a gross basis. In cases of secured loans where the Bank possesses collateral (mortgage/auto loans) the realisable value of the collateral is taken into consideration in assessing the allowance for impairment.

Collectively assessed loans and advances

Other performing loans – The management of the Bank assesses, based on historical experience and the prevailing economic and credit conditions, the magnitude of loans which may be impaired but not identified as at the reporting date.

In assessing collective impairment the Bank uses statistical modeling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modeling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

The collective impairment allowance is determined after taking into account factors such as historical loss experience in portfolios of similar credit risk characteristics, estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against individual loans and management's judgement based on experience as to whether current economic and credit conditions are such that the actual level of inherent losses at the reporting date is likely to be greater or less than that suggested by historical experience. The period between a loss occurring and its identification is estimated by management for each identified portfolio.

13. Portfolio Monitoring & Identifying Credit Risk Loans (continued)

Incurred but not yet identified on individual loans

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics based on industry, product or loan rating for the purpose of calculating an estimated collective loss. This reflects impairment losses that the Bank may have incurred as a result of events occurring before the reporting date, which the Bank is not able to identify on an individual loan basis, and that can be reliably estimated. As soon as information becomes available which identifies losses on individual loans within the group of the customer, those loans are removed for the purpose of collective impairment and assessed on an individual basis for impairment.

Homogenous groups of loans and advances

Statistical methods are used to determine impairment losses on a collective basis for homogenous groups of loans that are not considered individually significant, because individual loan assessment is impracticable. Losses in these groups of loans are recorded on individual basis when individual loans are written off, at which point they are removed from the group.

Impairment of retail loans is calculated by applying a formula approach which allocates progressively higher loss rates in line with the overdue installment date.

Write-off of loans and advances

A loan and advance (and the related impairment allowance) is normally written off, either partially or in full, when there is no realistic prospect of recovery of the principal amount and, for a collateralised loan, when the proceeds from realizing the security have been received.

Reversal of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the consolidated income statement in the period in which it occurs.

Derivative related credit risk

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Bank. The Bank enters into derivative contracts with financial institutions and corporates which are of satisfactory credit standing as per the Bank's independent credit assessment. Credit risk in derivatives is mitigated through limit control and master netting agreements as explained in Note 41.4.

13. Portfolio Monitoring & Identifying Credit Risk Loans (continued)

Off-balance sheet

The Bank applies the same risk management policies for off-balance sheet risks as it does for its on-balance sheet risks. In the case of commitments to lend, customers and counterparties will be subject to the same credit management policies as for loans and advances. Collateral may be sought depending on the strength of the counterparty and the nature of the transaction.

Movement of the individual and collective impairment allowance on loans and advances

		AED '000	
		2012	2011
Opening Balance of Provisions for Impaired Loans		**5,711,876**	6,296,437
Add:	Charge for the year		-
	a. Specific provisions	**1,676,510**	1,886,939
	b. Collective provisions	**197,613**	416,167
Less:	Write-off of impaired loans to income statement	**(809,111)**	(2,487,492)
Less:	Recovery of loan loss provisions	**(183,015)**	(220,746)
Less:	Discount unwind/Currency transalation	**(130,153)**	(179,429)
Closing Balance of Provisions for Impaired Loans		**6,463,720**	5,711,876

13. Portfolio Monitoring & Identifying Credit Risk Loans (continued)

Impaired Loans by Geography

2012

AED '000

	Overdue (Gross of interest in suspense-IIS & Specific Provision-SP)			Provisions			
	Less than 90 days	**90 days and above**	**Total**	**Specific**	**General**	**Interest in suspense**	**Total Impaired Assets (net of IIS & SP)**
United Arab Emirates	-	7,128,490	7,128,490	3,988,430	-	701,902	2,438,159
Other GCC countries	-	582,017	582,017	207,204	-	95,489	279,324
Other Arab countries	-	102	102	-	-	28	74
Asia	-	240	240	-	-	104	136
Europe	-	30,684	30,684	11,503	-	5,090	14,091
Rest of the world	-	40	40	-	-	14	25
Total	-	**7,741,573**	**7,741,573**	**4,207,137**	**2,256,583**	**802,628**	**2,731,808**

2011

AED '000

	Overdue (Gross of interest in suspense-IIS & Specific Provision-SP)			Provisions		Interest in suspense	Total Impaired Assets (net of IIS & SP)
	Less than 90 days	90 days and above	Total	Specific	General		
United Arab Emirates	-	6,337,972	6,337,972	3,474,197		878,987	1,984,788
Other GCC countries	-	595,265	595,265	172,724	-	61,397	361,144
Other Arab countries	-	870	870	-	-	157	713
Asia	-	386	386	-	-	56	330
Europe	-	31,368	31,368	5,883		6	25,479
Rest of the world	-	29	29	-	-	-	29
Total	-	6,965,889	6,965,889	3,652,804	2,059,072	940,603	2,372,482

Total collateral held against non-performing customers amounted to AED 5,660,393 thousand (2011: AED 4,770,434 thousand) in the form of financial guarantees, fixed deposits under lien, share collateral, hypothecated assets, mortgaged properties, etc.

13. Portfolio Monitoring & Identifying Credit Risk Loans (continued)

Impaired Loans by Economic Activities

2012

AED '000

Economic Activity	Overdue (Gross of interest in suspense-IIS & Specific Provision-SP)			Provisions		Interest in suspense	Total Impaired Assets
	Less than 90 days	90 days and above	Total	Specific	General		
Agriculture	-	5	5	-	-	4	1
Energy	-	17	17	-	-	5	13
Trading	-	17,973	17,973	9,987	-	7,261	724
Development & construction	-	2,014,824	2,014,824	727,957	-	186,689	1,100,179
Real Estate investment	-	861,265	861,265	358,409	-	152,007	350,848
Transport	-	1,065	1,065	113	-	526	426
Government	-		-		-		-
Financial institutions	-	325,756	325,756	287,026	-	15,743	22,987
Manufacturing	-	2,079	2,079	1,121	-	539	419
Services	-	1,057,671	1,057,671	353,097	-	111,283	593,290
Personal - Retail	-	1,413,402	1,413,402	901,377	-	157,450	354,575
Personal collaterised	-	2,047,516	2,047,516	807,050	-	171,121	1,069,346
Other	-	-	-	761,000	-	-	(761,000)
	-	7,741,573	7,741,573	4,207,137	2,256,583	802,628	2,731,808

2011

AED '000

Economic Activity	Overdue (Gross of interest in suspense-IIS & Specific Provision-SP)			Provisions		Interest in suspense	Total Impaired Assets
	Less than 90 days	90 days and above	Total	Specific			
Agriculture	-	6	6	-	-	3	2
Energy	-	25	25	-	-	8	18
Trading	-	30,078	30,078	14,479	-	5,360	10,240
Development & construction	-	1,188,493	1,188,493	359,373	-	98,410	730,711
Real Estate investment	-	866,775	866,775	201,637	-	99,215	565,923
Transport	-	834	834	280	-	380	174
Government	-	-	-	-	-	-	-
Financial institutions	-	9	9	3	-	2	5
Manufacturing	-	108,885	108,885	98,482	-	10,144	259
Services	-	2,373,735	2,373,735	1,067,023	-	224,335	1,082,377
Personal - Retail	-	1,955,618	1,955,618	710,006	-	424,935	820,676
Personal collaterised	-	441,431	441,431	311,521	-	77,812	52,099
Other	-	-	-	890,000	-	-	(890,000)
Total	-	6,965,889	6,965,889	3,652,804	2,059,072	940,603	2,372,482

Total collateral held against non-performing customers amounted to AED 5,660,393 thousand (2011: AED 4,770,434 thousand) in the form of financial guarantees, fixed deposits under lien, share collateral, hypothecated assets, mortgaged properties, etc.

14. Market Risk Framework, Measurement and Monitoring

Market risk is the risk that the Bank's valuations of financial instruments will fluctuate because of changes in market risk factors such as interest rates, foreign exchange rates, equity prices, commodities prices and options' volatilities.

Market price risk

Market price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual security, or its issuer, or factors affecting all securities traded in the market. The Bank is exposed to market risk with respect to its investments in marketable securities and other financial instruments like derivatives and foreign exchange instruments.

Management of market risk

The Board of Directors have set risk limits based on the Value-at Risk, Sensitivity/Stress analysis and FX Open Position notional limits which are closely monitored by the Risk Management Division and reported regularly to the Senior Management and discussed by the ALCO.

The Bank's activities expose it primarily to the financial risk of changes in foreign currency exchange rates and interest rates. The Bank enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign exchange risk.

Market risk is identified, measured, monitored, and controlled by an independent risk control function. Market risk management aims to reduce volatility in operating performance and make the Bank's market risk profile transparent to Senior Management, the Board of Directors and Regulators.

Market risk management is overseen by the Management Risk and Credit Committee (MRCC) and performs the following primary functions:

- Establishment of a comprehensive market risk policy framework;
- Establishment of a comprehensive Mark-to-Market valuation policy framework;
- Independent measurement, monitoring and control of market risk;
- Setting up, approval and monitoring of limits.

Risk identification and classification

The MRCC identifies and classifies market risk for the Bank and puts in place risk management policies and procedures. All business segments are responsible for comprehensive identification and verification of market risks within their business units. Regular meetings are held between market risk management and the heads of risk taking businesses to discuss and decide on risk exposures in the context of the market environment.

14. Market Risk Framework, Measurement and Monitoring (continued)

Risk identification and classification (continued)

The Bank separates its exposure to market risk between trading and non-trading portfolios. Trading portfolios are held by the Treasury and Derivatives Division, and include positions arising from market making and proprietary position taking, together with financial assets and liabilities that are managed on a fair value basis.

Market risk is broadly classified into trading and non-trading categories:

Trading risk

Market risk which includes interest rate risk, foreign exchange, equities and commodities and other trading risks involve the potential decline in net income or financial condition due to adverse changes in market rates.

Trading risk includes positions that are held by the Bank's trading unit whose main business strategy is to trade or make markets. Unrealised gains and losses in these positions are generally reported in principal transactions under consolidated income statement.

Non-trading risk

Non-trading risk arises from execution of the Bank's core business strategies, products and services to its customers, and the strategic positions the Bank undertakes to manage risk exposures.

These exposures can result from a variety of factors including but not limited to re-pricing of gaps in assets, liabilities and off-balance sheet instruments and changes in the level and shape of market interest rate curves.

Non-trading risk includes securities and other assets held for longer-term investment in securities and derivatives used to manage the Bank's asset/liability exposures. Unrealised gains and losses in these positions are generally not reported in principal transactions revenue.

Risk measurement

The following are the tools used to measure the market risk, because no single measure can reflect all aspects of market risk, the Bank uses various matrices, both statistical and non-statistical, including:

- Statistical risk measures
- Non-statistical risk measures; and
- Sensitivity analysis

14. Market Risk Framework, Measurement and Monitoring (continued)

Statistical risk measures

Statistical risk measures include Value-at-Risk and Back-testing.

The Bank primarily uses 10 day Unfiltered Historical Simulation Value-at-Risk at 99% confidence level (CL) to monitor and control market risk on a day to day basis.

Non-statistical risk measures

Non-statistical risk measures, other than stress testing, include independent market valuations, net open positions, basis point values, option sensitivities and position concentrations . These measures provide granular information on the Bank's market risk exposure.

The Bank uses non-statistical scenario based risk limits to support the Value-at-Risk in the monitoring and control of market risk on a day to day basis.

Sensitivity analysis

The scenarios used for interest rate risk assess the change in the portfolio to parallel and non-parallel rate shocks. The non-parallel rate shocks simulate steepening, bending and twisting interest rate scenarios. Portfolio sensitivity for major interest rate and foreign currency exchange rate risks (parallel rate shock) is analysed separately for the Bank's trading portfolio.

Capital Calculation

Capital is allocated in respect of market risk under the general guidelines and framework set out under Basel II Section VI, Market Risk, which defines this risk as the risk of losses in on and off-balance sheet positions arising from movements in market prices.

The market risks subject to a capital charge are as follows: -

- Interest Rate Risk,
- Foreign exchange Risk,
- Equity Exposure Risk,
- Commodity Risk, and
- Options Risk

14. Market Risk Framework, Measurement and Monitoring (continued)

Capital Requirement for Market Risk under Standardised Approach

	AED '000	
	2012	2011
Market Risk		
Interest rate risk	**272,078**	229,855
Equity position risk	**83,969**	-
Foreign exchange risk	**28,984**	22,048
Commodity risk	**281**	408
Options Risk	**64,633**	141
Total Capital Requirement	**449,945**	252,452

AED '000

	2012		2011	
	Risk Weighted Assets	**Capital requirements**	Risk Weighted Assets	Capital requirements
Interest Rate Risk - Trading Book				
Specific Risk	**40,399**	**4,848**	733	88
General Risk - Maturity based	**2,226,915**	**267,230**	1,914,725	229,767
General Risk - Duration based	**-**	**-**	-	-
Foreign Exchange Risk	**241,532**	**28,984**	183,733	22,048
Equity Exposure Risk- Trading Book			-	-
General Risk	**349,871**	**41,985**	-	-
Specific Risk	**349,871**	**41,985**	-	-
Commodity Risk- Trading Book	**2,344**	**281**	3,400	408
Options Risk	**-**	**-**	-	-
Simplified Approach	**-**	**-**	-	-
Intermediate Approach	**538,612**	**64,633**	1,175	141
Market Risk Total Capital Charge	**3,749,544**	**449,945**	2,103,767	252,452

15. Equity Position in Banking Books

Quantitative Details of Equity Position

AED '000

	2012		2011	
	Publicly Traded/Quoted	**Privately Held/Un-quoted**	Publicly Traded/Quoted	Privately Held/Un-quoted
Equities	**425**	**205,621**	6,905	180,906
Collective investment schemes	**-**	**-**	-	-
Any other investments	**-**	**-**	-	-
Total	**425**	**205,621**	6,905	180,906

For details of the accounting policies and valuation methodology, please refer to Note 3.7 to the consolidated financial statements under 'Summary of Significant Accounting Policies'. Detail of fair value are reported in Note 9 to the consolidated financial statements under the heading of "Investment Securities".

AED '000

	2012	2011
Realised, unrealised and latent revaluation gains (losses) during the year		
Gains (losses)	**-**	0
Realised gains (losses)from sales and liquidations	**(7,607)**	6,972
Unrealised gains (losses) recognised in the balance sheet but not through profit and loss account	**5,512**	9,707
Latent revaluation gains (losses) for investment recorded at cost but not recognised in balance sheet or profit or loss account	**-**	-
Total	**(2,095)**	16,679

15. Equity Position in Banking Books (continued)

Quantitative Details of Equity Position (continued)

	AED '000	
	2012	2011
Items in table above included in Tier 1/tier2 capital		
Amount included in Tier I capital	**(7,607)**	6,972
Amount included in Tier II capital	**2,480**	4,368
Total	**(5,127)**	11,340
Capital requirements by Equity Groupings		
Stategic investments	**-**	-
Available for sale	**37,088**	33,806
Held for trading	**-**	-
Total Capital Requirement	**37,088**	33,806

16. Operational Risk Management

The Bank defines operational Risk as “the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events”. Operational risks can expose the Bank to potentially large losses as well. While the Bank cannot eliminate all operational risks, it has developed a comprehensive process of identifying, assessing, controlling/mitigating, monitoring and reporting operational risk.

The ultimate responsibility for Bank-wide operational risk profile, as well as compliance with laws and regulations, rests with the Board of Directors (BoD), even though this responsibility has been delegated to the senior management. Ongoing management of operational risk is coordinated by the Operational Risk Management Department (ORMD) and reviewed/controlled by the Management Executive Committee (MEC) and Management Risk & Credit Committee (MRCC) as applicable for policy purposes.

The Operational Risk Governance Framework is built on a number of elements which allow the Bank to effectively manage and measure its Operational Risk profile and to calculate the amount of Operational Risk capital that the Bank needs to hold to absorb potential losses.

16. Operational Risk Management (continued)

The Internal Audit function provides further independent review of the Bank's operational risk management processes, systems and controls and reports independently to the Board. The bank currently follows the Standardised Approach for calculating the capital charge. The capital charge for the year ended 31 December 2012 was AED 783,193 thousand (2011: AED 696,616 thousand).