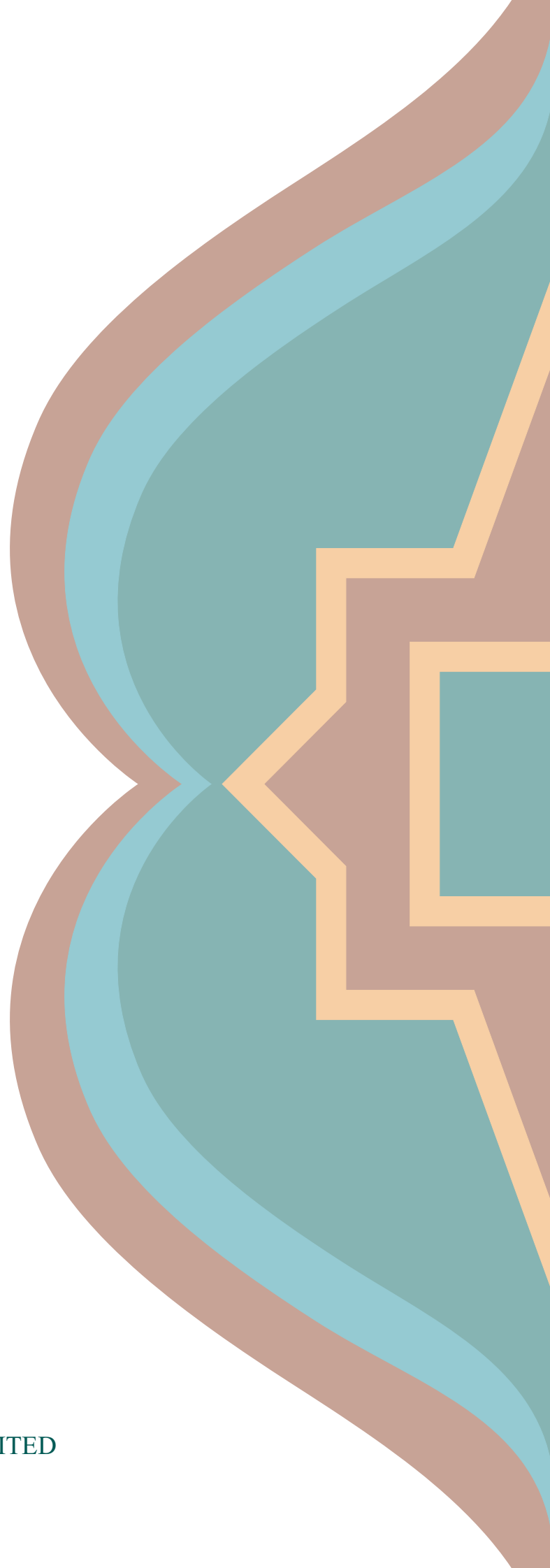




YOUR PARTNER IN
ARAB FINANCE WORLDWIDE



Financial Highlights

| 12 months ended/as at 31st December | | 2006 | 2005 | 2004 | 2003 | 2002 |
|--|---|-------------|-----------|-----------|-----------|-----------|
| Thousands of Pounds Sterling (unless otherwise stated) | | | | | | |
| Profit before provisions | # | 19,859 | 34,148 | 12,830 | 11,459 | 15,025 |
| Profit before tax | | 20,364 | 43,274 | 13,412 | 21,108 | 10,714 |
| Profit after tax | | 14,031 | 31,347 | 9,270 | 14,574 | 7,202 |
| Dividends declared | † | 7,000 | 25,100 | 7,500 | 14,000 | 7,000 |
| Earnings per share (p) | | 12.43 | 27.76 | 8.21 | 12.91 | 6.38 |
| Dividends per share (p) | | 6.20 | 22.23 | 6.64 | 12.40 | 6.20 |
| Shareholders' Funds | | 159,123 | 172,545 | 146,309 | 137,355 | 136,999 |
| Total Assets | | 2,472,830 | 2,189,838 | 1,877,981 | 1,237,871 | 1,344,460 |
| Capital Adequacy Ratio | | 16% | 17% | 21% | 27% | 25% |
| Dollar / sterling exchange rate | | | | | | |
| Year end | | \$1.96 | \$1.73 | \$1.93 | \$1.79 | \$1.61 |
| Average | | \$1.85 | \$1.82 | \$1.84 | \$1.65 | \$1.49 |
| Numbers of Shares (Actual) | | 112,923,000 | | | | |

Profits in 2005 were increased by a number of significant one-off items as explained in the Operating and Financial Review.

† Dividends are accounted for in the year in which they are paid, not the year in respect of which they are declared.

In the above table, the profits and balances for the two years ended 31 December 2003 were arrived at in accordance with UK GAAP. The Group has adopted IFRS with effect from 1 January 2005, but has also taken advantage of the exemptions contained in IAS39, IAS32 and IFRS4 from the requirement to restate comparative information for the year ended 31 December 2004. A number of adjustments would be required to the profits and balances for the year ended 31 December 2004 in order to make them comparable with the profits and balances for the year ended 31 December 2005. These adjustments were described in Note 36 of the accounts for the year ended 31 December 2005.

SHAREHOLDERS

| | |
|-------------------------------|---------|
| HSBC BANK MIDDLE EAST LIMITED | 46.51% |
| LIBYAN FOREIGN BANK | 25.00% |
| BANK AL-MAGHRIB | 7.86% |
| BANQUE EXTÉRIEURE D'ALGÉRIE | 7.86% |
| CENTRAL BANK OF EGYPT | 7.86% |
| RAFIDAIN BANK | 4.91% |
| | 100.00% |

British Arab Commercial Bank Limited

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British Arab Commercial Bank Limited

BOARD OF DIRECTORS

Mr Andrew Dixon OBE Chairman

Appointed a director of the Bank on 28 February 1998 and Chairman on 30 June 2003.
Chairman of Management Committee and Compensation Committee.

Dr Khaled Zentuti Vice Chairman

Appointed 22 July 2004. Member of Management Committee and Compensation Committee.

Dr Mohamed Bait-Elmal

Appointed 21 July 2006.

Mr Niall Booker

Appointed 1 June 2006.

Mr Robert Gray

Appointed 1 April 2005. Chairman of Audit Committee.

HE Abdellatif Jouahri

Appointed 23 April 2003. Member of Audit Committee.

Dr Khaled Kagigi

Appointed 25 February 2006. Member of Audit Committee.

Mr Christopher Keirle

Appointed 1 January 2000. Member of Management Committee.

Mr Mohamed Loukal

Appointed 26 May 2005. Member of Audit Committee.

HE Dr Farouk El-Okdah

Appointed 31 December 2003. Member of Management Committee and Compensation Committee.

Mr Michael Parr Chief Executive

Appointed 27 September 2002. Member of Management Committee and Compensation Committee.

Mr Sadek Abuhallala ceased to be a director on 25 February 2006.

Mr David Hodgkinson ceased to be a director on 1 June 2006.

Mr Mohamed Lahmar ceased to be a director on 21 July 2006.

British Arab Commercial Bank Limited

MANAGEMENT

EXECUTIVE MANAGERS

| | |
|------------------|--|
| Michael Parr | CHIEF EXECUTIVE |
| Mohamed Fezzani | DEPUTY CHIEF EXECUTIVE & GENERAL MANAGER (Member of Management Committee) |
| Jon Bowen | TREASURER |
| David Crew | HEAD OF HUMAN RESOURCES |
| Crispian Denby | CHIEF FINANCIAL OFFICER & COMPANY SECRETARY |
| Rollo Greenfield | CHIEF OPERATING OFFICER |
| George Kimber | ASSISTANT GENERAL MANAGER – INSTITUTIONAL & CORPORATE BANKING |
| John Trench | HEAD OF RISK MANAGEMENT |

MANAGERS

| | |
|-----------------|---|
| Gary Bishop | TRADE SERVICES |
| Geoff Duncanson | INSTITUTIONAL & CORPORATE BANKING |
| Roger Screech | HEAD OF INFORMATION TECHNOLOGY & COMMUNICATIONS |

| | |
|--------------------|--|
| Richard Abbott | FINANCIAL CONTROL |
| Layth Al-Falaki | RISK MANAGEMENT |
| Richard Allan | AUDIT |
| Andy Barker | INFORMATION TECHNOLOGY & COMMUNICATIONS OPERATIONS |
| Antoine Bassila | INSTITUTIONAL & CORPORATE BANKING |
| Chafik Ben Romdane | INSTITUTIONAL & CORPORATE BANKING |
| Keith Briaris | TREASURY & CAPITAL MARKETS |
| Robert Claxson | INFORMATION TECHNOLOGY & COMMUNICATIONS PROJECTS |
| Steve Cook | FACILITIES MANAGEMENT |
| Séan Dooley | BANKING SERVICES |
| Mike Galer | INSTITUTIONAL & CORPORATE BANKING |
| Glynis Hatch | HUMAN RESOURCES |
| Eric Houston | INSTITUTIONAL & CORPORATE BANKING |
| Stephen Lacey | TREASURY & CAPITAL MARKETS & LOANS ADMINISTRATION |
| Ken Law | INSTITUTIONAL & CORPORATE BANKING |
| Stephen Maltby | INSTITUTIONAL & CORPORATE BANKING |
| Amer Mismar | TREASURY & CAPITAL MARKETS |
| Ian Moore | TREASURY & CAPITAL MARKETS |
| Ephrem Nikitas | AUDIT |
| Jim Walker | INSTITUTIONAL & CORPORATE BANKING |
| Steve Windle | OPERATIONS |

OVERSEAS REPRESENTATIVES

| | |
|----------------|---------|
| Lamri Haltalli | ALGERIA |
| Ahmed Bakoush | LIBYA |

British Arab Commercial Bank Limited

CHAIRMAN'S STATEMENT

I am pleased to report that BACB made further progress at the operating level in 2006. Profit before impairment losses on loans and advances and other one-off items was £17.0m compared with £15.0m in the previous year, a 13% improvement. Profit before tax in 2005 was increased by a number of one-off items; that recorded in 2006 also benefited from one-off items but to a lesser extent with the result that 2006 net profits were lower than in 2005.

The decision was taken at the end of 2005 to hedge dollar revenues, which after premium costs yielded a net benefit to the Group as the dollar weakened from a 2005 average rate of \$1.82 = £1 to \$1.85. Costs continued to be well controlled, and the cost to income ratio remains satisfactory at 47%. The opportunity was taken to strengthen customer-facing functions, and headcount was increased during 2006 for the first time in several years.

Turnover of letters of credit confirmed by the Group, and income earned from this business line reached record levels in 2006, reflecting buoyant imports and other trade activity in BACB's core countries. Banking services also recorded its best ever result, made possible by higher than planned general payment volumes and the acquisition of new client mandates, coupled with rising international interest rates. The Group experienced high demand for new finance in the Gulf region during the year, though pricing for such facilities has declined. Nevertheless, our lending revenues held up well and the average spreads achieved were little changed from 2005.

Certain parts of the region in which the Group specialises were unsettled during 2006, and careful credit and due diligence monitoring will continue to be required across our activities in those countries.

Because of the significantly lower level of one-off profits realised in 2006 noted above, return on equity was unable to match the 20% achieved in 2005. Liquidity was held at satisfactory levels throughout the period, and the Group continues to be regarded by its customers as an important counterparty in their dealings in professional markets. While the total capital ratio did fall from 17% to 16% (in part reflecting these increased professional market dealings), it nevertheless remained well above the minimum levels required by the Group's regulator. The Bank's A- investment grade rating was reaffirmed by Fitch.

In line with the "Connecting the Bank" initiative referred to in my previous Statements, the quality of the Group's Markets business has been upgraded, and a range of new products and services introduced to our customers. I believe that client service quality offers a key competitive advantage to a bank such as BACB, and I am pleased to say that the Group's attention to continually improving service levels for its clients has produced favourable results. In line with this, BACB has introduced internet banking to its clients.

For the second time in three years BACB won the Clean City Award Chairman's Cup, which is awarded for outstanding performance in effective waste management and recycling.

I would like to acknowledge with gratitude the continuing support of clients and shareholders, and thank staff for their impressive contribution towards a further year of success.

Andrew Dixon OBE
Chairman

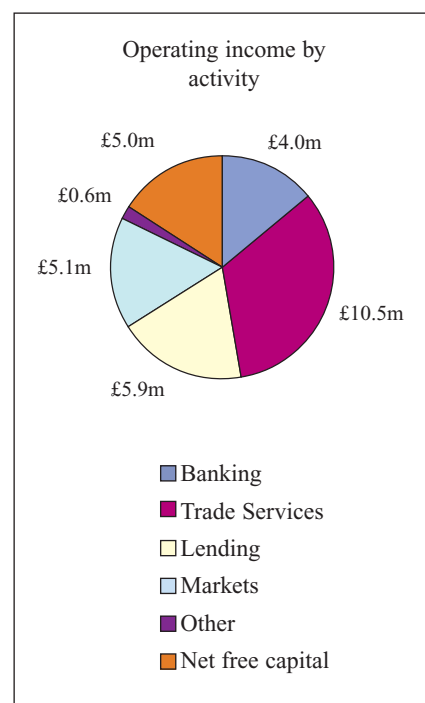
OPERATING AND FINANCIAL REVIEW

RESULTS (AUDITED)

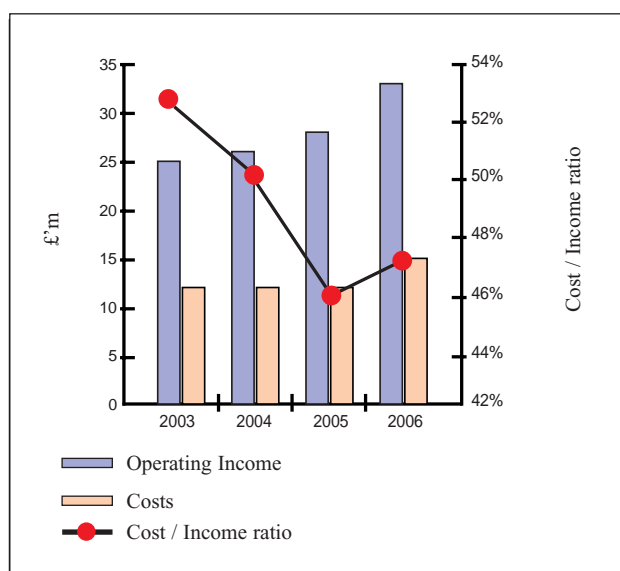
Profits before income tax for 2006 were £20,364,000 against £43,274,000 in 2005. Profits in 2005 were increased by a number of one-off items totalling £28,247,000, and the underlying operating profit for that year was £15,027,000.

2006 profits have also benefited from the sale at the start of the year of the Group's restructured claims on Iraq at a profit to book value amounting to £2,852,000, and a release of collective impairment provisions of £552,000. Underlying operating profit for 2006 was therefore £16,960,000, an increase of 13% over 2005 on a comparable basis.

Profits improved in all the Group's principal activities. Customer lending totals were higher than the year before, and trade services activity was also ahead of prior year, both on little changed overall margins. The banking department also had a strong year with increased volumes of account activity, and higher balances on customer accounts. In the Treasury, foreign exchange dealing had a successful year both in servicing customer requirements and also in proprietary trading, and the stabilisation of US interest rates allowed some recovery in interest earnings from that department.



General administrative expenses increased by 10% in the year. Part of this increase related to staff remuneration which is linked to performance, but there was also some strengthening in client facing functions in the year, and staff numbers were increased for the first time in a number of years.



Despite this increase the Group's cost / income ratio remained below 50%.

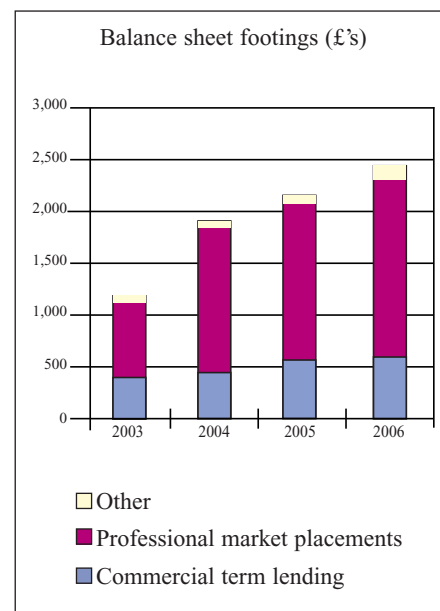
While the dollar weakened very substantially during the year, the average rate at which dollar earnings were crystallised into sterling was similar to the average rate experienced during 2005. Thus, while movements in balance sheet totals from one year to the next have been somewhat distorted by exchange rate changes, the profit and loss account was less impacted. The growth in the Group's balance

British Arab Commercial Bank Limited

sheet total of £283m would have been an increase of £454m at constant December 2006 exchange rates.

The increase in balance sheet totals arose mainly from higher levels of short date deposits placed with the Group by its customers, both by way of current account balances in the Banking department, but also as term deposits in the Treasury. These deposits are placed out in professional interbank markets on similar terms, or are used to purchase liquid debt securities. Their overall impact on the Group's structural liquidity is therefore modest and largely neutral.

Late in 2005, currency options were purchased to protect the expected 2006 dollar revenues from a weakening in the dollar. The strike price on the options was \$1.77, well below the average rate subsequently experienced, and a good profit was earned in exercising those options.



INTERNATIONAL FINANCIAL REPORTING STANDARDS (“IFRS”) (AUDITED)

The Group adopted IFRS in preparing its 2005 accounts. The accounts presented herewith are therefore the second accounts that the Group has prepared in accordance with those standards.

The Group has not early adopted IFRS 7 – Financial Instruments: Disclosures, adoption of which is required for financial statements covering periods commencing 1 January 2007.

Much of the disclosure required by IFRS 7 is already included within these accounts. However, recognising that IFRS 7 represents best practice, the Group makes further disclosures as set out below:

1. No financial assets have been reclassified at either amortised cost rather than fair value, or at fair value rather than amortised cost.
2. No financial assets have been transferred in such a way that a part or all of the financial asset does not qualify for derecognition in accordance with paragraph 15-37 of IAS39.
3. No financial assets owned by the Group have been pledged as collateral for liabilities or contingent liabilities.
4. The Group does not hold collateral on terms where it is permitted to sell or re-pledge that collateral in the absence of default by the owner.
5. The Group has not issued instruments which contain both a liability and an equity component, nor instruments with multiple embedded derivatives.
6. The Group has not defaulted on any loans payable, nor breached any terms under such loans.

British Arab Commercial Bank Limited

Note 3 to these accounts sets out various qualitative and quantitative disclosures in connection with the credit, liquidity and market risks assumed by the Group. Below are certain additional disclosures as regards credit risk:

7. The Group holds no financial assets that would otherwise be past due or impaired whose terms have been renegotiated.
8. At 31 December 2006, no amounts were past due at the reporting date which were in respect of unimpaired financial assets.

As explained in Note 3, the Group employs a credit rating system to facilitate monitoring of the overall portfolio. At 31 December 2006, the Group assessed credit risk using this methodology as follows:

| Risk | Contingent liabilities and other commitments | Cash, loans and advances and debt securities | Gross Exposure | Cash collateral | Net credit exposure |
|-------------------------------|--|--|------------------|------------------|---------------------|
| Low | 118,588 | 1,754,219 | 1,872,807 | 0 | 1,872,807 |
| Satisfactory | 345,985 | 384,384 | 730,369 | (144,095) | 586,274 |
| Fair | 134,184 | 234,986 | 369,170 | (12,719) | 356,451 |
| Watchlist | 0 | 0 | 0 | 0 | 0 |
| Substandard | 360 | 0 | 360 | 0 | 360 |
| Doubtful | 1,483 | 1,862 | 3,345 | 0 | 3,345 |
| Loss | 0 | 0 | 0 | 0 | 0 |
| Total credit exposures | 600,600 | 2,375,451 | 2,976,051 | (156,814) | 2,819,237 |

MANAGEMENT REVIEW (UNAUDITED)

Capital Base

The Group's regulatory capital base at 31 December 2006 was as follows:

| | |
|---|----------------|
| | £'000 |
| Tier 1 Capital | 152,032 |
| Tier 2 Capital | <u>26,515</u> |
| Total Capital | 178,547 |
| Deductions from capital | <u>(1,001)</u> |
| Total eligible capital at 31 December 2006 | <u>177,546</u> |
| <i>Total eligible capital at 31 December 2005</i> | <u>175,569</u> |

The amounts of regulatory capital shown above differ from the balances shown in the Group's balance sheet in light of regulatory adjustments in respect of certain reserves, which arise on the application of IFRS.

The Group assesses the adequacy of its capital using regulatory rules for weighting assets. The increase in balance sheet totals noted above gave rise to some increase in risk weighted assets with the result that capital adequacy (the ratio of total eligible capital to risk weighted assets) fell from 17% at 31 December 2005 to 16% at 31 December 2006. While the Group's capital adequacy ratio remains well above both regulatory minimum levels, and above levels

British Arab Commercial Bank Limited

considered prudent by the directors, it is recognised that risk asset growth will ultimately be constrained by the Group's capital resources.

The Group intends to implement the new Capital Requirements Directive (Basel II) during 2007. It is not expected that the application of the directive will materially affect the Group's position.

Trade Services

BACB continued to build its position as a leading conduit for exporters seeking secure payment terms into the Arab countries of North Africa and the Eastern Mediterranean region. 2006 saw record levels of business handled and the value of obligations outstanding at year-end arising from exports and contracts worldwide exceeded US\$1 billion (£510m).

Whilst the letter of credit remains the payment method of choice in a majority of markets, the effects of globalisation on the supply chain are beginning to be felt in several of the Group's niche markets giving rise to client demand for alternative instruments. Having successfully handled a number of more complex structured transactions to support these needs, new markets have opened up to the bank, including both India and China, which have become significant net exporters to the region. Further product development is underway to ensure that the Group is well positioned to benefit further from these developments in 2007 and beyond.

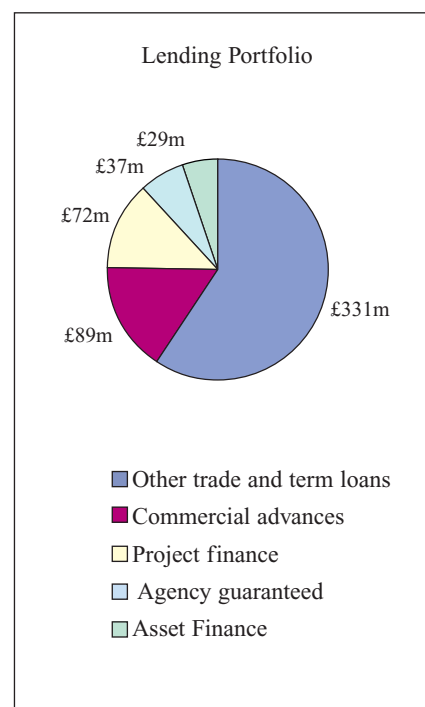
Lending

In sterling terms, commercial term lending increased by a net £11m in the year. However, approximately 80% of the book is denominated in US Dollars (with the main part of the balance in Euro), and lending balances in US Dollar terms grew by \$150m to \$1,094m. Outstandings at 31 December 2006 were £558m (31 December 2005: £547m) of which £109m comprised loans and advances to banks and £449m loans and advances to customers.

The Group responded to significant demand for finance from energy related projects arising in the Gulf in 2006, driving the increase in the loan book seen above. In addition, the Group continued to make available short-term trade-related discounting and refinancing facilities to both exporters and importers in support of BACB's trade finance business. The majority of the Group's loan facilities are structured in a conventional, interest bearing, manner, but a growing proportion is represented by facilities structured in an Islamically acceptable manner, and this trend is expected to continue.

Average margins achieved on lending continued at a similar level to that achieved in the previous year.

The Group is well positioned to participate more actively in the developing capital markets of the region, in particular by leading loan underwriting transactions.



British Arab Commercial Bank Limited

Banking Operations

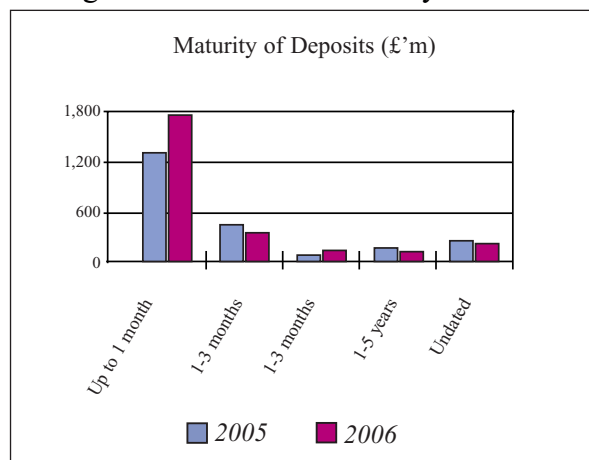
Payment volumes rose again, by 10% in 2006, maintaining the excellent growth trend observed in recent years. BACB has been increasingly successful in offering international accounts and related services to regional banks and corporates, providing bespoke and flexible services to meet their varying needs.

Towards the end of the year a new electronic delivery channel, BACB-e, was offered to clients and an active roll-out programme was underway at year-end. The product delivers a high level of drilldown on account enquiry and has been well received. Preparations are well advanced to offer further functionality via this channel during 2007.

Markets

Overall Markets earnings were 8% above plan and 21% ahead of 2005 after allowing for brokerage and clearing costs.

During 2006 the senior Treasury team was strengthened as part of a strategy to introduce a



broader variety of products. As a result 10% of revenues in 2007 came from derivative products (other than foreign exchange), and this figure is expected to grow in future. Capital market expertise is also being developed to enable the Group to meet the growing needs of its customers across a fuller range of Treasury services with a view to building BACB's reputation as an important and trusted window on professional markets, particularly for its customers in North African markets.

The Group has up to date systems in place to allow efficient and low risk settlements, and has added new risk management systems to support the move into more complex products. Further systems developments planned for 2007 will ensure that the Group is positioned to continue to grow its product offering.

Recognising the growing demand for financial products in the Islamic world, the Group has been working with clients to design relevant products. Recent changes in UK tax laws have greatly simplified the ability of UK based financial institutions to enter this important sector, which shows considerable promise for the future.

Information Management

As noted above, developments in 2006 included the rollout of BACB-e. A new derivative module was added to the core banking system (MIDAS) to support increased product complexity in the treasury division, which will extend the Group's capabilities in these markets.

British Arab Commercial Bank Limited

A major improvement in the organisation of management information in a central location was achieved through the successful commissioning of a data warehouse complemented by Applix TM1 OLAP. In addition to delivering powerful and flexible MI at the desktop (e.g. for BASEL II), the warehouse has delivered an updated version of the Group's client profitability database with an ability to drill down on transaction data not readily available from core system reporting. This application is expected to become an increasingly important client relationship management tool.

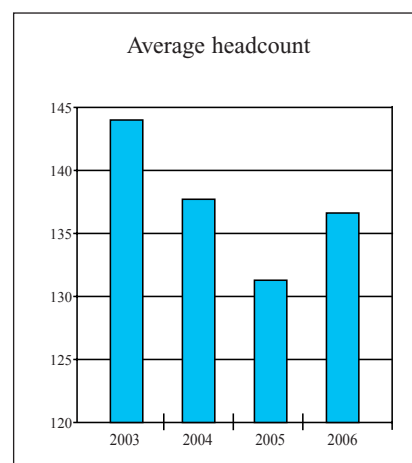
In 2007, the Group intends to introduce a major upgrade to its core banking system (MIDAS Plus). The upgrade will be used as an opportunity to replace a long-standing in-house developed credit exposure management system and also to support further new product development. As mentioned earlier in this report, further effort will also be devoted to the continued development of BACB-e.

Facilities Management

The Group takes seriously its responsibilities for health and safety, both for its employees and third parties. The Group is also committed to reducing the environmental impact of its operations, both through recycling and waste minimisation, and reduced energy consumption. In this regard, the Group was pleased to be awarded the Chairman's Cup and Premier Award by the judges in the City Corporation 2006 Clean City Award Scheme.

Human Resources

The total staffing in place increased for the first time in five years during 2006 and was 140 by the year-end, an increase of 8 over 2005. The additional roles were all in client facing areas and reflected both the growth in the Group's business and its increasing complexity. We expect this rate of increase to continue in 2007 and during the year will continue to identify new skill areas requiring resource given the increasing complexity in the business environment. During the year, a small number of trainees were recruited although continued reduction in staff turnover and the greater use of redeployment has led to a reduced demand for recruitment.



Once again in 2006, there was a significant increase in new employment legislation in the UK, including far-reaching legislation covering age discrimination. As a result, the Group's HR policies have been reviewed and a number of changes implemented, with workshops being held to train managers and update staff.

The Group continued to expand the range of employee benefits made available under the Group's flexible benefit arrangements. These allow employees to select those benefits that are of greatest value to them, whilst enabling the Group to maintain an effective control on overall staff costs.

All staff have participated in internal training sessions during the year; in addition 34 members of staff attended a total of 71 externally run training courses, totalling 110 days of

British Arab Commercial Bank Limited

training, covering a range of technical and management skills. The Group continued to encourage its staff to undertake the Certified Documentary Credit Specialist qualification (CDCS) and the Investment Administration Qualification (IAQ), which are held by about half of the relevant staff.

Corporate Governance and Committee Structure

As a private company, the Group is not obliged to follow the recommendations set out in the various codes on Corporate Governance which are mandatory for listed companies, and in particular the various principles and requirements set out in the Combined Code on Corporate Governance. However, the Group's directors recognise that these codes represent best practice for UK companies, and they have accordingly incorporated the recommendations into the Group's corporate governance arrangements where appropriate.

The Group's constitution is set out in the Articles of Association of the Bank, and in an agreement between the shareholders of the Bank ("the Shareholders' Agreement"). These documents and agreements provide that the shareholders of the Bank may appoint directors in accordance with their shareholdings. They also provide for the appointment of the Chairman and the Chief Executive, and for the formation of certain committees to oversee the day to day running of the Group.

The Board has appointed a number of committees consisting of certain directors and senior executives. The following are the principal committees:

Management Committee

The Management Committee is constituted within the terms of the Shareholders' Agreement. The Board has delegated to that committee responsibility for the general management of the Group subject to the overall control of, and the directions from time to time given by, the Board. The committee comprises the directors identified on page 2, together with the Chief Executive and the Deputy Chief Executive. The committee met four times during 2006.

Credit Committee

The Credit Committee comprises the three directors other than the Chief Executive who are members of Management Committee, or their delegates. The committee is responsible for considering individual or collective applications for credit facilities or limits above the levels which the Board have delegated to Executive Management.

Audit Committee

The Audit Committee comprises directors who are not members of either Management Committee or Credit Committee. The Audit Committee met four times in 2006 with the Group's Chief Executive, senior financial, internal audit and compliance executives, and with the external auditors in attendance to consider the Group's financial reporting, the nature and scope of the audit reviews, and the effectiveness of the systems of internal control and compliance.

British Arab Commercial Bank Limited

Compensation Committee

The Compensation Committee meets as required to agree the remuneration and employment policies of the Group.

Executive Management

The Executive Management comprises the executive managers identified on page 3 who are responsible for the day-to-day operations and management of the Group. Reporting to the Board, these managers have authority delegated by the Board in writing to enter into transactions, and to extend credit (within authorised limits) in the ordinary course of the Group's business. The Executive Management has itself constituted a number of sub-committees to manage particular aspects of the Group's business, including inter-alia the Asset and Liability Committee (ALCO), the Risk Committee and the Systems Steering Committee. Other managers and staff within the Group carry authority to bind the Group under "A and B Signature Authority" arrangements handed down by the Board.

British Arab Commercial Bank Limited

and its subsidiary companies

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they have elected to prepare both the Group and Bank financial statements in accordance with IFRSs as adopted by the EU and applicable laws.

The Group and Bank financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the Group and the Bank and the performance for that period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the Group and Bank financial statements, the directors are required to:

select suitable accounting policies and then apply them consistently;

make judgements and estimates that are reasonable and prudent;

state whether they have been prepared in accordance with IFRSs as adopted by the EU; and

prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Bank will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Bank and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law, the Directors are also responsible for preparing a Directors' Report that complies with that law.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Bank's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

British Arab Commercial Bank Limited

and its subsidiary companies

DIRECTORS' REPORT

for the year ended 31 December 2006

The directors present their annual report and the audited financial statements for the year ended 31 December 2006. These financial statements have been prepared in accordance with the Companies Act 1985 and applicable accounting standards.

Activities

The Group is authorised under the terms of the Financial Services and Markets Act 2000 and is regulated by the Financial Services Authority.

The Group continued to transact its international banking business in the areas of treasury markets, commercial and correspondent banking and medium-term lending. Substantially all of the Group's activities are conducted through the parent company ('the Bank') and the Bank's subsidiary has been established solely for the purpose of issuing debt securities.

Financial risk management objectives and policies

The Group is subject to various operational and market risks in its day-to-day operations.

The Group's objectives and policies with regard to financial risk, including the policy for hedging, are set out in Note 3 to the financial statements and an indication of the exposure to financial risk is provided both there and in Notes 4, 20, and 31 to 32.

Results

The profit after taxation for the year amounted to £14,031,000. The Directors recommend a dividend in respect of this profit of 6.199p per ordinary share amounting to £7,000,000 (2005: 22.228p per ordinary share amounting to £25,100,000). The amount of this dividend will be recognised during 2007. The balance of profit amounting to £7,031,000 will be retained in the Profit and Loss account.

Business Review

Commentary on the Group's financial performance in the year is provided in the Operating and Financial Review set out on pages 5 to 12 (sections that have been audited are clearly marked).

British Arab Commercial Bank Limited

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DIRECTORS' REPORT (continued)

for the year ended 31 December 2006

Charitable donations

Charitable donations during the year amounted to £2,000.

Directors and their interests

A list of the directors who served during the year is shown on page 2. None of the directors holds or has held shares in the Group. All of the directors benefited from qualifying third party indemnity provisions in place during the financial year and at the date of this report.

Directors' representation

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they each are aware, there is no relevant audit information of which the Group's auditors are unaware; and each director has taken all steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

Auditors

KPMG Audit Plc was appointed to act as the Group's auditors for the year ended 31 December 2006.

KPMG Audit Plc have expressed their willingness to continue in office as auditors and a resolution proposing their re-appointment will be presented at the forthcoming annual general meeting.

Crispian Denby

Secretary

By order of the Board

2 March 2007

British Arab Commercial Bank Limited

and its subsidiary companies

INDEPENDENT AUDITORS' REPORT

to the members of British Arab Commercial Bank Limited

We have audited the group and parent company financial statements (the 'financial statements') of British Arab Commercial Bank Limited ('the Bank') for the year ended 31 December 2006 which comprise the Group Income Statement, the Group and Bank Balance Sheets, the Group and Bank Cash Flow Statements, the Group and Bank Statements of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Bank's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Bank's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 13.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross-referred from the Business Review section of the Directors' Report.

In addition we report to you if, in our opinion, the Bank has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

British Arab Commercial Bank Limited

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INDEPENDENT AUDITORS' REPORT (continued)

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at 31 December 2006 and of the Group's profit for the year then ended;
- The Bank financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Bank's affairs as at 31 December 2006;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc

Chartered Accountants

Registered Auditor

2 March 2007

London

British Arab Commercial Bank Limited

and its subsidiary companies

All amounts in £'000s unless otherwise stated

GROUP INCOME STATEMENT

For the year ended 31 December 2006

| | Note | 2006 | 2005 |
|--|------|----------|----------|
| Interest and similar income | 6 | 111,964 | 63,240 |
| Less: Interest expense and similar charges | 6 | (96,168) | (48,925) |
| Net interest income | | 15,796 | 14,315 |
| Fee and commission income | 7 | 12,255 | 10,831 |
| Fee and commission expense | 7 | (564) | (629) |
| Net fee and commission income | | 11,691 | 10,202 |
| Dividend income | | 0 | 698 |
| Net trading income | 8 | 3,575 | 3,014 |
| Gains less losses from available for sale financial assets | | 2,852 | 19,121 |
| Other operating income | | 465 | 57 |
| Total operating income | | 34,379 | 47,407 |
| General administrative expenses | 9 | (14,520) | (13,259) |
| Net credit for impairment losses on loans and advances | 14 | 505 | 9,126 |
| | | (14,015) | (4,133) |
| Profit before income tax | | 20,364 | 43,274 |
| Income tax expense | 10 | (6,333) | (11,927) |
| Profit for the year | | 14,031 | 31,347 |

All of the Profit for the financial year and the prior year was derived from continuing activities.

The notes on pages 22 to 68 form part of these financial statements.

British Arab Commercial Bank Limited

and its subsidiary companies

All amounts in £'000s unless otherwise stated

BALANCE SHEETS

As at 31 December 2006

| | Note | Group 2006 | Bank 2006 | Group 2005 | Bank 2005 |
|---|------|------------------|------------------|------------------|------------------|
| Assets | | | | | |
| Cash, notes and coin | | 419 | 419 | 407 | 407 |
| Loans and advances to banks | 12 | 1,282,075 | 1,282,075 | 1,173,949 | 1,173,949 |
| Loans and advances to customers | 13 | 467,560 | 467,560 | 396,794 | 396,794 |
| Debt securities | 15 | 681,874 | 681,874 | 579,475 | 579,475 |
| Equity shares | 16 | 1,001 | 1,001 | 939 | 939 |
| Shares in group undertakings | 17 | 0 | 1 | 0 | 3 |
| Property, plant and equipment | 18 | 11,061 | 11,061 | 12,896 | 12,896 |
| Intangible assets | 18 | 757 | 757 | 623 | 623 |
| Deferred taxation | 19 | 372 | 372 | 880 | 880 |
| Derivatives | 20 | 2,376 | 2,376 | 1,198 | 1,198 |
| Prepayments, accrued income and other debtors | 21 | 25,335 | 25,335 | 21,789 | 21,788 |
| Net pension asset | 22 | 0 | 0 | 888 | 888 |
| Total assets | | 2,472,830 | 2,472,831 | 2,189,838 | 2,189,840 |
| Liabilities | | | | | |
| Deposits from banks | 23 | 1,275,978 | 1,275,978 | 1,274,675 | 1,274,675 |
| Other deposits | 23 | 826,037 | 826,041 | 578,045 | 578,050 |
| Debt securities in issue | 24 | 172,474 | 70,855 | 121,213 | 5,795 |
| Other liabilities, accruals and deferred income | 25 | 11,964 | 113,580 | 8,525 | 123,941 |
| Derivatives | 20 | 2,024 | 2,024 | 1,909 | 1,909 |
| Corporation tax payable | | 2,118 | 2,118 | 7,220 | 7,220 |
| Net pension liability | 22 | 448 | 448 | 0 | 0 |
| Subordinated liabilities | 26 | 22,664 | 22,664 | 25,706 | 25,706 |
| | | 2,313,707 | 2,313,708 | 2,017,293 | 2,017,296 |
| Called up share capital | 27 | 83,557 | 83,557 | 83,557 | 83,557 |
| Reserves | 28 | 75,566 | 75,566 | 88,988 | 88,987 |
| Capital and reserves attributable to the Group's equity holders | | 159,123 | 159,123 | 172,545 | 172,544 |
| Total equity and liabilities | | 2,472,830 | 2,472,831 | 2,189,838 | 2,189,840 |

The notes on pages 22 to 68 form part of these financial statements.

Signed:

A Dixon
Chairman

K Zentuti
Vice Chairman

MJ Parr
Director and Chief Executive

2 March 2007

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STATEMENTS OF RECOGNISED INCOME AND EXPENSE

For the year ended 31 December 2006

| Group | 31 December 2006 | | | Total |
|--|------------------|---------------------------|-------------------|---------------|
| | AFS Reserve | Cash flow hedging reserve | Retained Earnings | |
| Net actuarial losses on pension fund | 0 | 0 | (2,407) | (2,407) |
| Fair value gains or losses recognised directly in equity | 1,685 | 0 | 0 | 1,685 |
| Fair value gains or losses removed from equity and recognised in the income statement | (2,852) | 0 | 0 | (2,852) |
| Cash flow hedge gains or losses recognised in equity | 0 | 206 | 0 | 206 |
| Cash flow hedge gains or losses removed from equity and recognised in the income statement | 0 | 7 | 0 | 7 |
| | (1,167) | 213 | (2,407) | (3,361) |
| Tax on items taken directly to or transferred from equity | 350 | (64) | 722 | 1,008 |
| Profit for the year | 0 | 0 | 14,031 | 14,031 |
| Total recognised income / (expense) for the year | (817) | 149 | 12,346 | 11,678 |

| Bank | 31 December 2006 | | | Total |
|--|------------------|---------------------------|-------------------|---------------|
| | AFS Reserve | Cash flow hedging reserve | Retained Earnings | |
| Net actuarial losses on pension fund | 0 | 0 | (2,407) | (2,407) |
| Fair value gains or losses recognised directly in equity | 1,685 | 0 | 0 | 1,685 |
| Fair value gains or losses removed from equity and recognised in the income statement | (2,852) | 0 | 0 | (2,852) |
| Cash flow hedge gains or losses recognised in equity | 0 | 206 | 0 | 206 |
| Cash flow hedge gains or losses removed from equity and recognised in the income statement | 0 | 7 | 0 | 7 |
| | (1,167) | 213 | (2,407) | (3,361) |
| Tax on items taken directly to or transferred from equity | 350 | (64) | 722 | 1,008 |
| Profit for the year | 0 | 0 | 14,032 | 14,032 |
| Total recognised income / (expense) for the year | (817) | 149 | 12,347 | 11,679 |

| Group and Bank | 31 December 2005 | | | Total |
|--|------------------|---------------------------|-------------------|---------------|
| | AFS Reserve | Cash flow hedging reserve | Retained Earnings | |
| Net actuarial losses on pension fund | 0 | 0 | (502) | (502) |
| Fair value gains or losses recognised directly in equity | 5,820 | 0 | 0 | 5,820 |
| Fair value gains or losses removed from equity and recognised in the income statement | (19,121) | 0 | 0 | (19,121) |
| Cash flow hedge gains or losses recognised in equity | 0 | (7) | 0 | (7) |
| Cash flow hedge gains or losses removed from equity and recognised in the income statement | 0 | (171) | 0 | (171) |
| | (13,301) | (178) | (502) | (13,981) |
| Tax on items taken directly to or transferred from equity | 2,852 | 53 | 151 | 3,056 |
| Profit for the year | 0 | 0 | 31,347 | 31,347 |
| Total recognised income / (expense) for 2005 | (10,449) | (125) | 30,996 | 20,422 |
| Effect of transition to IFRS: IAS 39 adjustments | 11,213 | 120 | 1,981 | 13,314 |
| Total recognised income / (expense) for the year | 764 | (5) | 32,977 | 33,736 |

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STATEMENTS OF CASH FLOW

For the year ended 31 December 2006

| | Group 2006 | Bank 2006 | Group 2005 | Bank 2005 |
|--|-----------------------|----------------------|-----------------------|----------------------|
| Net cash flow from operating activities | | | | |
| Profit before taxation | 20,364 | 20,365 | 43,274 | 43,274 |
| Adjustments for: | | | | |
| Loan impairment losses | (505) | (505) | (9,126) | (9,126) |
| Provisions utilised | (614) | (614) | (25,684) | (25,684) |
| Depreciation and amortisation | 1,066 | 1,066 | 921 | 921 |
| Profit on sale of equity shares | 0 | 0 | (19,121) | (19,121) |
| (Profit) / Loss on sale of tangible fixed assets | 0 | 0 | (1) | (1) |
| Non-cash items included in net profit | (53) | (53) | (53,011) | (53,011) |
| Loans, advances and other debt securities other than cash and cash equivalents | (598,152) | (598,152) | 51,737 | 51,737 |
| Other debtors and prepayments | (4,007) | (4,008) | (6,937) | (6,937) |
| Change in operating assets | (602,159) | (602,160) | 44,800 | 44,800 |
| Customer accounts and deposits by banks | 401,231 | 401,231 | 99,543 | 99,541 |
| Debt securities in issue | 65,757 | 65,757 | 0 | 0 |
| Other liabilities | 4,781 | 4,781 | 1,261 | 59,214 |
| Change in operating liabilities | 471,769 | 471,769 | 100,804 | 158,755 |
| Tax paid | (10,491) | (10,491) | (6,493) | (6,493) |
| Net cash from operating activities | (120,570) | (120,570) | 129,374 | 187,325 |
| Cash flow from investing activities: | | | | |
| Proceeds on sale of equity shares | 0 | 0 | 20,021 | 20,021 |
| Purchases of equity shares | 0 | 0 | (143) | (143) |
| Proceeds on sale of tangible assets | 4 | 4 | 1 | 1 |
| Purchase of tangible assets | (392) | (392) | (312) | (312) |
| Purchase of intangible assets | (381) | (381) | (286) | (286) |
| Net cash used in investing activities | (769) | (769) | 19,281 | 19,281 |
| Cash flows from financing activities | | | | |
| Dividends paid | (25,100) | (25,100) | (7,500) | (7,500) |
| Debt securities issued | 0 | 0 | 57,951 | 0 |
| Net (decrease)/increase in cash and cash equivalents | (146,439) | (146,439) | 199,106 | 199,106 |
| Cash equivalents at the beginning of the year | 1,511,789 | 1,511,789 | 1,226,335 | 1,226,335 |
| Effect of exchange rate change on cash and cash equivalents | 119,863 | 119,863 | 86,348 | 86,348 |
| Cash and cash equivalents at the end of the year | 1,245,487 | 1,245,487 | 1,511,789 | 1,511,789 |
| Cash and cash equivalents comprise | | | | |
| Cash, notes and coin | 419 | 419 | 407 | 407 |
| Loans and advances to banks of three months or less | 1,008,904 | 1,008,904 | 1,163,173 | 1,163,173 |
| Certificates of deposit of three months or less | 236,164 | 236,164 | 348,209 | 348,209 |
| | 1,245,487 | 1,245,487 | 1,511,789 | 1,511,789 |

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NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2006

1. General information

British Arab Commercial Bank Limited ('the Bank') is a private company, limited by shares. The Bank was incorporated in England and Wales on 23 March 1972 as UBAF Limited. The Bank's name was changed to UBAF Bank Limited on 4 January 1977, and to its current form on 4 March 1996. The Bank's registered office (and principal place of business) is situated in England, and is currently at 8-10 Mansion House Place, London EC4N 8BJ.

The consolidated financial statements of the Group for the year ended 31 December 2006 comprise the Bank and its subsidiaries (together referred to as 'the Group').

The Group carries on the business of international banking, and its worldwide activities are regulated by the Financial Services Authority.

The financial statements were authorised for issue by the directors on 2 March 2007.

2. Accounting policies

From 1 January 2005, the Group has prepared its consolidated financial statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU and effective for the Group's reporting for the year ended 31 December 2006. IFRS comprise accounting standards issued by the International Accounting Standards Board ('IASB') and its predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') and its predecessor body.

The Group has not early adopted IFRS7 (Financial Instruments: Disclosures). The impact of IFRS7 is discussed in the Operating and Financial Review on pages 6 and 7.

Where the Bank enters into financial guarantee contracts to guarantee the indebtedness of other companies within the Group, the Bank considers these to be insurance arrangements and accounts for them as such. In this respect, the Bank treats the guarantee contract as a contingent liability until such time as it becomes probable that the Bank will be required to make a payment under the guarantee.

The financial statements have been prepared in Sterling, rounded to the nearest thousand. They are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, financial instruments held at fair value through the profit and loss account, and financial instruments classified as being available-for-sale.

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. The results form the basis for making judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRS that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in Note 5.

British Arab Commercial Bank Limited

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NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2006

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

a) Basis of consolidation

i. Subsidiaries

Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

ii. Associates

Associates are those entities in which the Group has significant influence, but no control over the financial and operating policies.

In the opinion of the Directors, the Group has no Associates (see Note 16).

iii. Transactions eliminated on consolidation

Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Under section 230(4) of the Companies Act 1985 the Bank is exempt from the requirements to present its own profit and loss account.

b) Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised in Interest and similar income and Interest expense and similar charges in the income statement using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts. Interest on impaired financial assets is recognised at the original effective interest rate of the financial asset applied to the carrying amount as reduced by any allowance for impairment.

c) Fee and commission income

The Group earns fee income from a diverse range of services it provides to its customers. Fee income is accounted for as follows:

- i. if the income is earned on the execution of a significant act, it is recognised as revenue when the significant act has been completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as the arrangement for the acquisition of securities);
- ii. if the income is earned as services are provided, it is recognised as revenue as the services are provided (for example, documentary credit confirmation fees, custody and banking service fees); and

British Arab Commercial Bank Limited

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NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2006

iii. if the income is an integral part of the effective interest rate of a financial instrument, it is recognised as an adjustment to the effective interest rate (for example, loan origination fees) and recorded in interest income (See Note 2 b)).

The Group provides certain guarantee facilities which are dependant on uncertain future events. These facilities include surety bonds, fidelity bonds, performance bonds and bid bonds. In each case, the guarantees given by the Group are covered by matching counter-indemnities provided by a third party. Fees and commissions arising from the provision of such services are recognised rateably over the period for which the service is provided.

d) Foreign currencies

The Directors regard Sterling as the currency of the primary economic environment in which the Bank operates. Accordingly, Sterling is regarded as being the functional currency of the Bank, which is also the reporting currency of the Group.

Transactions in foreign currencies are recorded in sterling at the rate of exchange prevailing at the rates ruling at the end of the month in which the transaction arose. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction.

e) Net trading income

Income from dealing activities is included on a mark-to-market basis. Interest received on securities held for dealing purposes, and associated funding costs, are included within Interest and similar income, and Interest expense and similar charges.

f) Derivatives and hedge accounting

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values are obtained from quoted market prices in active markets, or by using valuation techniques, including recent market transactions, where an active market does not exist. Valuation techniques include discounted cash flow models and option pricing models as appropriate. All derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative.

In the normal course of business, the fair value of a derivative on initial recognition is considered to be the transaction price (i.e. the fair value of the consideration given or received). However, in certain circumstances the fair value of an instrument will be evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets, including interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Group recognises a trading profit or loss on inception of the derivative. If observable market data is not available, the initial increase in fair value indicated by the valuation model, but based on unobservable inputs, is not recognised immediately in the income statement but is recognised over the life of the transaction on an appropriate basis, or recognised in the income statement when the inputs become observable, or when the transaction matures or is closed out.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract, the embedded derivative meets the definition of a derivative, and the combined

British Arab Commercial Bank Limited

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NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2006

contract is not designated at fair value through profit and loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

Derivative assets and liabilities on different transactions are only netted if the transactions are with the same counterparty, a legal right of set-off exists, and the cash flows are intended to be settled on a net basis, and assets and liabilities are realised and settled simultaneously.

The method of recognising fair value gains or losses depends on whether the derivative is held for trading, or is designated as a hedging instrument, and if so, the nature of the risk being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement. Where derivatives are designated as hedges, the Group classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedge'); or (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedge'). Hedge accounting is applied to derivatives designated as hedging instruments provided certain criteria are met.

Hedge accounting

It is the Group's policy to document, at the inception of a hedging relationship, the relationship between the hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking the hedge. Such policies also require documentation of the assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items attributable to the hedged risks. Interest on designated qualifying hedges is included in Net interest income.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement in Interest and similar income, together with changes in the fair value of the asset or liability or group thereof that are attributable to the hedged risk.

If the hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to the income statement over the residual period to maturity. Where the adjustment relates to the carrying amount of a hedged available-for-sale equity security, this remains in equity until the disposal of the equity security.

Cash flow hedge

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

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity until the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2006

Hedge effectiveness testing

To qualify for hedge accounting, IAS39 requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness). Actual effectiveness (retrospective effectiveness) must also be demonstrated on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method adopted by the Group for assessing hedge effectiveness will depend on its risk management strategy.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness, the changes in fair value or cash flows must offset each other in the range of 80% to 125% for the hedge to be deemed effective.

Derivatives that do not qualify for hedge accounting

All gains and losses arising from changes in the fair value of any derivative that does not qualify for hedge accounting are recognised immediately in the income statement. These gains and losses are reported in Interest and similar income.

g) Financial assets

The Group has classified its financial assets in the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management has determined the classification of its investments at 1 January 2005, and thereafter on initial recognition.

i. Financial assets at fair value through profit and loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit and loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges.

ii. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services to a debtor with no intention of trading the receivable.

iii. Held-to-maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. Were the Group to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available for sale.

The Group's management has not identified any assets as falling within this category.

iv. Available-for-sale

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2006

Purchases and sales of financial assets held to maturity and available-for-sale are recognised on settlement date, being the date on which the Group makes payment to receive the asset. Loans are recognised when cash is advanced to the borrowers. Financial assets are initially recognised at fair value plus directly attributable transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership. Derivatives and financial assets at fair value through profit and loss are recognised on trade date, being the date on which an irrevocable commitment to enter into a contract is executed.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised in income to the extent that the change in value arises from a fair value hedging relationship (Note 2 f)) with the balance recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity is recognised in profit and loss. However, interest calculated using the effective interest method is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payment is established.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

h) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

i) De-recognition of financial assets and liabilities

Financial assets are de-recognised when the rights to receive cash flows from the assets have expired; or where the Group has transferred its contractual right to receive the cash flows of the financial assets and either:

- i. substantially all the risks and rewards of ownership have been transferred; or
- ii. substantially all the risks and rewards have neither been retained nor transferred but control is retained.

Financial liabilities are de-recognised when they are extinguished, i.e. when the obligation is discharged or cancelled or expires.

j) Impairment of financial assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2006

attention of the Group about the following loss events:

- i. significant financial difficulty of the issuer or obligor;
- ii. a breach of contract, such as default or delinquency in interest or principal payments;
- iii. the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
- iv. it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- v. the disappearance of an active market for that financial asset because of financial difficulties; or
- vi. observable data indicating that there is a measurable decrease in the estimated future cashflows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
 - adverse changes in the payment status of borrowers in the group; or
 - national or local economic conditions that correlate with defaults on the assets in the group.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

Once a financial asset or group of similar assets has been written down as a result of an impairment loss, interest income is thereafter recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the loss.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e., on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current

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conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets reflect and are directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from the realisation of security have been received.

If in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed to the extent it is now excessive by reducing the loan impairment allowance account. The amount of any reversal is recognised in the income statement.

Available-for-sale assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss, is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

k) Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation calculated on a straight line basis to write off the assets over their estimated useful lives as follows:

| | |
|----------------------------------|--------------|
| Equipment | 3 or 5 years |
| Motor vehicles | 5 years |
| Furniture, fixtures and fittings | 10 years |
| Leasehold improvements | 10 years |
| Leasehold premises | 50 years |

Leasehold premises and leasehold land (see 2 m) below) comprises the Bank's principal office in London. All property plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

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Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

l) Intangible assets

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software, including directly incurred internal costs. Costs associated with maintaining computer software programs are recognised as an expense as incurred.

The capitalised cost of computer software is amortised over 3 or 5 years. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

m) Prepayments and accrued income

The cost of leasehold land is amortised as a rental prepayment over the life of the lease (147 years and 1 month) on a straight-line basis. At 31 December 2006, the lease had 140 years and 2 months remaining.

n) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition, and include cash, notes and coin, treasury bills and other eligible bills, loans and advances to banks, and certificates of deposit.

o) Provisions

Provisions for restructuring costs and legal claims are recognised when the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated.

p) Employee benefits

The Group provides both a defined benefit and a defined contribution pension plan for its staff. In each case, the assets of the schemes are held separately from those of the Group. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity, and where the Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The net asset or liability recognised in the balance sheet in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past

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service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to retained earnings. Other gains and losses are taken to the Income Statement.

For the defined contribution plan, the Group pays contributions to the HSBC Defined Contribution Retirement Benefit Scheme. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

q) Income tax

Income tax on the profit or loss for the year comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in shareholders' equity, in which case it is recognised in shareholders' equity.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantially enacted by the balance sheet date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are offset when the Group intends to settle on a net basis and the legal right to set off exists.

Deferred tax is recognised on temporary differences between the carrying amount of assets and liabilities in the balance sheet and the amount attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled.

Deferred tax relating to actuarial gains and losses arising from post-employment benefit plans which are recognised directly in equity, is also credited or charged directly to equity.

Deferred tax relating to fair value re-measurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

r) Debt securities in issue

Debt securities in issue are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortised cost and any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

If the Group purchases its own debt, it is removed from the balance sheet, and the difference between the carrying amount of a liability and the consideration paid is included in net trading income.

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s) Share capital

Share issue costs

Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Company's shareholders.

t) Segmental reporting

Income, assets and liabilities are allocated to geographical segments on the basis of each customer's location. Segment results and segment assets all relate to commercial banking undertaken on an international basis, and there is no secondary segment.

The Group currently expects to adopt IFRS8 with effect from 1 January 2009 and will accordingly present segmental information which reflects the operating segments used to make operating decisions at that time.

3. Risk management

The Group has an established risk management culture, long-standing written policies and procedures, and follows a documented control framework, the maintenance of which falls within the general responsibility of the Group's Audit Committee, a sub-committee of the Board.

A key element within these controls is the Internal Audit and the Risk Management functions.

The Internal Audit function undertakes an ongoing risk based review programme covering all areas of the Group's operations. The Manager Internal Audit reports to Audit Committee and to the Chief Executive.

The Risk Management function ensures that the risks faced by the Group are properly identified and that appropriate policies and monitoring programmes are in place to minimise losses arising in all areas of risk. Risk Management also has responsibility for review and amendment of the Group's internal credit gradings, market and operational risk management practices to ensure optimal capital utilisation on implementation of the new EU Capital Requirements Directive.

Under the new arrangements, the Group plans to adopt the Standardised Approach to Credit Risk and the Basic Indicator Approach to Operational Risk. Implementation plans are well advanced.

The Head of Risk Management also reports to the Group's Audit Committee and to the Chief Executive. He undertakes the roles of Compliance Officer and Money Laundering Reporting Officer, and has responsibility for monitoring all aspects of regulatory compliance.

CREDIT RISK

The Group is exposed to credit risk in its on and off-balance sheet activities, and in its daily settlements. The Group manages credit risk by establishing country and individual counterparty limits and limits for closely related counterparties, based upon an independent assessment by the Group's Risk Management and Institutional & Corporate Banking departments of relevant political, economic and financial information. Once approved, such limits are subject to annual credit review by these departments and submitted for re-approval under delegated credit authorities.

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The Group takes cash collateral and employs other credit mitigants in appropriate circumstances. The Group ensures that documentation for such facilities is in accordance with best practice and is legally secure. At 31 December 2006 the value of cash collateral held by the Group on terms under which set off can be applied in the event of default by the counterparty was £156,813,000 (2005: £57,961,000). Collateral may also be taken in the form of personal guarantees given by individuals associated with the obligating counterparty, but no value is ascribed in these circumstances.

The Group is also a third-party member of the Continuous Linked Settlement (CLS) system, which eliminates settlement risk on eligible trades.

The Group also employs a credit grading system, to facilitate monitoring of the quality of the overall portfolio and individual segments thereof, including movements in the portfolio over time.

The Group's Risk Committee, of which the Chief Executive, Deputy Chief Executive and other executive managers are members, meets quarterly to consider high-level policies and country limits, whilst a monthly Credit Forum provides more regular opportunities to review credit exposures and to serve as an additional point of reference and challenge regarding the assumption of additional credit and country risk.

The Group provides facilities to some 448 counterparties encompassing exposure to 55 countries and territories (2005: 397 counterparties in 60 countries). Regional concentrations of credit risk arising from the Group's operations were as follows:

31 December 2006

| | Contingent liabilities and other commitments | Cash, loans and advances and debt securities | Total |
|-------------------------------|---|---|------------------|
| United Kingdom | 52,771 | 987,776 | 1,040,547 |
| Other European Union | 78,325 | 621,616 | 699,941 |
| Middle East and Africa | 419,383 | 468,646 | 888,029 |
| Other Countries | 50,121 | 303,281 | 353,402 |
| Impairments | 0 | (5,868) | (5,868) |
| Gross credit exposures | 600,600 | 2,375,451 | 2,976,051 |

31 December 2005

| | | | |
|-------------------------------|----------------|------------------|------------------|
| <i>United Kingdom</i> | <i>20,397</i> | <i>862,206</i> | <i>882,603</i> |
| <i>Other European Union</i> | <i>49,489</i> | <i>539,648</i> | <i>589,137</i> |
| <i>Middle East and Africa</i> | <i>440,581</i> | <i>491,413</i> | <i>931,994</i> |
| <i>Other Countries</i> | <i>33,573</i> | <i>237,161</i> | <i>270,734</i> |
| <i>Impairments</i> | <i>0</i> | <i>(7,859)</i> | <i>(7,859)</i> |
| Gross credit exposures | 544,040 | 2,122,569 | 2,666,609 |

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For the year ended 31 December 2006

By industry, concentrations of credit risk were as follows:

| | 2006 | 2005 |
|---|------------------|------------------|
| Financial institutions (including central banks) | | |
| Banks | 2,238,868 | 2,043,756 |
| UK building societies | 69,304 | 71,818 |
| Multilateral financial institutions | 18,281 | 23,800 |
| Other financial intermediaries | 52,997 | 27,082 |
| | 2,379,450 | 2,166,456 |
| Corporates | | |
| Construction and engineering | 24,915 | 21,168 |
| Energy | 234,484 | 210,167 |
| Mineral products | 29,155 | 14,872 |
| Telecommunications | 43,924 | 16,470 |
| Transport and storage | 55,972 | 40,789 |
| Other | 172,954 | 121,981 |
| | 561,404 | 425,447 |
| Public administration | 41,065 | 82,565 |
| Impairments | (5,868) | (7,859) |
| Gross credit exposures | 2,976,051 | 2,666,609 |

Gross credit exposures comprise:

| | 2006 | 2005 |
|----------------------------------|------------------|------------------|
| Cash, notes and coin | 419 | 407 |
| Loans and advances to banks | 1,282,075 | 1,173,949 |
| Less bills discounted (Note 12) | (56,477) | (28,056) |
| Loans and advances to customers | 467,560 | 396,794 |
| Debt securities | 681,874 | 579,475 |
| | 2,375,451 | 2,122,569 |
| Contingent liabilities (Note 29) | 116,366 | 97,958 |
| Other commitments (Note 30) | 484,234 | 446,082 |
| | 600,600 | 544,040 |
| | 2,976,051 | 2,666,609 |

MARKET RISKS

Banking and trading

As part of its banking activities, and for the purpose of providing efficient services to its customers, the Group holds and issues financial instruments including derivative contracts. The Group's objectives in holding such instruments, or entering into such contracts, may either be characterised as being in pursuance of its principal banking activities, or as a trading activity carried on as an adjunct to its banking activities.

The Group's trading activities are accounted for on a mark-to-market basis, and financial assets, financial liabilities and derivatives which form part of such activities are accounted for at fair value through the profit and loss account. In identifying activities to be accounted for on this basis, the Group takes into consideration the following factors:

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For the year ended 31 December 2006

- The Group's motive for trading that instrument, and in particular where the purpose is to sell or repurchase in the short term, or
- where the instruments formed part of a portfolio for which there is evidence of a recent actual pattern of short term profit-taking, or
- where it is a derivative other than a financial guarantee contract, or a designated and effective hedging instrument.

The Group's trading activities are limited to transactions in financial instruments, mainly comprising the trading of foreign exchange and debt securities. Market risk is primarily to exchange and interest rates. Exposures to those markets, together with a description of the risk management policies arising from both banking and trading activities are set out below. Market risk exposures are measured and monitored daily and are formally reviewed monthly by the Group's Asset and Liability Committee.

Exchange rate risk

The Group makes loans, and takes deposits, in a number of currencies. Payments made on behalf of customers in one currency may be met from balances held in another currency. Further, the Group is active in the international foreign exchange markets, both for own account trading, and for the management of Group assets and liabilities. Note 33 sets out the concentrations of currency assets and liabilities in the Group's balance sheet.

The Group manages its exposures to foreign exchange risk by way of limits on the size of permitted positions, both intra-day and overnight. Overnight positions are protected by stop-loss orders placed with reputable correspondent banks. The size of the position limits is consistent with the amount of profit that the Group is prepared to place at risk in the foreign exchange markets.

The Group's overall net short position at 31 December 2006 (being the sterling equivalent value of all the currencies where currency obligations were higher than currency receivables) was £1,293,000 (2005: £10,126,000). Positions as determined daily were as follows:

| | 2006 | 2005 |
|---------|-------|--------|
| Maximum | 8,907 | 10,126 |
| Minimum | 102 | 123 |
| Average | 690 | 644 |

Interest rate risk

The Group is exposed to changes in interest rates in various currencies arising from gaps in the future dates of repricing of assets, liabilities and derivative instruments. The Group manages that risk by calculating sensitivity of changes in the present value of committed future cash flows to a 0.01% change in interest rates using a methodology called the Present Value of a Basis Point ('PVBP'). Limits are placed on the overall amount of calculated PVBP, and the size of those limits is consistent with the amount of profit that the Group is prepared to place at risk in the interest rate market. The Group considers the impact of changes in future interest rates on its future income streams by reference to these interest rate gaps.

As at 31 December 2006, PVBP amounted to £11,901 (2005: £6,631). PVBP (calculated on a daily basis) was as follows:

| | 2006 | 2005 |
|---------|--------|--------|
| | £ | £ |
| Maximum | 12,388 | 10,833 |
| Minimum | 4,451 | 3,960 |
| Average | 7,825 | 7,233 |

Note 32 sets out the re-pricing characteristics of the Group's balance sheet at 31 December 2006.

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For the year ended 31 December 2006

Hedges

Derivative contracts are used in both the banking and trading books to modify market risk exposures in the light of perceptions about future movements in those markets. In the banking book, in particular, derivative contracts are used to reduce market risk exposure arising from banking book positions, which in the absence of those contracts, would result in unwanted exposures, or excesses to market risk limits. Such contracts are described as hedges. Hedge transactions are documented as such at inception, and the positions being hedged are clearly identified at the outset. Hedge accounting is applied in accordance with IAS39, and hedges are not generally entered into which would not qualify as such in accordance with the rules in that standard, although certain contracts which had previously been regarded as hedges were found, on transition to IFRS, not to qualify as such in accordance with the rules in IAS39. The majority of derivative hedges are designated as fair value hedges (see also Note 2 f) to the financial statements).

OTHER RISKS

Liquidity management

The Group is exposed to the risk that it will be unable to meet its obligations as they fall due, arising from the differing maturity profiles of its assets and liabilities. The Group controls that risk by placing limits on the mismatch of maturity dates, and by holding stocks of liquid assets which could be sold at short notice if the need arose. The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.

| Group | | | | | | | |
|---|----------------------|-------------------|--------------------|------------------|---------------------|------------------|------------------|
| At 31 December 2006 | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Undated | Total |
| Loans and advances to banks | 1,003,973 | 162,412 | 66,177 | 44,116 | 5,397 | 0 | 1,282,075 |
| Loans and advances to customers | 20,728 | 32,199 | 91,548 | 155,616 | 171,319 | (3,850) | 467,560 |
| Debt securities | 321,957 | 177,490 | 148,927 | 33,500 | 0 | 0 | 681,874 |
| Other assets | 0 | 0 | 0 | 0 | 0 | 41,321 | 41,321 |
| Total assets | 1,346,658 | 372,101 | 306,652 | 233,232 | 176,716 | 37,471 | 2,472,830 |
| Deposits from banks | 934,615 | 292,844 | 38,444 | 10,075 | 0 | 0 | 1,275,978 |
| Other deposits | 778,476 | 24,388 | 23,173 | 0 | 0 | 0 | 826,037 |
| Debt securities in issue | 0 | 15,292 | 55,563 | 101,619 | 0 | 0 | 172,474 |
| Subordinated liabilities | 0 | 0 | 0 | 0 | 0 | 22,664 | 22,664 |
| Other liabilities and shareholders' funds | 0 | 0 | 0 | 0 | 0 | 175,677 | 175,677 |
| Total equity and liabilities | 1,713,091 | 332,524 | 117,180 | 111,694 | 0 | 198,341 | 2,472,830 |
| Net liquidity gap | (366,433) | 39,577 | 189,472 | 121,538 | 176,716 | (160,870) | |

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| Bank | | | | | | | |
|--|--------------------------|-------------------|--------------------|------------------|-------------------------|------------------|------------------|
| At 31 December 2006 | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Undated | Total |
| Loans and advances to banks | 1,003,973 | 162,412 | 66,177 | 44,116 | 5,397 | 0 | 1,282,075 |
| Loans and advances to customers | 20,728 | 32,199 | 91,548 | 155,616 | 171,319 | (3,850) | 467,560 |
| Debt securities | 321,957 | 177,490 | 148,927 | 33,500 | 0 | 0 | 681,874 |
| Other assets | 0 | 0 | 0 | 0 | 0 | 41,322 | 41,322 |
| Total assets | 1,346,658 | 372,101 | 306,652 | 233,232 | 176,716 | 37,472 | 2,472,831 |
| Deposits from banks | 934,615 | 292,844 | 38,444 | 10,075 | 0 | 0 | 1,275,978 |
| Other deposits | 778,480 | 24,388 | 23,173 | 0 | 0 | 0 | 826,041 |
| Debt securities in issue | 0 | 15,292 | 55,563 | 0 | 0 | 0 | 70,855 |
| Subordinated liabilities | 0 | 0 | 0 | 0 | 0 | 22,664 | 22,664 |
| Other liabilities and shareholders' funds | 0 | 0 | 0 | 101,619 | 0 | 175,674 | 277,293 |
| Total equity and liabilities | 1,713,095 | 332,524 | 117,180 | 111,694 | 0 | 198,338 | 2,472,831 |
| Net liquidity gap | (366,437) | 39,577 | 189,472 | 121,538 | 176,716 | (160,866) | |

| Group | | | | | | | |
|--|--------------------------|-------------------|------------------------|------------------|-------------------------|------------------|------------------|
| At 31 December 2005 | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Undated | Total |
| Loans and advances to banks | 873,931 | 175,181 | 57,371 | 59,491 | 7,975 | 0 | 1,173,949 |
| Loans and advances to customers | 25,994 | 21,100 | 70,220 | 160,975 | 123,509 | (5,004) | 396,794 |
| Debt securities | 151,091 | 299,124 | 77,760 | 51,500 | 0 | 0 | 579,475 |
| Other assets | 0 | 0 | 0 | 0 | 0 | 39,620 | 39,620 |
| Total assets | 1,051,016 | 495,405 | 205,351 | 271,966 | 131,484 | 34,616 | 2,189,838 |
| Deposits from banks | 783,675 | 450,312 | 26,975 | 13,713 | 0 | 0 | 1,274,675 |
| Other deposits | 528,252 | 15,021 | 34,772 | 0 | 0 | 0 | 578,045 |
| Debt securities in issue | 5,795 | 0 | 0 | 115,418 | 0 | 0 | 121,213 |
| Subordinated liabilities | 0 | 0 | 0 | 0 | 0 | 25,706 | 25,706 |
| Other liabilities and shareholders' funds | 0 | 0 | 0 | 0 | 0 | 190,199 | 190,199 |
| Total equity and liabilities | 1,317,722 | 465,333 | 61,747 | 129,131 | 0 | 215,905 | 2,189,838 |
| Net liquidity gap | (266,706) | 30,072 | 143,604 | 142,835 | 131,484 | (181,289) | |

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| <i>Bank</i> | | | | | | | |
|--|--------------------------|-------------------|------------------------|------------------|-------------------------|------------------|------------------|
| <i>At 31 December 2005</i> | <i>Up to 1 month</i> | <i>1-3 months</i> | <i>3-12 months</i> | <i>1-5 years</i> | <i>Over 5 years</i> | <i>Undated</i> | <i>Total</i> |
| <i>Loans and advances</i> | | | | | | | |
| <i>to banks</i> | 873,931 | 175,181 | 57,371 | 59,491 | 7,975 | 0 | 1,173,949 |
| <i>Loans and advances</i> | | | | | | | |
| <i>to customers</i> | 25,994 | 21,100 | 70,220 | 160,975 | 123,509 | (5,004) | 396,794 |
| <i>Debt securities</i> | 151,091 | 299,124 | 77,760 | 51,500 | 0 | 0 | 579,475 |
| <i>Other assets</i> | 0 | 0 | 0 | 0 | 0 | 39,622 | 39,622 |
| <i>Total assets</i> | 1,051,016 | 495,405 | 205,351 | 271,966 | 131,484 | 34,618 | 2,189,840 |
| <i>Deposits from banks</i> | 783,675 | 450,312 | 26,975 | 13,713 | 0 | 0 | 1,274,675 |
| <i>Other deposits</i> | 528,257 | 15,021 | 34,772 | 0 | 0 | 0 | 578,050 |
| <i>Debt securities in issue</i> | 5,795 | 0 | 0 | 0 | 0 | 0 | 5,795 |
| <i>Subordinated liabilities</i> | 0 | 0 | 0 | 0 | 0 | 25,706 | 25,706 |
| <i>Other liabilities and shareholders' funds</i> | 0 | 0 | 0 | 115,418 | 0 | 190,196 | 305,614 |
| <i>Total equity and liabilities</i> | 1,317,727 | 465,333 | 61,747 | 129,131 | 0 | 215,902 | 2,189,840 |
| <i>Net liquidity gap</i> | (266,711) | 30,072 | 143,604 | 142,835 | 131,484 | (181,284) | |

In measuring its liquidity, the Group regards £635,830,000 (2005: £557,121,000) of its holdings of debt securities as being immediately available funds on the grounds that they can be sold into deep and liquid markets at short notice. In addition, certain liabilities are regarded as having a longer term maturity than their contractual terms imply in the light of their behavioural characteristics.

Operational risk

Operational Risk is defined by the Basel Committee on Banking Supervision as:

“The risk of loss resulting from inadequate or failed processes, people and systems, or from external events”.

The operational risks facing the Group have been carefully analysed and comprehensive risk management policies, procedures and controls are in place to minimise their impact. These procedures and controls are documented in formal procedure manuals, accessible by all staff and are regularly updated. Responsibility for the overall management of operational risk falls within the responsibility of the bank's Risk Management department.

Key elements of the control environment are the strict segregation of duties, clearly defined authority levels and expenditure controls and strict safeguards over the integrity of and access to all types of confidential data. Secure offsite storage arrangements for key magnetic data and paper records are in place.

Underpinning the Group's operational controls is the existence of an independent Internal Audit function and comprehensive contingency planning and disaster recovery arrangements that include the availability of a “warm” site where replicated systems and office facilities are available. These arrangements are the subject of regular testing in accordance with documented procedures.

Semi-annual reviews of potential areas of operational risk are undertaken by departmental managers and following analysis of the results, issues arising are reported to the Group's Audit Committee. In addition,

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a reporting system is in place to capture and analyse instances of operational loss “near misses” which are similarly reported to Audit Committee. Where control weaknesses are identified as a result, changes to procedures are made.

To assist with the identification of operational risk in specific transactions, a predictive model has been developed that is currently undergoing live testing.

Operational losses are closely monitored and reported to the bank’s Asset and Liability Committee.

Operational losses in 2006 amounted to £9,000 (2005: £9,000).

Reputational risk

Reputational risk is recognised as a key risk area and strong policies are in place to minimise the potential impact. These include comprehensive Know Your Customer (KYC) requirements, environmental, defence and sectoral lending policies and a risk based due diligence programme. Electronic transaction screening and a behavioural monitoring system are also in place to prevent inadvertent involvement in money laundering, terrorist financing or fraud.

4. Fair values of financial assets and liabilities

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Group’s balance sheet at their fair value. Bid prices are used to estimate fair values of assets, whereas offer prices are applied for liabilities.

| Group and Bank | 31 December 2006 | | 31 December 2005 | |
|---------------------------------|------------------|------------|------------------|------------|
| | Carrying value | Fair value | Carrying value | Fair value |
| Financial assets | | | | |
| Loans and advances to banks | 1,256,080 | 1,255,980 | 1,123,023 | 1,122,920 |
| Loans and advances to customers | 440,687 | 440,508 | 369,350 | 369,087 |
| Financial liabilities | | | | |
| Deposits from banks | 1,265,903 | 1,265,792 | 1,274,675 | 1,274,508 |
| Other deposits | 826,037 | 825,968 | 578,045 | 578,024 |
| Debt securities in issue | 172,474 | 172,809 | 121,213 | 122,097 |
| Subordinated liabilities | 22,664 | 24,505 | 25,706 | 26,876 |

Loans and advances to banks and customers

Due from other banks includes inter-bank placements and other loans and advances, net of accumulated impairments. The estimated fair value of loans and advances is based on discounted cash flows using prevailing market interest rates for debts with similar credit risk and re-pricing terms.

Deposits

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without a quoted market price is based on discounted cash flows using market interest rates for debts with similar remaining maturity.

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The market interest and exchange rates as at year end for the principal currencies in which the Group has assets and liabilities, and by reference to which assets and liabilities have been valued, were as follows:

| | 31 December 2006 | | | 31 December 2005 | | |
|----------------|------------------|------------|--------|------------------|------------|--------|
| | Sterling | US Dollars | Euro | Sterling | US Dollars | Euro |
| Interest rates | | | | | | |
| 3 month | 5.40% | 5.49% | 3.79% | 4.67% | 4.62% | 2.52% |
| 6 month | 5.49% | 5.45% | 3.89% | 4.62% | 4.74% | 2.64% |
| 1 year | 5.55% | 5.41% | 4.07% | 4.58% | 4.89% | 2.87% |
| 5 year | 5.48% | 5.14% | 4.11% | 4.61% | 4.88% | 3.16% |
| Exchange rates | 1.0000 | 1.9618 | 1.4889 | 1.0000 | 1.7256 | 1.4585 |

Debt securities in issue

The aggregate fair values of listed debt securities are calculated based on quoted market prices. Unlisted debt securities are valued by reference to discounted cash flows using market interest rates for debts with similar remaining maturity.

Subordinated liabilities

Subordinated liabilities represent perpetual obligations and include interest rate floor provisions. The obligations are not quoted, and a valuation has been estimated using discounted cash flow techniques based on yields observed in the market for perpetual instruments issued by other similar organisations with similar credit rating, adjusted to reflect the estimated value of the interest rate floor provisions, using option pricing models.

5. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Impairment losses on loans and advances

The Group reviews its loan portfolios to assess impairment at least on an annual basis. In determining whether an impairment loss should be recorded in the income statement, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from individual loans and advances. The Group also considers whether there is a measurable decrease in the estimated future cash flows from portfolios of loans and advances before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. To the extent that the net present value of estimated cash flows differs by +/-5%, the individual impairment losses would be estimated to be £38,000 higher or lower.

Pension fund

The Group assesses the value of its defined benefit pension fund assets and obligations in accordance with IAS19. The standard requires that certain assumptions be made which are set out in Note 22. The scheme actuary has estimated that the value of the scheme liabilities would increase by £4,550,000 if the discount rate were to be 4.5% rather than 5.0% (leaving all other assumptions the same) (2005: scheme

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liabilities would increase by £4,095,000 if the discount rate were to be 4.25% rather than 4.75%), and that the value of the scheme liabilities would increase by £1,010,000 if the rate of increase in salaries were to be 4.25%pa rather than 3.75%pa (leaving all other assumptions the same) (2005: scheme liabilities would increase by £866,000 if the rate of increase in salaries were to be 4.0% rather than 3.5%).

The mortality assumptions have been set in consultation with the actuary to the Scheme. The Scheme's membership is not sufficiently large to permit statistical analysis in the choice of table and therefore reflects the experience of other schemes in the finance sector in the UK, but with an additional allowance for further mortality improvement in the future. The assumption used is believed to be at the upper end of the range used by similar companies. The life expectancy at age 60 of members who are yet to retire has been taken to be 26.6 years for men, and 29.4 years for women; the corresponding expectancy at age 60 for a current male pensioner is 25.0 years, and for women is 27.9 years. It is considered that any further addition to the liabilities for improving mortality would be unduly conservative.

The Group's Management is not aware of any other judgement areas that would materially affect the income statement.

6. Net interest income

| | Group and Bank | |
|--|----------------|---------------|
| | 2006 | 2005 |
| Interest income | | |
| Professional market placements | 80,381 | 41,333 |
| Loans and advances | 31,335 | 21,552 |
| Other | 248 | 355 |
| | <u>111,964</u> | <u>63,240</u> |
| Interest income comprises | | |
| Interest arising on financial assets at fair value through the income statement | 359 | 748 |
| Interest recognised on impaired assets (Note 14) | 11 | 532 |
| Other interest | 111,594 | 61,960 |
| | <u>111,964</u> | <u>63,240</u> |
| Interest expense | | |
| Banks and customers | 87,295 | 41,881 |
| Debt securities in issue | 7,113 | 5,426 |
| Subordinated loans | 1,760 | 1,618 |
| | <u>96,168</u> | <u>48,925</u> |
| Interest expense comprises | | |
| Interest arising on financial liabilities at fair value through the income statement | 159 | 0 |
| Other interest | 96,009 | 48,925 |
| | <u>96,168</u> | <u>48,925</u> |

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7. Net fee and commission income

| | Group and Bank | |
|---|----------------|---------------|
| | 2006 | 2005 |
| Fee and commission income | | |
| Safe custody | 30 | 42 |
| Trade services | | |
| Guarantees | 797 | 834 |
| Other trade services income | 9,733 | 8,313 |
| Term lending (other than amounts which form part of the effective interest rate) | 623 | 612 |
| Banking payments and services | 1,072 | 1,030 |
| | <u>12,255</u> | <u>10,831</u> |
| Fee and commission expense | | |
| Brokerage and other fees | <u>564</u> | <u>629</u> |

8. Net trading income

| | Group and Bank | |
|--------------------------|----------------|--------------|
| | 2006 | 2005 |
| Foreign exchange dealing | 3,072 | 2,792 |
| Other | 503 | 222 |
| | <u>3,575</u> | <u>3,014</u> |

Foreign exchange dealing income includes gains and losses from spot and forward contracts, options and translated foreign currency assets and liabilities.

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9. Administrative expenses

| | Group and Bank | |
|---|----------------|---------------|
| | 2006 | 2005 |
| Staff costs: | | |
| Wages and salaries | 4,996 | 4,788 |
| Social security costs | 788 | 665 |
| Other pension costs: | | |
| - Defined benefit scheme | 257 | 368 |
| - Defined contribution scheme | 136 | 124 |
| Directors' remuneration: | | |
| Emoluments | 550 | 520 |
| Pension costs | 29 | 27 |
| Fees payable to the Bank's auditors for the audit of the Bank's annual financial statements | 102 | 100 |
| Fees payable to the Bank's auditors for other services* : | | |
| - The audit of the Bank's subsidiaries | 4 | 5 |
| - Other services pursuant to legislation | 4 | 4 |
| - All other services (principally accounting advice) | 26 | 50 |
| Depreciation (including amortisation of intangibles) | 1,066 | 921 |
| Amortisation of prepaid rental on land | 63 | 63 |
| Profit on sale of tangible and intangible assets | 0 | (1) |
| Regulatory supervision fees | 15 | 14 |
| Other administrative expenses | 6,484 | 5,611 |
| | <u>14,520</u> | <u>13,259</u> |

* In addition, an audit fee of £5,000 (2005:5,000) is payable to the Group's auditors in respect of the audit of the BACB Pension Scheme, the cost of which is borne by the BACB Pension Scheme.

The average number of employees during the year was 136 (2005: 131).

The emoluments of the highest paid director were £242,000 (2005: £218,000) and the amount of his accrued pension as at balance sheet date was £80,000 (2005: £71,000) including that accrued prior to his service with the Group. Directors' remuneration include amounts due in respect of pension contributions to a defined benefit scheme for one director (2005: one director).

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NOTES TO THE FINANCIAL STATEMENTS (continued)

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10. Tax on profit on ordinary activities

| | Group and Bank | |
|---|----------------|--------|
| | 2006 | 2005 |
| Current tax: | | |
| Total UK corporation tax charge | 5,400 | 11,200 |
| Amounts dealt with through reserves | 307 | (28) |
| Current tax on items taken through the income statement | 5,707 | 11,172 |
| Adjustment in respect of previous periods | (10) | 392 |
| Deferred tax (Note 19): | | |
| Origination and reversal of timing differences | 437 | 323 |
| Adjustment in respect of previous periods | 50 | (276) |
| Amounts associated with movements in the pension fund | 149 | 316 |
| Group tax charge | 6,333 | 11,927 |

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30% (2005: 30%). The tax assessed for the period is lower than the standard rate of corporation tax in the UK as explained below:

| | Group and Bank | |
|--|----------------|---------|
| | 2006 | 2005 |
| Profit on ordinary activities before tax | 20,364 | 43,274 |
| Profit on ordinary activities multiplied by standard rate of corporation tax in the UK | 6,109 | 12,982 |
| Items taken through reserves | 0 | 28 |
| Amortisation of opening IFRS adjustments | (150) | (150) |
| Utilisation of capital losses and indexation | 0 | (1,436) |
| Movement in disallowed provisions | 0 | (66) |
| Temporary differences in pension fund contributions | (415) | (330) |
| Permanently disallowed items | 80 | 57 |
| Differences between capital allowances in period and depreciation | 87 | 61 |
| Other items | (4) | 26 |
| UK Corporation tax charge | 5,707 | 11,172 |

11. Consolidated profit dealt with in the accounts of British Arab Commercial Bank Limited

£14,032,000 of the consolidated profit for the financial year (2005: £31,347,000) has been dealt with in the accounts of British Arab Commercial Bank Limited.

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For the year ended 31 December 2006

12. Loans and advances to banks

Loans and advances to banks with fixed interest rates (other than those with a single interest period less than 1 year) amounted to £20,870,000 (2005: £24,893,000).

| | Group and Bank | |
|--------------------------------|------------------|------------------|
| | 2006 | 2005 |
| Professional market placements | 1,116,548 | 982,914 |
| Commercial term lending | 52,256 | 134,432 |
| Bills discounted | 56,477 | 28,056 |
| Overdrafts and other advances | 56,794 | 28,547 |
| | <u>1,282,075</u> | <u>1,173,949</u> |

13. Loans and advances to customers

Loans and advances to customers with fixed interest rates (other than those with a single interest period less than 1 year) amounted to £19,097,000 (2005: £24,734,000).

| | Group and Bank | |
|---|----------------|----------------|
| | 2006 | 2005 |
| Professional market placements to non banks | 10,075 | 11,590 |
| Commercial term lending | 449,076 | 384,637 |
| Overdrafts and other advances | 14,277 | 8,426 |
| Less Provisions for impairments (Note 14) | (5,868) | (7,859) |
| | <u>467,560</u> | <u>396,794</u> |

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For the year ended 31 December 2006

14. Impairment losses on loans and advances and Provisions

The movements in impairment provisions were as follows:

| | 2006 | | | 2005 | | |
|---|------------|------------|-------|------------|------------|----------|
| | Individual | Collective | Total | Individual | Collective | Total |
| Loans and advances to customers | | | | | | |
| Balance at 1 January | 2,855 | 5,004 | 7,859 | 6,114 | 5,156 | 11,270 |
| Exchange translation | (259) | (602) | (861) | 803 | 111 | 914 |
| Effect of discounting (Note 6) | (11) | 0 | (11) | (532) | 0 | (532) |
| Provisions written off | (614) | 0 | (614) | (205) | 0 | (205) |
| Profit and loss account | | | | | | |
| New allowances | 134 | 0 | 134 | 1,021 | 0 | 1,021 |
| Reversal of allowances no longer required | (87) | (552) | (639) | (4,346) | (263) | (4,609) |
| | 47 | (552) | (505) | (3,325) | (263) | (3,588) |
| Balance at 31 December | 2,018 | 3,850 | 5,868 | 2,855 | 5,004 | 7,859 |
| Loans and advances to banks | | | | | | |
| Balance at 1 January | 0 | 0 | 0 | 30,872 | 0 | 30,872 |
| Exchange translation | 0 | 0 | 0 | 145 | 0 | 145 |
| Provisions written off | 0 | 0 | 0 | (25,479) | 0 | (25,479) |
| Profit and loss account | | | | | | |
| New allowances | 0 | 0 | 0 | 0 | 0 | 0 |
| Reversal of allowances no longer required | 0 | 0 | 0 | (5,538) | 0 | (5,538) |
| | 0 | 0 | 0 | (5,538) | 0 | (5,538) |
| Balance at 31 December | 0 | 0 | 0 | 0 | 0 | 0 |
| Total | | | | | | |
| Balance at 1 January | 2,855 | 5,004 | 7,859 | 36,986 | 5,156 | 42,142 |
| Exchange translation | (259) | (602) | (861) | 948 | 111 | 1,059 |
| Effect of discounting (Note 6) | (11) | 0 | (11) | (532) | 0 | (532) |
| Provisions written off | (614) | 0 | (614) | (25,684) | 0 | (25,684) |
| Profit and loss account | | | | | | |
| New allowances | 134 | 0 | 134 | 1,021 | 0 | 1,021 |
| Reversal of allowances no longer required | (87) | (552) | (639) | (9,884) | (263) | (10,147) |
| | 47 | (552) | (505) | (8,863) | (263) | (9,126) |
| Balance at 31 December | 2,018 | 3,850 | 5,868 | 2,855 | 5,004 | 7,859 |

The Group is active in wholesale markets. Accordingly, its portfolio of financial assets comprises a relatively small number of individually significant claims, rather than a large number of individually insignificant claims as would be the case for similar companies acting in retail markets. This means that each claim due to the Group is subject to individual impairment review at the reporting date taking account of the factors described in Note 1j).

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Collective impairments arise in respect of groups of exposures to certain countries which are assessed to represent a higher risk based on economic, political and financial sector factors, and where the pricing in secondary markets for claims arising in those countries is higher than would represent a normal credit spread, and therefore provides evidence for impairment.

At 31 December 2006 four facilities comprising amounts due to the Group of £4,536,000 were determined to be impaired (2005: five facilities comprising £3,616,000 due to the Group). No collateral was held in respect of these facilities, but £4,333,000 was covered by personal guarantees issued by the owners of two of the borrowing companies (2005: £2,028,000 was covered by a personal guarantee issued by the owner of one of the borrowing companies).

During 2006, the Group took possession of a security property in discharge of a claim amounting to £113,000 at 31 December 2005. This property was sold realising net proceeds of £87,000.

15. Debt securities

Debt securities comprised marketable securities.

| | Group and Bank | |
|---|----------------|----------------|
| | 2006 | 2005 |
| Unlisted certificates of deposit | 558,846 | 477,440 |
| Listed other debt securities held for investment purposes | 123,028 | 102,035 |
| | <u>681,874</u> | <u>579,475</u> |

Debt securities with fixed interest rates (other than those with a single interest period less than 1 year) amounted to £86,500,000 (2005: £102,041,000).

16. Equity shares

Equity shares comprise unlisted long-term participations of not more than 10% of the share capital of the following companies:

Banque d'Affaires de Tunisie: 2,474 ordinary shares of Tunisian Dinars 100
International Company for Leasing SAE: 936,960 ordinary shares of Egyptian Pounds 10

The movements on equity shares were as follows:

| | Group and Bank | |
|---------------------------------------|----------------|------------|
| | 2006 | 2005 |
| Balance at 1 January | 939 | 15,193 |
| Exchange translation | 0 | 75 |
| Changes in fair value during the year | 62 | 5,549 |
| Additions | 0 | 143 |
| Sales proceeds | 0 | (20,021) |
| Balance at 31 December | <u>1,001</u> | <u>939</u> |

17. Shares in group undertakings

At 31 December 2006 the Bank owned 100% of the ordinary share capital of the following unlisted companies registered in England and Wales unless otherwise stated:

| Company | Nature of Business | Accounting Date |
|--|---|-----------------|
| BACB (Jersey) Limited (registered in Jersey) | Issuing listed securities on behalf of the Bank | 31 December |
| UBAF Limited | Dormant | 30 September |

During the year, two dormant subsidiary companies were wound up. The share value of these companies totalling £2,000 was repaid to the Bank.

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18. Property, plant and equipment and Intangible assets

| | Long Leasehold | | Total | Intangible assets | |
|---|---------------------------|-------------------|----------------------|-------------------|----------------------|
| | Premises and Improvements | Other assets | | Computer software | Total |
| Cost | | | | | |
| Balance at 1 January 2006 | 14,795 | 2,475 | 17,270 | 2,387 | 19,657 |
| Transfers to prepaid rental for land | (771) | 0 | (771) | 0 | (771) |
| Additions during the year | 197 | 195 | 392 | 381 | 773 |
| Disposals during the year | 0 | (243) | (243) | 0 | (243) |
| At 31 December 2006 | <u>14,221</u> | <u>2,427</u> | <u>16,648</u> | <u>2,768</u> | <u>19,416</u> |
| Less: accumulated depreciation | | | | | |
| Balance at 1 January 2006 | 2,498 | 1,876 | 4,374 | 1,764 | 6,138 |
| Transfers from prepaid rental for land | 633 | 0 | 633 | 0 | 633 |
| Charge for the year | 546 | 273 | 819 | 247 | 1,066 |
| Disposals during the year | 0 | (239) | (239) | 0 | (239) |
| At 31 December 2006 | <u>3,677</u> | <u>1,910</u> | <u>5,587</u> | <u>2,011</u> | <u>7,598</u> |
| Net book value at 31 December 2006 | <u>10,544</u> | <u>517</u> | <u>11,061</u> | <u>757</u> | <u>11,818</u> |
| Cost | | | | | |
| Balance at 1 January 2005 | 14,754 | 2,297 | 17,051 | 2,101 | 19,152 |
| Additions during the year | 41 | 271 | 312 | 286 | 598 |
| Disposals during the year | 0 | (93) | (93) | 0 | (93) |
| At 31 December 2005 | <u>14,795</u> | <u>2,475</u> | <u>17,270</u> | <u>2,387</u> | <u>19,657</u> |
| Less: accumulated depreciation | | | | | |
| Balance at 1 January 2005 | 2,068 | 1,707 | 3,775 | 1,535 | 5,310 |
| Charge for the year | 430 | 262 | 692 | 229 | 921 |
| Disposals during the year | 0 | (93) | (93) | 0 | (93) |
| At 31 December 2005 | <u>2,498</u> | <u>1,876</u> | <u>4,374</u> | <u>1,764</u> | <u>6,138</u> |
| Net book value at 1 January 2005 | <u>12,686</u> | <u>590</u> | <u>13,276</u> | <u>566</u> | <u>13,842</u> |
| Net book value at 31 December 2005 | <u>12,297</u> | <u>599</u> | <u>12,896</u> | <u>623</u> | <u>13,519</u> |

Other assets comprise furniture, fixtures and fittings, office equipment and motor vehicles.

There were commitments for capital expenditure of £174,000 (2005: £204,000). All the land and buildings are owned by the Group for the purposes of occupation in connection with its business.

The original cost of fully depreciated tangible and intangible assets still in use by the Group at year-end is £1,442,000 (2005: £1,463,000).

Additions to computer software include £119,000 (2005: £50,000) in respect of internal costs directly associated with the testing and implementation of purchased software applications.

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19. Deferred taxation

| | Group and Bank | |
|---|----------------|------------|
| | 2006 | 2005 |
| Capital allowances in advance of depreciation | (771) | (751) |
| Unamortised balance of opening IFRS adjustments | 1,199 | 1,349 |
| Temporary differences in pension fund contributions | 0 | 316 |
| Other short term temporary differences | (56) | (34) |
| | <u>372</u> | <u>880</u> |
| Balance at 1 January | 880 | (2,007) |
| Adjustments taken through reserves | (21) | 2,934 |
| Charge to profit & loss account | (487) | (47) |
| Balance at 31 December | <u>372</u> | <u>880</u> |

The Group expects to earn taxable profits in future years which will exceed the reversal of the temporary differences and which have given rise to a deferred tax asset.

20. Derivatives

The following were outstanding for the Group and Bank:

| | 31 December 2006 | | |
|---|------------------|----------------------|----------------------|
| | Contract amount | Positive fair values | Negative fair values |
| Spot and forward foreign exchange contracts held for trading purposes | 414,662 | 1,048 | (1,858) |
| Interest rate swaps qualifying as fair value hedges | 93,312 | 767 | (91) |
| Currency swaps not qualifying as hedges | 1,298 | 126 | 0 |
| Interest rate swaps not qualifying as hedges | 11,067 | 65 | (75) |
| Purchased foreign exchange options qualifying as cash flow hedges | 16,465 | 370 | 0 |
| | | <u>2,376</u> | <u>(2,024)</u> |

| | 31 December 2005 | | |
|--|------------------|----------------------|-----------------------|
| | Contract amount | Positive fair values | Negative fair values |
| <i>Spot and forward foreign exchange contracts held for trading purposes</i> | <i>154,802</i> | <i>500</i> | <i>(1,007)</i> |
| <i>Interest rate swaps qualifying as fair value hedges</i> | <i>59,465</i> | <i>279</i> | <i>(776)</i> |
| <i>Currency swaps not qualifying as hedges</i> | <i>4,760</i> | <i>279</i> | <i>0</i> |
| <i>Interest rate swaps not qualifying as hedges</i> | <i>23,130</i> | <i>1</i> | <i>(126)</i> |
| <i>Purchased foreign exchange options qualifying as cash flow hedges</i> | <i>10,169</i> | <i>139</i> | <i>0</i> |
| | | <u><i>1,198</i></u> | <u><i>(1,909)</i></u> |

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Foreign exchange contracts are agreements by which an amount of one currency is exchanged for a different amount of a different currency at a specified future date. The contract amount in the table above is the amount receivable.

Interest rate swaps are agreements by which interest on an agreed amount is paid at various dates in the future on a specified basis, and in exchange interest is received on the same amount, but on a different basis. Currency swaps are similar to interest rate swaps, except the interest paid, and the related reference amount, is in a different currency to the interest received, and its related reference amount.

Foreign exchange options are agreements to enter into a foreign exchange contract at a rate which has been fixed at the outset, at a specified date in the future if the market rate ruling at a future date is more (or less) than the fixed rate.

Interest rate swaps qualifying as fair value hedges comprise synthetic alterations whereby interest bearing assets or liabilities with fixed or extended re-pricing periods have been converted into shorter re-pricing periods which can be more easily accommodated within the Group's risk management policies.

Interest rate and currency swaps not qualifying as hedges are regarded as being hedges of economic exposures, but do not qualify for hedge accounting in accordance with IAS39.

Foreign exchange options qualifying as cash flow hedges have been undertaken with a view to protecting the exchange rate at which foreign currency revenues expected to arise in 2007 will be crystallized into the Bank's functional currency.

Derivatives entered into by the Group are in accordance with standard market terms.

21. Prepayments, accrued income and other debtors

| | Group 2006 | Bank 2006 | <i>Group 2005</i> | <i>Bank 2005</i> |
|--------------------------------|-----------------------|----------------------|-----------------------|----------------------|
| Prepaid rental for land | 8,825 | 8,825 | 7,485 | 7,485 |
| Prepayments and accrued income | 16,232 | 16,232 | 13,188 | 13,188 |
| Other debtors | 278 | 278 | 1,116 | 1,115 |
| | <u>25,335</u> | <u>25,335</u> | <u>21,789</u> | <u>21,788</u> |

The Group is obliged to pay ground rent in respect of its leasehold land interest over the remaining life of the lease; currently £160,000 p.a. (2005: £160,000 p.a.).

22. Pension fund

49 (2005: 52) of the Group's employees are members of the BACB Pension Scheme, which is a defined benefits scheme. The contributions are determined by a qualified actuary, based on triennial valuations using the Attained Age method. The scheme is closed to new entrants with the result that the overall age profile of the active membership is rising. This valuation method is designed to smooth contributions over the remaining working lives of the members. A full actuarial valuation was carried out at 31 December 2004. This valuation showed that the market value of the assets at that date was sufficient to cover 101.3% of the actuarial value of the future benefits that had accrued to members. The contributions to the scheme, which are met entirely by the Group, have been made at a rate of 30.1% of pensionable salaries. Contributions paid in the year ended 31 December 2006 amounted to £755,000 (2005: £1,422,000, including a special contribution of £670,000) and the Group expects to contribute £785,000 in the year commencing 1 January 2007.

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The Scheme does not hold any securities issued by the Group, nor does it own any property occupied by the Group.

The assumptions in the 2004 valuation which had the most significant effect on the results of that valuation were those relating to the annual rate of return on investments and the annual rates of increase in salaries and pensions and were as follows:

| | |
|---|---------------|
| Rate of increase in salaries | 3.50% |
| Rate of increase in pensions in payment | 2.75% |
| Discount rate: Pre-retirement liabilities | 6.00% |
| Post-retirement liabilities | 4.75% |
| Inflation assumption | 2.75% |
| Mortality assumptions | |
| - Pre retirement Male | None |
| - Pre retirement Female | None |
| - Post retirement Male | PMA92 c2020 * |
| - Post retirement Female | PFA92 c2020 * |
| * PXA92 c2015 used for pensioners | |

The last full valuation of the scheme as at 31 December 2004 has been updated to 31 December 2006 by a qualified independent actuary, using approximate actuarial techniques and available information, and using the Projected Unit method as required by IAS19. The updated valuation incorporates the mortality assumptions that have been adopted for the full valuation, but strengthened by the adoption of the "medium cohort" projection. The current service cost determined under this method is expected to rise in future years. The following major actuarial assumptions were made:

| | At 31 December 2006 | At 31 December 2005 |
|---|-------------------------------|---------------------------|
| Rate of increase in salaries | 3.75% | 3.50% |
| Rate of increase in pensions in payment | 3.00% | 2.75% |
| Discount rate | 5.00% | 4.75% |
| Inflation assumption | 3.00% | 2.75% |
| Mortality assumptions | | |
| - Pre retirement (male/female) | None | None |
| - Post retirement for non pensioners (male/female) | PMA92C2020MC/ PFA92C2020MC | PMA92C2020/ PFA92C2020 |
| - Post retirement for pensioners (male/female) | PMA92C2007MC/ PFA92C2007MC | PMA92C2015/ PFA92C2015 |
| Life expectancy for non pensioner members aged 60 (male/female) | 26.6/29.4 years | 24.5/27.5 years |
| Life expectancy for pensioner members aged 60 (male/female) | 25.0/27.9 years | 24.0/27.0 years |

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Based on these assumptions, the assets in the scheme and the expected rate of return were:

| | Long-term rate of return expected at 31 December 2006 | Value at 31 December 2006 | <i>Long-term rate of return expected at 31 December 2005</i> | <i>Value at 31 December 2005</i> |
|------------------------------|--|--|--|--|
| Equities | 7.50% | 25,924 | 7.50% | 23,492 |
| Corporate bonds | 5.00% | 0 | 4.75% | 0 |
| Gilts | 4.50% | 13,303 | 4.25% | 13,439 |
| Purchased annuities | 5.00% | 2,979 | 4.75% | 2,883 |
| Cash | 4.75% | 546 | 4.00% | 804 |
| Weighted average return | 6.32% | | 6.12% | |
| Total market value of assets | | <u>42,752</u> | | <u>40,618</u> |
| Actual return on plan assets | | <u>2,327</u> | | <u>5,479</u> |

The overall expected rate of return is determined by reference to market expectations for each class of asset. It is based upon a combination of historical analysis and the forecasts of market professionals.

The pension cost for the defined benefit scheme was as follows:

| | 2006 | 2005 |
|--|-------------------|---------------------|
| Analysis of defined benefit obligations | | |
| Present value of funded obligations | 43,392 | 39,349 |
| Present value of unfunded obligations | <u>0</u> | <u>0</u> |
| Present value of defined benefit obligations | 43,392 | 39,349 |
| Fair value of plan assets | <u>(42,752)</u> | <u>(40,618)</u> |
| | 640 | (1,269) |
| Related deferred tax liability | <u>(192)</u> | <u>381</u> |
| Net liability /(asset) in balance sheet | <u>448</u> | <u>(888)</u> |
| Profit and loss impact | | |
| Employer's current service cost | 872 | 822 |
| Expected return on pension scheme assets | (2,482) | (2,234) |
| Interest on pension scheme liabilities | <u>1,867</u> | <u>1,780</u> |
| Total included in employee benefits expense | <u>257</u> | <u>368</u> |

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| | 2006 | 2005 |
|---|---------------|---------------|
| Analysis of the amounts to be included in the statement of recognised income and expense | | |
| Net actuarial gains / (losses) recognised in the year | (2,407) | (502) |
| Net cumulative actuarial gains / (losses) | (3,672) | (1,265) |
| Change in present value of defined benefit obligations | | |
| Opening defined benefit obligation | 39,349 | 33,982 |
| Employer's current service cost | 872 | 822 |
| Interest on obligation | 1,867 | 1,780 |
| Actuarial (gains) / losses on obligations | 2,252 | 3,747 |
| Benefits paid | (948) | (982) |
| Present value of scheme liabilities at end of year | 43,392 | 39,349 |
| Change in fair value of plan assets | | |
| Opening fair value of plan assets | 40,618 | 34,699 |
| Expected return on plan assets | 2,482 | 2,234 |
| Actuarial gains / (losses) on plan assets | (155) | 3,245 |
| Contributions by plan employer | 755 | 1,422 |
| Benefits paid | (948) | (982) |
| Fair value of plan assets at end of year | 42,752 | 40,618 |

History of experience gains and losses:

| | 2006 | 2005 | 2004 |
|---|---------|-------|-------|
| Difference between the expected and the actual return on scheme assets | (155) | 3,245 | 1,124 |
| Percentage of scheme assets | 0% | 8% | 3% |
| Experience gains and losses on scheme liabilities | 0 | (163) | 601 |
| Percentage of the present value of the scheme liabilities | 0% | (0%) | 2% |
| Total amount recognised in the Statement of recognised income and expense | (2,407) | (502) | (452) |
| Percentage of the present value of the scheme liabilities | (6%) | (1%) | (1%) |

On 31 January 1998, the BACB Pension Scheme was closed to new entrants and employees recruited after that date have become members of the HSBC Defined Contribution Retirement Benefit Scheme. At 31 December 2006, 74 employees were members of that scheme (2005: 60 employees). Contributions to the HSBC Defined Contribution Retirement Benefit Scheme are made by both employer and employee in accordance with a fixed formula. In the year ended 31 December 2006, the Group paid £136,000 (2005: £124,000) by way of contributions into that scheme. There were no outstanding or pre-paid contributions to this scheme at 31 December 2006 (2005: £Nil).

23. Deposits

Deposits with fixed interest rates (other than those with a single interest period less than 1 year) amounted to £10,075,000 (2005: All deposits had variable rates of interest).

The Group has not had any defaults of principal, interest or other breaches with respect to its liabilities during 2006 (2005: Nil).

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24. Debt securities in issue

| | Group 2006 | Bank 2006 | <i>Group 2005</i> | <i>Bank 2005</i> |
|------------------------------------|-----------------------|----------------------|-----------------------|----------------------|
| Certificates of deposit issued | 70,855 | 70,855 | 5,795 | 5,795 |
| \$200m Floating Rate Note due 2010 | 101,619 | 0 | 115,418 | 0 |
| | <u>172,474</u> | <u>70,855</u> | <u>121,213</u> | <u>5,795</u> |

The Bank's wholly owned subsidiary company, BACB (Jersey) Limited has issued US\$200,000,000 Guaranteed Floating Rate Notes due 2010. These notes are listed on the London Stock Exchange. Proceeds on issue have in turn been lent to the Bank by way of a promissory note.

Debt securities in issue bear variable rates of interest.

25. Other liabilities, accruals and deferred income

| | Group 2006 | Bank 2006 | <i>Group 2005</i> | <i>Bank 2005</i> |
|------------------------------|-----------------------|----------------------|-----------------------|----------------------|
| Due to subsidiaries | 0 | 101,619 | 0 | 115,418 |
| Other liabilities | 1,283 | 1,284 | 1,513 | 1,512 |
| Total other liabilities | <u>1,283</u> | <u>102,903</u> | <u>1,513</u> | <u>116,930</u> |
| Accruals and deferred income | 10,681 | 10,677 | 7,012 | 7,011 |
| | <u>11,964</u> | <u>113,580</u> | <u>8,525</u> | <u>123,941</u> |

26. Subordinated liabilities

At 31 December 2006 there were loans to the Group, subordinated in all respects to the claims of other creditors and repayable either on liquidation of the borrower, or if agreed with the lender, with express permission granted by the Financial Services Authority. All these loans qualify for inclusion in full in the Group's capital base and bear interest based on interbank offered rates for six month dollar deposits. Of the total loans, £14,007,000 includes minimum interest rate provisions between 8% and 8.25% (2005: £15,923,000 includes minimum interest rate provisions between 8% and 8.25%).

27. Called up share capital

Authorised share capital comprises 115,000,000 Ordinary Shares of £1 each, 140,000,000 Ordinary Shares of US\$1 each and 5,000,000 Deferred Non-Voting Shares of £1 each. There was no change in authorised or issued share capital during the year. Each paid up Ordinary £1 share carries the same rights as each paid up Ordinary \$1 share. No rights attach to the Deferred Non-Voting shares until such time as they become paid up. Issued share capital comprises:

| | Group and Bank | |
|--|-----------------------|---------------|
| | 2006 | 2005 |
| 31,973,000 Ordinary Shares of £1 each fully paid | 31,973 | 31,973 |
| 80,950,000 Ordinary Shares of US\$1 each fully paid | 51,584 | 51,584 |
| 5,000,000 Deferred Non-Voting Shares of £1 each nil paid | 0 | 0 |
| | <u>83,557</u> | <u>83,557</u> |

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28. Reconciliation of movements in equity

| Group | Share capital | Reserves attributable to equity holders | | | | Total |
|---|---------------|---|-----------------|-------------------|----------------|----------------|
| | | AFS reserve | Cash flow | Retained earnings | Total reserves | |
| | | | hedging reserve | | | |
| Balance at 1 January 2005 | 83,557 | 11,213 | 120 | 64,733 | 76,066 | 159,623 |
| Net losses not recognised in the income statement | 0 | (10,449) | (125) | (351) | (10,925) | (10,925) |
| Profit for the financial year | 0 | 0 | 0 | 31,347 | 31,347 | 31,347 |
| Total recognised income for 2005 | 0 | (10,449) | (125) | 30,996 | 20,422 | 20,422 |
| Dividend relating to 2004 | 0 | 0 | 0 | (7,500) | (7,500) | (7,500) |
| Balance at 31 December 2005 | 83,557 | 764 | (5) | 88,229 | 88,988 | 172,545 |
| Net gains/(losses) not recognised in the income statement | 0 | (817) | 149 | (1,685) | (2,353) | (2,353) |
| Profit for the financial year | 0 | 0 | 0 | 14,031 | 14,031 | 14,031 |
| Total recognised income for 2006 | 0 | (817) | 149 | 12,346 | 11,678 | 11,678 |
| Dividend relating to 2005 | 0 | 0 | 0 | (25,100) | (25,100) | (25,100) |
| Balance at 31 December 2006 | 83,557 | (53) | 144 | 75,475 | 75,566 | 159,123 |

| Bank | Share capital | Reserves attributable to equity holders | | | | Total |
|---|---------------|---|-----------------|-------------------|----------------|----------------|
| | | AFS reserve | Cash flow | Retained earnings | Total reserves | |
| | | | hedging reserve | | | |
| Balance at 1 January 2005 | 83,557 | 11,213 | 120 | 64,732 | 76,065 | 159,622 |
| Net losses not recognised in the income statement | 0 | (10,449) | (125) | (351) | (10,925) | (10,925) |
| Profit for the financial year | 0 | 0 | 0 | 31,347 | 31,347 | 31,347 |
| Total recognised income for 2005 | 0 | (10,449) | (125) | 30,996 | 20,422 | 20,422 |
| Dividend relating to 2004 | 0 | 0 | 0 | (7,500) | (7,500) | (7,500) |
| Balance at 31 December 2005 | 83,557 | 764 | (5) | 88,228 | 88,987 | 172,544 |
| Net gains/(losses) not recognised in the income statement | 0 | (817) | 149 | (1,685) | (2,353) | (2,353) |
| Profit for the financial year | 0 | 0 | 0 | 14,032 | 14,032 | 14,032 |
| Total recognised income for 2006 | 0 | (817) | 149 | 12,347 | 11,679 | 11,679 |
| Dividend relating to 2005 | 0 | 0 | 0 | (25,100) | (25,100) | (25,100) |
| Balance at 31 December 2006 | 83,557 | (53) | 144 | 75,475 | 75,566 | 159,123 |

The directors have declared a dividend of 6.199p per share amounting to £7,000,000 in respect of the profits for the year ended 31 December 2006 (2005:22.228p per share amounting to £25,100,000). The dividend will be paid in 2007, and will be deducted from Revenue Reserves in the year ended 31 December 2007.

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29. Contingent liabilities

The Group and Bank extend guarantee facilities to customers including performance guarantees, bid and bail bonds, and other guarantees related to non-financial events. Such transactions amounted to £116,366,000 at 31 December 2006 (2005: £97,958,000).

The Group and the Bank's practice is to extend such facilities against a counter indemnity provided by a third party. Accordingly, the Group and the Bank's risk in such transactions is a failure of the party providing the counter-indemnity, rather than that a loss arises as a result of a claim under the guarantee being called. No losses arose from such contracts in the year ended 31 December 2006 (2005: Nil).

The Bank has irrevocably and unconditionally guaranteed the obligations of its wholly owned subsidiary company, BACB (Jersey) Limited, to meet all payments of principal and interest under the Floating Rate Note issued by that company.

30. Other commitments

| | Group and Bank | |
|---|-----------------------|----------------|
| | 2006 | 2005 |
| Other commitments comprise: | | |
| credit lines and other commitments to lend: | | |
| under one year | 11,120 | 8,581 |
| over one year | 60,496 | 40,054 |
| documentary credits and short-term trade-related transactions | 364,845 | 383,976 |
| own acceptances | 47,773 | 13,471 |
| | <u>484,234</u> | <u>446,082</u> |

31. Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies in Note 2 describes how the classes of financial instruments are measured, and how income and expense, including fair value gains and losses, are recognised. The following table analyses the financial assets and liabilities in the balance sheets by the class of financial instrument to which they are assigned and therefore by the measurement basis.

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| Group 31 December 2006 | Loans and receivables | Available for sale | At fair value through profit and loss | Derivatives designated as fair value hedging instruments | Derivatives designated as cash flow hedging instruments | Financial assets and liabilities at amortised cost | Total |
|--|--------------------------|-----------------------|---|--|---|---|------------------|
| Assets | | | | | | | |
| Cash, notes and coin | 0 | 0 | 0 | 0 | 0 | 419 | 419 |
| Loans and advances to banks | 1,256,080 | 24,974 | 1,021 | 0 | 0 | 0 | 1,282,075 |
| Loans and advances to customers | 440,687 | 25,575 | 1,298 | 0 | 0 | 0 | 467,560 |
| Debt securities | 0 | 681,874 | 0 | 0 | 0 | 0 | 681,874 |
| Equity shares | 0 | 1,001 | 0 | 0 | 0 | 0 | 1,001 |
| Derivatives | 0 | 0 | 1,239 | 767 | 370 | 0 | 2,376 |
| Prepayments, accrued income and other debtors | 0 | 0 | 0 | 0 | 0 | 25,335 | 25,335 |
| Total financial assets | 1,696,767 | 733,424 | 3,558 | 767 | 370 | 25,754 | 2,460,640 |
| Total non-financial assets | | | | | | | 12,190 |
| Total assets | | | | | | | 2,472,830 |
| Liabilities | | | | | | | |
| Deposits from banks | 0 | 0 | 10,075 | 0 | 0 | 1,265,903 | 1,275,978 |
| Other deposits | 0 | 0 | 0 | 0 | 0 | 826,037 | 826,037 |
| Debt securities in issue | 0 | 0 | 0 | 0 | 0 | 172,474 | 172,474 |
| Derivatives | 0 | 0 | 1,933 | 91 | 0 | 0 | 2,024 |
| Other liabilities, accruals and deferred income | 0 | 0 | 0 | 0 | 0 | 14,082 | 14,082 |
| Subordinated liabilities | 0 | 0 | 0 | 0 | 0 | 22,664 | 22,664 |
| Total financial liabilities | 0 | 0 | 12,008 | 91 | 0 | 2,301,160 | 2,313,259 |
| Total non-financial liabilities | | | | | | | 159,571 |
| Total equity and liabilities | | | | | | | 2,472,830 |

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| Group 31 December 2005 | <i>Loans and receivables</i> | <i>Available for sale</i> | <i>At fair value through profit and loss</i> | <i>Derivatives designated as fair value hedging instruments</i> | <i>Derivatives designated as cash flow hedging instruments</i> | <i>Financial assets and liabilities at amortised cost</i> | <i>Total</i> |
|--|----------------------------------|-------------------------------|--|---|--|---|------------------|
| Assets | | | | | | | |
| <i>Cash, notes and coin</i> | 0 | 0 | 0 | 0 | 0 | 407 | 407 |
| <i>Loans and advances to banks</i> | 1,123,023 | 50,926 | 0 | 0 | 0 | 0 | 1,173,949 |
| <i>Loans and advances to customers</i> | 364,882 | 31,912 | 0 | 0 | 0 | 0 | 396,794 |
| <i>Debt securities</i> | 0 | 559,493 | 19,982 | 0 | 0 | 0 | 579,475 |
| <i>Equity shares</i> | 0 | 939 | 0 | 0 | 0 | 0 | 939 |
| <i>Derivatives</i> | 0 | 0 | 780 | 279 | 139 | 0 | 1,198 |
| <i>Prepayments, accrued income and other debtors</i> | 0 | 0 | 0 | 0 | 0 | 21,789 | 21,789 |
| Total financial assets | 1,487,905 | 643,270 | 20,762 | 279 | 139 | 22,196 | 2,174,551 |
| <i>Total non-financial assets</i> | | | | | | | 15,287 |
| Total assets | | | | | | | 2,189,838 |
| Liabilities | | | | | | | |
| <i>Deposits from banks</i> | 0 | 0 | 0 | 0 | 0 | 1,274,675 | 1,274,675 |
| <i>Other deposits</i> | 0 | 0 | 0 | 0 | 0 | 578,045 | 578,045 |
| <i>Debt securities in issue</i> | 0 | 0 | 0 | 0 | 0 | 121,213 | 121,213 |
| <i>Derivatives</i> | 0 | 0 | 1,133 | 776 | 0 | 0 | 1,909 |
| <i>Other liabilities, accruals and deferred income</i> | 0 | 0 | 0 | 0 | 0 | 15,745 | 15,745 |
| <i>Subordinated liabilities</i> | 0 | 0 | 0 | 0 | 0 | 25,706 | 25,706 |
| Total financial liabilities | 0 | 0 | 1,133 | 776 | 0 | 2,015,384 | 2,017,293 |
| <i>Total non-financial liabilities</i> | | | | | | | 172,545 |
| Total equity and liabilities | | | | | | | 2,189,838 |

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| Bank 31 December 2006 | Loans and receivables | Available for sale | At fair value through profit and loss | Derivatives designated as fair value hedging instruments | Derivatives designated as cash flow hedging instruments | Financial assets and liabilities at amortised cost | Total |
|--|--------------------------|-----------------------|---|--|---|---|------------------|
| Assets | | | | | | | |
| Cash, notes and coin | 0 | 0 | 0 | 0 | 0 | 419 | 419 |
| Loans and advances to banks | 1,256,080 | 24,974 | 1,021 | 0 | 0 | 0 | 1,282,075 |
| Loans and advances to customers | 440,687 | 25,575 | 1,298 | 0 | 0 | 0 | 467,560 |
| Debt securities | 0 | 681,874 | 0 | 0 | 0 | 0 | 681,874 |
| Equity shares | 0 | 1,001 | 0 | 0 | 0 | 0 | 1,001 |
| Shares in Group undertakings | 0 | 0 | 0 | 0 | 0 | 1 | 1 |
| Derivatives | 0 | 0 | 1,239 | 767 | 370 | 0 | 2,376 |
| Prepayments, accrued income and other debtors | 0 | 0 | 0 | 0 | 0 | 25,335 | 25,335 |
| Total financial assets | 1,696,767 | 733,424 | 3,558 | 767 | 370 | 25,755 | 2,460,641 |
| Total non-financial assets | | | | | | | 12,190 |
| Total assets | | | | | | | 2,472,831 |
| Liabilities | | | | | | | |
| Deposits from banks | 0 | 0 | 10,075 | 0 | 0 | 1,265,903 | 1,275,978 |
| Other deposits | 0 | 0 | 0 | 0 | 0 | 826,041 | 826,041 |
| Debt securities in issue | 0 | 0 | 0 | 0 | 0 | 70,855 | 70,855 |
| Derivatives | 0 | 0 | 1,933 | 91 | 0 | 0 | 2,024 |
| Other liabilities, accruals and deferred income | 0 | 0 | 0 | 0 | 0 | 115,698 | 115,698 |
| Subordinated liabilities | 0 | 0 | 0 | 0 | 0 | 22,664 | 22,664 |
| Total financial liabilities | 0 | 0 | 12,008 | 91 | 0 | 2,301,161 | 2,313,260 |
| Total non-financial liabilities | | | | | | | 159,571 |
| Total equity and liabilities | | | | | | | 2,472,831 |

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| Bank 31 December 2005 | <i>Loans and receivables</i> | <i>Available for sale</i> | <i>At fair value through profit and loss</i> | <i>Derivatives designated as fair value hedging instruments</i> | <i>Derivatives designated as cash flow hedging instruments</i> | <i>Financial assets and liabilities at amortised cost</i> | <i>Total</i> |
|--|----------------------------------|-------------------------------|--|---|--|---|------------------|
| Assets | | | | | | | |
| <i>Cash, notes and coin</i> | 0 | 0 | 0 | 0 | 0 | 407 | 407 |
| <i>Loans and advances to banks</i> | 1,123,023 | 50,926 | 0 | 0 | 0 | 0 | 1,173,949 |
| <i>Loans and advances to customers</i> | 364,882 | 31,912 | 0 | 0 | 0 | 0 | 396,794 |
| <i>Debt securities</i> | 0 | 559,493 | 19,982 | 0 | 0 | 0 | 579,475 |
| <i>Equity shares</i> | 0 | 939 | 0 | 0 | 0 | 0 | 939 |
| <i>Shares in group undertakings</i> | 0 | 0 | 0 | 0 | 0 | 3 | 3 |
| <i>Derivatives</i> | 0 | 0 | 780 | 279 | 139 | 0 | 1,198 |
| <i>Prepayments, accrued income and other debtors</i> | 0 | 0 | 0 | 0 | 0 | 21,788 | 21,788 |
| Total financial assets | 1,487,905 | 643,270 | 20,762 | 279 | 139 | 22,198 | 2,174,553 |
| <i>Total non-financial assets</i> | | | | | | | 15,287 |
| Total assets | | | | | | | 2,189,840 |
| Liabilities | | | | | | | |
| <i>Deposits from banks</i> | 0 | 0 | 0 | 0 | 0 | 1,274,675 | 1,274,675 |
| <i>Other deposits</i> | 0 | 0 | 0 | 0 | 0 | 578,050 | 578,050 |
| <i>Debt securities in issue</i> | 0 | 0 | 0 | 0 | 0 | 5,795 | 5,795 |
| <i>Derivatives</i> | 0 | 0 | 1,133 | 776 | 0 | 0 | 1,909 |
| <i>Other liabilities, accruals and deferred income</i> | 0 | 0 | 0 | 0 | 0 | 131,161 | 131,161 |
| <i>Subordinated liabilities</i> | 0 | 0 | 0 | 0 | 0 | 25,706 | 25,706 |
| Total financial liabilities | 0 | 0 | 1,133 | 776 | 0 | 2,015,387 | 2,017,296 |
| <i>Total non-financial liabilities</i> | | | | | | | 172,544 |
| Total equity and liabilities | | | | | | | 2,189,840 |

Of the total £3,558,000 (2005: £20,762,000) assets at fair value through the profit and loss account, £1,239,000 (2005: £20,762,000) represents financial assets and derivatives held for trading purposes, and £1,137,000 (2005: £Nil) financial assets and derivatives designated as such at inception. Of the total £12,008,000 (2005: £1,133,000) liabilities at fair value through the profit and loss account, £1,933,000 (2005: £1,133,000) represents financial liabilities and derivatives held for trading purposes, and £10,075,000 (2005: £Nil) financial liabilities and derivatives designated as such at inception.

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32. Interest rate sensitivity gaps

Interest rate sensitivity gaps in the Bank and the Group, together with average effective interest rates, were as follows:

| Group 31 December 2006 | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Non- interest bearing | Total | Effective interest rate % |
|---|------------------|------------------|----------------|----------------|-----------------|-----------------------------|------------------|---------------------------------|
| Loans and advances to banks | 1,015,654 | 186,234 | 62,649 | 13,460 | 4,078 | 0 | 1,282,075 | 5.19% |
| Loans and advances to customers | 97,207 | 186,912 | 156,833 | 22,043 | 8,416 | (3,851) | 467,560 | 5.98% |
| Debt securities | 321,957 | 177,490 | 148,927 | 33,500 | 0 | 0 | 681,874 | 4.84% |
| Derivatives | 0 | 0 | 0 | 0 | 0 | 2,376 | 2,376 | 0.00% |
| Other assets | 0 | 0 | 0 | 0 | 0 | 38,945 | 38,945 | 0.00% |
| Total assets | 1,434,818 | 550,636 | 368,409 | 69,003 | 12,494 | 37,470 | 2,472,830 | 5.15% |
| Deposits from banks | 934,615 | 292,844 | 38,444 | 10,075 | 0 | 0 | 1,275,978 | 4.81% |
| Other deposits | 778,476 | 24,388 | 23,173 | 0 | 0 | 0 | 826,037 | 4.65% |
| Debt securities in issue | 0 | 116,911 | 55,563 | 0 | 0 | 0 | 172,474 | 5.60% |
| Derivatives | 0 | 0 | 0 | 0 | 0 | 2,024 | 2,024 | 0.00% |
| Subordinated liabilities | 0 | 13,998 | 8,666 | 0 | 0 | 0 | 22,664 | 7.30% |
| Other liabilities and shareholders' funds | 0 | 0 | 0 | 0 | 0 | 173,653 | 173,653 | 0.00% |
| Total equity and liabilities | 1,713,091 | 448,141 | 125,846 | 10,075 | 0 | 175,677 | 2,472,830 | 4.49% |
| Derivatives (at contract value) | | | | | | | | |
| Receivable | 33,749 | 32,960 | 24,034 | 20,149 | 0 | (117) | | 4.30% |
| Payable | 28,036 | 37,459 | 16,465 | 24,737 | 4,078 | 0 | | 4.32% |
| Overall gap | (272,560) | 97,996 | 250,132 | 54,340 | 8,416 | (138,324) | | |
| Cumulative gap | (272,560) | (174,564) | 75,568 | 129,908 | 138,324 | | | |

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| Group 31 December 2005 | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Non- interest bearing | Total | Effective interest rate % |
|--|--------------------------------|-------------------|------------------------------|------------------|-------------------------------|--|------------------|--|
| <i>Loans and advances to banks</i> | 882,995 | 220,193 | 49,402 | 11,409 | 6,967 | 2,983 | 1,173,949 | 3.94% |
| <i>Loans and advances to customers</i> | 101,915 | 164,470 | 105,346 | 25,759 | 4,553 | (5,249) | 396,794 | 4.73% |
| <i>Debt securities</i> | 151,126 | 299,124 | 77,760 | 51,500 | 0 | (35) | 579,475 | 4.25% |
| <i>Derivatives</i> | 0 | 0 | 0 | 0 | 0 | 1,198 | 1,198 | 0.00% |
| <i>Other assets</i> | 0 | 0 | 0 | 0 | 0 | 38,422 | 38,422 | 0.00% |
| Total assets | 1,136,036 | 683,787 | 232,508 | 88,668 | 11,520 | 37,319 | 2,189,838 | 4.09% |
| <i>Deposits from banks</i> | 783,288 | 464,025 | 26,975 | 0 | 0 | 387 | 1,274,675 | 3.85% |
| <i>Other deposits</i> | 528,252 | 15,021 | 34,772 | 0 | 0 | 0 | 578,045 | 3.15% |
| <i>Debt securities in issue</i> | 5,795 | 115,902 | 0 | 0 | 0 | (484) | 121,213 | 4.86% |
| <i>Derivatives</i> | 0 | 0 | 0 | 0 | 0 | 1,909 | 1,909 | 0.00% |
| <i>Subordinated liabilities</i> | 0 | 15,923 | 9,852 | 0 | 0 | (69) | 25,706 | 7.07% |
| <i>Other liabilities and shareholders' funds</i> | 0 | 0 | 0 | 0 | 0 | 188,290 | 188,290 | 0.00% |
| Total equity and liabilities | 1,317,335 | 610,871 | 71,599 | 0 | 0 | 190,033 | 2,189,838 | 3.43% |
| <i>Derivatives (at contract value)</i> | | | | | | | | |
| <i>Receivable</i> | 32,091 | 26,056 | 23,855 | 5,795 | 0 | (391) | | 2.99% |
| <i>Payable</i> | 6,500 | 28,189 | 12,010 | 33,740 | 6,967 | 0 | | 3.64% |
| <i>Overall gap</i> | (155,708) | 70,783 | 172,754 | 60,723 | 4,553 | (153,105) | | |
| Cumulative gap | (155,708) | (84,925) | 87,829 | 148,552 | 153,105 | | | |

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| Bank 31 December 2006 | Up to 1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | Non- interest bearing | Total | Effective interest rate % |
|---|------------------|------------------|----------------|----------------|-----------------|-----------------------------|------------------|------------------------------------|
| Loans and advances to banks | 1,015,654 | 186,234 | 62,649 | 13,460 | 4,078 | 0 | 1,282,075 | 5.19% |
| Loans and advances to customers | 97,207 | 186,912 | 156,833 | 22,043 | 8,416 | (3,851) | 467,560 | 5.98% |
| Debt securities | 321,957 | 177,490 | 148,927 | 33,500 | 0 | 0 | 681,874 | 4.84% |
| Derivatives | 0 | 0 | 0 | 0 | 0 | 2,376 | 2,376 | 0.00% |
| Other assets | 0 | 0 | 0 | 0 | 0 | 38,946 | 38,946 | 0.00% |
| Total assets | 1,434,818 | 550,636 | 368,409 | 69,003 | 12,494 | 37,471 | 2,472,831 | 5.15% |
| Deposits by banks | 934,615 | 292,844 | 38,444 | 10,075 | 0 | 0 | 1,275,978 | 4.81% |
| Customer accounts | 778,480 | 24,388 | 23,173 | 0 | 0 | 0 | 826,041 | 4.65% |
| Debt securities in issue | 0 | 15,292 | 55,563 | 0 | 0 | 0 | 70,855 | 5.60% |
| Derivatives | 0 | 0 | 0 | 0 | 0 | 2,024 | 2,024 | 0.00% |
| Subordinated liabilities | 0 | 13,998 | 8,666 | 0 | 0 | 0 | 22,664 | 7.30% |
| Other liabilities and shareholders' funds | 0 | 101,619 | 0 | 0 | 0 | 173,650 | 275,269 | 2.12% |
| Total equity and liabilities | 1,713,095 | 448,141 | 125,846 | 10,075 | 0 | 175,674 | 2,472,831 | 4.49% |
| Derivatives (at contract value) | | | | | | | | |
| Receivable | 33,749 | 32,960 | 24,034 | 20,149 | 0 | (117) | | |
| Payable | 28,036 | 37,459 | 16,465 | 24,737 | 4,078 | 0 | | 4.30% |
| Overall gap | (272,564) | 97,996 | 250,132 | 54,340 | 8,416 | (138,320) | | 4.32% |
| Cumulative gap | (272,564) | (174,568) | 75,564 | 129,904 | 138,320 | | | |

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| <i>Bank 31 December 2005</i> | <i>Up to 1 month</i> | <i>1-3 months</i> | <i>3-12 months</i> | <i>1-5 years</i> | <i>Over 5 years</i> | <i>Non- interest bearing</i> | <i>Total</i> | <i>Effective interest rate %</i> |
|--|--------------------------|-----------------------|------------------------|------------------|-------------------------|--------------------------------------|------------------|--|
| <i>Loans and advances to banks</i> | 882,995 | 220,193 | 49,402 | 11,409 | 6,967 | 2,983 | 1,173,949 | 3.94% |
| <i>Loans and advances to customers</i> | 101,915 | 164,470 | 105,346 | 25,759 | 4,553 | (5,249) | 396,794 | 4.73% |
| <i>Debt securities</i> | 151,126 | 299,124 | 77,760 | 51,500 | 0 | (35) | 579,475 | 4.25% |
| <i>Derivatives</i> | 0 | 0 | 0 | 0 | 0 | 1,198 | 1,198 | 0.00% |
| <i>Other assets</i> | 0 | 0 | 0 | 0 | 0 | 38,424 | 38,424 | 0.00% |
| <i>Total assets</i> | 1,136,036 | 683,787 | 232,508 | 88,668 | 11,520 | 37,321 | 2,189,840 | 4.09% |
| <i>Deposits by banks</i> | 783,288 | 464,025 | 26,975 | 0 | 0 | 387 | 1,274,675 | 3.85% |
| <i>Customer accounts</i> | 528,252 | 15,021 | 34,772 | 0 | 0 | 0 | 578,045 | 3.15% |
| <i>Debt securities in issue</i> | 5,795 | 0 | 0 | 0 | 0 | 0 | 5,795 | 3.89% |
| <i>Derivatives</i> | 0 | 0 | 0 | 0 | 0 | 1,909 | 1,909 | 0.00% |
| <i>Subordinated liabilities</i> | 0 | 15,923 | 9,852 | 0 | 0 | (69) | 25,706 | 7.07% |
| <i>Other liabilities and shareholders' funds</i> | 0 | 115,902 | 0 | 0 | 0 | 187,808 | 303,710 | 1.86% |
| <i>Total liabilities</i> | 1,317,335 | 610,871 | 71,599 | 0 | 0 | 190,035 | 2,189,840 | 3.43% |
| <i>Derivatives (at contract value)</i> | | | | | | | | |
| <i>Receivable</i> | 32,091 | 26,056 | 23,855 | 5,795 | 0 | (391) | | 2.99% |
| <i>Payable</i> | 6,500 | 28,189 | 12,010 | 33,740 | 6,967 | 0 | | 3.64% |
| <i>Overall gap</i> | (155,708) | 70,783 | 172,754 | 60,723 | 4,553 | (153,105) | | |
| <i>Cumulative gap</i> | (155,708) | (84,925) | 87,829 | 148,552 | 153,105 | | | |

Non-interest bearing items comprise share capital, accumulated impairments, tangible and intangible assets and other sundry debtors and creditors not subject to interest. Such non-interest bearing liabilities are used to fund the Group's assets by way of internal placements. Gap limits available to the Group's dealers for the management of interest rate risk in the banking book are stated net of these placements.

A simultaneous increase in interest rates of 0.5% in all currencies, and in all maturities on 1 January 2007 would reduce the present value of the gaps in the banking book by £506,000. However, earnings from the placement of non-interest bearing items would increase during 2007 by £315,000 (2005: a 0.5% increase in interest rates would have reduced the present value of the gaps by £254,000, but earnings in 2006 would have been increased by £411,000).

Derivatives include interest rate and currency swap transactions, the purpose of which are to reduce economic exposure to interest rate risk, whether formally qualifying as hedges or otherwise. The purpose of such hedges is to ensure that longer dated interest rate repricings, such as typically arise from fixed rate loans or deposits, are converted into shorter periods as can be accommodated within the gap limits.

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33. Foreign currency assets / liabilities

Foreign currency assets and liabilities for the Bank and the Group were as follows:

| Group 31 December 2006 | Sterling | Dollars | Euro | Other currencies | Total |
|---|-----------------|----------------|----------------|-----------------------------|--------------|
| Total assets | 403,967 | 1,608,192 | 404,809 | 55,862 | 2,472,830 |
| Total equity and liabilities | (381,307) | (1,834,206) | (221,258) | (36,059) | (2,472,830) |
| Derivatives (at contract value) | (21,218) | 224,701 | (183,507) | (19,976) | 0 |
| Net exposures | 1,442 | (1,313) | 44 | (173) | |
| Contingent liabilities and other commitments | 14,598 | 315,519 | 260,404 | 10,079 | 600,600 |
| | | | | | |
| Group 31 December 2005 | Sterling | Dollars | Euro | Other currencies | Total |
| Total assets | 374,208 | 1,288,588 | 479,590 | 47,452 | 2,189,838 |
| Total equity and liabilities | (400,391) | (1,311,475) | (456,119) | (21,853) | (2,189,838) |
| Derivatives (at contract value) | 18,949 | 32,870 | (26,555) | (25,264) | 0 |
| Net exposures | (7,234) | 9,983 | (3,084) | 335 | |
| Contingent liabilities and other commitments | 20,360 | 324,208 | 186,089 | 13,383 | 544,040 |
| | | | | | |
| Bank 31 December 2006 | Sterling | Dollars | Euro | Other currencies | Total |
| Total assets | 403,968 | 1,608,192 | 404,809 | 55,862 | 2,472,831 |
| Total equity and liabilities | (381,308) | (1,834,206) | (221,258) | (36,059) | (2,472,831) |
| Derivatives (at contract value) | (21,218) | 224,701 | (183,507) | (19,976) | 0 |
| Net exposures | 1,442 | (1,313) | 44 | (173) | |
| Contingent liabilities and other commitments | 14,598 | 315,519 | 260,404 | 10,079 | 600,600 |
| | | | | | |
| Bank 31 December 2005 | Sterling | Dollars | Euro | Other currencies | Total |
| Total assets | 374,210 | 1,288,588 | 479,590 | 47,452 | 2,189,840 |
| Total equity and liabilities | (400,393) | (1,311,475) | (456,119) | (21,853) | (2,189,840) |
| Derivatives (at contract value) | 18,949 | 32,870 | (26,555) | (25,264) | 0 |
| Net exposures | (7,234) | 9,983 | (3,084) | 335 | |
| Contingent liabilities and other commitments | 20,360 | 324,208 | 186,089 | 13,383 | 544,040 |

The Group's policies for managing the risk of exchange revaluations on foreign currency assets and liabilities are explained in Note 3.

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34. Legal proceedings

The Group does not consider that the outcomes of any proceedings against it, either individually or in aggregate, are likely to have a material effect on its financial position.

35. Consolidated segmental report

The consolidated segmental report for the Group was as follows:

| | European Union | | Middle East & Africa | | Other Countries | | Total | |
|--|----------------|---------------|----------------------|---------------|-----------------|--------------|----------------|---------------|
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| GROSS INCOME | | | | | | | | |
| Interest and similar income | 74,556 | 40,796 | 25,058 | 15,772 | 12,350 | 6,672 | 111,964 | 63,240 |
| Fee and commission income | 811 | 1,001 | 11,077 | 9,411 | 367 | 419 | 12,255 | 10,831 |
| Dividend income | 0 | 0 | 0 | 698 | 0 | 0 | 0 | 698 |
| Net trading income | 1,092 | 1,214 | 2,403 | 1,685 | 80 | 115 | 3,575 | 3,014 |
| Gains less losses from available for sale financial assets | 0 | 0 | 2,852 | 19,121 | 0 | 0 | 2,852 | 19,121 |
| Other operating income | 391 | (2) | 0 | 21 | 74 | 38 | 465 | 57 |
| Total gross income | 76,850 | 43,009 | 41,390 | 46,708 | 12,871 | 7,244 | 131,111 | 96,961 |
| Segment net income | 3,884 | 6,191 | 15,177 | 26,778 | 519 | 457 | 19,580 | 33,426 |
| Depreciation and amortisation | (1,113) | (1,081) | (16) | (10) | 0 | 0 | (1,129) | (1,091) |
| Impairment losses released | 87 | 4,566 | 552 | 5,581 | | 0 | 639 | 10,147 |
| Impairment losses charge | (106) | (113) | (28) | (908) | 0 | 0 | (134) | (1,021) |
| Segment profit | 2,752 | 9,563 | 15,685 | 31,441 | 519 | 457 | 18,956 | 41,461 |
| Common costs | | | | | | | (3,655) | (3,226) |
| Income on shareholders' funds | | | | | | | 5,063 | 5,039 |
| Profit before income tax | | | | | | | 20,364 | 43,274 |
| BALANCE SHEET | | | | | | | | |
| Total assets | 1,649,091 | 1,437,214 | 520,458 | 516,379 | 303,281 | 236,245 | 2,472,830 | 2,189,838 |
| Total liabilities | 615,288 | 679,781 | 1,855,413 | 1,498,098 | 2,129 | 11,959 | 2,472,830 | 2,189,838 |
| Commitments and Engagements | 131,096 | 69,886 | 419,383 | 440,581 | 50,121 | 33,573 | 600,600 | 544,040 |

Group capital expenditure and related depreciation arises in the European Union. Segment expenses, other than depreciation and amortisation, are principally cash in nature.

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36. Related parties

The Group regards the following as being related parties in accordance with IAS24:

- a) The Group's regulator regards Libyan Foreign Bank and the HSBC Group as being connected to the Group in view of the size of their shareholdings. The Group therefore considers these parties to be in a position to exert significant influence over the Group. The Group enters into commercial transactions in the ordinary course of business with its shareholders on an arm's-length basis.
- b) The Bank's wholly owned subsidiary, BACB (Jersey) Limited, is a related party under the terms of IAS24.
- c) Key management personnel, including the Group's directors, and identified Executive Managers.

Transactions with related parties were as follows:

| | Nature of related party | | |
|--|-------------------------|--------------------|--------------------------|
| | Significant influence | Subsidiary company | Key management personnel |
| Balances at 31 December 2006 | | | |
| Loans and advances | 8,764 | 101,619 | 1 |
| Deposits | 390,033 | 101,619 | 0 |
| Subordinated liabilities | 17,936 | 0 | 0 |
| Derivatives (contract amount) | 23,870 | 0 | 0 |
| Contingent liabilities and other commitments | 22,529 | 0 | 0 |
| Volumes executed during 2006 | | | |
| Loans and advances | 3,173,727 | 0 | 0 |
| Deposits | 45,651,384 | 0 | 0 |
| Subordinated liabilities | 0 | 0 | 0 |
| Derivatives (contract amount) | 16,524,277 | 0 | 0 |
| Contingent liabilities and other commitments | 18,436 | 0 | 0 |
| Included in profit for the year | | | |
| Interest receivable | 1,166 | 5,966 | 0 |
| Interest payable | 26,088 | 5,966 | 0 |
| Fees and commissions receivable | 751 | 0 | 0 |
| Fees and commissions payable | 249 | 0 | 0 |
| Balances at 31 December 2005 | | | |
| Loans and advances | 48,022 | 115,418 | 7 |
| Deposits | 345,612 | 115,418 | 0 |
| Subordinated liabilities | 20,105 | 0 | 0 |
| Derivatives (contract amount) | 78,209 | 0 | 0 |
| Contingent liabilities and other commitments | 19,973 | 0 | 0 |
| Volumes executed during 2005 | | | |
| Loans and advances | 4,404,155 | 115,418 | 0 |
| Deposits | 17,275,422 | 115,418 | 0 |
| Subordinated liabilities | 0 | 0 | 0 |
| Derivatives (contract amount) | 11,538,615 | 0 | 0 |
| Contingent liabilities and other commitments | 19,560 | 0 | 0 |
| Included in profit for the year | | | |
| Interest receivable | 1,617 | 4,503 | 0 |
| Interest payable | 11,258 | 4,503 | 0 |
| Fees and commissions receivable | 1,093 | 0 | 0 |
| Fees and commissions payable | 278 | 80 | 0 |

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In addition, the Group has entered into the following further related party transactions:

- d) The Group's Chief Executive is seconded from HSBC Group, and the Deputy Chief Executive from Libyan Foreign Bank. The full employment costs of £564,000 (2005: £507,000) for these long-term arrangements were met by the Group. Other executives are seconded from time to time by either party for varying periods. The costs of these secondments amounted to £235,000 (2005: £208,000).
- e) The Bank has issued undertakings in respect of the obligations of BACB (Jersey) Limited. In turn, that company has lent the proceeds arising on the issue of listed securities to the Bank by way of a promissory note, on terms which match those of the securities.
- f) Key management compensation

| | 2006 | 2005 |
|--|--------------|--------------|
| Attendance and standing fees | 308 | 302 |
| Salaries and other short term benefits | 1,307 | 1,266 |
| Post-employment benefits | 319 | 331 |
| | <u>1,934</u> | <u>1,899</u> |

- g) At 31 December 2006 no amount was outstanding by way of loans from any Executive Managers of the Group, and no amount was outstanding from any director. (At 31 December 2005 £7,000 was outstanding by way of loans to four Executive Managers of the Group, and no amount was outstanding from any director).

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British Arab Commercial Bank Limited
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Registered in England Number 1047302

