Arab Banking Corporation (B.S.C.)

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

31 MARCH 2018 (REVIEWED)

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REPORT ON REVIEW OF INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS TO THE BOARD OF DIRECTORS OF ARAB BANKING CORPORATION (B.S.C.)

Introduction

We have reviewed the accompanying interim condensed consolidated financial statements of Arab Banking Corporation (B.S.C.) [the "Bank"] and its subsidiaries [together the "Group"] as at 31 March 2018, comprising of the interim consolidated statement of financial position as at 31 March 2018 and the related interim consolidated statements of profit or loss, comprehensive income, cash flows and changes in equity for the three-month period then ended and explanatory notes. The Board of Directors is responsible for the preparation and presentation of these interim condensed consolidated financial statements in accordance with International Accounting Standard 34 *Interim Financial Reporting* (IAS 34). Our responsibility is to express a conclusion on these interim condensed consolidated financial statements based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IAS 34.

Ernst + Young

14 May 2018
Manama, Kingdom of Bahrain

INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 March 2018 (Reviewed)

All figures in US$ Million

	Note	***2018***	*2017*
ASSETS			
Liquid funds		**1,123**	1,388
Trading securities		**1,472**	1,051
Placements with banks and other financial institutions		**2,723**	3,170
Securities bought under repurchase agreements		**1,253**	1,521
Non-trading investments	5	**5,238**	5,599
Loans and advances	6	**15,351**	15,329
Interest receivable		**491**	445
Other assets		**1,081**	873
Premises and equipment		**126**	123
TOTAL ASSETS		**28,858**	29,499
LIABILITIES			
Deposits from customers		**16,937**	16,755
Deposits from banks		**3,007**	3,408
Certificates of deposit		**38**	27
Securities sold under repurchase agreements		**1,076**	1,628
Interest payable		**427**	427
Taxation		**57**	58
Other liabilities		**844**	636
TERM NOTES, BONDS AND OTHER TERM FINANCING		**2,122**	2,148
Total liabilities		**24,508**	25,087
EQUITY			
Share capital		**3,110**	3,110
Statutory reserve		**481**	481
Retained earnings		**835**	939
Other reserves		**(569)**	(600)
EQUITY ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**3,857**	3,930
Non-controlling interests		**493**	482
Total equity		**4,350**	4,412
TOTAL LIABILITIES AND EQUITY		**28,858**	29,499

These interim condensed consolidated financial statements were authorised for issue by the Board of Directors on 14 May 2018 and signed on their behalf by the Chairman, Deputy Chairman and the Group Chief Executive Officer.

Saddek El Kaber Chairman	Hilal Mishari Al Mutairi Deputy Chairman	Khaled Kawan Group Chief Executive Officer

The attached notes 1 to 12 form part of these interim condensed consolidated financial statements.

INTERIM CONSOLIDATED STATEMENT OF PROFIT OR LOSS

Three-month period ended 31 March 2018 (Reviewed)

All figures in US$ Million

	Note	Reviewed Three months ended 31 March 2018	2017
OPERATING INCOME			
Interest and similar income		**359**	384
Interest and similar expense		**(221)**	(250)
Net interest income		**138**	134
Other operating income	7	**73**	95
Total operating income		**211**	229
Credit loss expense on financial assets	8	**(12)**	(29)
NET OPERATING INCOME AFTER PROVISIONS		**199**	200
OPERATING EXPENSES			
Staff		**82**	78
Premises and equipment		**9**	9
Other		**28**	25
Total operating expenses		**119**	112
PROFIT BEFORE TAXATION		**80**	88
Taxation on foreign operations		**(14)**	(23)
PROFIT FOR THE PERIOD		**66**	65
Profit attributable to non-controlling interests		**(13)**	(15)
PROFIT ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**53**	50
BASIC AND DILUTED EARNINGS PER SHARE (EXPRESSED IN US$)		**0.02**	0.02

Saddek El Kaber
Chairman

Hilal Mishari Al Mutairi
Deputy Chairman

Khaled Kawan
Group Chief Executive Officer

The attached notes 1 to 12 form part of these interim condensed consolidated financial statements.

INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Three-month period ended 31 March 2018 (Reviewed)

All figures in US$ Million

	Reviewed Three months ended 31 March	
	2018	*2017*
PROFIT FOR THE PERIOD	**66**	65
Other comprehensive income:		
Other comprehensive income that will be reclassified (or recycled) to profit or loss in subsequent periods:		
Foreign currency translation:		
Unrealised gain on exchange translation in foreign subsidiaries	**1**	31
Debt instruments at FVOCI		
Net change in fair value during the period	**(7)**	-
Available-for-sale financial assets:		
Net change in fair value during the period	**-**	31
	(6)	62
Other comprehensive income that will not be reclassified (or recycled) to profit or loss in subsequent periods:		
Net change in pension fund reserve	**-**	-
	-	-
Other comprehensive (loss) income for the period	**(6)**	62
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD	**60**	127
Attributable to:		
Shareholders of the parent	**50**	101
Non-controlling interests	**10**	26
	60	127

The attached notes 1 to 12 form part of these interim condensed consolidated financial statements.

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS

Three-month period ended 31 March 2018 (Reviewed)

All figures in US$ million

	Reviewed Three months ended 31 March	
	2018	*2017*
OPERATING ACTIVITIES		
Profit for the period	**66**	65
Adjustments for:		
Credit loss expense on financial assets	**12**	29
Depreciation and amortisation	**5**	5
Gain on disposal of premises and equipment - net	**-**	(4)
Gain on disposal of non-trading investments - net	**(1)**	(7)
Changes in operating assets and liabilities:		
Treasury bills and other eligible bills	**(30)**	111
Trading securities	**(450)**	(68)
Placements with banks and other financial institutions	**477**	57
Securities bought under repurchase agreements	**241**	148
Loans and advances	**68**	306
Interest receivable and other assets	**(266)**	(133)
Deposits from customers	**126**	1,204
Deposits from banks	**(431)**	(1,397)
Securities sold under repurchase agreements	**(548)**	22
Interest payable and other liabilities	**124**	302
Other non-cash movements	**(25)**	(342)
Net cash (used in) from operating activities	**(632)**	298
INVESTING ACTIVITIES		
Purchase of non-trading investments	**(342)**	(946)
Sale and redemption of non-trading investments	**698**	1,191
Purchase of premises and equipment	**(4)**	(6)
Sale of premises and equipment	**1**	11
Investment in subsidiaries - net	**4**	3
Net cash from investing activities	**357**	253
FINANCING ACTIVITIES		
Issue of certificates of deposit - net	**11**	-
Repurchase of term notes, bonds and other term financing - net	**(26)**	(188)
Dividend paid to non-controlling interests	**(6)**	(6)
Net cash used in financing activities	**(21)**	(194)
Net change in cash and cash equivalents	**(296)**	357
Effect of exchange rate changes on cash and cash equivalents	**1**	(47)
Cash and cash equivalents at beginning of the period	**1,160**	1,530
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	**865**	1,840

The attached notes 1 to 12 form part of these interim condensed consolidated financial statements.

INTERIM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Three-month period ended 31 March 2018 (Reviewed)

All figures in US$ Million

	Equity attributable to the shareholders of the parent								*Non-controlling interests*	*Total equity*
				Other reserves						
	Share capital	*Statutory reserve*	*Retained earnings**	*General reserve*	*Foreign exchange translation adjustments*	*Cumulative changes in fair value*	*Pension fund reserve*	*Total*		
At 31 December 2017	3,110	481	939	100	(638)	(29)	(33)	3,930	482	4,412
Impact of adopting IFRS 9 (note 4)	-	-	(62)	-	-	34	-	(28)	(8)	(36)
Restated balance as at 1 January 2018	3,110	481	877	100	(638)	5	(33)	3,902	474	4,376
Profit for the period	-	-	53	-	-	-	-	53	13	66
Other comprehensive income (loss) for the period	-	-	-	-	4	(7)	-	(3)	(3)	(6)
Total comprehensive income (loss) for the period	-	-	53	-	4	(7)	-	50	10	60
Dividend**	-	-	(93)	-	-	-	-	(93)	-	(93)
Other equity movements in subsidiaries	-	-	(2)	-	-	-	-	(2)	9	7
At 31 March 2018 (reviewed)	**3,110**	**481**	**835**	**100**	**(634)**	**(2)**	**(33)**	**3,857**	**493**	**4,350**

* Retained earnings include non-distributable reserves arising from consolidation of subsidiaries amounting to US$ 426 million (31 December 2017: US$ 424 million).

** A dividend of US$ 0.03 per share (2017: US$ 0.03 per share) has been approved for payment at the Annual General Meeting held on 25 March 2018.

INTERIM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Three-month period ended 31 March 2018 (Reviewed)

All figures in US$ Million

	Equity attributable to the shareholders of the parent								*Non-controlling interests*	*Total equity*
				Other reserves						
	Share capital	*Statutory reserve*	*Retained earnings**	*General reserve*	*Foreign exchange translation adjustments*	*Cumulative changes in fair value*	*Pension fund reserve*	*Total*		
At 1 January 2017	3,110	462	859	100	(625)	(45)	(35)	3,826	434	4,260
Profit for the year	-	-	50	-	-	-	-	50	15	65
Other comprehensive income for the period	-	-	-	-	20	31	-	51	11	62
Total comprehensive income for the period	-	-	50	-	20	31	-	101	26	127
Dividend	-	-	(93)	-	-	-	-	(93)	-	(93)
Other equity movements in subsidiaries	-	-	(1)	-	-	-	-	(1)	8	7
At 31 March 2017 (reviewed)	3,110	462	815	100	(605)	(14)	(35)	3,833	468	4,301

The attached notes 1 to 12 form part of these interim condensed consolidated financial statements.

All figures in US$ million

1 INCORPORATION AND ACTIVITIES

Arab Banking Corporation (B.S.C.) [the "Bank"] is incorporated in the Kingdom of Bahrain by an Amiri decree and operates under a wholesale banking licence issued by the Central Bank of Bahrain. The Bank is a Bahraini Shareholding Company with limited liability and is listed on the Bahrain Bourse. The Central Bank of Libya is the ultimate parent of the Bank and its subsidiaries (together 'the Group').

The Bank's registered office is at ABC Tower, Diplomatic Area, P.O. Box 5698, Manama, Kingdom of Bahrain. The Bank is registered under commercial registration number 10299 issued by the Ministry of Industry, Commerce and Tourism, Kingdom of Bahrain.

The Group offers a range of international wholesale banking services including Corporate Banking & Financial Institutions, Project & Structured Finance, Syndications, Treasury, Trade Finance services and Islamic Banking. Retail banking services are only provided in the MENA region.

2 BASIS OF PREPARATION AND CHANGES TO THE GROUP'S ACCOUNTING POLICIES

2.1 Basis of preparation

The interim condensed consolidated financial statements for the three-month period ended 31 March 2018 have been prepared in accordance with IAS 34 *Interim Financial Reporting* .

The interim condensed consolidated financial statements do not contain all information and disclosures required in the annual consolidated financial statements, and should be read in conjunction with the Group's annual consolidated financial statements for the year ended 31 December 2017. The Bank has adopted IFRS 9 "Financial instruments" (IFRS 9) and IFRS 15 "Revenue from contracts with customers" (IFRS 15) from 1 January 2018 and accounting policies for these new standards are disclosed in note 3. In addition, results for the three-month period ended 31 March 2018 are not necessarily indicative of the results that may be expected for the financial year ending 31 December 2018.

2.2 Basis of consolidation

These interim condensed consolidated financial statements include the financial statements of the Bank and its subsidiaries after elimination of inter-company transactions and balances.

2.3 New standards, interpretations and amendments adopted by the Group

The accounting policies adopted in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of the Group’s annual consolidated financial statements for the year ended 31 December 2017, except for the adoption of new standards effective as of 1 January 2018.

For the accounting policies with respect to prior year comparative figures refer to the annual consolidated financial statements for year ended 31 December 2017.

The following new and amended accounting standards became effective in 2018 and have been adopted by the Group in preparation of these interim condensed consolidated financial statements as applicable.

All figures in US$ million

2 BASIS OF PREPARATION AND CHANGES TO THE GROUP'S ACCOUNTING POLICIES (continued)

2.3 *New standards, interpretations and amendments adopted by the Group (continued)*

2.3.1 *IFRS 9 Financial instruments*

IFRS 9 replaces IAS 39 Financial instruments: recognition and measurement (IAS 39) for annual periods beginning on or after 1 January 2018, bringing together all three aspects of the accounting for financial instruments: classification and measurement; impairment; and hedge accounting. The Group has applied IFRS 9 with the initial application date of 1 January 2018.

The Group has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings and reserves as at 1 January 2018.

The key changes to the Group's accounting policies resulting from its adoption of IFRS 9 are summarized below.

2.3.1.1 *Classification and measurement of financial assets*

Under IFRS 9, the classification and measurement category of all financial assets, except equity instruments and derivatives, is assessed based on a combination of the entity’s business model for managing the financial assets and its contractual cash flow characteristics.

The IAS 39 measurement categories of financial assets (fair value through profit or loss (FVTPL), available for sale (AFS), held-to-maturity (HTM) and amortised cost) have been replaced by:

- Debt instruments at amortised cost;
- Debt instruments at fair value through other comprehensive income (FVOCI), with gains or losses recycled to profit or loss on derecognition;
- Equity instruments at FVOCI, with no recycling of gains or losses to profit or loss on derecognition; and
- Financial assets as fair value through profit or loss (FVTPL).

The above designation of equity investments at FVOCI (i.e. election to present subsequent changes in fair value of an equity investment that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies in other comprehensive income) and debt investment that meets the amortised cost or FVOCI criteria as FVTPL (only if doing so eliminates or significantly reduces an accounting mismatch), is through an irrevocable election / designation at initial recognition of a financial asset.

The Group’s classification of its financial assets is explained in detail in note 3. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in note 4.

2 BASIS OF PREPARATION AND CHANGES TO THE GROUP'S ACCOUNTING POLICIES (continued)

2.3 *New standards, interpretations and amendments adopted by the Group (continued)*

2.3.1 *IFRS 9 Financial instruments (IFRS 9) (continued)*

2.3.1.2 *Classification and measurement of financial liabilities*

Classification of financial liabilities remained largely unchanged for the Group. Financial liabilities continue to be measured at amortised cost.

2.3.1.3 *Impairment of financial assets*

IFRS 9 impairment requirements are based on expected credit loss (ECL) model as compared to the incurred loss model approach under IAS 39. Key changes to the Group's accounting policy for impairment of financial assets are listed below:

Under IFRS 9, the Group applies a three-stage approach to measuring ECL on all loans and debt type financial assets (including loan commitments and financial guarantee contracts) accounted for at amortised cost and FVOCI. Assets migrate through the following three stages based on the change in the credit quality since initial recognition:

i) Stage 1: 12 months ECL
For exposures where there has not been a significant increase in credit risk (SICR) since initial recognition and that are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.

ii) Stage 2: Lifetime ECL - not credit impaired
For exposures where there has been a SICR since initial recognition but that are not credit impaired, a lifetime ECL is recognised.

iii) Stage 3: Lifetime ECL - credit impaired
Financial assets are assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred. As this uses the same criteria as under IAS 39, the Group's methodology for specific provisions remains unchanged. For financial assets that have become credit impaired, a lifetime ECL is recognised.

For more details on the accounting policies, refer to note 3 in the interim condensed consolidated financial statements. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in note 4.

2.3.2 *IFRS 7(revised) Financial instruments: Disclosures (IFRS 7R)*

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial instruments: Disclosures was updated and the Group has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in note 4.

Reconciliations from opening to closing ECL allowances for significant movements are presented in notes 5 and 6.

IFRS 7R also requires additional and more detailed disclosures for hedge accounting. However, the adoption of IFRS 9 for hedge accounting did not have a material impact on the hedging activities / accounting for the Group, therefore, these will be disclosed in the annual consolidated financial statements for the year ending 31 December 2018.

All figures in US$ million

2 BASIS OF PREPARATION AND CHANGES TO THE GROUP'S ACCOUNTING POLICIES (continued)

2.3 *New standards, interpretations and amendments adopted by the Group (continued)*

2.3.3 *IFRS 15 Revenue from contracts with customers*

The Group adopted IFRS 15 resulting in a change in the revenue recognition policy of the Group in relation to its contracts with customers.

IFRS 15 outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue guidance, which is found currently across several standards and interpretations within IFRS. It established a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The Group has opted for the modified retrospective application permitted by IFRS 15 upon adoption of the new standard. Modified retrospective application also requires the recognition of the cumulative impact of adoption of IFRS 15 on all contracts as at 1 January 2018 in equity. There were no adjustments to opening retained earnings and other account balances on the adoption of IFRS 15.

2.4 New standards, interpretations and amendments issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's interim condensed consolidated financial statements are disclosed below. The Group intends to adopt the following standard, if applicable, when it becomes effective.

Topic	***Effective date***
IFRS 16 Leases	1 January 2019

The Group is assessing the impact of implementation of the above standard.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies, estimates and assumptions used in the preparation of these interim condensed consolidated financial statements are consistent with those used in the preparation of the annual consolidated financial statements for the year ended 31 December 2017 except for the policies explained below. Based on the adoption of new standards explained in notes 2 and 3, the following accounting policies are applicable effective 1 January 2018 replacing / amending or adding to the corresponding accounting policies set out in the annual consolidated financial statements for year ended 31 December 2017.

3.1 Financial instruments

3.1.1 *Date of recognition*

Financial assets and liabilities, with the exception of loans and advances to customers, deposits to customers and banks, are initially recognised on the trade date, i.e., the date that the Group becomes a party to the contractual provisions of the instrument. This includes regular way trades: purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place. Loans and advances to customers are recognised when funds are transferred to the customers' accounts. The Group recognises deposits from customers and banks when funds are transferred to the Group.

All figures in US$ million

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Financial instruments (continued)

3.1.2 *Initial measurement*

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments, as described in notes 3.2 and 3.3.

At initial recognition, the Group measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at FVTPL, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees and commissions. Transaction costs of financial assets and financial liabilities carried at FVTPL are expensed in profit or loss. Immediately after initial recognition, an ECL is recognised for financial assets measured at amortised cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognised in the consolidated statement of profit or loss when an asset is newly originated. When the fair value of financial assets and liabilities at initial recognition differs from the transaction price, the Group accounts for the Day 1 profit or loss, as described below.

3.1.3 *Day 1 profit or loss*

When the transaction price of the instrument differs from the fair value at origination, the difference is treated as follows:

(a) When the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e. a Level 1 input) or based on a valuation technique that uses data only from observable markets, the difference is recognised as a day 1 gain or loss.

(b) In all other cases, the difference is deferred and the timing of recognition of deferred day 1 profit or loss is determined individually. It is either amortised over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or when the instrument is derecognised.

3.2 Financial assets

3.2.1 *Debt type instruments - Classification and subsequent measurement*

Before 1 January 2018, the Group classified its financial assets as loans and receivables (amortised cost), FVTPL, available-for-sale or held-to-maturity (amortised cost), as explained in the annual consolidated financial statements for the year ended 31 December 2017.

From 1 January 2018, the Group has applied IFRS 9 and classifies its financial assets - debt type instruments in the following measurement categories:

- Amortised cost.
- Fair value through other comprehensive income (FVOCI); or
- Fair value through profit or loss (FVTPL);

The classification requirements for financial assets is as below.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Financial assets (continued)

3.2.1 *Debt type instruments - Classification and subsequent measurement (continued)*
Classification and subsequent measurement of debt instruments depend on:

(i) the Group’s business model for managing the asset; and

(ii) the cash flow characteristics of the asset i.e. solely payments of principal and interest (SPPI) test.

Based on these factors, the Group classifies its debt instruments into one of the following three measurement categories:

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent SPPI, and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any ECL allowance recognised and measured. Interest income from these financial assets is included in ‘Interest and similar income’ using the EIR method.

- Fair value through other comprehensive income (FVOCI): Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets’ cash flows represent SPPI, and that are not designated at FVTPL, are measured at fair value through other comprehensive income (FVOCI). Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument’s amortised cost which are recognised in consolidated profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Other operating income' as 'Gain or loss on disposal of non-trading investments'. Interest income from these financial assets is included in ‘Interest and similar income’ using the effective interest rate (EIR) method.

- Fair value through profit or loss (FVTPL): Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. The Group may also designate a financial asset at FVTPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies. A gain or loss on a debt investment that is subsequently measured at FVTPL and is not part of a hedging relationship is recognised in consolidated profit or loss and presented in the consolidated statement of profit or loss within 'Other operating income' as 'Gain on trading securities' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Other operating income' as 'Gain on disposal of non-trading investments'. Interest income from these financial assets is included in ‘Interest and similar income’ using the EIR method.

3.2.2 *Business model*
The Group determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective. The business model reflects how the Group manages the assets in order to generate cash flows. That is, whether the Group’s objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of ‘held for trading’ business model and measured at FVTPL. The business model assessment is not carried out on an instrument-by-instrument basis but at the aggregate portfolio level and is based on observable factors such as:

- The stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of the assets;
- How the asset’s and business model performance is evaluated and reported to key management personnel and Group Asset and Liability Committee (GALCO);
- How risks are assessed and managed.

All figures in US$ million

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Financial assets (continued)

3.2.2 *Business model (continued)*

- The frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Group's original expectations, the Group does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

Financial assets that are held for trading and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

3.2.3 *SPPI test*

The Group assesses the contractual terms of financial asset to identify whether they meet the SPPI test.

Principal for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

Interest is the consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group considers:

- the currency in which the financial asset is denominated, and the period for which the interest rate is set;
- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse asset arrangements).

Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at FVTPL.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are SPPI.

The Group reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period other than the reclassifications made on the initial adoption of IFRS 9 at the date of transition.

3.2.4 *Equity type instruments - classification and subsequent measurement*

Equity instruments are instruments that meet the definition of equity from the issuer’s perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer’s net assets.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Financial assets (continued)

3.2.4 *Equity type instruments - classification and subsequent measurement (continued)*

Upon initial recognition, the Group elects to irrevocably designate certain equity investments at FVOCI which are held for purposes other than held for trading. When this election is used, fair value gains and losses are recognised in other comprehensive income and are not subsequently reclassified to consolidated profit or loss, including on disposal. Equity investments at FVOCI are not subject to impairment assessment. All other equity investments which the Group has not irrevocably elected at initial recognition or transition, to classify at FVOCI, are recognised at FVTPL.

Gains and losses on equity investments at FVTPL are included in the 'Other operating income' as 'Gain on disposal of non-trading investments' line in the consolidated statement of profit or loss.

Dividends are recognised in the consolidated statement of profit or loss as 'Other operating income' when the Group’s right to receive payments is established.

3.2.5 *Modified or forbearance of loans*

The Group sometimes makes concessions or modifications to the original terms of loans as a response to the borrower’s financial difficulties, rather than taking possession or to otherwise enforce collection of collateral. The Group considers a loan forborne when such concessions or modifications are provided as a result of the borrower’s present or expected financial difficulties and the Group would not have agreed to them if the borrower had been financially healthy. Indicators of financial difficulties include:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.
- Whether any substantial new terms are introduced, such as a profit share/equity-based return that substantially affects the risk profile of the loan.
- Significant extension of the loan term when the borrower is not in financial difficulty.
- Significant change in the interest rate.
- Change in the currency the loan is denominated in.
- Insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Group derecognises the original financial asset and recognises a ‘new’ asset at fair value and recalculates a new EIR for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Group also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the customer being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Group recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognises a modification gain or loss in consolidated profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original EIR (or credit-adjusted EIR for purchased or originated credit-impaired financial assets).

All figures in US$ million

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Financial assets (continued)

3.2.5 *Modified or forbearance of loans (continued)*
Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms. It is the Group's policy to monitor forborne loans to help ensure that future payments continue to be likely to occur. Derecognition decisions and classification between Stage 2 and Stage 3 are determined on a case-by-case basis or based on SICR criteria. If these procedures identify a loss in relation to a loan, it is disclosed and managed as an impaired Stage 3 forborne asset until it is collected or written off or is transferred back to Stage 2.

3.2.6 *Derecognition other than on a modification*
Financial assets, or a portion thereof, are derecognised when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Group transfers substantially all the risks and rewards of ownership, or (ii) the Group neither transfers nor retains substantially all the risks and rewards of ownership and the Group has not retained control.

The Group enters into transactions where it retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to other entities and transfers substantially all of the risks and rewards. These transactions are accounted for as 'pass through' transfers that result in derecognition if the Group:

(i) Has no obligation to make payments unless it collects equivalent amounts from the assets;

(ii) Is prohibited from selling or pledging the assets; and

(iii) Has an obligation to remit any cash it collects from the assets without material delay.

Collateral (shares and bonds) furnished by the Group under standard repurchase agreements and securities lending and borrowing transactions are not derecognised because the Group retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met. This also applies to certain securitisation transactions in which the Group retains a subordinated residual interest.

3.3 Financial liabilities

3.3.1 *Classification and subsequent measurement*
In both the current and prior period, financial liabilities are classified as subsequently measured at amortised cost, except for:

- Financial liabilities at FVTPL: this classification is applied to derivatives and financial liabilities held for trading (e.g. short positions in the trading booking). Gains or losses on financial liabilities designated at FVTPL are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially in profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in consolidated profit or loss;

- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Group recognises any expense incurred on the financial liability; and

- Financial guarantee contracts and loan commitments.

3.3.2 *Derecognition*
Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

All figures in US$ million

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3 Financial liabilities (continued)

3.3.2 *Derecognition (continued)*

The exchange between the Group and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original EIR, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

3.4 Impairment

The Group assesses on a forward-looking basis, the ECL associated with its debt instruments assets carried at amortised cost and FVOCI and against the exposure arising from loan commitments and financial guarantee contracts. The Group recognises an ECL for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible

- The time value of money; and

- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

3.5 Financial guarantee contracts and loan commitments

The Group issues financial guarantees, letters of credit and loan commitments.

Financial guarantees are initially recognised in the interim condensed consolidated financial statements at fair value, being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the interim consolidated statement of profit or loss, and – under IAS 39 – the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee, or – under IFRS 9 – an ECL provision.

The premium received is recognised in the interim consolidated statement of profit or loss in other operating income on a straight line basis over the life of the guarantee.

Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Group is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, under IAS 39, a provision was made if they were an onerous contract but, from 1 January 2018, these contracts are in the scope of the ECL requirements.

The nominal contractual value of financial guarantees, letters of credit and undrawn loan commitments, where the loan agreed to be provided is on market terms, are not recorded on in the interim consolidated statement of financial position.

All figures in US$ million

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.6 Derivatives and hedging activities

A derivative is a financial instrument or other contract with all three of the following characteristics:

- Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract (i.e., the 'underlying').
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts expected to have a similar response to changes in market factors.
- It is settled at a future date.

The Group enters into derivative transactions with various counterparties. These include interest rate swaps, futures, credit default swaps, cross-currency swaps, forward foreign exchange contracts and options on interest rates, foreign currencies and equities. Derivatives are initially recognised at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

All derivatives are measured at FVTPL except for when the derivative is designated and qualifies as a hedging instrument, and if so, the nature of the item being hedged determines the method of recognising the resulting gain or loss. The Group designates certain derivatives as either:

(a) Hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedges);
(b) Hedges of highly probable future cash flows attributable to a recognised asset or liability (cash flow hedges); or
(c) Hedges of a net investment in a foreign operation (net investment hedges).

The Group documents, at the inception of the hedge, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its 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.

(a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the consolidated statement of profit or loss, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to profit or loss over the period to maturity and recorded as net interest income.

(b) Cash flow hedge

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

Amounts accumulated in equity are recycled to the consolidated statement of profit or loss in the periods when the hedged item affects profit or loss. They are recorded in the income or expense lines in which the revenue or expense associated with the related hedged item is reported.

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 and is recognised in the periods when the hedged item affects profit or loss. When a forecast transaction is no longer expected to occur (for example, the recognised hedged asset is disposed of), the cumulative gain or loss previously recognised in other comprehensive income is immediately reclassified to the consolidated statement of profit or loss.

All figures in US$ million

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.6 Derivatives and hedging activities (continued)

(c) Net investment hedge

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised directly in other comprehensive income; the gain or loss relating to the ineffective portion is recognised immediately in the consolidated statement of profit or loss. Gains and losses accumulated in equity are included in the consolidated statement of profit or loss when the foreign operation is disposed of as part of the gain or loss on the disposal.

The Group did not have any impact on its retained earnings or profit or loss due to change in hedge accounting under IFRS 9.

3.7 Interest income

Under both IFRS 9 and IAS 39, interest income is recorded using the EIR method for all financial instruments measured at amortised cost, financial instruments designated at FVTPL. Interest income on interest bearing financial assets measured at FVOCI under IFRS 9, similarly to interest bearing financial assets classified as available-for-sale or held to maturity under IAS 39 are also recorded by using the EIR method. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

3.8 Significant accounting judgements, estimates and assumptions

In preparing these interim condensed consolidated financial statements, significant judgements made by management in applying accounting policies and key sources of estimation were the same as those that were applied to the annual consolidated financial statements for the year ended 31 December 2017 except for new judgements and estimates explained below:

Measurement of the expected credit loss allowance (ECL)

The measurement of the ECL for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions, credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses), estimation of the amount and timing of the future cash flows and collateral values. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Group's ECL calculation are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Internal credit rating model, which assigns probability of defaults (PDs) to the individual ratings;
- Determining criteria for significant increase in credit risk (SICR);
- Choosing appropriate models and assumptions for the measurement of ECL;
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PD, exposure at default (EAD) and loss given default (LGD);

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.8 Significant accounting judgements, estimates and assumptions (continued)

Measurement of the expected credit loss allowance (ECL) (continued)

- Selection and relative weightings of forward-looking scenarios to derive the economic inputs into the ECL models;
- Establishing groups of similar financial assets for the purposes of measuring ECL; and
- Determining relevant period of exposure with respect to the revolving credit facilities and facilities undergoing restructuring at the time of the reporting date.

Classification of financial assets

Classification of financial assets in the appropriate category depends upon the business model and SPPI test. Determining the appropriate business model and assessing whether the cash flows generated by the financial asset meet the SPPI test is complex and requires significant judgements by management.

The Group applies judgement while carrying out SPPI test and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense.

Collateral valuation

To mitigate its credit risks on financial assets, the Group seeks to use collateral, where possible. The collateral comes in various forms, such as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. The Group's accounting policy for collateral assigned to it through its lending arrangements under IFRS 9 is the same is it was under IAS 39. Collateral, unless repossessed, is not recorded on the Group's consolidated statement of financial position. However, the fair value of collateral affects the calculation of ECLs. It is generally assessed, at a minimum, at inception and re-assessed on a periodic basis. However, some collateral, for example, cash or securities relating to margining requirements, is valued daily.

To the extent possible, the Group uses active market data for valuing financial assets held as collateral. Other financial assets which do not have readily determinable market values are valued using models. Non-financial collateral, such as real estate, is valued based on data provided by third parties such as mortgage brokers, or based on housing price indices.

Collateral repossessed

The Group's accounting policy under IFRS 9 remains the same as it was under IAS 39. Any repossessed assets are held for sale at their fair value (if financial assets) and fair value less cost to sell for non-financial assets at the repossession date in, line with the Group's policy.

In its normal course of business, the Group does not physically repossess properties or other assets in its retail portfolio, but engages external agents to recover funds, generally at auction, to settle outstanding debt. Any surplus funds are returned to the customers/obligors. As a result of this practice, the residential properties under legal repossession processes are not recorded on the balance sheet.

All figures in US$ million

4 TRANSITION DISCLOSURES

(a) The Group performed a detailed analysis of its business models for managing financial assets and analysis of their cash flow characteristics.

The following table reconciles the carrying amounts of financial assets and financial liabilities, from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018:

Financial assets

		31 December 2017				*1 January 2018*	
	Note	***IAS 39 category***	***IAS 39 Carrying amount***	***Reclassification***	***Remeasurement***	***IFRS 9 carrying amount***	***IFRS 9 category***
Liquid funds		Amortised cost (loans and receivables)	1,388	-	(1)	1,387	Amortised cost
Loans and advances		Amortised cost (loans and receivables)	15,329	(36)	(18)	15,275	Amortised cost
Transfers to FVTPL (IFRS 9)	***(C)***			*(36)*			
Placements with banks and other financial institutions		Amortised cost (loans and receivables)	3,170	-	(3)	3,167	Amortised cost
Securities bought under repurchase agreements		Amortised cost (loans and receivables)	1,521	-	-	1,521	Amortised cost
Non-trading investments – debt instruments at amortised cost		Amortised cost (loans and receivables)	-	1,177	16 *	1,193	Amortised cost
Transfers from available-for-sale (IAS 39)	***(B)***			*960*			
Transfers from held to maturity (IAS 39)	***(F)***			*217*			
Non-trading investments – Held to maturity		HTM	217	(217)	-	-	
Transfers to debt instruments at amortised cost	***(F)***			*(217)*			
Total financial assets measured at amortised cost			**21,625**	**924**	**(6)**	**22,543**	

* This includes positive fair value of US$ 17 million relating to fair value impact arising due to reclassification and recorded in cumulative changes in fair value reserve net of ECL of US$ 1 million at the transition date.

All figures in US$ million

4 TRANSITION DISCLOSURES (continued)

	Note	*31 December 2017* IAS 39 category	*31 December 2017* IAS 39 Carrying amount	Reclassification	Remeasurement	*1 January 2018* IFRS 9 carrying amount	*1 January 2018* IFRS 9 category
Financial assets at FVTPL							
Trading securities		FVTPL	1,051	289	3	1,343	FVTPL
Transfers from loans and receivables				*36*			
Transfers from AFS - debt securities				*238*			
Transfers from AFS - equity securities				*15*			
Total financial assets at FVTPL			**1,051**	**289**	**3**	**1,343**	
Financial assets at FVOCI							
Non-trading investments – FVOCI (debt securities)			-	4,158	-	4,158	FVOCI
Transfers from available-for-sale financial assets (IAS 39)				*4,158*			
Non-trading investments – FVOCI (equity securities)			-	11	-	11	FVOCI
Transfers from available-for-sale financial assets (IAS 39)				*11*			
Non-trading investments – equity and debt instruments under AFS category		AFS	5,382	(5,382)	-	-	
Transfers to trading securities - debt instruments	***(A)***			*(238)*			
Transfers to trading securities - equity instruments	***(E)***			*(15)*			
Transfers to amortised cost (IFRS 9)	***(B)***			*(960)*			
Transfers to FVOCI – equity instruments	***(D)***			*(11)*			
Transfers to FVOCI – debt instruments	***(F)***			*(4,158)*			
Total financial assets at FVOCI			**5,382**	**(1,213)**	**-**	**4,169**	
Total financial assets			**28,058**	**-**	**(3)**	**28,055**	
Non-financial assets							
Other assets - deferred tax assets			873	-	14 **	887	
Total assets			**28,931**	**-**	**11**	**28,942**	
Financial liabilities							
Other liabilities - Off balance sheet exposures			(636)	-	(47)	(683)	
Net impact of remeasurements			**28,295**	**-**	**(36)**	**28,259**	

** This represents deferred tax impacts arising due to remeasurements of financial assets.

All figures in US$ million

4 TRANSITION DISCLOSURES (continued)

The total remeasurement loss of US$ 36 million was recognised in opening retained earnings, cumulative changes in fair value and non controlling interests at 1 January 2018.

The following explains how applying the new classification requirements of IFRS 9 led to changes in classification of certain financial assets held by the Group as shown in the table above:

(A) Debt instruments previously classified as available for sale but which fail the SPPI test

The Group holds a portfolio of debt instruments that failed to meet the SPPI requirement for amortised cost classification under IFRS 9. As a result, these instruments, which amounted to US$ 253 million were classified as FVTPL on the date of initial application.

(B) Securities within the liquidity portfolio (HQLA assets)

After assessing its business model for securities within the Group’s liquidity portfolio (high quality liquid assets (HQLA)), which are mostly held to collect the contractual cash flows and sell, the Group has identified certain securities which are managed separately and for which the past practice has been (and the Group’s intention remains) to hold to collect the contractual cash flows. Consequently, the Group assessed that the appropriate business model for this group of securities is hold to collect. These securities, with fair value amounting to US$ 960 million and which were previously classified as available-for-sale, were classified as amortised cost from the date of initial application. The remainder of the Group’s liquidity portfolio is held to collect contractual cash flows and sell.

(C) Loans and advances at amortised cost but which fail SPPI test

These represented loans and advances that failed to meet the SPPI requirement for amortised cost classification under IFRS 9. Accordingly, these loans and advances amounting to US$ 36 million were classified as FVTPL from the initial date of application.

(D) Designation of equity instruments at FVOCI

The Group has elected to irrevocably designate certain of its strategic investments at carrying value of US$ 11 million in a portfolio of non-trading equity investments at FVOCI as permitted under IFRS 9 from the initial date of application. These investments were previously classified as available-for-sale. The changes in fair value of such securities will no longer be reclassified to profit or loss when they are disposed of.

(E) Designation of equity instruments at FVTPL

The Group has elected to designate certain of its investments at a carrying value of US$ 15 million as FVTPL as permitted under IFRS 9 from the initial date of application. These investments were previously classified as available-for-sale. Any changes in fair value of these securities will be recognised in the profit or loss.

(F) Reclassification from retired categories with no change in measurement

In addition to the above, the following debt instruments have been reclassified to new categories under IFRS 9, as their previous categories under IAS 39 were ‘retired’, with no changes to their measurement basis:

(i) Those previously classified as available-for-sale and now classified as measured at FVOCI; and

(ii) Those previously classified as held to maturity and now classified as measured at amortised cost.

For financial assets and liabilities that have been reclassified to the amortised cost category, the following table shows their fair value as at 31 March 2018 and the fair value gain or loss that would have been recognised if these financial assets and liabilities had not been reclassified as part of the transition to IFRS 9:

Reclassifications to amortised cost	***31 March 2018***
From available-for-sale (IAS 39 classification) – Item (B) above	
Fair value as at 31 March 2018	955
Fair value gain/(loss) that would have been recognised in cumulative changes in fair value in equity during the year if the financial asset had not been reclassified	(22)

All figures in US$ million

4 TRANSITION DISCLOSURES (continued)

(b) Impact on retained earnings and other reserves

	Retained earnings	*Cumulative changes in fair value*	*Non-controlling interests*
Closing balance under IAS 39 (31 December 2017)	939	(29)	482
Fair value changes recognised on reclassification of financial assets	3	17	-
Recognition of expected credit losses under IFRS 9:			
- Liquid funds	(1)	-	-
- Non-trading investments	(17)	17*	(1)
- Loans and advances	(7)	-	(11)
- Placements with banks and other financial institutions	(3)	-	-
- Other liabilities - Off balance sheet exposures	(45)	-	(2)
	(73)	17	(14)
Deferred tax impact on adoption on IFRS 9	8	-	6
Opening balance under IFRS 9 (1 January 2018)	877	5	474

* This represents corresponding remeasurement increase in fair value of debt securities classified at FVOCI due to recording of ECL on transition date of IFRS 9.

(c) Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The following table reconciles the prior period's closing loan loss provisions measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 ECL model at 1 January 2018:

Measurement category	*Loan loss allowance under IAS 39*	*Reclassification*	*Remeasurement*	*ECL under IFRS 9*
Loans and receivables (IAS 39) / Financial assets at amortised cost (IFRS 9)				
Liquid funds	-	-	1	1
Placements with banks and other financial institutions	-	-	3	3
Loans and advances	572	-	18	590
	572	**-**	**22**	**594**
Non-trading investments				
FVOCI (debt securities)	103	-	17	120
Debt instruments at amortised cost	-	-	1	1
	103	**-**	**18**	**121**
Credit commitments and contingent items	6	-	47	53
Total	**681**	**-**	**87**	**768**

All figures in US$ million

5 NON-TRADING INVESTMENTS

	31 March 2018	*31 December 2017*
Debt securities		
Available-for-sale	**-**	5,459
Held to maturity	**-**	217
Debt instruments at amortised cost	**1,206**	-
FVOCI (debt securities)	**4,145**	-
	5,351	5,676
ECL allowances	**(121)**	(103)
Debt securities - net	**5,230**	5,573
Equity securities		
Available-for-sale	**-**	26
Equity securities measured at FVOCI	**8**	-
Equity securities - net	**8**	26
	5,238	5,599

Following is the stage wise break-up of debt securities:

	31 March 2018				*31 December 2017*
	Stage 1	***Stage 2***	***Stage 3***	***Total***	*Total*
Debt securities, gross	**5,092**	**156**	**103**	**5,351**	5,676
ECL allowances	**(14)**	**(4)**	**(103)**	**(121)**	(103)
	5,078	**152**	**-**	**5,230**	5,573

Following is the stage wise break-up as of the date of transition to IFRS 9:

	1 January 2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
Debt securities, gross	5,192	128	103	5,423
ECL allowances	(14)	(4)	(103)	(121)
	5,178	124	-	5,302

ECL allowances as at 1 January 2018 amounted to US$ 121 million and that there were no transfers between the stages or charges during the period, therefore, movement in ECL allowances has not been presented.

All figures in US$ million

6 LOANS AND ADVANCES

	31 March 2018				*31 December 2017*
	Stage 1	***Stage 2***	***Stage 3***	***Total***	*Total*
Loans and advances	**14,125**	**1,231**	**586**	**15,942**	15,901
ECL allowances	**(44)**	**(159)**	**(388)**	**(591)**	(572)
	14,081	**1,072**	**198**	**15,351**	15,329

Following is the stage wise break-up as of the date of transition to IFRS 9:

	1 January 2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
Loans and advances	14,090	1,224	551	15,865
ECL allowances	(42)	(172)	(376)	(590)
	14,048	1,052	175	15,275

An analysis of movement in the ECL allowances during the period are as follows:

	Stage 1	***Stage 2***	***Stage 3***	***Total***
As at 1 January 2018	42	172	376	590
Net transfers between Stage 1,2 and 3	-	(18)	18	-
Amounts written-off	-	-	(19)	(19)
Charge for the period - net	2	5	13	20
As at 31 March 2018	**44**	**159**	**388**	**591**

7 OTHER OPERATING INCOME

	31 March 2018	*31 March 2017*
Fee and commission income - net	**50**	52
Bureau processing income	**6**	4
Gain on dealing in derivatives and foreign currencies - net	**18**	-
(Loss) gain on hedging foreign currency movements *	**(2)**	9
Gain on disposal of non-trading investments - net	**1**	7
(Loss) gain on trading investments - net	**(3)**	11
Gain on sale of premises and equipment - net	**-**	4
Other - net	**3**	8
	73	95

*(Loss) gain on hedging currency movements relate to a transaction which has an offsetting impact on the tax expense for the period.

All figures in US$ million

8 CREDIT LOSS EXPENSE ON FINANCIAL ASSETS

	31 March 2018	*31 March 2017*
Loans and advances	**20**	28
Non-trading securities	**-**	1
Credit commitments and contingent items	**(8)**	-
	12	29

9 OPERATING SEGMENTS

For management purposes, the Group is organised into five operating segments which are based on business units and their activities. The Group has accordingly been structured to place its activities under the distinct divisions which are as follows:

- **MENA subsidiaries** cover retail, corporate and treasury activities of subsidiaries in North Africa and Levant;
- **International wholesale banking** encompasses corporate and structured finance, trade finance, Islamic banking services and syndications;
- **Group treasury** comprises treasury activities of Bahrain Head Office, New York and London;
- **ABC Brasil** primarily reflects the commercial banking and treasury activities of the Brazilian subsidiary Banco ABC Brasil S.A., focusing on the corporate and middle market segments in Brazil; and
- **Other** includes activities of Arab Financial Services B.S.C. (c).

Three-month period ended 31 March 2018	***MENA subsidiaries***	***International wholesale banking***	***Group treasury***	***ABC Brasil***	***Other***	***Total***
Net interest income	**30**	**40**	**10**	**48**	**10**	**138**
Other operating income	**11**	**20**	**7**	**31**	**4**	**73**
Total operating income	**41**	**60**	**17**	**79**	**14**	**211**
Profit before credit losses	**18**	**37**	**11**	**45**	**8**	**119**
Credit loss expense on financial assets	**(1)**	**(4)**	**-**	**(7)**	**-**	**(12)**
Profit before taxation and unallocated operating expenses	**17**	**33**	**11**	**38**	**8**	**107**
Taxation on foreign operations	**(5)**	**(2)**	**-**	**(7)**	**-**	**(14)**
Unallocated operating expenses						**(27)**
Profit for the period						**66**
Operating assets as at 31 March 2018	**3,345**	**9,866**	**7,575**	**7,994**	**78**	**28,858**
Operating liabilities as at 31 March 2018	**2,886**	**-**	**14,712**	**6,897**	**13**	**24,508**

All figures in US$ million

9 OPERATING SEGMENTS (continued)

Three-month period ended 31 March 2017	*MENA subsidiaries*	*International wholesale banking*	*Group treasury*	*ABC Brasil*	*Other*	*Total*
Net interest income	30	37	2	60	5	134
Other operating income	11	19	13	42	10	95
Total operating income	41	56	15	102	15	229
Profit before credit losses	19	36	9	69	9	142
Credit loss expense on financial assets	(1)	(4)	-	(24)	-	(29)
Profit before taxation and unallocated operating expenses	18	32	9	45	9	113
Taxation on foreign operations	(5)	(2)	-	(16)	-	(23)
Unallocated operating expenses						(25)
Profit for the period						65
Operating assets as at 31 December 2017	3,397	9,912	7,928	8,184	78	29,499
Operating liabilities as at 31 December 2017	2,899	-	15,194	6,983	11	25,087

10 FINANCIAL INSTRUMENTS

The following table provides the fair value measurement heirarchy of the Group's financial assets and financial liabilities.

Quantitative disclosure of fair value measurement hierarchy for assets as at 31 March 2018:

Financial assets measured at fair value:

	Level 1	***Level 2***	***Total***
Trading securities	**1,472**	**-**	**1,472**
Non-trading investments	**3,893**	**139**	**4,032**
Derivatives held for trading	**132**	**189**	**321**
Derivatives held as hedges	**-**	**4**	**4**

Quantitative disclosure of fair value measurement hierarchy for liabilities as at 31 March 2018:

Financial liabilities measured at fair value:

	Level 1	***Level 2***	***Total***
Derivatives held for trading	**109**	**186**	**295**
Derivatives held as hedges	**-**	**2**	**2**

All figures in US$ million

10 FINANCIAL INSTRUMENTS (continued)

Quantitative disclosure of fair value measurement hierarchy for assets as at 31 December 2017:

Financial assets measured at fair value:

	Level 1	*Level 2*	*Total*
Trading securities	1,051	-	1,051
Non-trading investments	4,925	436	5,361
Derivatives held for trading	57	139	196
Derivatives held as hedges	-	1	1

Quantitative disclosure of fair value measurement hierarchy for liabilities as at 31 December 2017:

Financial liabilities measured at fair value:

	Level 1	*Level 2*	*Total*
Derivatives held for trading	49	131	180
Derivatives held as hedges	-	5	5

Fair values of financial instruments not carried at fair value
Except for the following, the fair value of financial instruments which are not carried at fair value are not materially different from their carrying value.

	31 March 2018		*31 December 2017*	
	Carrying value	***Fair value***	*Carrying value*	*Fair value*
Financial assets				
Non-trading investments at amortised cost	**1,206**	**1,172**	223	249
Financial liabilities				
Term notes, bonds and other term financing	**2,122**	**2,131**	2,148	2,159

For financial instruments that are recognised at fair value on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation at the end of each reporting period.

Financial instruments in level 1
The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in Level 1. Instruments included in Level 1 comprise primarily DAX, FTSE 100 and Dow Jones equity investments classified as trading securities or available for sale.

Financial instruments in level 2
The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

Transfers between level 1 and level 2
There were no transfers between level 1 and level 2 during the period ended 31 March 2018 (31 December 2017: none).

All figures in US$ million

11 CREDIT COMMITMENTS AND CONTINGENT ITEMS

a) Exposure and ECL by stage

	31 March 2018				*31 December 2017*
	Stage 1	***Stage 2***	***Stage 3***	***Total***	*Total*
Credit commitments and contingencies	**3,708**	**384**	**16**	**4,108**	4,100
ECL allowances	**(12)**	**(30)**	**(3)**	**(45)**	(6)

Following is the stage wise break-up as of the date of transition to IFRS 9:

	1 January 2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
Credit commitments and contingencies	3,757	327	16	4,100
ECL allowances	(13)	(37)	(3)	(53)

An analysis of movement in the ECL allowances during the period are as follows:

	Stage 1	***Stage 2***	***Stage 3***	***Total***
As at 1 January 2018	13	37	3	53
ECL movements for the period - net	(1)	(7)	-	(8)
As at 31 March 2018	**12**	**30**	**3**	**45**

b) Credit commitments and contingencies

	31 March 2018	*31 December 2017*
Short-term self-liquidating trade and transaction-related contingent items	**3,506**	3,437
Direct credit substitutes, guarantees	**4,118**	3,979
Undrawn loans and other commitments	**2,029**	2,179
	9,653	9,595
Credit exposure after applying credit conversion factor	**4,108**	4,100
Risk weighted equivalents	**3,333**	3,282

All figures in US$ million

11 CREDIT COMMITMENTS AND CONTINGENT ITEMS (continued)

c) Derivatives

The outstanding notional amounts at the consolidated statement of financial position date were as follows:

	31 March 2018	*31 December 2017*
Interest rate swaps	**7,877**	7,076
Currency swaps	**589**	583
Forward foreign exchange contracts	**6,566**	4,739
Options	**6,333**	3,576
Futures	**3,670**	4,086
	25,035	20,060
Risk weighted equivalents (credit and market risk)	**1,810**	1,738

12 TRANSACTIONS WITH RELATED PARTIES

Related parties represent the ultimate parent, major shareholders, associates, directors and key management personnel of the Group and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Group's management.

The period-end balances in respect of related parties included in the interim condensed consolidated statement of financial position are as follows:

	Ultimate parent	***Major share-holder***	***Directors***	***31 March 2018***	*31 December 2017*
Deposits from customers	**3,134**	**670**	**6**	**3,810**	3,782
Term notes, bonds and other term financing	**1,505**	**-**	**-**	**1,505**	1,505
Short-term self-liquidating trade and transaction-related contingent items	**288**	**-**	**-**	**288**	331

The income and expenses in respect of related parties included in the interim condensed consolidated statement of profit or loss are as follows:

	31 March 2018	*31 March 2017*
Commission income	**2**	2
Interest expense	**26**	20