Arab Banking Corporation (B.S.C.)

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2019

EY
Building a better working world

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ARAB BANKING CORPORATION (B.S.C.)

Report on the Audit of the Consolidated Financial Statements

Opinion
We have audited the consolidated financial statements of Arab Banking Corporation (B.S.C.) ("the Bank") and its subsidiaries (together "the Group"), which comprise the consolidated statement of financial position as at 31 December 2019 and the consolidated statements of profit or loss, comprehensive income, cash flows and changes in equity for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2019, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the 'Auditor's responsibilities for the audit of the consolidated financial statements' section of our report. We are independent of the Group in accordance with the International Code of Ethics for Professional Accountants (including International Independence Standards) ("IESBA Code") together with the ethical requirements that are relevant to our audit of the financial statements in the Kingdom of Bahrain, and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters
Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements for the year ended 31 December 2019. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the 'Auditor's responsibilities for the audit of the consolidated financial statements' section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matter below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ARAB BANKING CORPORATION (B.S.C.) (continued)

Report on the Audit of the Consolidated Financial Statements (continued)

Key audit matters (continued)

Impairment provision for loans and advances and other financial assets subject to credit risk

Description of key audit matter	*How the key audit matter was addressed in the audit*
The process for estimating impairment provision on loans and advances and other financial assets associated with credit risk in accordance with IFRS 9 Financial instruments (IFRS 9) is significant and complex area. IFRS 9 requires use of expected credit loss ("ECL") models for the purposes of calculating impairment loss. ECL models requires the Group to exercise significant judgement using subjective assumptions when determining both the timing and the amounts of ECL for loans and advances and other financial assets subject to credit risk. Because of the complexity of requirements under IFRS 9, significance of judgements applied and the Group's exposure to loans and advances and other financial assets subject to credit risk forming a major portion of the Group's assets, the audit of ECL is a key area of focus.	Our approach included testing the controls associated with the relevant processes for estimating ECL and performing substantive procedures on such estimates. Our procedures, among others, focused on following: • We assessed: - the Group's IFRS 9 based impairment provisioning policy including significant increase in credit risk criteria with the requirements of IFRS 9; - Group's ECL modeling techniques and methodology against the requirements of IFRS 9; - the theoretical soundness and tested the mathematical integrity of the models. • We obtained an understanding of the design and tested the operating effectiveness of relevant controls over ECL models, including models build and approval, ongoing monitoring / validation, model governance and mathematical accuracy. We have also checked completeness and accuracy of the data used and the reasonableness of the management assumptions.

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ARAB BANKING CORPORATION (B.S.C.) (continued)

Report on the Audit of the Consolidated Financial Statements (continued)

Key audit matters (continued)

Impairment provision for loans and advances and other financial assets subject to credit risk (continued)

Description of key audit matter	*How the key audit matter was addressed in the audit*
As at 31 December 2019, the Group's gross loans and advances amounted to US$ 17,069 million and the related ECL amounted to US$ 617 million, comprising US$ 125 million of ECL against Stage 1 and 2 exposures and US$ 492 million against exposures classified under Stage 3. The basis of calculation of ECL is presented in the summary of significant accounting policies and note 24 to the consolidated financial statements.	• We understood and assessed the significant modeling assumptions for exposures as well as overlays with a focus on: - Key modeling assumptions adopted by the Group; and - Basis for and data used to determine overlays. • For a sample of exposures, we performed procedures to evaluate: - Appropriateness of exposure at default, probability of default and loss given default (including collateral values used) in the calculation of ECL; - Timely identification of exposures with a significant increase in credit risk and appropriateness of the Group's staging; and - ECL calculation. • For forward looking information used by the Group's management in its ECL calculations, we held discussions with management and checked internal approvals by management for economic outlook used for purposes of calculating ECL; • We considered the adequacy of the disclosures in the consolidated financial statements in relation to impairment of loans and advances and other financial assets subject to credit risk as required under IFRS 9. We involved our credit risk and IT specialists where their specific expertise was required. Refer to the significant accounting judgements, estimates and assumptions, disclosures of loans and advances and credit risk in notes 4, 9 and 24 to the consolidated financial statements.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ARAB BANKING CORPORATION (B.S.C.) (continued)

Report on the Audit of the Consolidated Financial Statements (continued)

Other information included in the Group's 2019 annual report

Other information consists of the information included in the Group's 2019 annual report, other than the consolidated financial statements and our auditor's report thereon. The Board of Directors is responsible for the other information. Prior to the date of this auditors' report, we obtained the Directors report which forms part of the annual report, and the remaining sections of the annual report are expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information obtained prior to the date of the auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Board of Directors for the consolidated financial statements

The Board of Directors is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs and for such internal control as the Board of Directors determines is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error. In preparing the consolidated financial statements, the Board of Directors is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ARAB BANKING CORPORATION (B.S.C.) (continued)

Report on the Audit of the Consolidated Financial Statements (continued)

Auditor's responsibilities for the audit of the consolidated financial statements (continued)
As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.

- Conclude on the appropriateness of the Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the audit committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ARAB BANKING CORPORATION (B.S.C.) (continued)

Report on the Audit of the Consolidated Financial Statements (continued)

Auditor's responsibilities for the audit of the consolidated financial statements (continued)

We also provide the audit committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the audit committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

As required by the Bahrain Commercial Companies Law and (Volume 1) of the Central Bank of Bahrain (CBB) Rule Book, we report that:

a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;

b) the financial information contained in the Directors report is consistent with the consolidated financial statements;

c) we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2019 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position; and

d) satisfactory explanations and information have been provided to us by management in response to all our requests.

The partner in charge of the audit resulting in this independent auditor's report is Ashwani Siotia.

Ernst & Young

Partner's registration no: 117
9 February 2020
Manama, Kingdom of Bahrain

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 December 2019

All figures in US$ Million

	Note	***2019***	*2018*
ASSETS			
Liquid funds	6	**1,874**	1,607
Trading securities	7	**507**	977
Placements with banks and other financial institutions		**2,051**	2,991
Securities bought under repurchase agreements	26	**1,398**	1,668
Non-trading investments	8	**5,836**	5,661
Loans and advances	9	**16,452**	14,884
Other assets	11	**1,767**	1,601
Premises and equipment		**183**	160
TOTAL ASSETS		**30,068**	29,549
LIABILITIES			
Deposits from customers		**16,666**	16,425
Deposits from banks		**3,897**	4,207
Certificates of deposit		**399**	39
Securities sold under repurchase agreements	26	**1,008**	1,271
Taxation	12	**63**	43
Other liabilities	13	**1,466**	1,236
Borrowings	14	**2,080**	2,012
Total liabilities		**25,579**	25,233
EQUITY	15		
Share capital		**3,110**	3,110
Treasury shares		**(6)**	(4)
Statutory reserve		**520**	501
Retained earnings		**1,051**	966
Other reserves		**(644)**	(711)
EQUITY ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**4,031**	3,862
Non-controlling interests		**458**	454
Total equity		**4,489**	4,316
TOTAL LIABILITIES AND EQUITY		**30,068**	29,549

The consolidated financial statements were authorised for issue by the Board of Directors on 9 February 2020 and signed on their behalf by the Chairman, Deputy Chairman and the Group Chief Executive Officer.

Saddek El Kaber Chairman	Mohammad Abdulredha Saleem Deputy Chairman	Khaled Kawan Group Chief Executive Officer

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

Year ended 31 December 2019

All figures in US$ Million

	Note	***2019***	*2018*
OPERATING INCOME			
Interest and similar income	16	**1,460**	1,472
Interest and similar expense	17	**(896)**	(913)
Net interest income		**564**	559
Other operating income	18	**301**	258
Total operating income		**865**	817
Credit loss expense	10	**(82)**	(79)
NET OPERATING INCOME AFTER CREDIT LOSS EXPENSE		**783**	738
OPERATING EXPENSES			
Staff		**343**	316
Premises and equipment		**42**	38
Other		**139**	120
Total operating expenses		**524**	474
PROFIT BEFORE TAXATION		**259**	264
Taxation on foreign operations	12	**(23)**	(16)
PROFIT FOR THE YEAR		**236**	248
Profit attributable to non-controlling interests		**(42)**	(46)
PROFIT ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**194**	202
BASIC AND DILUTED EARNINGS PER SHARE (EXPRESSED IN US$)	31	**0.06**	0.07

Saddek El Kaber	Mohammad Abdulredha Saleem	Khaled Kawan
Chairman	Deputy Chairman	Group Chief Executive Officer

The attached notes 1 to 33 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2019

All figures in US$ Million

	Note	***2019***	*2018*
PROFIT FOR THE YEAR		**236**	248
Other comprehensive income:			
Other comprehensive income that will be reclassified (or recycled) to profit or loss in subsequent periods:			
Foreign currency translation:			
Unrealised loss on exchange translation in foreign subsidiaries		**(25)**	(169)
Debt instruments at FVOCI:			
Net change in fair value during the year	15	**81**	(42)
		56	(211)
Other comprehensive income that will not be reclassified (or recycled) to profit or loss in subsequent periods:			
Net change in pension fund reserve		**(2)**	3
Net change in fair value of equity securities during the year	15	**(2)**	-
		(4)	3
Other comprehensive income (loss) for the year		**52**	(208)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**288**	40
Attributable to:			
Shareholders of the parent		**261**	57
Non-controlling interests		**27**	(17)
		288	40

The attached notes 1 to 33 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2019

All figures in US$ Million

	Note	***2019***	*2018*
OPERATING ACTIVITIES			
Profit for the year		**236**	248
Adjustments for:			
Credit loss expense	10	**82**	79
Depreciation and amortisation		**41**	23
Gain on disposal of non-trading debt investments - net	18	**(13)**	(8)
Changes in operating assets and liabilities:			
Treasury bills and other eligible bills		**49**	(38)
Trading securities		**427**	(94)
Placements with banks and other financial institutions		**1,016**	47
Securities bought under repurchase agreements		**205**	(375)
Loans and advances		**(1,650)**	(463)
Other assets		**(191)**	(387)
Deposits from customers		**213**	581
Deposits from banks		**(298)**	1,029
Securities sold under repurchase agreements		**(258)**	(288)
Other liabilities		**270**	198
Other non-cash movements		**(101)**	54
Net cash from operating activities		**28**	606
INVESTING ACTIVITIES			
Purchase of non-trading investments		**(4,234)**	(1,977)
Sale and redemption of non-trading investments		**4,221**	1,875
Purchase of premises and equipment		**(42)**	(60)
Sale of premises and equipment		**4**	4
Investment in subsidiaries - net		**12**	6
Net cash used in investing activities		**(39)**	(152)
FINANCING ACTIVITIES			
Issue of certificates of deposit - net		**360**	12
Issue of borrowings		**197**	262
Repayment of borrowings		**(123)**	(384)
Repurchase of borrowings	14	**(6)**	(6)
Dividend paid to the Group's shareholders		**(93)**	(93)
Dividend paid to non-controlling interests		**(23)**	(26)
Purchase of treasury shares	15	**(2)**	(4)
Net cash from (used in) financing activities		**310**	(239)
Net change in cash and cash equivalents		**299**	215
Effect of exchange rate changes on cash and cash equivalents		**17**	(34)
Cash and cash equivalents at beginning of the year		**1,341**	1,160
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	6	**1,657**	1,341

The attached notes 1 to 33 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2019

All figures in US$ Million

	Equity attributable to the shareholders of the parent				*Other reserves*					*Non-controlling interests*	*Total equity*
	Share capital	*Treasury shares*	*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	-	-	-	(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 year	-	-	-	202	-	-	-	-	202	46	248
Other comprehensive (loss) income for the year	-	-	-	-	-	(106)	(42)	3	(145)	(63)	(208)
Total comprehensive income (loss) for the year	-	-	-	202	-	(106)	(42)	3	57	(17)	40
Dividend	-	-	-	(93)	-	-	-	-	(93)	-	(93)
Purchase of treasury shares	-	(4)	-	-	-	-	-	-	(4)	-	(4)
Transfers during the year	-	-	20	(20)	-	-	-	-	-	-	-
Other equity movements in subsidiaries	-	-	-	-	-	-	-	-	-	(3)	(3)
At 31 December 2018	3,110	(4)	501	966	100	(744)	(37)	(30)	3,862	454	4,316
Profit for the year	-	-	-	194	-	-	-	-	194	42	236
Other comprehensive (loss) income for the year	-	-	-	-	-	(10)	79	(2)	67	(15)	52
Total comprehensive income (loss) for the year	-	-	-	194	-	(10)	79	(2)	261	27	288
Dividend	-	-	-	(93)	-	-	-	-	(93)	-	(93)
Purchase of treasury shares	-	(2)	-	-	-	-	-	-	(2)	-	(2)
Transfers during the year	-	-	19	(19)	-	-	-	-	-	-	-
Other equity movements in subsidiaries	-	-	-	3	-	-	-	-	3	(23)	(20)
At 31 December 2019	**3,110**	**(6)**	**520**	**1,051**	**100**	**(754)**	**42**	**(32)**	**4,031**	**458**	**4,489**

* Retained earnings include non-distributable reserves arising from consolidation of subsidiaries amounting to US$ 479 million (2018: US$ 429 million).

The attached notes 1 to 33 form part of these consolidated financial statements.

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 [CBB]. 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, Islamic Banking, and recently entered into the digital, mobile-only banking space named "ila Bank" within retail consumer banking services. Retail banking services are only provided in the MENA region.

2 BASIS OF PREPARATION

2.1 Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards [IFRS] issued by the International Accounting Standards Board [IASB] and the relevant provisions of the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law and the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives.

2.2 Accounting convention

The consolidated financial statements are prepared under the historical cost convention, as modified by the measurement at fair value of derivatives, certain debt and equity financial assets. In addition, as more fully discussed below, assets and liabilities that are hedged items in fair value hedges, and are otherwise carried at cost, are adjusted to record changes in fair values attributable to the risk being hedged.

The Group's consolidated financial statements are presented in United States Dollars (US$), which is also the Group's functional currency. All values are rounded to the nearest million (US$ million), except when otherwise indicated.

2.3 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries as at 31 December 2019. Control is achieved when the Bank has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- Exposure, or rights, to variable returns from its involvement with the investee, and
- The ability to use its power over the investee to affect those returns.

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement with the other vote holders of the investee;
- Rights arising from other contractual arrangements; and
- The Group’s voting rights and potential voting rights.

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated financial statements from the date the Group gains control until the date the Group ceases to control the subsidiary.

2 BASIS OF PREPARATION (continued)

2.3 Basis of consolidation (continued)

Profit or loss and each component of other comprehensive income (OCI) are attributed to the equity holders of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with the Group’s accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without loss of control, is accounted for as an equity transaction. If the Bank loses control over a subsidiary, it derecognises the related assets (including goodwill), liabilities, non-controlling interests and other components of equity, while any resultant gain or loss is recognised in profit or loss. Any investment retained is recognised at fair value at the date of loss of control.

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS

3.1 Standards effective for the year

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in previous year, except for the adoption of the following new standards or amendments to existing standards, applicable to the Group, and which are effective for annual periods beginning on or after 1 January 2019:

IFRS 16 Leases (IFRS 16)

IFRS 16 supersedes IAS 17 Leases (IAS 17), IFRIC 4 Determining whether an Arrangement contains a Lease (IFRIC 4), SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for most leases under a single on-balance sheet model.

Prior to the adoption of IFRS 16, the Group accounted and classified each of its leases (as lessee) at the inception date as either a finance lease or an operating lease in accordance with IAS 17.

Upon adoption of IFRS 16, the Group applied a single recognition and measurement approach for all leases that it is the lessee, except for short-term leases and leases of low-value assets. The Group recognised lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets. The Group adopted IFRS 16 using a modified retrospective method of adoption with the date of initial application of 1 January 2019, and accordingly, the comparative information is not restated. Under this method, IFRS 16 is applied retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application. The Group elected to use the transition practical expedient allowing the standard to be applied only to contracts that were previously identified as leases applying IAS 17 and IFRIC 4 at the date of initial application. The Group also elected to use the recognition exemptions for lease contracts that, at the commencement date, have a lease term of 12 months or less and do not contain a purchase option (‘short-term leases’), and lease contracts for which the underlying asset is of low value (‘low-value assets’).

The Group has recorded right-of-use assets representing the right to use the underlying assets under other assets and the corresponding lease liabilities to make lease payments under other liabilities. When measuring lease liabilities, the Group discounted lease payments using its incremental borrowing rate at 1 January 2019. The effect of adopting IFRS 16 is disclosed in notes 11 and 13 to these consolidated financial statements.

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.1 Standards effective for the year (continued)

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment (Interpretation)
The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 and does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses instances where an entity separately considers uncertain tax treatments, or makes assumptions related to how a tax authorities would treat certain tax positions. In addition the Interpretation also addresses how an entity determines the taxable profit (tax loss), tax base, amongst other key tax positions including changes in facts and circumstances.

Given the Group's international footprint, the Group, through applying significant judgement in identifying uncertainties over tax treatments assessed whether the Interpretation had an impact on its consolidated financial statements.

Upon adoption of the Interpretation, the Group considered whether it has any uncertain tax positions, particularly those relating to transfer pricing. The Bank's and its subsidiaries' tax filings in different jurisdictions include deductions related to intra-group transactions. The Group determined, based on the transfer pricing documentation prepared and analysis performed, that it is probable that its transfer pricing positions (including those for the subsidiaries) will be accepted by the taxation authorities. The Interpretation did not have an impact on the consolidated financial statements of the Group.

Amendments to IFRS 9: Prepayment features with negative compensation
Under IFRS 9, a debt instrument can be measured at amortised cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract. These amendments had no impact on the consolidated financial statements of the Group.

Amendments to IAS 19: Plan Amendment, Curtailment or Settlement
The amendments to IAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments specify that when a plan amendment, curtailment or settlement occurs during the annual reporting period, an entity is required to determine the current service cost for the remainder of the period after the plan amendment, curtailment or settlement, using the actuarial assumptions used to remeasure the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event. An entity is also required to determine the net interest for the remainder of the period after the plan amendment, curtailment or settlement using the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event, and the discount rate used to remeasure that net defined benefit liability (asset). These amendments had no impact on the consolidated financial statements of the Group as it did not have any plan amendments, curtailments, or settlements during the year.

Annual improvements 2015-2017 cycle
These improvements include:

- IFRS 3 Business combinations
- IAS 12 Income taxes
- IAS 23 Borrowing costs

Since the Group's current practice is in line with these amendments, they had no impact on the consolidated financial statements of the Group. Further, the amendments related to IFRS 3 had no impact on the consolidated financial statements of the Group as there are no transactions where joint control is obtained.

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.2 Standards 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 consolidated financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

Interest Rate Benchmark Reform: Amendments to IFRS 9, IAS 39 and IFRS 7

Interest Rate Benchmark Reform Amendments to IFRS 9, IAS 39 and IFRS 7 includes a number of reliefs, which apply to all hedging relationships that are directly affected by interest rate benchmark reform. A hedging relationship is affected if the reform gives rise to uncertainties about the timing and or amount of benchmark based cash flows of the hedged item or the hedging instrument.

As a result of interest rate benchmark reform, there may be uncertainties about the timing and or amount of benchmark-based cash flows of the hedged item or the hedging instrument during the period before the replacement of an existing interest rate benchmark with an alternative nearly risk-free interest rate (an RFR). This may lead to uncertainty whether a forecast transaction is highly probable and whether prospectively the hedging relationship is expected to be highly effective.

These amendments are effective for reporting periods beginning on or after 1 January 2020, with early application permitted. The Group is currently assessing the impact of this standard and will apply from the effective date.

Amendments to IFRS 3: Definition of a Business

In October 2018, the IASB issued amendments to the definition of a 'business' in IFRS 3 Business Combinations to help entities determine whether an acquired set of activities and assets is a business or not. They clarify the minimum requirements for a business, remove the assessment of whether market participants are capable of replacing any missing elements, add guidance to help entities assess whether an acquired process is substantive, narrow the definitions of a business and of outputs, and introduce an optional fair value concentration test.

Since the amendments apply prospectively to transactions or other events that occur on or after 1 January 2020, the Group will not be affected by these amendments on the date of transition.

Amendments to IAS 1 and IAS 8: Definition of Material

In October 2018, the IASB issued amendments to IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to align the definition of 'material' across the standards and to clarify certain aspects of the definition. These amendments are effective for reporting periods beginning on or after 1 January 2020, with early application permitted. The new definition states that, 'Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.'

The amendments to the definition of material is not expected to have a significant impact on the Group's consolidated financial statements.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

4.1 Liquid funds

Liquid funds comprise of cash, nostro balances, balances with central banks and treasury bills and other eligible bills. Liquid funds are initially measured at their fair value and subsequently remeasured at amortised cost.

4.2 Cash and cash equivalents

Cash and cash equivalents referred to in the consolidated statement of cash flows comprise of cash and non-restricted balances with central banks, deposits with central banks, treasury bills and other eligible bills with original maturities of three months or less.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.3 Trading securities

Trading securities are initially recorded at fair value. Subsequent to initial measurement, gains and losses arising from changes in fair values are included in the consolidated statement of profit or loss in the period in which they arise. Interest earned and dividends received are included in 'Interest and similar income' and 'Other operating income' respectively, in the consolidated statement of profit or loss.

4.4 Placements with banks and other financial institutions

Placements with banks and other financial institutions are initially measured at fair value and subsequently remeasured at amortised cost, net of any amounts written off and provision for impairment. The carrying values of such assets which are being effectively hedged for changes in fair value are adjusted to the extent of the changes in fair value being hedged, with the resultant changes being recognised in the consolidated statement of profit or loss.

4.5 Investments in associates

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

The considerations made in determining significant influence or joint control are similar to those necessary to determine control over subsidiaries. Investments in associates are accounted for under the equity method.

4.6 Premises and equipment

Premises and equipment are stated at cost, less accumulated depreciation and provision for impairment in value, if any.

Freehold land is not depreciated. Depreciation on other premises and equipment is provided on a straight-line basis over their estimated useful lives.

4.7 Deposits

All money market and customer deposits are initially measured at fair value and subsequently remeasured at amortised cost. An adjustment is made to these, if part of an effective fair value hedging strategy, to adjust the value of the deposit for the fair value being hedged with the resultant changes being recognised in the consolidated statement of profit or loss.

4.8 Repurchase and reverse repurchase agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date (repos) are not derecognised. The counterparty liability for amounts received under these agreements are shown as sale of securities under repurchase agreement in the consolidated statement of financial position. The difference between sale and repurchase price is treated as interest expense and is accrued over the life of the agreement using the effective interest rate. Assets purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognised in the consolidated statement of financial position, as the Group does not obtain control over the assets. The difference between purchase and resale price is treated as interest income using the effective yield method.

4.9 Employee pension and other end of service benefits

Costs relating to employee pension and other end of service benefits are generally accrued in accordance with actuarial valuations based on prevailing regulations applicable in each location.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.10 Recognition of income and expenses

4.10.1 The effective interest rate (EIR) method

Under IFRS 9, interest income is recorded using the EIR method for all financial assets measured at amortised cost, interest rate derivatives for which hedge accounting is applied and the related amortisation/recycling effect of hedge accounting. Interest income on interest bearing financial assets measured at FVOCI under IFRS 9 is also recorded using the EIR method. Interest expense is also calculated using the EIR method for all financial liabilities held at amortised cost. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset or liability or, when appropriate, a shorter period, to the gross carrying amount of the financial asset.

The EIR (and therefore, the amortised cost of the financial asset) is calculated by taking into account transaction costs and any discount or premium on the acquisition of the financial asset, as well as fees and costs that are an integral part of the EIR. The Group recognises interest income using a rate of return that represents the best estimate of a constant rate of return over the expected life of the loan. Hence, the EIR calculation also takes into account the effect of potentially different interest rates that may be charged at various stages of the financial asset's expected life, and other characteristics of the product life cycle (including prepayments, penalty interest and charges).

If expectations of fixed rate financial assets' or liabilities' cash flows are revised for reasons other than credit risk, then changes to future contractual cash flows are discounted at the original EIR with a consequential adjustment to the carrying amount. The difference from the previous carrying amount is booked as a positive or negative adjustment to the carrying amount of the financial asset or liability on the balance sheet with a corresponding increase or decrease in interest revenue/expense calculated using the effective interest method.

For floating-rate financial instruments, periodic re-estimation of cash flows to reflect the movements in the market rates of interest also alters the effective interest rate, but when instruments were initially recognised at an amount equal to the principal, re-estimating the future interest payments does not significantly affect the carrying amount of the asset or the liability.

4.10.2 Interest and similar income/expense

Net interest income comprises interest income and interest expense calculated using the effective interest method.

The Group calculates interest income on financial assets, other than those considered credit-impaired, by applying the EIR to the gross carrying amount of the financial asset.

When a financial asset becomes credit-impaired (therefore regarded as 'Stage 3'), the Group suspends the recognition of interest income of the financial asset. If the financial asset cures and is no longer credit-impaired, the Group reverts to calculating interest income on a gross basis.

4.10.3 Fee and commission income

The Group earns fee and commission income from a diverse range of financial services it provides to its customers. Fee and commission income is recognised at an amount that reflects the consideration to which the Group expects to be entitled in exchange for providing the services.

The performance obligations, as well as the timing of their satisfaction, are identified, and determined, at the inception of the contract. When the Group provides a service to its customers, consideration is invoiced and generally due immediately upon satisfaction of a service provided at a point in time or at the end of the contract period for a service provided over time. The Group has generally concluded that it is the principal in its revenue arrangements because it typically controls the services before transferring them to the customer.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.10 Recognition of income and expenses (continued)

4.10.3 Fee and commission income (continued)

Performance obligations satisfied over time include asset management and other services, where the customer simultaneously receives and consumes the benefits provided by the Group's performance as the Group performs. The Group's fee and commission income from services where performance obligations are satisfied over time include the following:

Asset management fees

These fees are earned for the provision of asset management services, which include portfolio diversification and rebalancing, typically over defined periods. These services represent a single performance obligation comprised of a series of distinct services which are substantially the same, being provided continuously over the contract period. Asset management fees consist of management and performance fees that are considered variable consideration.

Management fees are invoiced quarterly and determined based on a fixed percentage of the net asset value of the funds under management at the end of the quarter. The fees are allocated to each quarter because they relate specifically to services provided for a quarter, and are distinct from the services provided in other quarters. The fees generally crystallise at the end of each quarter and are not subject to a clawback. Consequently, revenue from management fees is generally recognised at the end of each quarter.

Loan commitment fees

These are fixed annual fees paid by customers for loan and other credit facilities with the Group, but where it is unlikely that a specific lending arrangement will be entered into with the customer and the loan commitment is not measured at fair value. The Group promises to provide a loan facility for a specified period. As the benefit of the services is transferred to the customer evenly over the period of entitlement, the fees are recognised as revenue on a straight-line basis.

4.10.4 Net trading income

Net trading income includes all gains and losses from changes in fair value and the related interest income or expense and dividends, for financial assets held for trading.

4.11 Treasury shares

Own equity instruments that are reacquired (treasury shares) are recognised at cost and deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments. Any difference between the carrying amount and the consideration, if reissued, is recognised as share premium.

4.12 Financial instruments

4.12.1 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 received by the Group.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.12 Financial instruments (continued)

4.12.2 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 4.13 and 4.14.

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.

4.12.3 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.

4.13 Financial assets

4.13.1 Debt type instruments - classification and subsequent measurement
The classification requirements for financial assets is as below.

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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.13 Financial assets (continued)

4.13.1 Debt type instruments - Classification and subsequent measurement (continued)

- 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 other comprehensive income (OCI), except for the recognition of expected credit losses or writebacks, interest income and foreign exchange gains and losses. 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 debt 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 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 year in which it arises. Interest income from these financial assets is included in 'Interest and similar income' using the EIR method.

4.13.2 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; and
- 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.

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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.13 Financial assets (continued)

4.13.3 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; and
- 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.

4.13.4 Reclassification

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 year.

4.13.5 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.

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 'Income from trading book' line in the consolidated statement of profit or loss.

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.13 Financial assets (continued)

4.13.6 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.

In order for the loan to be reclassified out of the forborne category, the customer has to meet all of the following criteria:

- All of its facilities has to be considered performing;
- Regular payments of more than an insignificant amount of principal or interest have been made during most of the period when asset has been classified as forborne; and
- The customer does not have any contract that is more than 30 days past due.

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).

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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.13 Financial assets (continued)

4.13.7 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.

4.14 Financial liabilities

4.14.1 Classification and subsequent measurement

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. 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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.14 Financial liabilities (continued)

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

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.

4.15 Impairment
The Group assesses on a forward-looking basis, the expected credit loss (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 on origination and reassess the expected 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 outcomes;
- 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.

To calculate ECL, the Group estimates the risk of a default occurring on the financial instrument during its expected life. ECLs are estimated based on the present value of all cash shortfalls over the remaining expected life of the financial asset, i.e., the difference between: the contractual cash flows that are due to the Group under the contract, and the cash flows that the Group expects to receive, discounted at the effective interest rate of the loan or an approximation thereof.

Measurement of ECL
ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Group expects to receive);

- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;

- undrawn loan commitments: estimates the expected portion of the loan commitment that are drawn down over the expected life of the loan commitment; and calculates the present value of cash shortfalls between the contractual cash flows that are due to the entity if the holder of the loan commitment draws down that expected portion of the loan and the cash flows that the entity expects to receive if that expected portion of the loan is drawn down; and

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.15 Impairment (continued)

Measurement of ECL (continued)

- financial guarantee contracts: estimates the ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the guarantor expects to receive from the holder, the debtor or any other party. If a loan is fully guaranteed, the ECL estimate for the financial guarantee contract would be the same as the estimated cash shortfall estimate for the loan subject to the guarantee.

For the purposes of calculation of ECL, the Group categorises its FVOCI debt securities, loans and advances and loan commitments and financial guarantee contracts into Stage 1, Stage 2 and Stage 3, based on the applied impairment methodology, as described below:

- Stage 1 – Performing: when financial assets are first recognised, the Group recognises an allowance based upto 12-month ECL.
- Stage 2 – Significant increase in credit risk: when a financial asset shows a significant increase in credit risk, the Group records an allowance for the lifetime ECL.
- Stage 3 – Impaired: the Group recognises the lifetime ECL for these financial assets.

For the purposes of categorisation into above stages, the Group has established a policy to perform an assessment at the end of each reporting period of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument.

The Group records impairment for FVOCI debt securities, depending on whether they are classified as Stage 1, 2, or 3, as explained above. However, the ECL does not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the asset were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss.

No impairment is recorded on equity instruments.

Stage 1
The Group measures loss allowances at an amount up to 12-month ECL for Stage 1 customers. All financial assets are classified as Stage 1 on initial recognition date. Subsequently on each reporting date the Group classifies following as Stage 1:

- debt type assets that are determined to have low credit risk at the reporting date; and
- on which credit risk has not increased significantly since their initial recognition.

The Group applies low credit risk expedient and considers following types of debts as 'low credit risk (LCR)':

- All local currency sovereign exposures funded in local currency;
- All local currency exposures to the Government of Bahrain or the CBB; and
- All exposures with external rating A- or above.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.15 Impairment (continued)

Stage 2
IFRS 9 requires financial assets to be classified in Stage 2 when their credit risk has increased significantly since their initial recognition. For these assets, a loss allowance needs to be recognised based on their lifetime ECLs.

The Group considers whether there has been a significant increase in credit risk of an asset by comparing the rating migration upon initial recognition of the asset against the risk of a default occurring on the asset as at the end of each reporting period. In each case, this assessment is based on forward-looking assessment, in order to recognise the probability of higher losses associated with more negative economic outlooks. In addition, a significant increase in credit risk is assumed if the borrower falls more than 30 days past due in making its contractual payments, or if the Group expects to grant the borrower forbearance or facility has been restructured owing to credit related reasons, or the facility is placed on the Group's list of accounts requiring close monitoring. Further, any facility having an internal credit risk rating of 8 are also subject to stage 2 ECL calculation.

It is the Group's policy to evaluate additional available reasonable and supportive forward-looking information as further additional drivers.

For revolving facilities such as credit cards and overdrafts, the Group measures ECLs by determining the period over which it expects to be exposed to credit risk, taking into account the credit risk management actions that it expects to take once the credit risk has increased and that serve to mitigate losses.

Stage 3
Financial assets are included in Stage 3 when there is objective evidence that the loan is credit impaired. At each reporting date, the Group assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Group on terms that the Group would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganization; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a loan that is overdue for 90 days or more is considered impaired.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Group considers the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.15 Impairment (continued)

Stage 3 (continued)

- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

Other than originated credit-impaired loans, loans are transferred from out of Stage 3 if they no longer meet the criteria of credit-impaired after a cooling-off period of 12 months.

Forward looking information
The Group incorporates forward-looking information in the measurement of ECLs.

The Group considers forward-looking information such as macroeconomic factors (e.g., GDP growth, oil prices, country's equity indices and unemployment rates) and economic forecasts. To evaluate a range of possible outcomes, the Group formulates three scenarios: a base case, an upward and a downward scenario. The base case scenario represents the more likely outcome from Moody’s macro-economic models. For each scenario, the Group derives an ECL and apply a probability weighted approach to determine the impairment allowance.

The Group uses internal information coming from internal economic experts, combined with published external information from government and private economic forecasting services. These forward looking assumptions undergo an internal governance process before they are applied for different scenarios.

Presentation of allowance for ECL in the statement of financial position
Loss allowances for ECL are presented in the consolidated statement of financial position as follows:

- financial assets measured at amortized cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: as a provision under other liabilities; and
- debt instruments measured at FVOCI: no loss allowance is recognised in the consolidated statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the cumulative changes in fair value reserve.

Limitation of estimation techniques
The models applied by the Group may not always capture all characteristics of the market at a point in time as they cannot be recalibrated at the same pace as changes in market conditions. Interim adjustments are expected to be made until the base models are updated. Although the Group uses data that is as current as possible, models used to calculate ECLs are based on data that is up to date except for certain macro-economic factors for which the data is updated once it is available.

Experienced credit adjustment
The Group’s ECL allowance methodology requires the Group to use its experienced credit judgement to incorporate the estimated impact of factors not captured in the modelled ECL results, in all reporting periods.

4.16 Provisions
Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expense relating to any provision is presented in the consolidated statement of profit or loss net of any reimbursement.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.17 Financial guarantee contracts and loan commitments

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

Financial guarantees are initially recognised in the 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 consolidated statement of profit or loss, and an ECL provision.

The premium received is recognised in the 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.

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 in the consolidated statement of financial position.

An ECL is calculated and recorded for these in a similar manner as for debt type financial instruments as explained in note 4.15.

4.18 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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.18 Derivatives and hedging activities (continued)

(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 rate 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.

(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.

4.19 Fair value measurement

The Group measures financial instruments at fair value at each consolidated statement of financial position date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.19 Fair value measurement (continued)

The principal or the most advantageous market must be accessible by the Group. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interests.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 valuation: Directly observable quotes for the same instrument.
- Level 2 valuation: Directly observable proxies for the same instrument accessible at valuation date.
- Level 3 valuation: Derived proxies (interpolation of proxies) for similar instruments that have not been observed.

For assets and liabilities that are recognised in the consolidated financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

4.20 Taxation on foreign operations

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on foreign operations is provided for in accordance with the fiscal regulations applicable in each location. No provision is made for any liability that may arise in the event of distribution of the reserves of subsidiaries. A substantial portion of such reserves is required to be retained to meet local regulatory requirements.

4.21 Foreign currencies

Transactions and balances

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

Monetary assets and liabilities in foreign currencies are translated into the Group's functional currency at the rates of exchange ruling at the date of the consolidated statement of financial position. Any gains or losses are taken to the consolidated statement of profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Group companies

As at the reporting date, the assets and liabilities of foreign operations are translated into the Bank's functional currency at rates of exchange ruling at the date of the consolidated statement of financial position. Income and expense items are translated at average exchange rates for the year. Exchange differences arising on translation are recorded in the consolidated statement of comprehensive income under unrealised gain or loss on exchange translation in foreign subsidiaries. On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation is recognised in the consolidated statement of profit or loss.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.22 Trade and settlement date accounting

All “regular way” purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset, except for loans and advances to customers, deposits to customers and banks.

4.23 Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and, accordingly, are not included in the consolidated statement of financial position.

4.24 Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognised amounts and the Group intends to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated statement of financial position.

4.25 Borrowings

Issued financial instruments (or their components) are classified as liabilities under 'Borrowings', where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder.

Borrowings are initially measured at fair value plus transaction costs. After initial measurement, the borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.

4.26 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 'Other operating income'.

4.27 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/financial guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. 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 internal valuation techniques as appropriate. 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.

4.28 Collateral repossessed

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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.29 Significant accounting judgements, estimates and assumptions

The preparation of the Group’s consolidated financial statements requires management to make judgements, estimates and assumptions that affect the reported amount of revenues, expenses, assets and liabilities, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods. In the process of applying the Group’s accounting policies, management has made the following judgements and assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Existing circumstances and assumptions about future developments may change due to circumstances beyond the Group’s control and are reflected in the assumptions if and when they occur. Items with the most significant effect on the amounts recognised in the consolidated financial statements with substantial management judgement and/or estimates are collated below with respect to judgements/estimates involved.

Going concern

The Bank's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future. Furthermore, the management is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

Measurement of the expected credit loss allowance (ECL)

The measurement of the ECL for financial assets subject to credit risk 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 GDP, oil prices, equity indices, unemployment levels and collateral values, and the effect on PD, exposure at default (EAD) and loss given default (LGD);
- 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.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of valuation models. The inputs to these models are derived from observable market data where possible, but if this is not available, judgement is required to establish fair values. Refer to note 23 for further disclosures.

All figures in US$ Million

5 CLASSIFICATION OF FINANCIAL INSTRUMENTS

As at 31 December, financial instruments have been classified as follows:

At 31 December 2019	***FVTPL***	***FVOCI***	***Amortised cost***	***Total***
ASSETS				
Liquid funds	**-**	**-**	**1,874**	**1,874**
Trading securities	**507**	**-**	**-**	**507**
Placements with banks and other financial institutions	**-**	**-**	**2,051**	**2,051**
Securities bought under repurchase agreements	**-**	**-**	**1,398**	**1,398**
Non-trading investments	**-**	**4,927**	**909**	**5,836**
Loans and advances	**11**	**192**	**16,249**	**16,452**
Other assets	**515**	**-**	**1,230**	**1,745**
	1,033	**5,119**	**23,711**	**29,863**

	FVTPL	***FVOCI***	***Amortised cost***	***Total***
LIABILITIES				
Deposits from customers	-	**-**	**16,666**	**16,666**
Deposits from banks	-	**-**	**3,897**	**3,897**
Certificates of deposit	-	**-**	**399**	**399**
Securities sold under repurchase agreements	-	**-**	**1,008**	**1,008**
Taxation and other liabilities	**463**	**-**	**1,066**	**1,529**
Borrowings	-	**-**	**2,080**	**2,080**
	463	**-**	**25,116**	**25,579**

All figures in US$ Million

5 CLASSIFICATION OF FINANCIAL INSTRUMENTS (continued)

At 31 December 2018	*FVTPL*	*FVOCI*	*Amortised cost*	*Total*
ASSETS				
Liquid funds	-	-	1,607	1,607
Trading securities	977	-	-	977
Placements with banks and other financial institutions	-	-	2,991	2,991
Securities bought under repurchase agreements	-	-	1,668	1,668
Non-trading investments	-	4,541	1,120	5,661
Loans and advances	19	216	14,649	14,884
Other assets	450	-	1,134	1,584
	1,446	4,757	23,169	29,372

	FVTPL	*FVOCI*	*Amortised cost*	*Total*
LIABILITIES				
Deposits from customers	-	-	16,425	16,425
Deposits from banks	-	-	4,207	4,207
Certificates of deposit	-	-	39	39
Securities sold under repurchase agreements	-	-	1,271	1,271
Taxation and other liabilities	413	-	866	1,279
Borrowings	-	-	2,012	2,012
	413	-	24,820	25,233

6 LIQUID FUNDS

	2019	*2018*
Cash on hand	**31**	32
Balances due from banks	**311**	272
Deposits with central banks	**1,238**	987
Treasury bills and other eligible bills with original maturities of three months or less	**77**	50
Cash and cash equivalents	**1,657**	1,341
Treasury bills and other eligible bills with original maturities of more than three months	**217**	266
	1,874	1,607
ECL allowances	**-**	-
	1,874	1,607

7 TRADING SECURITIES

	2019	*2018*
Debt instruments	**491**	960
Equity instruments	**16**	17
	507	977

All figures in US$ Million

8 NON-TRADING INVESTMENTS

	2019	*2018*
Debt securities		
At amortised cost	**912**	1,124
At FVOCI	**5,005**	4,649
	5,917	5,773
ECL allowances	**(91)**	(121)
Debt securities - net	**5,826**	5,652
Equity securities		
At FVOCI	**10**	9
Equity securities	**10**	9
	5,836	5,661

The external ratings distribution of non-trading investments are given below:

	2019	*2018*
AAA rated debt securities	**444**	1,274
AA to A rated debt securities	**2,132**	1,931
Other investment grade debt securities	**1,733**	1,356
Other non-investment grade debt securities	**1,542**	927
Unrated debt securities	**66**	285
Equity securities	**10**	9
	5,927	5,782
ECL allowances	**(91)**	(121)
	5,836	5,661

Following are the stage wise break-up of debt securities as at 31 December 2019 and 31 December 2018:

	2019			
	Stage 1	***Stage 2***	***Stage 3***	***Total***
Debt securities, gross	**5,788**	**55**	**74**	**5,917**
ECL allowances	**(13)**	**(4)**	**(74)**	**(91)**
	5,775	**51**	**-**	**5,826**

All figures in US$ Million

8 NON-TRADING INVESTMENTS (continued)

	2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
Debt securities, gross	5,534	137	102	5,773
ECL allowances	(13)	(6)	(102)	(121)
	5,521	131	-	5,652

An analysis of movement in the ECL allowances during the years ended 31 December 2019 and 31 December 2018 are as follows:

	2019			
	Stage 1	***Stage 2***	***Stage 3***	***Total***
As at 1 January	**13**	**6**	**102**	**121**
Transfers to stage 1	**-**	**-**	**-**	**-**
Transfers to stage 2	**-**	**-**	**-**	**-**
Transfers to stage 3	**-**	**-**	**-**	**-**
Net transfers between stages	**-**	**-**	**-**	**-**
Additions	**-**	**-**	**-**	**-**
Recoveries / write back	**-**	**(2)**	**-**	**(2)**
Write back for the year - net	**-**	**(2)**	**-**	**(2)**
Amounts written-off	**-**	**-**	**(28)**	**(28)**
Exchange adjustments and other movements	**-**	**-**	**-**	**-**
As at 31 December	**13**	**4**	**74**	**91**

	2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
As at 1 January	14	4	103	121
Transfers to stage 1	1	(1)	-	-
Transfers to stage 2	-	-	-	-
Transfers to stage 3	-	-	-	-
Net transfers between stages	1	(1)	-	-
Additions	-	1	-	1
Recoveries / write back	-	-	-	-
Charge for the year - net	-	1	-	1
Exchange adjustments and other movements	(2)	2	(1)	(1)
As at 31 December	13	6	102	121

Interest income received during the year on impaired investments classified under Stage 3 amounted to US$ nil million (2018: nil).

All figures in US$ Million

9 LOANS AND ADVANCES

Below is the classification of loans and advances by measurement:

	2019			
	Stage 1	***Stage 2***	***Stage 3***	***Total***
At FVTPL				
- Wholesale	**11**	**-**	**-**	**11**
At FVOCI				
- Wholesale	**192**	**-**	**-**	**192**
At Amortised cost				
- Wholesale	**14,758**	**803**	**601**	**16,162**
- Retail	**614**	**56**	**34**	**704**
	15,575	**859**	**635**	**17,069**
ECL allowances	**(58)**	**(67)**	**(492)**	**(617)**
	15,517	**792**	**143**	**16,452**

	2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
At FVTPL				
- Wholesale	19	-	-	19
At FVOCI				
- Wholesale	216	-	-	216
At Amortised cost				
- Wholesale	13,068	905	586	14,559
- Retail	590	33	31	654
	13,893	938	617	15,448
ECL allowances	(47)	(88)	(429)	(564)
	13,846	850	188	14,884

Below is the classification of loans and advances by industrial sector:

	Gross loans		***ECL allowances***		***Net loans***	
	2019	*2018*	***2019***	*2018*	***2019***	*2018*
Financial services	**3,308**	3,299	**22**	20	**3,286**	3,279
Energy	**1,165**	696	**9**	7	**1,156**	689
Utilities	**756**	621	**4**	11	**752**	610
Distribution	**609**	251	**4**	4	**605**	247
Retailers	**278**	367	**2**	1	**276**	366
Manufacturing	**2,734**	2,464	**65**	67	**2,669**	2,397
Construction	**1,242**	1,096	**140**	112	**1,102**	984
Mining and quarrying	**413**	337	**9**	2	**404**	335
Transport	**768**	888	**12**	18	**756**	870
Personal/consumer finance	**657**	560	**37**	26	**620**	534
Commercial real estate financing	**601**	507	**8**	1	**593**	506
Residential mortgage	**102**	188	**1**	1	**101**	187
Trade	**1,306**	1,241	**161**	165	**1,145**	1,076
Agriculture, fishing and forestry	**1,332**	1,207	**30**	29	**1,302**	1,178
Technology, media and telecommunications	**334**	267	**30**	33	**304**	234
Government	**183**	184	**2**	3	**181**	181
Other services	**1,281**	1,275	**81**	64	**1,200**	1,211
	17,069	15,448	**617**	564	**16,452**	14,884

All figures in US$ Million

9 LOANS AND ADVANCES (continued)

An analysis of movement in the ECL allowances during the years ended 31 December 2019 and 31 December 2018 are as follows:

	2019			
	Stage 1	***Stage 2***	***Stage 3***	***Total***
As at 1 January	**47**	**88**	**429**	**564**
Transfers to stage 1	**1**	**(1)**	**-**	**-**
Transfers to stage 2	**(1)**	**1**	**-**	**-**
Transfers to stage 3	**-**	**(21)**	**21**	**-**
Net transfers between stages	**-**	**(21)**	**21**	**-**
Additions	**11**	**1**	**81**	**93**
Recoveries / write back	**-**	**-**	**(14)**	**(14)**
Charge for the year - net	**11**	**1**	**67**	**79**
Amounts written-off	**-**	**-**	**(50)**	**(50)**
Exchange adjustments and other movements	**-**	**(1)**	**25**	**24**
As at 31 December	**58**	**67**	**492**	**617**

	2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
As at 1 January	42	172	376	590
Transfers to stage 1	13	(9)	(4)	-
Transfers to stage 2	(2)	2	-	-
Transfers to stage 3	-	(51)	51	-
Net transfers between stages	11	(58)	47	-
Additions	-	-	133	133
Recoveries / write back	(2)	(26)	(20)	(48)
(Write back) / charge for the year - net	(2)	(26)	113	85
Amounts written-off	-	-	(82)	(82)
Exchange adjustments and other movements	(4)	-	(25)	(29)
As at 31 December	47	88	429	564

The fair value of collateral that the Group holds relating to loans and advances individually determined to be impaired and classified under Stage 3 at 31 December 2019 amounts to US$ 114 million (2018: US$ 232 million).

At 31 December 2019, interest in suspense on past due loans under Stage 3 amounts to US$ 101 million (2018: US$ 86 million).

10 CREDIT LOSS EXPENSE

	2019	*2018*
Non-trading debt investments (note 8)	**(2)**	1
Loans and advances (note 9)	**79**	85
Credit commitments and contingent items (note 21)	**6**	(6)
Other financial assets	**(1)**	(1)
	82	79

All figures in US$ Million

11 OTHER ASSETS

	2019	*2018*
Interest receivable	**316**	410
Right-of-use assets	**64**	-
Trade receivables	**269**	243
Positive fair value of derivatives (note 20)	**518**	468
Assets acquired on debt settlement	**69**	82
Deferred tax assets	**124**	98
Bank owned life insurance	**39**	38
Margin dealing accounts	**61**	40
Staff loans	**29**	27
Advances and prepayments	**39**	30
Investments in an associate	**22**	17
Others	**217**	148
	1,767	1,601

The negative fair value of derivatives amounting to US$ 520 million (2018: US$ 444 million) is included in other liabilities (note 13). Details of derivatives are given in note 20.

Below are the carrying amounts of the Group's right-of-use assets and movements during the year recognised in the consolidated statements of financial position and profit or loss:

	Right-of-use assets
As at 1 January 2019	**70**
Add: New/terminated leases - net	**5**
Less: Amortisation	**(10)**
Others (including foreign exchange movements)	**(1)**
As at 31 December 2019	**64**

12 TAXATION ON FOREIGN OPERATIONS

Determining the Group's taxation charge for the year involves a degree of estimation and judgement.

	2019	*2018*
Consolidated statement of financial position		
Current tax liability	**20**	25
Deferred tax liability	**43**	18
	63	43
Consolidated statement of profit or loss		
Current tax on foreign operations	**24**	33
Deferred tax on foreign operations	**(1)**	(17)
	23	16
Analysis of tax charge		
At Bahrain (income tax rate of nil)	**-**	-
On profits of subsidiaries operating in other jurisdictions	**35**	67
Credit arising from tax treatment of hedging currency movements	**(12)**	(51)
Income tax expense reported in the consolidated statement of profit or loss	**23**	16

All figures in US$ Million

12 TAXATION ON FOREIGN OPERATIONS (continued)

The effective tax rates on the profit of subsidiaries in MENA was 28% (2018: 29%) and United Kingdom was 16% (2018: 19%) as against the actual tax rates of 19% to 38% (2018: 19% to 35%) in MENA and 19% (2018: 19%) in United Kingdom. In the Bank's Brazilian subsidiary, the effective tax rate was 2% (2018: nil) as against the actual tax rate of 42% (2018: 38%).

As reflected above, the tax credit for the year includes US$ 12 million arising from the tax treatment of hedging currency movements (2018: tax credit of US$ 51 million) on a certain transaction. For the purpose of determining the tax expense for the year, the accounting profit has been adjusted for tax purposes. After giving effect to these adjustments at the group level, the average effective tax rate is 9% (2018: 6%).

In view of the operations of the Group being subject to various tax jurisdictions and regulations, it is not practical to provide a reconciliation between the accounting and taxable profits.

13 OTHER LIABILITIES

	2019	*2018*
Interest payable	**388**	359
Lease liabilities	**69**	-
Negative fair value of derivatives (note 20)	**520**	444
Employee related payables	**130**	127
Margin deposits including cash collateral	**48**	62
Deferred income	**21**	29
ECL allowances for credit commitments and contingent items (note 21)	**38**	52
Accrued charges and other payables	**252**	163
	1,466	1,236

The positive fair value of derivatives amounting to US$ 518 million (2018: US$ 468 million) is included in other assets (note 11). Details of derivatives are given in note 20.

Below are the carrying amounts of the Group's lease liabilities and movements during the year recognised in the consolidated statements of financial position and profit or loss:

	Lease liabilities
As at 1 January 2019	**70**
Add: New/terminated leases - net	**5**
Add: Interest expense	**4**
Less: Repayments	**(9)**
Others (including foreign exchange movements)	**(1)**
As at 31 December 2019	**69**

All figures in US$ Million

14 BORROWINGS

In the ordinary course of business, the Bank and certain subsidiaries raise term financing through various capital markets at commercial rates.

Total obligations outstanding at 31 December 2019

Aggregate maturities	Currency	Rate of Interest %	*Parent bank*	*Subsidiaries*	*Total*
2020*	US$	*7.875*	-	**126**	**126**
2020	US$	*Libor + 1.20%*	-	**175**	**175**
2020	US$	*Libor + 1.25%*	-	**75**	**75**
2021	US$	*Libor + 1.80%*	**171**	-	**171**
2021	EUR	*Libor + 1.10%*	-	**84**	**84**
2022	US$	*Libor + 2.25%*	**1,330**	-	**1,330**
2023	TND	*10.03*	-	**6**	**6**
Perpetual**	BRL	*7.81*	-	**113**	**113**
			1,501	**579**	**2,080**
Total obligations outstanding at 31 December 2018			1,561	451	2,012

* Subordinated

During the year ended 31 December 2019, the Bank repurchased a portion of its term loan borrowings with a nominal value of US$ 6 million (2018: US$ 6 million). The resultant net gain on the repurchase amounting to US$ nil (2018 : US$ nil) is included in "Other operating income".

** Additional Tier 1 ("AT1")

During the year, a subsidiary of the Bank issued perpetual financial instruments amounting to US$ 113 million. This instrument has been approved by its local regulator for inclusion in AT1 capital and accordingly has been included as part of AT1 for the purpose of capital adequacy ratio calculation as disclosed in note 32.

15 EQUITY

a) Share capital

	2019	*2018*
Authorised – 3,500 million shares of US$ 1 each (2018: 3,500 million shares of US$ 1 each)	**3,500**	3,500
Issued, subscribed and fully paid – 3,110 million shares of US$ 1 each (2018: 3,110 million shares of US$ 1 each)	**3,110**	3,110

b) Treasury shares

The Group owns 14,997,026 treasury shares (2018: 12,200,000 shares) for a cash consideration of US$ 6 million (2018: US$ 4 million).

c) Statutory reserve

As required by the Articles of Association of the Bank and the Bahrain Commercial Companies Law, 10% of the profit for the year is transferred to the statutory reserve. Such annual transfers will cease when the reserve totals 50% of the paid up share capital. The reserve is not available except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

d) General reserve

The general reserve underlines the shareholders’ commitment to enhance the strong equity base of the Bank. There are no restrictions on the distribution of this reserve.

All figures in US$ Million

15 EQUITY (continued)

e) Cumulative changes in fair value

	2019	*2018*
At 1 January	**(37)**	5
Net movement in fair value during the year	**79**	(42)
At 31 December	**42**	(37)

16 INTEREST AND SIMILAR INCOME

	2019	*2018*
Loans and advances	**897**	908
Securities and investments	**359**	384
Placements with banks and other financial institutions	**193**	175
Others	**11**	5
	1,460	1,472

17 INTEREST AND SIMILAR EXPENSE

	2019	*2018*
Deposits from banks	**234**	217
Deposits from customers	**554**	596
Borrowings	**98**	94
Certificates of deposit and others	**10**	6
	896	913

18 OTHER OPERATING INCOME

	2019	*2018*
Fee and commission income - net*	**199**	205
Bureau processing income	**33**	32
Income from trading book - net	**11**	10
Gain on dealing in foreign currencies - net	**28**	39
Loss on hedging foreign currency movements**	**(12)**	(51)
Gain on disposal of non-trading debt investments - net	**13**	8
Other - net	**29**	15
	301	258

*Included in the fee and commission income is US$ 13 million (2018: US$ 13 million) of fee income relating to funds under management.

**Loss on hedging foreign currency movements relate to a transaction which has an offsetting impact on the tax expense for the year.

All figures in US$ Million

19 GROUP INFORMATION

19.1 Information about subsidiaries

The principal subsidiaries, all of which have 31 December as their year-end, are as follows:

	Principal activities	*Country of incorporation*	*Interest of Arab Banking Corporation (B.S.C.)*	
			2019	*2018*
			%	%
ABC International Bank Plc	*Banking*	*United Kingdom*	**100.0**	100.0
ABC Islamic Bank (E.C.)	*Banking*	*Bahrain*	**100.0**	100.0
Arab Banking Corporation (ABC) - Jordan	*Banking*	*Jordan*	**87.0**	87.0
Banco ABC Brasil S.A.	*Banking*	*Brazil*	**61.1**	60.6
ABC Algeria	*Banking*	*Algeria*	**87.7**	87.7
Arab Banking Corporation - Egypt [S.A.E.]	*Banking*	*Egypt*	**99.8**	99.8
ABC Tunisie	*Banking*	*Tunisia*	**100.0**	100.0
Arab Financial Services Company B.S.C. (c)	*Credit card and Fintech services*	*Bahrain*	**60.3**	56.6

19.2 Significant restrictions

The Group does not have significant restrictions on its ability to access or use its assets and settle its liabilities other than those resulting from supervisory frameworks within which banking subsidiaries operate. The supervisory frameworks require banking subsidiaries to keep certain levels of regulatory capital and liquid assets, limit their exposure to other parts of the Group and comply with other ratios. In certain jurisdictions, distribution of reserves is subject to prior supervisory approval.

19.3 Material partly-owned subsidiaries

Financial information of a subsidiary that has material non-controlling interests is provided below:

Banco ABC Brasil S.A.

	2019	*2018*
Proportion of equity interest held by non-controlling interests (%)	**38.9%**	39.4%
Dividends paid to non-controlling interests	**22**	22

The summarised financial information of this subsidiary is provided below. This information is based on amounts before inter-company eliminations.

	2019	*2018*
Summarised statement of profit or loss:		
Interest and similar income	**555**	648
Interest and similar expense	**(385)**	(471)
Other operating income	**116**	85
Credit loss expense	**(34)**	(39)
Operating expenses	**(128)**	(126)
Profit before tax	**124**	97
Taxation	**(2)**	17
Profit for the year	**122**	114
Profit attributable to non-controlling interests	**47**	45
Total comprehensive income (loss)	**86**	(38)
Total comprehensive income (loss) attributable to non-controlling interests	**33**	(15)

All figures in US$ Million

19 GROUP INFORMATION (continued)

19.3 Material partly-owned subsidiaries (continued)

Banco ABC Brasil S.A. (continued)

	2019	2018
Summarised statement of financial position:		
Total assets	**8,093**	7,757
Total liabilities	**7,089**	6,792
Total equity	**1,004**	965
Equity attributable to non-controlling interests	**390**	380
Summarised cash flow information:		
Operating activities	**369**	(92)
Investing activities	**(377)**	108
Financing activities	**76**	(13)
Net increase in cash and cash equivalents	**68**	3

20 DERIVATIVES AND HEDGING

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments.

The table below shows the positive and negative fair values of derivative financial instruments. The notional amount is that of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at year end and are not indicative of either market or credit risk.

	2019			*2018*		
	Positive fair value	***Negative fair value***	***Notional amount***	*Positive fair value*	*Negative fair value*	*Notional amount*
Derivatives held for trading						
Interest rate swaps	**107**	**123**	**9,525**	88	82	7,416
Currency swaps	**31**	**8**	**632**	27	14	507
Forward foreign exchange contracts	**18**	**37**	**5,000**	19	11	3,101
Options	**348**	**285**	**8,373**	314	298	6,661
Futures	**11**	**10**	**4,234**	2	8	3,208
	515	**463**	**27,764**	450	413	20,893
Derivatives held as hedges						
Interest rate swaps	**3**	**56**	**4,638**	15	26	2,303
Currency swaps	**-**	**-**	**31**	-	1	25
Forward foreign exchange contracts	**-**	**1**	**447**	3	4	560
	3	**57**	**5,116**	18	31	2,888
	518	**520**	**32,880**	468	444	23,781
Risk weighted equivalents (credit and market risk)			**2,226**			2,102

Derivatives are carried at fair value using valuation techniques based on observable market inputs.

20 DERIVATIVES AND HEDGING (continued)

Derivatives held as hedges include:

a) Fair value hedges which are predominantly used to hedge fair value changes arising from interest rate fluctuations in loans and advances, placements, deposits, debt instruments at FVOCI, debt instruments at amortised cost and subordinated loan of a subsidiary.

For the year ended 31 December 2019, the Group recognised a net loss of US$ 42 million (2018: net gain of US$ 26 million) on hedging instruments. The total gain on hedged items attributable to the hedged risk amounted to US$ 42 million (2018: loss of US$ 26 million).

b) The Group uses deposits which are accounted for as hedges of net investment in foreign operations. As at 31 December 2019, the Group had deposits amounting to US$ 644 million (2018: US$ 610 million) which were designated as net investment hedges.

Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and interest rate futures are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. Forward rate agreements are effectively tailor-made interest rate futures which fix a forward rate of interest on a notional loan, for an agreed period of time starting on a specified future date.

Swaps are contractual agreements between two parties to exchange interest or foreign currency amounts based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency. For cross-currency swaps, notional amounts are exchanged in different currencies. For cross-currency interest rate swaps, notional amounts and fixed and floating interest payments are exchanged in different currencies.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

Derivative related credit risk

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Group. The majority of the Group's derivative contracts are entered into with other financial institutions and there is no significant concentration of credit risk in respect of contracts with positive fair value with any individual counterparty at the date of the statement of financial position.

Derivatives held or issued for trading purposes

Most of the Group's derivative trading activities relate to sales, positioning and arbitrage. Sales activities involve offering products to customers. Positioning involves managing market risk positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying and profiting from price differentials between markets or products. Also included under this heading are any derivatives which do not meet IFRS 9 hedging requirements.

Derivatives held or issued for hedging purposes

The Group has adopted a comprehensive system for the measurement and management of risk. Part of the risk management process involves managing the Group's exposure to fluctuations in foreign exchange rates (currency risk) and interest rates through asset and liability management activities. It is the Group's policy to reduce its exposure to currency and interest rate risks to acceptable levels as determined by the Board of Directors. The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on an ongoing basis and hedging strategies used to ensure positions are maintained within established limits. The Board has established levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Interest rate gaps are reviewed on an ongoing basis and hedging strategies used to reduce the interest rate gaps to within the limits established by the Board of Directors.

20 DERIVATIVES AND HEDGING (continued)

Derivatives held or issued for hedging purposes (continued)

As part of its asset and liability management the Group uses derivatives for hedging purposes in order to reduce its exposure to currency and interest rate risks. This is achieved by hedging specific financial instruments, forecasted transactions as well as strategic hedging against overall statement of financial position exposures. For interest rate risk this is carried out by monitoring the duration of assets and liabilities using simulations to estimate the level of interest rate risk and entering into interest rate swaps and futures to hedge a proportion of the interest rate exposure, where appropriate. Since strategic hedging does not qualify for special hedge accounting related derivatives are accounted for as trading instruments.

The Group uses forward foreign exchange contracts, currency options, currency swaps to hedge against specifically identified currency risks. In addition, the Group uses interest rate swaps and interest rate futures to hedge against the interest rate risk arising from specifically identified loans and securities bearing fixed interest rates. In all such cases the hedging relationship and objective, including details of the hedged item and hedging instrument, are formally documented and the transactions are accounted for as hedges.

The Group applies hedge accounting in two separate hedging strategies, as follows:

Interest rate risk on fixed rate debt type instruments (fair value hedge)

The Group holds a portfolio of long-term variable and fixed rate loans / securities / deposits and therefore is exposed to changes in fair value due to movements in market interest rates. The Group manages this risk exposure by entering into pay fixed / receive floating interest rate swaps.

Only the interest rate risk element is hedged and therefore other risks, such as credit risk, are managed but not hedged by the Group. The interest rate risk component is determined as the change in fair value of the long-term variable / fixed rate loans and securities arising solely from changes in LIBOR (the benchmark rate of interest). Such changes are usually the largest component of the overall change in fair value. This strategy is designated as a fair value hedge and its effectiveness is assessed by critical terms matching and measured by comparing changes in the fair value of the loans attributable to changes in the benchmark rate of interest with changes in the fair value of the interest rate swaps.

The Group establishes the hedging ratio by matching the notional of the derivatives with the principal of the portfolio being hedged. Possible sources of ineffectiveness are as follows:

(i) differences between the expected and actual volume of prepayments, as the Group hedges to the expected repayment date taking into account expected prepayments based on past experience;

(ii) hedging derivatives with a non-zero fair value at the date of initial designation as a hedging instrument; and

(iii) counterparty credit risk which impacts the fair value of uncollateralised interest rate swaps but not the hedged items.

Net investment in foreign operation (net investment hedge)

The Group has an investment in a foreign operation which is consolidated in its financial statements. The foreign exchange rate exposure arising from this investment is hedged through the use of deposits. These deposits are designated as net investment hedges to hedge the equity of the subsidiaries. The Group establishes the hedging ratio by matching the deposits with the net assets of the foreign operation.

All figures in US$ Million

20 DERIVATIVES AND HEDGING (continued)

The following table sets out the maturity profile of the trading and hedging instruments used in the Group's trading and non-dynamic hedging strategies:

	Within 1 month	*1 - 3 months*	*3 - 6 months*	*6 - 12 months*	*1 - 5 years*	*5-10 years*	*Over 10 years*	*Total*
Notional								
2019	**4,967**	**3,897**	**2,116**	**4,672**	**12,139**	**4,623**	**466**	**32,880**
2018	2,509	2,473	1,505	4,413	8,757	3,015	1,109	23,781

Hedge ineffectiveness

Hedge effectiveness is determined at the inception of the hedge relationship, and through periodic prospective effectiveness assessments to ensure that an economic relationship exists between the hedged item and hedging instrument. For hedges of exposures to fluctuations in foreign exchange rates, the Group enters into hedge relationships where the critical terms of the hedging instrument match exactly with the terms of the hedged item. The Group therefore performs a qualitative assessment of effectiveness. If changes in circumstances affect the terms of the hedged item such that the critical terms no longer match exactly with the critical terms of the hedging instrument, the Group uses quantitative hedge effectiveness testing using the dollar offset method to assess effectiveness.

In hedges of foreign currency exposures, ineffectiveness may arise if the timing of the cash flows changes from what was originally estimated, or if there are changes in the credit risk of the Bank or the derivative counterparty.

Hedge ineffectiveness only arises to the extent the hedging instruments exceed in nominal terms the risk exposure from the foreign operations. Gains or losses on the hedging instrument relating to the effective portion of the hedge are recognised in OCI, while any gains or losses relating to the ineffective portion are recognised in the consolidated statement of profit or loss. On disposal of the foreign operation, the cumulative value of any such gains or losses recorded in equity is transferred to the consolidated statement of profit or loss.

The ineffectiveness during 2019 or 2018 in relation to the interest rate swaps is however not significant to the Group.

21 CREDIT COMMITMENTS AND CONTINGENT ITEMS

Credit commitments and contingent items include commitments to extend credit, standby letters of credit, acceptances and guarantees, which are structured to meet the various requirements of customers.

At the consolidated statement of financial position date, the principal outstanding and the risk weighted equivalents were as follows:

	2019	*2018*
Short-term self-liquidating trade and transaction-related contingent items	**2,449**	3,662
Direct credit substitutes and guarantees	**3,349**	4,043
Undrawn loans and other commitments	**2,416**	2,272
	8,214	9,977
Credit exposure after applying credit conversion factor	**4,103**	4,173
Risk weighted equivalents	**3,059**	3,274

All figures in US$ Million

21 CREDIT COMMITMENTS AND CONTINGENT ITEMS (continued)

The table below shows the contractual expiry by maturity of the Group's credit commitments and contingent items:

	2019	*2018*
On demand	**1,438**	2,430
1 - 6 months	**2,497**	3,095
6 - 12 months	**1,510**	1,946
1 - 5 years	**2,727**	2,453
Over 5 years	**42**	53
	8,214	9,977

Exposure (after applying credit conversion factor) and ECL by stage

	2019			
	Stage 1	***Stage 2***	***Stage 3***	***Total***
Credit commitments and contingencies	**3,789**	**289**	**25**	**4,103**
ECL allowances	**(14)**	**(13)**	**(11)**	**(38)**

	2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
Credit commitments and contingencies	3,996	160	17	4,173
ECL allowances	(14)	(22)	(16)	(52)

An analysis of changes in the ECL allowances are as follows:

	2019			
	Stage 1	***Stage 2***	***Stage 3***	***Total***
As at 1 January	**14**	**22**	**16**	**52**
Transfers to stage 1	**-**	**-**	**-**	**-**
Transfers to stage 2	**(1)**	**1**	**-**	**-**
Transfers to stage 3	**-**	**(12)**	**12**	**-**
Net transfers between stages	**(1)**	**(11)**	**12**	**-**
Additions	**1**	**2**	**3**	**6**
Recoveries / write back	**-**	**-**	**-**	**-**
Charge for the year - net	**1**	**2**	**3**	**6**
Exchange adjustments and other movements	**-**	**-**	**(20)**	**(20)**
As at 31 December	**14**	**13**	**11**	**38**

All figures in US$ Million

21 CREDIT COMMITMENTS AND CONTINGENT ITEMS (continued)

	2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
As at 1 January	13	37	3	53
Transfers to stage 1	2	(2)	-	-
Transfers to stage 2	-	-	-	-
Transfers to stage 3	-	(1)	1	-
Net transfers between stages	2	(3)	1	-
Additions	-	-	5	5
Recoveries / write back	(1)	(8)	(2)	(11)
(Write back) / charge for the year - net	(1)	(8)	3	(6)
Exchange adjustments and other movements	-	(4)	9	5
As at 31 December	14	22	16	52

The Group expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The Group is engaged in litigation in various jurisdictions. The litigation involves claims by and against the Group which have arisen in the ordinary course of business. The Directors of the Bank, after reviewing the claims pending against Group companies and based on the advice of relevant professional legal advisors, are satisfied that the outcome of these claims will not have a material adverse effect on the financial position of the Group.

22 SIGNIFICANT NET FOREIGN CURRENCY EXPOSURES

Significant net foreign currency exposures, arising mainly from investments in subsidiaries, are as follows:

	2019		*2018*	
Long (short)	***Currency***	***US$ equivalent***	*Currency*	*US$ equivalent*
Brazilian Real	**2,448**	**609**	2,269	585
Pound Sterling	**(9)**	**(12)**	4	6
Egyptian Pound	**1,783**	**111**	1,735	97
Jordanian Dinar	**85**	**120**	136	191
Algerian Dinar	**16,860**	**142**	15,422	130
Tunisian Dinar	**99**	**36**	74	25
Euro	**10**	**11**	1	2
Bahrain Dinar	**7**	**19**	8	20

All figures in US$ Million

23 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

23.1 31 December 2019

Quantitative disclosure of fair value measurement hierarchy for assets as at 31 December 2019:

Financial assets measured at fair value (net of ECL) :

	Level 1	***Level 2***	***Total***
Trading securities	**507**	**-**	**507**
Non-trading investments	**4,762**	**165**	**4,927**
Loans and advances	**11**	**192**	**203**
Derivatives held for trading	**213**	**302**	**515**
Derivatives held as hedges	**-**	**3**	**3**

Quantitative disclosure of fair value measurement hierarchy for liabilities as at 31 December 2019:

Financial liabilities measured at fair value:

	Level 1	***Level 2***	***Total***
Derivatives held for trading	**150**	**313**	**463**
Derivatives held as hedges	**-**	**57**	**57**

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.

	Carrying value	***Fair value***
Financial assets		
Non-trading investments at amortised cost - gross	**912**	**913**
Financial liabilities		
Borrowings	**2,080**	**2,079**

23.2 31 December 2018

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

Financial assets measured at fair value (net of ECL):

	Level 1	*Level 2*	*Total*
Trading securities	977	-	977
Non-trading investments	4,448	93	4,541
Loans and advances	19	216	235
Derivatives held for trading	272	178	450
Derivatives held as hedges	-	18	18

All figures in US$ Million

23 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

23.2 31 December 2018 (continued)

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

Financial liabilities measured at fair value:

	Level 1	*Level 2*	*Total*
Derivatives held for trading	263	150	413
Derivatives held as hedges	-	31	31

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.

	Carrying value	*Fair value*
Financial assets		
Non-trading investments at amortised cost - gross	1,124	1,070
Financial liabilities		
Borrowings	2,012	2,017

Financial instruments in level 1

The fair value of financial instruments traded in active markets is based on quoted market prices at the consolidated statement of financial position 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.

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 year ended 31 December 2019 (31 December 2018: none).

All figures in US$ Million

24 RISK MANAGEMENT

24.1 Introduction

Risk is inherent in the Group's activities and is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. The Group is exposed to credit risk, liquidity risk, operational risk, market risk, legal risk and strategic risk as well as other forms of risk inherent in its financial operations.

The Group continues to invest to strenthgen its comprehensive and robust risk management infrastructure. This includes risk identification processes under credit, market and operational risk spectrums, risk measurement models and rating systems as well as a strong business process to monitor and control these risks.

24.2 Risk management structure

Executive Management is responsible for implementing the Group's Risk Strategy/Appetite and Policy Guidelines set by the Board Risk Committee (BRC), including the identification and evaluation on a continuous basis of all material risks to the business and the design and implementation of appropriate internal controls to mitigate them. This is done through the Board Committees, Senior Management Committees, the Credit & Risk Group, Compliance and Balance Sheet Management Group functions at Head Office.

Within the broader governance framework, the Board Committees carry out the main responsibility for best practice of risk management and oversight. The BRC oversees the establishment of the risk appetite framework, risk capacity and risk appetite statement. The BRC is also responsible for coordinating with other board committees for monitoring compliance with the requirements of the regulatory authorities in various countries in which the Group operates. BRC is supported by three management level committees – Group Risk Committee (GRC), Group Asset Liability Committee (GALCO) and the Group Compliance Oversight Committee (GCOC).

The Board Audit Committee is responsible to the Board for ensuring that the Group maintains an effective system of financial, accounting and risk management controls and for monitoring compliance with the requirements of the regulatory authorities in various countries in which the Group operates.

The GRC defines, develops and monitors the Group’s overarching risk management framework considering the Group’s strategy and business plans. The GRC is responsible for initiating, discussions and monitoring of key regulations, both local and international, as applicable to the businesses and geographies in which the Group operates. The GRC is assisted by specialised sub-committees to manage credit risk (Group Credit Committee), operational risk (Group Operational Risk Committee) risk management framework, risk models (Group Risk Governance and Analytics Committee)and operational resilience (Group Operational Resilience Committee).

The GALCO is responsible for defining Asset and Liability management policy, which includes capital, liquidity & funding and market risk in line with the risk appetite framework. GALCO monitors the Group’s capital, liquidity, funding and market risks, and the Group’s risk profile in the context of economic developments and market volatility. GALCO is assisted by tactical sub-committees for Capital & Liquidity Management.

The GCOC has the oversight responsibilities relating to maintaining and enforcing a strong and sustainable compliance culture and is responsible for establishing the operating framework and the processes to support a permanent and an effective compliance function.

The above management structure, supported by teams of risk & credit analysts, and compliance officers, provide a coherent infrastructure to carry credit, risk, balance sheet management and compliance functions in a seamless manner.

Each subsidiary is responsible for managing its own risks and has its own Board Risk Committee and Management Committees with responsibilities generally analogous to the Group Committees.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.3 Risk measurement and reporting system

24.3.1 Risk mitigation

As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions.

The risk profile is assessed before entering into hedge transactions, which are authorised by the appropriate level of seniority within the Group. The effectiveness of hedges is monitored monthly by the Group. In situations of ineffectiveness, the Group will enter into a new hedge relationship to mitigate risk.

The Group actively uses collateral to reduce its credit risk (see below for details).

24.3.2 Excessive risk concentration

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

In order to avoid excessive concentrations of risk, the Group policies and procedures include specific guidelines to focus on country, industry and counterparty limits and maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

24.4 Credit risk

Credit risk is the risk that the Group will incur a loss because its customers, clients and counterparties failed to discharge their contractual obligations. The Group manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentration, and by monitoring exposures in relation to such limits.

The first level of protection against undue credit risk is through country, industry and other risk threshold limits, together with customer credit limits, set by the BRC and the Group Credit Committee and allocated between the Bank and its banking subsidiaries. Credit exposure to individual customers or customer groups is then controlled through a tiered hierarchy of delegated approval authorities based on the risk rating of the customer under the Group's internal credit rating system. Where unsecured facilities sought are considered to be beyond prudential limits, Group policies require collateral to mitigate the credit risk in the form of cash, securities, legal charges over the customer's assets or third-party guarantees. The Group also employs Risk Adjusted Return on Capital (RAROC) as a measure to evaluate the risk/reward relationship at the transaction approval stage.

24.4.1 Credit risk impairment assessment and mitigation

Exposure at default (EAD)

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation. EAD for unfunded facilities is calculated by multiplying the outstanding exposure with the credit conversion factor (CCF) ranging from 20% to 100%.

To calculate the EAD for a Stage 1 loan, the Group assesses the possible default events and the cash flows following within 12 months for the calculation of the 12 months ECL. For Stage 2 and Stage 3, the exposure at default is considered for events over the lifetime of the instruments.

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.1 Credit risk impairment assessment and mitigation (continued)

Loss given default (LGD)

The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. The Group uses models to calculate the LGD values taking into account the collateral type and value (with haircut), economic scenarios, industry of the borrower, guarantees, etc.

The Group segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type, wider range of collateral types) as well as borrower characteristics.

Definition of default and cure

The Group considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Group considers treasury and interbank balances defaulted and takes immediate action when the required payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Group also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Group carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Internal rating of the borrower indicating default or near-default;
- The borrower requesting emergency funding from the Group;
- The borrower having past due liabilities to public creditors or employees;
- The borrower is deceased;
- A material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral;
- A material decrease in the borrower’s turnover or the loss of a major customer;
- A covenant breach not waived by the Group;
- The debtor (or any legal entity within the debtor’s group) filing for bankruptcy application/protection;
- Debtor’s listed debt or equity suspended at the primary exchange because of rumours or facts about financial difficulties; and
- Cross default of the borrower.

It is the Group’s policy to consider a financial instrument as ‘cured’ and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least 12 consecutive months. The asset is then transferred to Stage 2 and after a cure period of further 6 months to Stage 1.

Credit risk grading and PD estimation process

The Group uses internal credit risk gradings that reflect its assessment of the probability of default of individual counterparties. The Group use internal rating models tailored to the various categories of counterparty. The quantitative and qualitative information is fed into the rating models to generate ratings. This is supplemented with external data such as external credit rating assessment on individual borrowers. In addition, the models enable expert judgement from the business originating and underwriting units to be fed into the final internal credit rating for each exposure. This allows for considerations which may not be captured as part of the other data inputs into the model.

The credit grades are calibrated such that the risk of default increases exponentially at each higher risk grade. For example, this means that the difference in the PD between a 01 and 02+ rating grade is lower than the difference in the PD between a 05- and 06+ rating grade.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.1 Credit risk impairment assessment and mitigation (continued)

Credit risk grading and PD estimation process (continued)

The following are additional considerations for each type of portfolio held by the Group:

Wholesale portfolio

Wholesale portfolio includes both corporate and small and medium enterprises (SME) loans. For corporate banking loans, the borrowers are assessed by specialised credit risk units of the Group. The credit risk assessment is based on a credit scoring model that takes into account various historical (for calibration) and current information such as:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond or CDS prices or press releases and articles.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

Retail portfolio

ECL for retail portfolio is assessed using roll rate methodology. The roll rate methodology used statistical analysis of historical data on delinquency to estimate the amount of loss. Management applied judgement to ensure that the estimate of loss arrived at on the basis of historical information was appropriately adjusted to reflect the economic conditions at the reporting date.

Treasury portfolio

For debt securities in the non-trading portfolio, external rating agency credit grades are used. These published grades are continuously monitored and updated. The external ratings are mapped to the Group's internal ratings scale and the PD's associated with each grade are used for the ECL computation.

The Group's rating method comprises 20 rating levels for instruments not in default (1 to 8) and three default classes (9 to 11). The master scale assigns each rating category a specified range of probabilities of default, which is stable over time. The rating methods are subject to a periodic validation and recalibration so that they reflect the latest projections in the light of all actually observed defaults.

The Group's internal credit rating grades alongwith the respective TTC PDs are as below:

Internal rating grades	Internal rating grade description	PD range (%)
01 to 04-	Superior	>= 0.00% to <0.49%
05+ to 05-	Satisfactory	>= 0.49% to <1.52%
06+ to 06-	Satisfactory	>= 1.52% to <5.02%
07+ to 07-	Marginal	>= 5.02% to <17.32%
08	Watchlist	>= 17.32%

The PDs obtained as above are then adjusted for IFRS 9 ECL calculations to incorporate forward looking information. This is repeated for each economic scenario as appropriate.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.1 Credit risk impairment assessment and mitigation (continued)

Significant increase in credit risk (SICR)

The Group continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12 month ECL or lifetime ECL, the Group assesses whether there has been a significant increase in credit risk since initial recognition. The Group considers an exposure to have significantly increased in credit risk on various factors including number of notches change in internal risk rating, transition to accounts requiring close monitoring, restructured / forbearance, historical delinquency, etc.

Further, the Group has used the low credit risk (LCR) expedient which includes all exposures meeting following criteria:

- All local currency sovereign exposures funded in local currency.
- All local currency exposures to the government of the Kingdom of Bahrain or Central Bank of Bahrain.
- All exposures with external rating A- or above.

A backstop is applied and the financial instrument considered to have experienced SICR if the borrower is more than 30 days past due on its contractual payments.

ECL measurement

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

- A financial instrument that is not credit-impaired on initial recognition or where the credit risk has not significantly increased since initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Group.
- If a SICR since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. Please refer above for a description of how the Group determines when a SICR has occurred.
- If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'.
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis.
- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information.

The following diagram summarises the impairment requirements under IFRS 9 (other than purchased or originated credit-impaired financial assets):

Change in credit quality since initial recognition

Stage 1	**Stage 2**	**Stage 3**
(Initial recognition)	Significant increase in credit risk (since initial recognition)	(Default or credit-impaired assets)
12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

Definition of default and credit-impaired assets

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Quantitative criteria

The borrower is more than 90 days past due on its contractual payments.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.1 Credit risk impairment assessment and mitigation (continued)

Definition of default and credit-impaired assets (continued)

Qualitative criteria
The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty.

These are instances where:
- The borrower is in long-term forbearance;
- The borrower is deceased;
- The borrower is insolvent;
- The borrower is in breach of financial covenant(s);
- An active market for that financial asset has disappeared because of financial difficulties;
- Concessions have been made by the lender relating to the borrower's financial difficulty;
- It is becoming probable that the borrower will enter bankruptcy or has applied for bankruptcy/protection; and
- Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses.

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the PD, EAD and LGD throughout the Group's expected loss calculations.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of 12 months for the purposes of transition from Stage 3 to 2. This period of 12 months has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions.

Measuring ECL – Explanation of inputs, assumptions and estimation techniques
The ECL is measured on either a 12-month (12m) or lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the discounted product of PD, EAD and LGD, defined as follows:

The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "Definition of default" above), either over the next 12 months (12m PD), or over the remaining lifetime (Lifetime PD) of the obligation.

EAD is based on the amounts the Group expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD). For example, for a revolving commitment, the Group includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.

LGD represents the Group's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim, availability of collateral or other credit support, geography and industry. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD). LGD is calculated on a 12-month or lifetime basis, where 12-month LGD is the percentage of loss expected to be made if the default occurs in the next 12 months and Lifetime LGD is the percentage of loss expected to be made if the default occurs over the remaining expected lifetime of the loan.

The ECL is determined by projecting the PD and LGD for each future month and for each individual exposure. The three components (PD, LGD and EAD) are multiplied together and the projected PD is adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier month). This effectively calculates an ECL for each future month, which is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.1 Credit risk impairment assessment and mitigation (continued)

Measuring ECL – Explanation of inputs, assumptions and estimation techniques (continued)

The Lifetime PD is developed by applying the forward looking information on 12-month PD over the maturity of the loan. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and credit grade band.

For amortising products and bullet repayment loans, this is based on the contractual repayments owed by the borrower over a 12 month or lifetime basis.

For revolving products, the exposure at default is predicted by taking current drawn balance and adding a "credit conversion factor" which allows for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type.

For secured products, this is primarily based on collateral values after applying approved haircuts depending on the collateral type. Further, the Group has applied LGD floors with respect to the fully secured portion of the portfolio depending on the collateral type.

For unsecured products, LGD's are computed based on models which take into account several factors such as country, industry, PD, etc which consider the recoveries made post default.

Forward-looking economic information is also included in determining the 12-month and lifetime PD and LGD. These assumptions vary by country of exposure. Refer to note 4 and below for an explanation of forward-looking information and its inclusion in ECL calculations.

The assumptions underlying the ECL calculation – such as how the maturity profile of the PDs and how collateral values change etc. – are monitored and reviewed on a quarterly basis.

There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

Economic variable assumptions

An overview of the approach to estimating ECLs is set out above and in note 4. To ensure completeness and accuracy, the Group obtains the data used from third party sources (e.g. Moody's and IMF) and a team of economists within its Credit and Risk Department verifies the accuracy of inputs to the Group's ECL models including determining the weights attributable to the multiple scenarios.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.1 Credit risk impairment assessment and mitigation (continued)

Economic variable assumptions (continued)

The most significant assumptions affecting the ECL allowance are as follows:

(i) GDP, given the significant impact on companies' performance and collateral valuations;

(ii) Oil price, given its impact on the region's economies in which the Bank and the majority of the Group's subsidiaries are domiciled and operated; and

(iii) Equity index, given its impact on the economy where the majority of the Group's exposures are lying.

The following table sets out the key macroeconomic variables of ECL calculation and weightages used for scenarios.

Key macroeconomic variables used	ECL scenario and assigned weightage	2020	2021	2022	2023	2024
	Base (40%)	[1.55%, 5.79%]	[1.50%, 5.82%]	[1.48%, 5.84%]	[1.46%, 5.80%]	[1.43%, 5.77%]
GDP growth rate	Upside (30%)	[2.48%, 12.47%]	[2.67%, 10.41%]	[2.26%, 6.76%]	[2.04%, 6.28%]	[1.90%, 6.15%]
	Downside (30%)	[- 6.86%, 3.61%]	[- 5.13%, 4.51%]	[- 3.40%, 5.09%]	[- 2.29%, 5.31%]	[- 1.67%, 5.38%]
	Base (40%)	9.07%	5.89%	4.23%	3.58%	3.30%
Oil price	Upside (30%)	36.40%	18.64%	11.81%	8.60%	6.90%
	Downside (30%)	-33.36%	-14.13%	-6.96%	-2.46%	-0.49%
	Base (40%)	[- 8.40%, 12.91%]	[- 1.73%, 12.73%]	[0.64%, 12.31%]	[1.06%, 11.54%]	[1.49%, 10.97%]
Equity index	Upside (30%)	[5.17%, 22.18%]	[5.86%, 18.45%]	[3.79%, 16.06%]	[3.14%, 14.31%]	[2.90%, 13.16%]
	Downside (30%)	[- 31.80%, -16.52%]	[- 12.38%, -4.70%]	[- 6.04%, -0.22%]	[- 3.56%, 1.86%]	[- 1.70%, 3.30%]

The above macroeconomic variables are selected based on the regression analysis between the macroeconomic variables and the PD. These economic variables and their associated impact on the PD and LGD vary by country and industry. Forecasts of these economic variables (for all sccenarios) are provided by Moody's on a quarterly basis and provide the best estimate view of the economy over future years.

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes and has analysed the non-linearities and asymmetries within the Group's different geographies to establish that the chosen scenarios are appropriately representative of the range of possible scenarios.

Sensitivity analysis
Based on the above significant assumptions and changes in each economic variable by +5% and -5% while keeping other key variables constant will result in a change in the ECL (stage 1 and 2) in the range of decrease by -4.9% to an increase by 6.6%.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

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

The Group's concentration of risk is managed by geographical region and by industry sector. The table below shows the maximum exposure to credit risk for the components of the consolidated statement of financial position, including credit commitments and contingent items. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Gross maximum exposure	
	2019	*2018*
Liquid funds	**1,843**	1,575
Trading debt securities	**491**	961
Placements with banks and other financial institutions	**2,051**	2,991
Securities bought under repurchase agreements	**1,398**	1,668
Non-trading debt investments	**5,826**	5,652
Loans and advances	**16,452**	14,884
Other credit exposures	**1,745**	1,584
	29,806	29,315
Credit commitments and contingent items (note 21)	**8,214**	9,977
Total	**38,020**	39,292

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

24.4.3 Risk concentration of the maximum exposure to credit risk

The Group's assets (before taking into account any cash collateral held or other credit enhancements) can be analysed by the following geographical regions:

	Assets			
	2019			
	Stage 1	***Stage 2***	***Stage 3***	***Total***
Western Europe	**2,363**	**170**	**-**	**2,533**
Arab World	**12,439**	**564**	**42**	**13,045**
Asia	**1,998**	**-**	**14**	**2,012**
North America	**2,671**	**2**	**5**	**2,678**
Latin America	**7,969**	**102**	**74**	**8,145**
Other	**1,351**	**34**	**8**	**1,393**
Total	**28,791**	**872**	**143**	**29,806**

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.3 Risk concentration of the maximum exposure to credit risk (continued)

	Assets			
	2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
Western Europe	3,095	136	1	3,232
Arab World	11,755	507	28	12,290
Asia	1,733	9	-	1,742
North America	3,257	-	20	3,277
Latin America	7,249	140	131	7,520
Other	1,028	218	8	1,254
Total	28,117	1,010	188	29,315

The Group's liabilities and equity can be analysed by the following geographical regions:

	Liabilities and equity	
	2019	*2018*
Western Europe	**2,064**	2,489
Arab World	**19,091**	18,879
Asia	**433**	468
North America	**692**	706
Latin America	**6,632**	6,046
Other	**894**	727
Total	**29,806**	29,315

The Group's commitments and contingencies can be analysed by the following geographical regions:

	Credit commitments and contingent items			
	2019			
	Stage 1	***Stage 2***	***Stage 3***	***Total***
Western Europe	**1,087**	**181**	**18**	**1,286**
Arab World	**2,690**	**205**	**6**	**2,901**
Asia	**376**	**22**	**-**	**398**
North America	**708**	**97**	**22**	**827**
Latin America	**2,723**	**14**	**-**	**2,737**
Other	**57**	**7**	**1**	**65**
Total	**7,641**	**526**	**47**	**8,214**

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.3 Risk concentration of the maximum exposure to credit risk (continued)

	Credit commitments and contingent items			
	2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
Western Europe	1,723	59	30	1,812
Arab World	3,809	111	-	3,920
Asia	253	84	-	337
North America	631	64	-	695
Latin America	3,076	-	-	3,076
Other	120	16	1	137
Total	9,612	334	31	9,977

An industry sector analysis of the Group's financial assets, before taking into account cash collateral held or other credit enhancements, is as follows:

	Gross maximum exposure			
	2019			
	Stage 1	***Stage 2***	***Stage 3***	***Total***
Financial services	**8,320**	**73**	**-**	**8,393**
Energy	**1,327**	**32**	**-**	**1,359**
Utilities	**1,083**	**21**	**-**	**1,104**
Distribution	**946**	**9**	**-**	**955**
Retailers	**305**	**68**	**-**	**373**
Manufacturing	**3,276**	**116**	**38**	**3,430**
Construction	**998**	**145**	**26**	**1,169**
Mining and quarrying	**424**	**11**	**8**	**443**
Transport	**897**	**64**	**-**	**961**
Personal /consumer finance	**626**	**59**	**6**	**691**
Commercial real estate financing	**575**	**11**	**8**	**594**
Residential mortgage	**101**	**-**	**1**	**102**
Trade	**1,103**	**195**	**2**	**1,300**
Agriculture, fishing and forestry	**1,351**	**19**	**17**	**1,387**
Technology, media and telecommunications	**473**	**-**	**-**	**473**
Government	**4,787**	**34**	**-**	**4,821**
Other services	**2,199**	**15**	**37**	**2,251**
Total	**28,791**	**872**	**143**	**29,806**

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.3 Risk concentration of the maximum exposure to credit risk (continued)

	Gross maximum exposure			
	2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
Financial services	9,290	301	-	9,591
Energy	899	35	-	934
Utilities	924	28	3	955
Distribution	663	7	-	670
Retailers	458	13	-	471
Manufacturing	2,955	154	72	3,181
Construction	837	41	34	912
Mining and quarrying	362	12	-	374
Transport	971	82	9	1,062
Personal /consumer finance	595	32	7	634
Commercial real estate financing	431	76	-	507
Residential mortgage	186	-	1	187
Trade	1,420	121	1	1,542
Agriculture, fishing and forestry	1,129	42	35	1,206
Technology, media and telecommunications	381	-	8	389
Government	4,842	34	-	4,876
Other services	1,774	32	18	1,824
Total	28,117	1,010	188	29,315

An industry sector analysis of the Group's financial assets, after taking into account cash collateral held or other credit enhancements, is as follows:

	Net maximum exposure	
	2019	*2018*
Financial services	**6,555**	7,638
Energy	**1,359**	934
Utilities	**1,104**	955
Distribution	**955**	670
Retailers	**371**	471
Manufacturing	**3,373**	3,136
Construction	**1,078**	823
Mining and quarrying	**443**	374
Transport	**961**	1,062
Personal /consumer finance	**691**	634
Commercial real estate financing	**594**	507
Residential mortgage	**102**	187
Trade	**1,293**	1,534
Agriculture, fishing and forestry	**1,387**	1,206
Technology, media and telecommunications	**473**	389
Government	**4,652**	4,287
Other services	**2,234**	1,797
Total	**27,625**	26,604

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.3 Risk concentration of the maximum exposure to credit risk (continued)

An industry sector analysis of the Group's credit commitments and contingent items, before taking into account cash collateral held or other credit enhancements, is as follows:

	Gross maximum exposure			
	2019			
	Stage 1	***Stage 2***	***Stage 3***	***Total***
Financial services	**2,274**	**85**	**1**	**2,360**
Energy	**330**	**62**	**-**	**392**
Utilities	**104**	**23**	**-**	**127**
Distribution	**64**	**4**	**-**	**68**
Retailers	**107**	**65**	**-**	**172**
Manufacturing	**976**	**168**	**28**	**1,172**
Construction	**722**	**79**	**18**	**819**
Mining and quarrying	**1,009**	**-**	**-**	**1,009**
Transport	**240**	**8**	**-**	**248**
Personal /consumer finance	**16**	**-**	**-**	**16**
Commercial real estate financing	**110**	**-**	**-**	**110**
Trade	**526**	**21**	**-**	**547**
Agriculture, fishing and forestry	**185**	**-**	**-**	**185**
Technology, media and telecommunications	**159**	**10**	**-**	**169**
Government	**50**	**-**	**-**	**50**
Other services	**769**	**1**	**-**	**770**
Total	**7,641**	**526**	**47**	**8,214**

	Gross maximum exposure			
	2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
Financial services	3,928	61	1	3,990
Energy	100	71	-	171
Utilities	121	48	-	169
Distribution	52	2	-	54
Retailers	80	-	-	80
Manufacturing	1,323	61	-	1,384
Construction	602	62	30	694
Mining and quarrying	957	-	-	957
Transport	325	-	-	325
Personal /consumer finance	36	-	-	36
Commercial real estate financing	189	-	-	189
Trade	379	16	-	395
Agriculture, fishing and forestry	190	-	-	190
Technology, media and telecommunications	272	-	-	272
Government	877	-	-	877
Other services	181	13	-	194
Total	9,612	334	31	9,977

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.3 Risk concentration of the maximum exposure to credit risk (continued)

An industry sector analysis of the Group's credit commitments and contingent items, after taking into account cash collateral held or other credit enhancements, is as follows:

	Net maximum exposure	
	2019	*2018*
Financial services	**2,230**	3,652
Energy	**392**	171
Utilities	**127**	169
Distribution	**68**	54
Retailers	**172**	80
Manufacturing	**1,141**	1,374
Construction	**817**	693
Mining and quarrying	**1,009**	957
Transport	**248**	325
Personal /consumer finance	**16**	36
Commercial real estate financing	**110**	189
Trade	**541**	391
Agriculture, fishing and forestry	**185**	190
Technology, media and telecommunications	**169**	271
Government	**42**	841
Other services	**769**	194
Total	**8,036**	9,587

24.4.4 Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group using internal credit ratings. The table below shows the credit quality by class of financial asset, based on the Group's credit rating system.

31 December 2019	***Neither past due nor impaired***				
	High grade	***Standard grade***	***Past due but not impaired***	***Past due and individually impaired***	***Total***
Liquid funds	**1,842**	**1**	**-**	**-**	**1,843**
Trading debt securities	**17**	**474**	**-**	**-**	**491**
Placements with banks and other financial institutions	**987**	**1,064**	**-**	**-**	**2,051**
Securities bought under repurchase agreements	**100**	**1,298**	**-**	**-**	**1,398**
Non-trading debt investments	**3,843**	**1,983**	**-**	**-**	**5,826**
Loans and advances	**4,218**	**12,016**	**75**	**143**	**16,452**
Other credit exposures	**1,510**	**235**	**-**	**-**	**1,745**
	12,517	**17,071**	**75**	**143**	**29,806**

31 December 2018	*Neither past due nor impaired*				
	High grade	*Standard grade*	*Past due but not impaired*	*Past due and individually impaired*	*Total*
Liquid funds	1,574	1	-	-	1,575
Trading debt securities	54	907	-	-	961
Placements with banks and other financial institutions	1,835	1,156	-	-	2,991
Securities bought under repurchase agreements	171	1,497	-	-	1,668
Non-trading debt investments	4,387	1,265	-	-	5,652
Loans and advances	4,478	10,163	55	188	14,884
Other credit exposures	1,392	192	-	-	1,584
	13,891	15,181	55	188	29,315

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.4 Credit quality per class of financial assets (continued)

The table below shows the credit quality by class of financial asset net ECL, based on internal credit ratings.

31 December 2019

	Liquid funds	*Trading debt securities*	*Placements with banks and other financial institutions*	*Securities bought under repurchase agreements*	*Non-trading debt investments*	*Loans and advances*
Stage 1 (12-month ECL)						
Rating grades 1 to 4-	**1,555**	**17**	**987**	**100**	**4,230**	**5,980**
Rating grades 5+ to 5-	**82**	**474**	**221**	**824**	**427**	**3,974**
Rating grades 6+ to 6-	**205**	**-**	**843**	**459**	**1,118**	**5,200**
Rating grade 7+ to 7-	**-**	**-**	**-**	**15**	**-**	**363**
Carrying amount (net)	**1,842**	**491**	**2,051**	**1,398**	**5,775**	**15,517**
Stage 2 (Lifetime ECL but not credit-impaired)						
Rating grades 1 to 4-	**-**	**-**	**-**	**-**	**-**	**7**
Rating grades 5+ to 5-	**-**	**-**	**-**	**-**	**-**	**45**
Rating grades 6+ to 6-	**-**	**-**	**-**	**-**	**51**	**387**
Rating grade 7+ to 7-	**1**	**-**	**-**	**-**	**-**	**220**
Rating grade 8	**-**	**-**	**-**	**-**	**-**	**133**
Carrying amount (net)	**1**	**-**	**-**	**-**	**51**	**792**
Stage 3 (Lifetime ECL and credit-impaired)						
Rating grades 9 to 11	**-**	**-**	**-**	**-**	**-**	**143**
Carrying amount (net)	**-**	**-**	**-**	**-**	**-**	**143**
Total	**1,843**	**491**	**2,051**	**1,398**	**5,826**	**16,452**

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.4 Credit quality per class of financial assets (continued)

31 December 2018

	Liquid funds	*Trading debt securities*	*Placements with banks and other financial institutions*	*Securities bought under repurchase agreements*	*Non-trading debt investments*	*Loans and advances*
Stage 1 (12-month ECL)						
Rating grades 1 to 4-	1,352	436	1,903	103	4,258	5,786
Rating grades 5+ to 5-	151	525	389	925	505	4,583
Rating grades 6+ to 6-	71	-	699	627	758	3,263
Rating grade 7+ to 7-	-	-	-	13	-	214
Carrying amount (net)	1,574	961	2,991	1,668	5,521	13,846
Stage 2 (Lifetime ECL but not credit-impaired)						
Rating grades 1 to 4-	-	-	-	-	-	40
Rating grades 5+ to 5-	-	-	-	-	-	82
Rating grades 6+ to 6-	1	-	-	-	131	442
Rating grade 7+ to 7-	-	-	-	-	-	131
Rating grade 8	-	-	-	-	-	155
Carrying amount (net)	1	-	-	-	131	850
Stage 3 (Lifetime ECL and credit-impaired)						
Rating grades 9 to 11	-	-	-	-	-	188
Carrying amount (net)	-	-	-	-	-	188
Total	1,575	961	2,991	1,668	5,652	14,884

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.4 Credit quality per class of financial assets (continued)

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio through a risk rating system. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of credit risk. All internal ratings are tailored to the various categories and are derived in accordance with the Group's credit policy. The attributable risk ratings are assessed and updated regularly. Each risk rating class has grades equivalent to Moody's, S&P, Fitch and CI rating agencies.

24.4.5 Carrying amount per class of financial assets whose terms have been renegotiated as at year-end

	2019	*2018*
Loans and advances	**267**	330

24.4.6 Overview of modified or forborne loans

From a risk management point of view, once an asset is forborne or modified, the Group's Remedial Loan Unit (RLU) continues to monitor the exposure until it is completely and ultimately derecognised.

No financial assets were modified having a loss allowance measured at an amount equal to lifetime ECL during 2019 (2018: gross carrying amount of US$ 9 million with a corresponding ECL of nil).

24.4.7 Collateral and other credit enhancements

The amount and type of collateral depends on an assessment of the credit risk of the counterparty. The types of collateral mainly includes cash, guarantees from banks, movable and immovable assets.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses. The Group also makes use of master netting agreements with counterparties.

Credit exposure loan to value ratios of real estate portfolio

The real estate credit exposure of the Group amounts to US$ 878 million (2018: US$ 834 million). Predominantly, the loan to value ratios for these exposures are in the range of 28% to 80% (2018: 30% to 60%).

24.4.8 Maximum exposure to credit risk – Financial instruments not subject to impairment

The following table contains an analysis of the maximum credit risk exposure from financial assets not subject to impairment (i.e. FVTPL):

	Maximum exposure to credit risk	
	2019	*2018*
Trading securities		
- Debt Securities	**491**	961
Trading derivatives	**515**	450
Hedging derivatives	**3**	18
Financial assets designated at FVTPL		
- Loans and advances to customers	**11**	19

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.5 Settlement risk

Settlement risk is the risk of loss due to the failure of a counterparty to honour its obligations to deliver cash, securities or other assets as contractually agreed. For certain types of transactions, the Group mitigates this risk through a settlement agent to ensure that a trade is settled only when both parties fulfil their settlement obligations. Settlement approvals form a part of credit approval and limit monitoring procedure.

24.6 Market risk

Market risk is the risk that the Group's earnings or capital, or its ability to support business strategy, will be impacted by the change in market rates or prices related to interest rates, equity prices, credit spreads, foreign exchange rates, and commodity prices.

The Group has established risk management policies and limits within which exposure to market risk is monitored, measured and controlled by the Risk Management Department (RMD) with strategic oversight exercised by GALCO. The RMD's Market Risk (MR) unit is responsible for developing and implementing market risk policy and risk measuring/monitoring methodology and for reviewing all new trading products and product limits prior to GALCO approval. The unit also has the responsibility to measure and report market risk against limits throughout the Group.

The Group manages market risk by classifying into two types: a) trading market risk; and b) investment market risk. Trading market risk arises primarily from positions held in the trading books from market-making to support client activities. This involves the management of client originated exposures in interest rates, equities, corporate and sovereign debt, foreign exchange rates, commodities and derivatives of these asset classes, such as forwards, futures, options and swaps. Trading market risk may also arise from positions originated by the Bank subject to the market risk appetite and limits defined by the GALCO and BRC.

Investment market risk arises from market factors affecting securities held in high quality liquid assets (HQLA) portfolio and liquid marketable securities which are held under its FVOCI portfolio and where the impact of the changes in fair value due to market factors is through FVOCI.

The trading and investment market risks are managed by MR using a full suite of market risk limits including Value at Risk, sensitivity limits on key market parameters, notional limits on the size of investment portfolios, stop-loss limits and also stress testing to monitor the impact of significant market moves. These limits are monitored by MR and reported daily to business lines and management.

24.7 Interest rate risk in the banking book

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. The Group is exposed to interest rate risk as a result of mismatches of interest rate re pricing of assets and liabilities. The most prominent market risk factor for the Group is interest rates. This risk is minimized as the Group's rate sensitive assets and liabilities are mostly floating rate, where the duration risk is lower. The Group has set risk limits for both earnings at risk (EAR) and economic value of equity (EVE) for interest rate risk in the banking book (IRRBB). In general, the Group uses matched currency funding and translates fixed rate instruments to floating rate to better manage the duration in the asset book.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's consolidated statement of profit or loss.

The sensitivity of the consolidated statement of profit or loss is the effect of the assumed changes in interest rates on the net interest income for one year, based on financial assets and financial liabilities held at 31 December, including the effect of hedging instruments. The sensitivity of equity is calculated by revaluing fixed rate FVOCI financial assets, including the effect of any associated hedges and swaps. Substantially all the FVOCI non-trading securities held by the Group are floating rate assets. Hence, the sensitivity to changes in equity due to interest rate changes is insignificant.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.7 Interest rate risk in the banking book (continued)

	2019			
	Increase in basis points	***Sensitivity consolidated statement of profit or loss***	***Decrease in basis points***	***Sensitivity consolidated statement of profit or loss***
US Dollar	**25**	**(2)**	**25**	**2**
Euro	**25**	**1**	**25**	**(1)**
Pound Sterling	**25**	**1**	**25**	**(1)**
Brazilian Real	**25**	**1**	**25**	**(1)**
Others	**25**	**1**	**25**	**(1)**

	2018			
	Increase in basis points	*Sensitivity consolidated statement of profit or loss*	*Decrease in basis points*	*Sensitivity consolidated statement of profit or loss*
US Dollar	25	(3)	25	3
Euro	25	-	25	-
Pound Sterling	25	1	25	(1)
Brazilian Real	25	1	25	(1)
Others	25	1	25	(1)

24.8 Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

The table below indicates the currencies to which the Group had significant exposure at 31 December 2019 and 31 December 2018 on its monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the US$, with all other variables held constant on the consolidated statement of profit or loss (due to the fair value of currency sensitive trading and non-trading monetary assets and liabilities) and equity (due to the change in fair value of currency swaps and forward foreign exchange contracts used as fair value hedges) and the effect of the impact of foreign currency movements on the structural positions of the Bank in its subsidiaries. A negative amount in the table reflects a potential net reduction in the consolidated statement of profit or loss or equity, while a positive amount reflects a potential net increase.

	2019			*2018*		
	Change in currency rate in %	***Effect on profit before tax***	***Effect on equity***	*Change in currency rate in %*	*Effect on profit before tax*	*Effect on equity*
Currency						
Brazilian Real	**+/- 5%**	**-**	**+/-30**	+/- 5%	-	+/-29
Egyptian Pound	**+/- 5%**	**-**	**+/-5**	+/- 5%	-	+/-5
Jordanian Dinar	**+/- 5%**	**+/-3**	**+/-9**	+/- 5%	-	+/-10
Algerian Dinar	**+/- 5%**	**-**	**+/-7**	+/- 5%	-	+/-6
Pound Sterling	**+/- 5%**	**+/-1**	**-**	+/- 5%	-	-
Bahrain Dinar	**+/- 5%**	**+/-1**	**-**	+/- 5%	+/-1	-

24.9 Equity price risk

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The non-trading equity price risk exposure arises from the Group's securities portfolio.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.9 Equity price risk (continued)

The effect on equity (as a result of a change in the fair value of trading equity instruments and equity instruments held at FVOCI) due to a reasonably possible change in equity indices or the net asset values, with all other variables held constant, is as follows:

	2019		*2018*	
	% Change in equity price	***Effect on consolidated statement of profit or loss/ equity***	*% Change in equity price*	*Effect on consolidated statement of profit or loss/ equity*
Trading equities	**+/- 5%**	**+/-1**	+/- 5%	+/-1
Equity securities at FVOCI	**+/- 5%**	**-**	+/- 5%	-

24.10 Operational risk

Operational Risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems including internal frauds, or from external events including external frauds. This definition includes legal, Technology (IT) and Shari'a non- compliance risks, but excludes strategic and reputational risk.

The Group adheres to the three lines of defence model for the management of operational risk. The business (First line of defence) is supported by independent Operational Risk Management Departments reporting to the local Chief Risk Officers or local Heads of Risk (Second line of defence). The management of Operational Risk is subject to independent review by Internal Audit (Third line of defence).

The Group Operational Risk Committee (GORCO), as a sub-committee of GRC assists with the management of Operational Risks across the Group to ensure that the Operational Risk Policy as approved by the BRC, is implemented and monitored across the Group.

The GORCO:

- Defines the policy for the management of Operational Risks and recommends for approval by the GRC and BRC.
- Advises the GRC and the BRC with establishing, approving and periodically reviewing the tolerance for Operational Risks at the Group.
- Monitors and reviews the Operational Risk losses across various Group businesses and its subsidiaries.
- Defines the various components of the Operational Risk Management Framework at the Group and oversees the implementation of the framework across the Group.
- Oversees the actions taken to maintain losses are in line with the Operational Risk Appetite.

The implementation of the Operational Risk Management Framework is governed by the GORCO. Local Operational Risk Committees oversee the implementation of the Operational Risk Management Framework and the management of Operational Risk across all subsidiaries and branches of the Group. The Group Operational Risk Management Department at Head Office is responsible for the development of the group-wide methodology, quality control and system support.

The Group has implemented the following for the management of Operational Risks:

- Operational Risk Appetite, as part of the Group Risk Appetite Statement;
- Incident management;
- Risk & Control Self-Assessments;
- Issue and Action management; and
- Key Risk and Performance Indicators.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.10 Operational risk (continued)

All loss events and relevant incidents are captured in a group-wide incident database. The threshold for reporting loss events is US$ 50 gross. The Group has implemented a group-wide Governance, Risk and Compliance solution, ARC solution. This group-wide solution is being used by Audit, Risk and Compliance.

A wide range of management information reports have been tailored to meet the needs of different stakeholders, these also provide information on the Operational Risk profile of the Bank and its subsidiaries.

Operational risk tolerance

The Group has expressed Operational Risk tolerance in the Board Approved Group Risk Appetite Statement in terms of absolute gross loss amounts due to Operational Risk incidents. In addition, the Group uses a quantitative and qualitative risk rating scale to classify actual and potential Operational Risks as ‘Critical’, Significant’, ‘Moderate’ or ‘Minor’.

Timeframes have been defined within which action plans must be prepared for the treatment of control weaknesses rated ‘Critical’, Significant’ or ‘Moderate’.

In line with the Board-led Group Risk Appetite Statement, Operational Risk tolerance is set and monitored by the Board Risk Committee.

24.10.1 Operational resilience

Operational resilience is the ability of the Bank to carry out its mission or business despite the occurrence of operational stress or disruption, protecting its customers, shareholders and ultimately the integrity of the financial system. The operational resilience framework includes a set of techniques that allow people, processes and informational systems to adapt to changing patterns, respond to and recover from factors that may hinder the Bank from functioning.

The Bank adheres to the three lines of defense model for the management of operational resilience risk. The business (first line of defence) is supported by an independent Cyber, IT Risk Management Departments reporting to Group Head of Risk (second line of defence). The management of operational resilience risk is subject to independent review by Internal Audit (third line of defence).

The Group Operational Resilience Committee (“GORC”) assists GRC with the oversight of the Bank’s Operational resilience framework, by such it oversees:

- Information security, including Cyber security
- Information Technology
- Business Continuity, Disaster Recovery and Crisis Management
- Bank’s compliance with Privacy laws (Personal Data Protection)
- Outsourcing and Vendor Management (External dependencies)

The GORC reviews and recommends to GRC, the Bank’s business resilience for each area it oversees.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.11 Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress conditions. To mitigate this risk, management seeks to fund its assets from diversified funding sources. In order to mitigate the liquidity risk, in addition to its core deposit base, the Bank maintains a adequate pool of high quality liquid assets (HQLA) that can be monetized within a short timeframe to meet potential outflows arising from stress. The Bank monitors its future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Group maintains HQLA at prudential levels to ensure that cash can quickly be made available to honour all its obligations, even under adverse conditions. The Group is generally in a position of surplus liquidity, its principal sources of liquidity being its deposit base, liquidity derived from its operations and inter-bank borrowings. The Liquidity Survival Horizon (LSH) represents the number of days the Group can survive the combined outflow of deposits and contractual drawdowns, under market driven realisable value scenarios.

The Group is also required to comply with the liquidity requirements as stipulated by its regulator, the CBB, which became effective during the year 2019. These requirements relate to maintaining a minimum of 100% liquidity coverage ratio (LCR) and net stable funding ratio (NSFR). LCR is calculated as a ratio of its stock of HQLA and net outflows over the next 30 calendar days. NSFR is calculated as a ratio of ‘available stable funding’ to ‘required stable funding’. As at 31 December 2019, the Group’s LCR and NSFR were at 303% and 115% respectively.

In addition, the internal liquidity/maturity profile is generated to summarize the actual liquidity gaps versus the revised gaps based on internal assumptions.

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2019 based on contractual undiscounted repayment obligations. See the next table for the expected maturities of these liabilities. Repayments which are subjected to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

At 31 December 2019	***Within 1 month***	***1 - 3 months***	***3 - 6 months***	***6 - 12 months***	***1 - 5 years***	***5-10 years***	***Over 10 years and undated***	***Total***
Financial liabilities								
Deposits from customers	**4,693**	**4,493**	**1,171**	**2,956**	**3,663**	**235**	**97**	**17,308**
Deposits from banks	**1,949**	**784**	**502**	**481**	**230**	**-**	**-**	**3,946**
Certificates of deposits	**11**	**253**	**30**	**81**	**28**	**-**	**-**	**403**
Securities sold under repurchase agreements	**496**	**467**	**-**	**-**	**56**	**-**	**-**	**1,019**
Interest payable and other liabilities	**1,466**	**-**	**-**	**-**	**-**	**-**	**-**	**1,466**
Borrowings	**-**	**-**	**155**	**290**	**1,782**	**1**	**113**	**2,341**
Total non-derivative undiscounted financial liabilities on statement of financial position	**8,615**	**5,997**	**1,858**	**3,808**	**5,759**	**236**	**210**	**26,483**
ITEMS OFF STATEMENT OF FINANCIAL POSITION								
Gross settled foreign currency derivatives	**2,955**	**2,290**	**968**	**3,912**	**3,948**	**8**	**-**	**14,081**
Guarantees	**3,022**	**-**	**-**	**-**	**-**	**-**	**-**	**3,022**

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.11 Liquidity risk (continued)

At 31 December 2018	*Within 1 month*	*1 - 3 months*	*3 - 6 months*	*6 - 12 months*	*1 - 5 years*	*5-10 years*	*Over 10 years*	*Total*
Financial liabilities								
Deposits from customers	5,582	2,444	2,182	2,946	3,562	291	13	17,020
Deposits from banks	2,015	988	490	592	185	-	-	4,270
Certificates of deposits	4	7	3	5	23	-	-	42
Securities sold under repurchase agreements	767	459	-	-	56	-	-	1,282
Interest payable and other liabilities	1,014	40	34	46	87	15	-	1,236
Borrowings	-	61	-	44	2,111	1	-	2,217
Total non-derivative undiscounted financial liabilities on statement of financial position	9,382	3,999	2,709	3,633	6,024	307	13	26,067
ITEMS OFF STATEMENT OF FINANCIAL POSITION								
Gross settled foreign currency derivatives	1,918	1,203	377	3,649	2,669	-	-	9,816
Guarantees	3,565	-	-	-	-	-	-	3,565

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.11 Liquidity risk (continued)

The maturity analysis of assets and liabilities analysed according to when they are expected to be recovered or settled or when they could be realised.

At 31 December 2019	*Within 1 month*	*1 -3 months*	*3 - 6 months*	*6 - 12 months*	*Total within 12 months*	*1 - 5 years*	*5-10 years*	*10 - 20 years*	*Over 20 years*	*Undated*	*Total over 12 months*	*Total*
ASSETS												
Liquid funds	**1,630**	**27**	**40**	**68**	**1,765**	**109**	**-**	**-**	**-**	**-**	**109**	**1,874**
Trading securities	**14**	**125**	**-**	**270**	**409**	**61**	**12**	**9**	**-**	**16**	**98**	**507**
Placements with banks and other financial institutions	**1,589**	**458**	**-**	**4**	**2,051**	**-**	**-**	**-**	**-**	**-**	**-**	**2,051**
Securities bought under repurchase agreements	**1,224**	**37**	**100**	**37**	**1,398**	**-**	**-**	**-**	**-**	**-**	**-**	**1,398**
Non-trading investments	**362**	**802**	**477**	**307**	**1,948**	**2,287**	**1,363**	**189**	**39**	**10**	**3,888**	**5,836**
Loans and advances	**2,971**	**2,368**	**2,014**	**3,077**	**10,430**	**5,266**	**604**	**152**	**-**	**-**	**6,022**	**16,452**
Others	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**1,950**	**1,950**	**1,950**
Total assets	**7,790**	**3,817**	**2,631**	**3,763**	**18,001**	**7,723**	**1,979**	**350**	**39**	**1,976**	**12,067**	**30,068**
LIABILITIES, SHAREHOLDERS' EQUITY AND NON-CONTROLLING INTERESTS												
Deposits from customers	**3,888**	**2,962**	**1,114**	**2,825**	**10,789**	**5,613**	**200**	**64**	**-**	**-**	**5,877**	**16,666**
Deposits from banks	**1,741**	**723**	**494**	**472**	**3,430**	**467**	**-**	**-**	**-**	**-**	**467**	**3,897**
Certificates of deposit	**11**	**252**	**29**	**81**	**373**	**26**	**-**	**-**	**-**	**-**	**26**	**399**
Securities sold under repurchase agreements	**495**	**465**	**-**	**-**	**960**	**48**	**-**	**-**	**-**	**-**	**48**	**1,008**
Borrowings	**-**	**-**	**126**	**250**	**376**	**1,591**	**-**	**-**	**-**	**113**	**1,704**	**2,080**
Others	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**1,529**	**1,529**	**1,529**
Shareholders' equity and non-controlling interests	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**4,489**	**4,489**	**4,489**
Total liabilities, shareholders' equity and non-controlling interests	**6,135**	**4,402**	**1,763**	**3,628**	**15,928**	**7,745**	**200**	**64**	**-**	**6,131**	**14,140**	**30,068**
Net liquidity gap	**1,655**	**(585)**	**868**	**135**	**2,073**	**(22)**	**1,779**	**286**	**39**	**(4,155)**	**(2,073)**	**-**
Cumulative net liquidity gap	**1,655**	**1,070**	**1,938**	**2,073**		**2,051**	**3,830**	**4,116**	**4,155**	**-**		

Within 1 month are primarily liquid securities that can be sold under repurchase agreements. Deposits are continuously replaced with other new deposits or rollover from the same or different counterparties, based on available lines of credit.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.11 Liquidity risk (continued)

At 31 December 2018	*Within 1 month*	*1 -3 months*	*3 - 6 months*	*6 - 12 months*	*Total within 12 months*	*1 - 5 years*	*5-10 years*	*10 - 20 years*	*Over 20 years*	*Undated*	*Total over 12 months*	*Total*
ASSETS												
Liquid funds	1,354	50	-	30	1,434	173	-	-	-	-	173	1,607
Trading securities	69	110	5	391	575	324	58	3	-	17	402	977
Placements with banks and other financial institutions	2,313	581	92	5	2,991	-	-	-	-	-	-	2,991
Securities bought under repurchase agreements	511	1,063	91	-	1,665	1	2	-	-	-	3	1,668
Non-trading investments	111	141	527	689	1,468	2,905	1,071	162	46	9	4,193	5,661
Loans and advances	2,598	2,004	1,941	2,351	8,894	4,920	873	190	7	-	5,990	14,884
Others	61	35	9	38	143	116	19	1	-	1,482	1,618	1,761
Total assets	7,017	3,984	2,665	3,504	17,170	8,439	2,023	356	53	1,508	12,379	29,549
LIABILITIES, SHAREHOLDERS' EQUITY AND NON-CONTROLLING INTERESTS												
Deposits from customers	3,822	1,696	2,066	2,784	10,368	5,785	265	7	-	-	6,057	16,425
Deposits from banks	1,930	894	478	578	3,880	327	-	-	-	-	327	4,207
Certificates of deposit	4	6	3	5	18	21	-	-	-	-	21	39
Securities sold under repurchase agreements	766	457	-	-	1,223	48	-	-	-	-	48	1,271
Borrowings	-	57	-	5	62	1,950	-	-	-	-	1,950	2,012
Others	17	40	34	46	137	87	15	-	-	1,040	1,142	1,279
Shareholders' equity and non-controlling interests	-	-	-	-	-	-	-	-	-	4,316	4,316	4,316
Total liabilities, shareholders' equity and non-controlling interests	6,539	3,150	2,581	3,418	15,688	8,218	280	7	-	5,356	13,861	29,549
Net liquidity gap	478	834	84	86	1,482	221	1,743	349	53	(3,848)	(1,482)	-
Cumulative net liquidity gap	478	1,312	1,396	1,482		1,703	3,446	3,795	3,848	-		

All figures in US$ Million

25 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).

	2019					
	MENA subsidiaries	*International wholesale banking*	*Group treasury*	*ABC Brasil*	*Other*	*Total*
Net interest income	**117**	**176**	**38**	**170**	**63**	**564**
Other operating income	**42**	**78**	**41**	**115**	**25**	**301**
Total operating income	**159**	**254**	**79**	**285**	**88**	**865**
Profit before credit losses	**62**	**141**	**57**	**157**	**46**	**463**
Credit loss expense	**(22)**	**(26)**	**-**	**(34)**	**-**	**(82)**
Profit before taxation and unallocated operating expenses	**40**	**115**	**57**	**123**	**46**	**381**
Taxation expense on foreign operations	**(11)**	**(4)**	**(1)**	**(7)**	**-**	**(23)**
Unallocated operating expenses						**(122)**
Profit for the year						**236**
Operating assets as at 31 December 2019	**3,558**	**10,132**	**8,198**	**8,113**	**67**	**30,068**
Operating liabilities as at 31 December 2019	**3,041**	**-**	**15,572**	**6,923**	**43**	**25,579**

All figures in US$ Million

25 OPERATING SEGMENTS (continued)

	2018					
	MENA subsidiaries	*International wholesale banking*	*Group treasury*	*ABC Brasil*	*Other*	*Total*
Net interest income	117	168	45	177	52	559
Other operating income	43	72	39	83	21	258
Total operating income	160	240	84	260	73	817
Profit before credit losses	69	138	61	135	45	448
Credit loss expense	(5)	(35)	-	(39)	-	(79)
Profit before taxation and unallocated operating expenses	64	103	61	96	45	369
Taxation (expense) credit on foreign operations	(19)	(8)	(1)	12	-	(16)
Unallocated operating expenses						(105)
Profit for the year						248
Operating assets as at 31 December 2018	3,283	9,540	8,877	7,778	71	29,549
Operating liabilities as at 31 December 2018	2,918	-	15,613	6,689	13	25,233

Geographical information

The Group operates in six geographic markets: Middle East and North Africa, Western Europe, Asia, North America, Latin America and others. The following table show the external total operating income of the major units within the Group, based on the country of domicile of the entity for the years ended 31 December 2019 and 2018:

2019	***Bahrain***	***Europe***	***Brasil***	***Other***	***Total***
Total operating income	**247**	**115**	**286**	**217**	**865**
2018					
Total operating income	232	120	262	203	817

There were no revenues derived from transactions with a single external customer that amounted to 10% or more of the Group's revenue (2018: none).

26 REPURCHASE AND RESALE AGREEMENTS

Proceeds from assets sold under repurchase agreements at the year-end amounted to US$ 1,008 million (2018: US$ 1,271 million). The carrying value of securities sold under repurchase agreements at the year-end amounted to US$ 1,024 million (2018: US$ 1,359 million).

Amounts paid for assets purchased under resale agreements at the year-end amounted to US$ 1,398 million (2018: US$ 1,668 million), net of ECL allowance, and relate to customer product and treasury activities. The market value of the securities purchased under resale agreements at the year-end amounted to US$ 1,465 million (2018: US$ 1,747 million).

All figures in US$ Million

27 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 year-end balances in respect of related parties included in the consolidated financial statements are as follows:

	Ultimate parent	*Major shareholder*	*Directors*	*2019*	*2018*
Deposits from customers	**3,161**	**700**	**8**	**3,869**	3,803
Borrowings	**1,505**	**-**	**-**	**1,505**	1,505
Short-term self-liquidating trade and transaction-related contingent items	**348**	**-**	**-**	**348**	515

The income and expenses in respect of related parties included in the consolidated financial statements are as follows:

	2019	*2018*
Commission income	**10**	8
Interest expense	**161**	122

Compensation of the key management personnel is as follows:

	2019	*2018*
Short term employee benefits	**17**	18
Post employment benefits	**3**	3
	20	21

28 FIDUCIARY ASSETS

Funds under management at the year-end amounted to US$ 16,346 million (2018: US$ 14,927 million). These assets are held in a fiduciary capacity and are not included in the consolidated statement of financial position.

29 ISLAMIC DEPOSITS AND ASSETS

Deposits from customers, banks and borrowings include Islamic deposits of US$ 1,775 million (2018: US$ 784 million). Loans and advances, non-trading investments and placements include Islamic assets of US$ 1,175 million (2018: US$ 1,167 million), US$ 818 million (2018: US$ 639 million) and US$ 285 million (2018: US$ 289 million).

30 ASSETS PLEDGED AS SECURITY

At the consolidated statement of financial position date, in addition to the items mentioned in note 26, assets amounting to US$ 380 million (2018: US$ 407 million) have been pledged as security for borrowings and other banking operations.

31 BASIC AND DILUTED EARNINGS PER SHARE AND PROPOSED DIVIDENDS AND TRANSFERS

31.1 Basic and diluted earnings per share

Basic earnings per share is calculated by dividing the profit for the year by the weighted average number of shares during the year. No figures for diluted earnings per share have been presented, as the Bank has not issued any capital based instruments which would have any impact on earnings per share, when exercised.

All figures in US$ Million

31 BASIC AND DILUTED EARNINGS PER SHARE AND PROPOSED DIVIDENDS AND TRANSFERS (continued)

31.1 Basic and diluted earnings per share (continued)

The Group's earnings for the year (before proposed dividends) are as follows:

	2019	*2018*
Profit attributable to the shareholders of the parent	**194**	202
Weighted average number of shares outstanding during the year (millions)	**3,088**	3,096
Basic and diluted earnings per share (US$)	**0.06**	0.07

31.2 Proposed dividends and transfers

	2019	*2018*
Proposed cash dividend for 2019 of US$ 0.03 per share (2018: US$ 0.03 per share)	**93**	93

The proposed cash dividend is subject to regulatory approvals and approval at the Annual General Meeting.

32 CAPITAL ADEQUACY

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

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

The risk asset ratio calculations as at 31 December 2019 are based on standardised measurement methodology and in accordance with the CBB Basel III guidelines.

CAPITAL BASE			***2019***	*2018*
CET 1			**4,262**	4,085
AT 1			**96**	49
Total Tier 1 capital			**4,358**	4,134
Tier 2			**251**	218
Total capital base	[a]		**4,609**	4,352

RISK WEIGHTED EXPOSURES

			2019	*2018*
Credit risk weighted assets and off balance sheet items			**22,412**	20,719
Market risk weighted assets and off balance sheet items			**1,690**	1,680
Operational risk weighted assets			**1,639**	1,578
Total risk weighted assets	[b]	#	**25,741**	23,977
Risk asset ratio	[a/b*100]		**17.9%**	18.2%
Minimum requirement			**12.5%**	12.5%

All figures in US$ Million

32 CAPITAL ADEQUACY (continued)

The Group's capital base primarily comprises:

(a) Tier 1 capital: share capital, treasury shares, reserves, retained earnings, non controlling interests, profit for the year and cumulative changes in fair value;

(b) Additional Tier 1 Capital: eligible portion of a perpetual financial instrument issued by a subsidiary of the Bank; and

(c) Tier 2 capital: eligible subordinated term debt and expected credit losses.

The Group has complied with all the capital adequacy requirements as set by the Central Bank of Bahrain.

33 CHANGES IN LIABILITIES ARISING FROM FINANCING ACTIVITIES

	1 January 2019	***Cash flow, net***	***Foreign exchange movement***	***31 December 2019***
Certificates of deposit	**39**	**360**	**-**	**399**
Borrowings	**2,012**	**68**	**-**	**2,080**
Total liabilities from financing activities	**2,051**	**428**	**-**	**2,479**

	1 January 2018	*Cash flow, net*	*Foreign exchange movement*	*31 December 2018*
Certificates of deposit	27	12	-	39
Borrowings	2,148	(128)	(8)	2,012
Total liabilities from financing activities	2,175	(116)	(8)	2,051