Arab Banking Corporation (B.S.C.)

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2018

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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 2018 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 2018, 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 Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), 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 2018. 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 matters below, provide the basis for our audit opinion on the accompanying 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)

Key audit matters (continued)

1. Adoption of IFRS 9 Financial instruments (IFRS 9)

Description of key audit matter	*How the key audit matter was addressed in the audit*
Effective from 1 January 2018, the Group has adopted IFRS 9 which replaces IAS 39 Financial instruments: recognition and measurement (IAS 39) and introduces new requirements in following elements with respect to financial instruments: • **Classification and measurement:** The new approach takes into account the contractual cash flow characteristics and business model in which financial assets are managed. IFRS 9 contains following three principal classification categories: - Amortised cost (AC) - Fair value through other comprehensive income (FVOCI) - Fair value through profit or loss (FVTPL) Refer note 5 to the consolidated financial statements for detailed changes in classification and measurement of financial assets under IFRS 9.	We have obtained an understanding of the Group's implementation process of IFRS 9, including understanding of the changes to the Group's IT systems and processes. Our procedures for each of the elements of IFRS 9 are detailed below: **Classification and measurement:** Our procedures focused on initial adoption of IFRS 9 on the following key areas: We read the Group's policy for classification and measurement of financial instruments and compared it with the requirements of IFRS 9; • We obtained an understanding and checked the Group's business model assessment and contractual cash flows characteristics assessment performed by the Group i.e. to test if the cash flows arising relate solely to payments of principal and interest ('SPPI test'); • We checked the classification analysis performed by the Group regarding the classification of financial instruments into amortised cost (AC), fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVTPL); and • We checked the appropriateness of the opening balance adjustments.

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)

1. Adoption of IFRS 9 Financial instruments (IFRS 9) (continued)

Description of key audit matter	*How the key audit matter was addressed in the audit*
• **Impairment:** The impairment requirements of IFRS 9 apply to all debt instruments that are measured at AC or FVOCI, and to off-balance sheet lending commitments such as loan commitments and financial guarantees. Under IFRS 9, expected credit loss (ECL) are recognized on initial recognition based on expectations of potential credit losses at the time of initial recognition which is then continuously remeasured to reflect the changes to the credit risk characteristics.	**Impairment:** Our approach included testing the controls associated with the relevant processes for estimating ECL and performing substantive procedures on such estimates for all financial assets subject to impairment testing under IFRS 9. Additionally, we also checked the appropriateness of the opening balance adjustments. For details of procedures performed refer to the key audit matter 'Impairment provision for loans and advances and other financial assets subject to credit risk' section.
• **Hedge accounting:** IFRS 9 incorporated new hedge accounting rules that intend to better align hedge accounting with risk management practices. This has resulted in removal of certain restrictions under IAS 39. On adoption, the Group has applied the requirements of IFRS 9 retrospectively without restating comparatives. Differences between previously reported carrying amounts and new carrying amounts of financial instruments as of 31 December 2017 and 1 January 2018 amounting to US$ 36 million has been recognised in the opening total equity. Refer note 5 in the consolidated financial statements for further details.	**Hedge accounting:** With respect to hedge accounting, we read the Group's policy and compared it with the requirements of IFRS 9, further, we have checked the appropriateness of the policy implementation. Additionally, we also checked the appropriateness of the opening balance adjustments. We compared the consolidated financial statement disclosures to the those required under IFRS 9 upon adoption of the standard. Refer to the accounting policies, critical accounting estimates and judgements and credit risk management disclosures in notes 4 and 24 to the 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)

2. 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 is significant and complex area. IFRS 9 is a new and complex accounting standard which requires use of ECL model for the purposes of calculating impairment loss. ECL model 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 forming a major portion of the Group's assets, the audit of ECL for loans and advances 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 model, including model 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.

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)

2. 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 2018, the Group's gross loans and advances amounted to US$ 15,448 million and the related ECL amounted to US$ 564 million, comprising US$ 135 million of ECL against Stage 1 and 2 exposures and US$ 429 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 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 critical accounting estimates and judgements, disclosures of loans and advances and credit risk management in notes 4, 9 and 24 to the 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)

Other information included in the Group's 2018 annual report
Other information consists of the information included in the Group's 2018 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.

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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)

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 Report of the Board of Directors 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 2018 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.

Partner's registration no: 117
10 February 2019
Manama, Kingdom of Bahrain

Arab Banking Corporation (B.S.C.)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 December 2018

All figures in US$ Million

	Note	***2018***	*2017*
ASSETS			
Liquid funds	7	**1,607**	1,388
Trading securities		**977**	1,051
Placements with banks and other financial institutions		**2,991**	3,170
Securities bought under repurchase agreements	26	**1,668**	1,521
Non-trading investments	8	**5,661**	5,599
Loans and advances	9	**14,884**	15,329
Other assets	11	**1,601**	1,318
Premises and equipment		**160**	123
TOTAL ASSETS		**29,549**	29,499
LIABILITIES			
Deposits from customers		**16,425**	16,755
Deposits from banks		**4,207**	3,408
Certificates of deposit		**39**	27
Securities sold under repurchase agreements	26	**1,271**	1,628
Taxation	12	**43**	58
Other liabilities	13	**1,236**	1,063
Borrowings	14	**2,012**	2,148
Total liabilities		**25,233**	25,087
EQUITY	15		
Share capital		**3,110**	3,110
Treasury shares		**(4)**	-
Statutory reserve		**501**	481
Retained earnings		**966**	939
Other reserves		**(711)**	(600)
EQUITY ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**3,862**	3,930
Non-controlling interests		**454**	482
Total equity		**4,316**	4,412
TOTAL LIABILITIES AND EQUITY		**29,549**	29,499

The consolidated financial statements were authorised for issue by the Board of Directors on 10 February 2019 and signed on their behalf by the Chairman, Deputy Chairman and the Group Chief Executive Officer.

Saddek El Kaber
Chairman

Hilal Mishari Al Mutairi
Deputy Chairman

Khaled Kawan
Group Chief Executive Officer

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

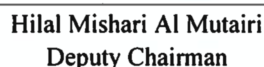
CONSOLIDATED STATEMENT OF PROFIT OR LOSS

Year ended 31 December 2018

All figures in US$ Million

	Note	***2018***	*2017*
OPERATING INCOME			
Interest and similar income	16	**1,472**	1,511
Interest and similar expense	17	**(913)**	(955)
Net interest income		**559**	556
Other operating income	18	**258**	313
Total operating income		**817**	869
Credit loss expense on financial assets	10	**(79)**	(96)
NET OPERATING INCOME AFTER CREDIT LOSS EXPENSE		**738**	773
OPERATING EXPENSES			
Staff		**316**	311
Premises and equipment		**38**	37
Other		**120**	114
Total operating expenses		**474**	462
PROFIT BEFORE TAXATION		**264**	311
Taxation on foreign operations	12	**(16)**	(58)
PROFIT FOR THE YEAR		**248**	253
Profit attributable to non-controlling interests		**(46)**	(60)
PROFIT ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		**202**	193
BASIC AND DILUTED EARNINGS PER SHARE (EXPRESSED IN US$)	31	**0.07**	0.06

Saddek El Kaber
Chairman


Hilal Mishari Al Mutairi
Deputy Chairman

Khaled Kawan
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 2018

All figures in US$ Million

	Note	***2018***	*2017*
PROFIT FOR THE YEAR		**248**	253
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		**(169)**	(23)
Debt instruments at FVOCI:			
Net change in fair value during the year	15	**(42)**	-
Available-for-sale financial assets			
Net change in fair value during the year	15	**-**	16
		(211)	(7)
Other comprehensive income that will not be reclassified (or recycled) to profit or loss in subsequent periods:			
Net change in pension fund reserve		**3**	2
		3	2
Other comprehensive loss for the year		**(208)**	(5)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**40**	248
Attributable to:			
Shareholders of the parent		**57**	198
Non-controlling interests		**(17)**	50
		40	248

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

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2018

All figures in US$ Million

	Note	***2018***	*2017*
OPERATING ACTIVITIES			
Profit for the year		**248**	253
Adjustments for:			
Credit loss expense on financial assets	10	**79**	96
Depreciation and amortisation		**23**	20
Gain on sale of premises and equipment - net		**-**	(5)
Gain on disposal of non-trading debt investments - net	18	**(8)**	(12)
Changes in operating assets and liabilities:			
Treasury bills and other eligible bills		**(38)**	73
Trading securities		**(94)**	(356)
Placements with banks and other financial institutions		**47**	1,059
Securities bought under repurchase agreements		**(375)**	15
Loans and advances		**(463)**	(579)
Other assets		**(387)**	158
Deposits from customers		**581**	1,601
Deposits from banks		**1,029**	(2,552)
Securities sold under repurchase agreements		**(288)**	1,467
Other liabilities		**198**	(81)
Other non-cash movements		**38**	(84)
Net cash from operating activities		**590**	1,073
INVESTING ACTIVITIES			
Purchase of non-trading investments		**(1,977)**	(2,185)
Sale and redemption of non-trading investments		**1,875**	2,321
Purchase of premises and equipment		**(60)**	(28)
Sale of premises and equipment		**4**	13
Investment in subsidiaries - net		**22**	26
Net cash (used in) from investing activities		**(136)**	147
FINANCING ACTIVITIES			
Issue of certificates of deposit - net		**12**	(8)
Issue of borrowings		**262**	175
Repayment of borrowings		**(384)**	(1,438)
Repurchase of borrowings	14	**(6)**	(199)
Dividend paid to the Group shareholders		**(93)**	(93)
Dividend paid to non-controlling interests		**(26)**	(29)
Purchase of treasury shares	15	**(4)**	-
Net cash used in financing activities		**(239)**	(1,592)
Net change in cash and cash equivalents		**215**	(372)
Effect of exchange rate changes on cash and cash equivalents		**(34)**	2
Cash and cash equivalents at beginning of the year		**1,160**	1,530
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	7	**1,341**	1,160

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2018

All figures in US$ Million

	Equity attributable to the shareholders of the parent									*Non-controlling interests*	*Total equity*
					Other reserves						
	Share capital	*Treasury shares*	*Statutory reserve*	*Retained earnings**	*General reserve*	*Foreign exchange translation adjustments*	*Cumulative changes in fair value*	*Pension fund reserve*	*Total*		
At 1 January 2017	3,110	-	462	859	100	(625)	(45)	(35)	3,826	434	4,260
Profit for the year	-	-	-	193	-	-	-	-	193	60	253
Other comprehensive (loss) income for the year	-	-	-	-	-	(13)	16	2	5	(10)	(5)
Total comprehensive income (loss) for the year	-	-	-	193	-	(13)	16	2	198	50	248
Dividend	-	-	-	(93)	-	-	-	-	(93)	-	(93)
Transfers during the year	-	-	19	(19)	-	-	-	-	-	-	-
Other equity movements in subsidiaries	-	-	-	(1)	-	-	-	-	(1)	(2)	(3)
At 31 December 2017	3,110	-	481	939	100	(638)	(29)	(33)	3,930	482	4,412
Impact of adopting IFRS 9 (note 5)	-	-	-	(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**

* Retained earnings include non-distributable reserves arising from consolidation of subsidiaries amounting to US$ 429 million (2017: US$ 424 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 and Islamic Banking. 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, 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 Group and its subsidiaries as at 31 December 2018. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group 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 its 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 a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

- Derecognises the assets (including goodwill) and liabilities of the subsidiary;
- Derecognises the carrying amount of any non-controlling interests;
- Derecognises the cumulative translation differences recorded in equity;
- Recognises the fair value of the consideration received;
- Recognises the fair value of any investment retained;
- Recognises any surplus or deficit in profit or loss; and
- Reclassifies the parent's share of components previously recognised in OCI to profit or loss or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities.

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 2018:

IFRS 9 Financial Instruments

Introduction

In July 2014, the IASB issued IFRS 9 Financial Instruments (IFRS 9), the standard that replaces IAS 39 Financial Instruments: Recognition and Measurement (IAS 39) for annual periods beginning on or after 1 January 2018. The Bank set up a multidisciplinary working group ('the Working Group') with members from its Risk, Finance and IT teams to prepare for IFRS 9 implementation ('the Project'). The Project was sponsored by the Chief Risk Officer and Chief Financial Officer, who regularly reported to the Bank's Board Risk Committee. The Bank has implemented IFRS 9 effective from 1 January 2018.

Classification and measurement

From a classification and measurement perspective, the new standard requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics. The IAS 39 measurement categories are replaced by: fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVOCI), and amortised cost. IFRS 9 also allows entities to continue to irrevocably designate instruments that qualify for amortised cost or FVOCI instruments as FVTPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the consolidated statement of profit or loss.

The accounting for financial liabilities largely remains the same as the requirements of IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVTPL. Such movements are presented in OCI with no subsequent reclassification to the statement of profit or loss, unless an accounting mismatch in profit or loss would arise.

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.1 Standards effective for the year (continued)

IFRS 9 Financial Instruments (continued)

Classification and measurement (continued)
Having implemented IFRS 9, the Group has concluded that:

- The majority of placements with banks and other financial institutions, loans and advances to customers and securities bought under repurchase agreements that are classified as loans and receivables under IAS 39 are measured at amortised cost under IFRS 9;
- Financial assets and liabilities held for trading and financial assets designated at FVTPL are continued to be measured at FVTPL;
- The majority of the debt securities classified as available for sale under IAS 39 are measured at FVOCI. Some securities, however, are classified as FVTPL, either because of their contractual cash flow characteristics or the business model within which they are held; and
- Debt securities classified as held to maturity are continued to be measured at amortised cost.

For an explanation of how the Group classifies financial assets and liabilities under IFRS 9, refer respective sections in note 4.

Hedge accounting
IFRS 9's hedge accounting requirements are designed to align the accounting more closely to the risk management framework; permit a greater variety of hedging instruments; and remove or simplify some of the rule-based requirements in IAS 39. The elements of hedge accounting: fair value, cash flow and net investment hedges are retained. There is an option in IFRS 9 for an accounting policy choice to continue with the IAS 39 hedge accounting framework; the Group currently is not applying this option and apply hedge accounting in accordance with IFRS 9 since there are no significant changes due to new hedge requirements.

Impairment of financial assets
Overview
IFRS 9 fundamentally changes the loan loss impairment methodology. The standard replaced IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach for non-impaired exposures. The Group is required to record an allowance for expected losses for all loans and other debt type financial assets not held at FVTPL, together with loan commitments and financial guarantee contracts. The allowance is based on the ECL associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case, the allowance is based on the probability of default over the life of the asset.

Under IFRS 9, credit losses are recognised earlier than under IAS 39. For an explanation of how the Group applies the impairment requirements of IFRS 9, see respective section of summary of significant accounting policies.

IFRS 7(revised) Financial instruments: Disclosures (IFRS 7R)
To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial instruments: Disclosures was updated and the Group has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in note 5.

Reconciliations from opening to closing ECL allowances for significant movements are presented in notes 8 and 9.

IFRS 7R also requires additional and more detailed disclosures for hedge accounting. However, the adoption of IFRS 9 for hedge accounting did not have a material impact on the hedging activities / accounting for the Group for the year ended 31 December 2018.

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

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.1 Standards effective for the year (continued)

IFRS 15 Revenue from Contracts with Customers (continued)

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

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

IFRIC Interpretation 22 Foreign currency transactions and advance considerations

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the date of the transactions for each payment or receipt of advance consideration. This Interpretation does not have any impact on the Group's consolidated financial statements.

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.

IFRS 16 Leases

The IASB issued the new standard for accounting for leases - IFRS 16 Leases in January 2016. The new standard does not significantly change the accounting for leases for lessors. However, it does require lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right-of-use assets. Lessees must apply a single model for all recognised leases, but will have the option not to recognise 'short-term' leases and leases of 'low-value' assets. Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in the statement of profit or loss.

IFRS 16, which is effective for annual periods beginning on or after 1 January 2019, requires lessees and lessors to make more extensive disclosures than under IAS 17.

The Group plans to apply IFRS 16 on 1 January 2019, using a modified retrospective approach. Therefore, the cumulative effect of adopting IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings at 1 January 2019, with no restatement of comparative information. The Group plans to apply the practical expedient to grandfather the definition of a lease on transition which means that it will apply IFRS 16 to all contracts entered into before 1 January 2019.

The adoption of the standard will not have a significant impact on the financial position of the Group.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

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 the following:

- Whether an entity considers uncertain tax treatments separately;
- The assumptions an entity makes about the examination of tax treatments by taxation authorities;
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- How an entity considers changes in facts and circumstances.

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.2 Standards issued but not yet effective (continued)

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment (continued)
An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The interpretation is effective for annual reporting periods beginning on or after 1 January 2019, but certain transition reliefs are available. The Group will apply interpretation from its effective date. Since the Group operates in a complex multinational tax environment, applying the Interpretation may affect its consolidated financial statements and the required disclosures. In addition, the Group may need to establish processes and procedures to obtain information that is necessary to apply the Interpretation on a timely basis.

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.

The amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted. These amendments have no impact on the consolidated financial statements of the Group.

Annual improvements 2015-2017 cycle (issued in December 2017)
These improvements include:

IFRS 3 Business combinations
The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation.

An entity applies those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2019, with early application permitted. These amendments will apply on future business combinations of the Group.

IAS 12 Income taxes
The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognises the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised those past transactions or events.

An entity applies those amendments for annual reporting periods beginning on or after 1 January 2019, with early application is permitted. When an entity first applies those amendments, it applies them to the income tax consequences of dividends recognised on or after the beginning of the earliest comparative period. Since the Group's current practice is in line with these amendments, the Group does not expect any effect on its consolidated financial statements.

IAS 23 Borrowing costs
The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete.

An entity applies those amendments to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies those amendments. An entity applies those amendments for annual reporting periods beginning on or after 1 January 2019, with early application permitted. Since the Group's current practice is in line with these amendments, the Group does not expect any effect on its consolidated financial statements.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

4A Policies applicable from 1 January 2018

4A.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.

4A.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 banks and financial institutions and treasury bills with original maturities of three months or less.

4A.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.

4A.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.

4A.6 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.

4A.7 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.

4A.8 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.

4A.9 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.

4A.10 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)

4A Policies applicable from 1 January 2018 (continued)

4A.11 Recognition of income and expenses
For all financial instruments measured at amortised cost and interest bearing financial instruments classified as FVOCI, interest income or expense is recorded at the effective interest rate, which is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense. Other fee income and expense are recognised when earned or incurred.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Where the Group enters into an interest rate swap to change interest from fixed to floating (or vice versa) the amount of interest income or expense is adjusted by the net interest on the swap.

The Group provides various services to its customers. These services are either rendered separately or bundled together with rendering of other services. The Group has concluded that revenue from rendering of various services should be recognised at the point when services are rendered, i.e. when performance obligation is satisfied. Fees earned for the provision of these services include commission income and asset management, custody and other management and advisory fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan. When it is unlikely that a loan will be drawn down, the loan commitment fees are recognised over the commitment period on a straight line basis.

Fees arising from negotiating or participating in the negotiation of a transaction for a third party, such as the arrangement of the acquisition of shares or other securities are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding performance obligation.

Results arising from trading activities include all gains and losses from changes in fair value and related interest income or expense and dividends for financial assets and financial liabilities held for trading. This includes any ineffectiveness recorded in hedging transactions.

4A.12 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 in the share premium.

4A.13 Financial instruments

4A.13.1 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)

4A Policies applicable from 1 January 2018 (continued)

4A.13 Financial instruments (continued)

4A.13.2 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 4A.13 and 4A.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.

4A.13.3 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.

4A.14 Financial assets

4A.14.1 Debt type instruments - Classification and subsequent measurement

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

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

The classification requirements for financial assets is as below.

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)

4A Policies applicable from 1 January 2018 (continued)

4A.14 Financial assets (continued)

4A.14.1 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 OCI, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses on the instrument's amortised cost which are recognised in consolidated profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Other operating income' as 'Gain or loss on disposal of non-trading investments'. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate (EIR) method.
- Fair value through profit or loss (FVTPL): Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. The Group may also designate a financial asset at FVTPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies. A gain or loss on a debt investment that is subsequently measured at FVTPL and is not part of a hedging relationship is recognised in consolidated profit or loss and presented in the consolidated statement of profit or loss within 'Other operating income' as 'Gain on trading securities' in the year in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Other operating income' as 'Gain on disposal of non-trading investments'. Interest income from these financial assets is included in 'Interest and similar income' using the EIR method.

4A.14.2 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. If cash flows after initial recognition are realised in a way that is different from the Group's original expectations, the Group does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4A Policies applicable from 1 January 2018 (continued)

4A.14 Financial assets (continued)

4A.14.3 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.

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 other than the reclassifications made on the initial adoption of IFRS 9 at the date of transition.

4A.14.4 Equity type instruments - classification and subsequent measurement
Equity instruments are instruments that meet the definition of equity from the issuer’s perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer’s net assets.

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

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

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4A Policies applicable from 1 January 2018 (continued)

4A.14 Financial assets (continued)

4A.14.5 Modified or forbearance of loans

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

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

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

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)

4A Policies applicable from 1 January 2018 (continued)

4A.14 Financial assets (continued)

4A.14.6 Derecognition other than on a modification

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

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

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

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

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

Collateral (shares and bonds) furnished by the Group under standard repurchase agreements and securities lending and borrowing transactions are not derecognised because the Group retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met.

4A.15 Financial liabilities

4A.15.1 Classification and subsequent measurement

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

- Financial liabilities at FVTPL: this classification is applied to derivatives and financial liabilities held for trading (e.g. short positions in the trading booking). Gains or losses on financial liabilities designated at FVTPL are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially in profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in consolidated profit or loss;
- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Group recognises any expense incurred on the financial liability; and
- Financial guarantee contracts and loan commitments.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4A Policies applicable from 1 January 2018 (continued)

4A.15 Financial liabilities (continued)

4A.15.2 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.

4A.16 Impairment

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

4A Policies applicable from 1 January 2018 (continued)

4A.16 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 loans are first recognised, the Group recognises an allowance based upto 12-month ECL.
- Stage 2 – Significant increase in credit risk: when a loan 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 loans.

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 investments.

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 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 CBB
- All exposures with external rating A- or above

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4A Policies applicable from 1 January 2018 (continued)

4A.16 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 that takes into account a number of economic scenarios, 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 amortized 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)

4A Policies applicable from 1 January 2018 (continued)

4A.16 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 probation 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 factors for which the data is updated once it is available and adjustments are made for significant events occurring prior to the reporting date.

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.

4A.17 Provisions
Provisions are recognised when the bank 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)

4A Policies applicable from 1 January 2018 (continued)

4A.18 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 – under IAS 39 – the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee, or – under IFRS 9 – an ECL provision.

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

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

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

4A.19 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)

4A Policies applicable from 1 January 2018 (continued)

4A.19 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 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.

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

4A.20 Interest income

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

4A.21 Fair value measurement

The Group measures financial instruments at fair value at each balance sheet 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)

4A Policies applicable from 1 January 2018 (continued)

4A.21 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 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 (market prices).
- Level 2 valuation: Directly observable proxies for the same instrument accessible at valuation date (mark-to-model with market data).
- Level 3 valuation: Derived proxies (interpolation of proxies) for similar instruments that have not been observed (mark-to-model with deduced proxies).

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.

4A.22 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.

4A.23 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 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 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 (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)

4A Policies applicable from 1 January 2018 (continued)

4A.24 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.

4A.25 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.

4A.26 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.

4A.27 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.

4A.28 Write-off

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

4A.29 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. The Group’s accounting policy for collateral assigned to it through its lending arrangements under IFRS 9 is the same as it was under IAS 39. Collateral, unless repossessed, is not recorded on the Group’s consolidated statement of financial position. However, the fair value of collateral affects the calculation of ECLs. It is generally assessed, at a minimum, at inception and re-assessed on a periodic basis. However, some collateral, for example, cash or securities relating to margining requirements, is valued daily.

To the extent possible, the Group uses active market data for valuing financial assets held as collateral. Other financial assets which do not have readily determinable market values are valued using 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.

4A.30 Collateral repossessed

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4A Policies applicable from 1 January 2018 (continued)

4A.31 Significant accounting judgments, 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 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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4A Policies applicable from 1 January 2018 (continued)

4A.31 Significant accounting judgments, estimates and assumptions (continued)

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

4B Policies applicable before adoption of IFRS 9
All the below mentioned policies of the Group were applicable specifically for the year ended 31 December 2017 and has been replaced with new set of policies with effect from 1 January 2018 upon adoption of IFRS 9. Refer section "Policies applicable from 1 January 2018" for more details.

4B.1 Non-trading securities
These are classified as follows:
- Held to maturity;
- Available-for-sale; and
- Other non-trading securities.

All non-trading securities are initially recognised at cost, being the fair value of the consideration given including incremental acquisition charges associated with the security.

Held to maturity
Securities which have fixed or determinable payments, fixed maturities and are intended to be held to maturity. After initial measurement, these are remeasured at amortised cost, less provision for impairment in value, if any.

Available-for-sale
Available-for-sale investments include equity and debt securities. Equity investments classified as available-for-sale are those which are neither classified as held for trading nor designated at FVTPL. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in market conditions.

After initial recognition, these are remeasured at fair value, unless fair value cannot be reliably determined in which case they are measured at cost less impairment. That portion of any fair value changes relating to an effective hedging relationship is recognised directly in the consolidated statement of profit or loss. Fair value changes which are not part of an effective hedging relationship, are reported under fair value movements during the year in the consolidated statement of comprehensive income until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as "cumulative changes in fair values" within equity, is included in consolidated statement of profit or loss for the year.

Other non-trading securities
Other non-trading securities are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. These instruments are not being held with the intent of sale in the near term. These investments are valued at fair value as at 1 July 2008, in accordance with the amendments to IAS 39 'Reclassification of Financial Assets'. Through the effective interest method, the new cost is amortised to the security's expected recoverable amount over the expected remaining life.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4B.2 Loans and advances

Loans and advances are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. After initial measurement, loans and advances are subsequently measured at amortised cost using the effective interest rate method, adjusted for effective fair value hedges less any amounts written off and provision for impairment. The losses arising from impairment of such loans and advances are recognised in the consolidated statement of profit or loss in 'impairment provisions - net' and in an impairment allowance account in the consolidated statement of financial position. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is recognised as 'interest and similar income' in the consolidated statement of profit or loss.

In relation to loans and advances which are part of an effective hedging relationship, any gain or loss arising from a change in fair value is recognised directly in the consolidated statement of profit or loss. The carrying values of loans and advances which are being effectively hedged for changes in fair value are adjusted to the extent of the changes in fair value being hedged.

4B.3 Impairment and uncollectability of financial assets

An assessment is made at each statement of financial position date to determine whether there is objective evidence that a specific financial asset or group of financial assets may be impaired. If such evidence exists, an impairment loss is recognised in the consolidated statement of profit or loss.

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

Financial assets carried at amortised cost and loans and receivables

For financial assets carried at amortised cost (such as amounts due from banks, loans and advances and held-to-maturity investments), the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the consolidated statement of profit or loss. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of ‘interest and similar income'. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group.

If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a written-off financial asset is later recovered, the recovery is credited to 'other operating income'.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4B.3 Impairment and uncollectability of financial assets (continued)

Financial assets carried at amortised cost and loans and receivables (continued)
The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. If the Group has reclassified trading assets to loans and advances, the discount rate for measuring any impairment loss is the new effective interest rate determined at the reclassification date. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal credit grading system, that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Available-for-sale financial assets
For available-for-sale financial assets, the Group assesses at each statement of financial position date whether there is objective evidence that an investment is impaired.

In the case of debt instruments classified as available-for-sale, the Group assesses individually whether there is objective evidence of impairment based on the same criteria as financial assets carried at amortised cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that asset previously recognised in the consolidated statement of profit or loss. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of 'interest and similar income'. If, in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to a credit event occurring after the impairment loss was recognised in the consolidated statement of profit or loss, the impairment loss is reversed through the consolidated statement of profit or loss.

In the case of equity investments classified as available-for-sale, objective evidence would also include a 'significant' or 'prolonged' decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated statement of profit or loss is removed from equity and recognised in the consolidated statement of profit or loss. Impairment losses on equity investments are not reversed through the consolidated statement of profit or loss. Increases in the fair value after impairment are recognised directly in equity.

4B.4 Derivatives and hedge accounting
The Group enters into derivative instruments including forwards, futures, forward rate agreements, swaps and options in the foreign exchange, interest rate and capital markets. These are stated at fair value. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the consolidated statement of financial position.

Changes in the fair values of derivatives held for trading activities or to offset other trading positions or which do not qualify for hedge accounting are included in other operating income in the consolidated statement of profit or loss.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4B.4 Derivatives and hedge accounting (continued)

For the purposes of hedge accounting, hedges are classified into three categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; (b) cash flow hedges which hedge the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction; and (c) net investment hedges which hedge the exposure to a net investment in a foreign operation.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objectives and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the Group will assess the effectiveness of changes in the hedging instrument's fair value in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

Changes in the fair value of derivatives that are designated, and qualify as fair value hedges and that prove to be highly effective in relation to the hedged risk, are included in other operating income along with the corresponding changes in the fair value of the hedged assets or liabilities which are attributable to the risk being hedged.

Changes in the fair value of derivatives that are designated, and qualify, as cash flow hedges and that prove to be highly effective in relation to the hedged risk are recognised in the consolidated statement of comprehensive income and the ineffective portion recognised in the consolidated statement of profit or loss. The gains or losses on cash flow hedges recognised initially in equity are transferred to the consolidated statement of profit or loss in the period in which the hedged transaction impacts the income. Where the hedged transaction results in the recognition of an asset or a liability the associated gain or loss that had been initially recognised in equity is included in the initial measurement of the cost of the related asset or liability.

Changes in fair value of derivatives or non-derivatives that are designated and qualify as net investment hedges and that prove to be highly effective in relation to the hedged risk are accounted for in a way similar to cash flow hedges.

Hedge accounting is discontinued when the derivative hedging instrument either expires or is sold, terminated or exercised, no longer qualifies for hedge accounting or is revoked. Upon such discontinuance:

- in the case of fair value hedges of interest-bearing financial instruments any adjustment to the carrying amount relating to the hedged risk is amortised in the consolidated statement of profit or loss over the remaining term to maturity.
- in the case of cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. When such transaction occurs the gain or loss retained in equity is recognised in the consolidated statement of profit or loss or included in the initial measurement of the cost of the related asset or liability, as appropriate. Where the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of profit or loss.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through the consolidated statement of profit or loss. These embedded derivatives are measured at fair value with the changes in fair value recognised in the consolidated statement of profit or loss.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4B.5 Significant accounting judgments, estimates and assumptions

Impairment losses on loans and advances
The Group reviews its individually significant loans and advances at each statement of financial position date to assess whether an impairment loss should be recorded in the consolidated statement of profit or loss. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.), concentrations of risks and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups).

The Group's internal grading process takes into consideration factors such as collateral held, deterioration in country risk, industry, technological obsolescence as well as identified structural weakness or deterioration in cash flows.

The impairment loss on loans and advances is disclosed in more detail in note 9.

Impairment losses on available-for-sale investments
The Group reviews its debt securities classified as available-for-sale investments at each statement of financial position date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and advances.

The Group also records impairment charges on available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is 'significant' or 'prolonged' requires judgment. In making this judgment, the Group evaluates, among other factors, historical share price movements and duration and extent to which the fair value of an investment is less than its cost.

5 TRANSITION DISCLOSURES

The Group has applied changes in accounting policies resulting from the adoption of IFRS 9 retrospectively, except as described below:

- Comparative periods have not been restated. A difference in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.

- Following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

  i. Determination of the business model within which a financial asset is held.
  ii. Designation and revocation of previous designated financial assets and financial liabilities as measured at FVTPL.
  iii. Assessment of cash flow contractual terms i.e. SPPI test.

It is assumed that the credit risk has not increased significantly for those debt securities who carry low credit risk at the date of initial application of IFRS 9.

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

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

Financial assets

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

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

All figures in US$ million

5 TRANSITION DISCLOSURES (continued)

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

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

All figures in US$ million

5 TRANSITION DISCLOSURES (continued)

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

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

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

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

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

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

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

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

(D) Designation of equity instruments at FVOCI

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

(E) Designation of equity instruments at FVTPL

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

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

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

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

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

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

Reclassifications to amortised cost	***31 December 2018***
From available-for-sale (IAS 39 classification) – Item (B) above	
Fair value as at 31 December 2018	868
Fair value gain/(loss) that would have been recognised in cumulative changes in fair value in equity during the year if the financial asset had not been reclassified	(19)

All figures in US$ million

5 TRANSITION DISCLOSURES (continued)

(b) Impact on retained earnings and other reserves

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

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

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

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

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

All figures in US$ Million

6 CLASSIFICATION OF FINANCIAL INSTRUMENTS

As at 31 December, financial instruments have been classified under IFRS 9 *Financial Instruments* as follows:

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**

All figures in US$ Million

6 CLASSIFICATION OF FINANCIAL INSTRUMENTS (continued)

At 31 December 2017	*Held for trading*	*Available-for-sale*	*Amortised cost/ Loans and receivables*	*Total*
ASSETS				
Liquid funds	-	-	1,388	1,388
Trading securities	1,051	-	-	1,051
Placements with banks and other financial institutions	-	-	3,170	3,170
Securities bought under repurchase agreements	-	-	1,521	1,521
Non-trading investments	-	5,368	231	5,599
Loans and advances	-	-	15,329	15,329
Other assets	196	-	1,105	1,301
	1,247	5,368	22,744	29,359

	Held for trading	*Available-for-sale*	*Amortised cost*	*Total*
LIABILITIES				
Deposits from customers	-	-	16,755	16,755
Deposits from banks	-	-	3,408	3,408
Certificates of deposit	-	-	27	27
Securities sold under repurchase agreements	-	-	1,628	1,628
Taxation and other liabilities	180	-	941	1,121
Borrowings	-	-	2,148	2,148
	180	-	24,907	25,087

7 LIQUID FUNDS

	2018	*2017*
Cash on hand	**32**	33
Balances due from banks	**272**	263
Deposits with central banks	**987**	779
Treasury bills and other eligible bills with original maturities of three months or less	**50**	85
Cash and cash equivalents	**1,341**	1,160
Treasury bills and other eligible bills with original maturities of more than three months	**266**	228
	1,607	1,388
ECL allowances	**-**	-
	1,607	1,388

All figures in US$ Million

8 NON-TRADING INVESTMENTS

	2018	*2017*
Debt securities		
Available-for-sale	**-**	5,459
Held to maturity	**-**	217
At amortised cost	**1,124**	-
At FVOCI	**4,649**	-
	5,773	5,676
Provisions	**-**	(103)
ECL allowances	**(121)**	-
Debt securities - net	**5,652**	5,573
Equity securities		
Available-for-sale, net of provision	**-**	26
At FVOCI	**9**	-
Equity securities - net	**9**	26
	5,661	5,599

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

	2018	*2017*
AAA rated debt securities	**1,274**	1,118
AA to A rated debt securities	**1,931**	1,874
Other investment grade debt securities	**1,356**	1,089
Other non-investment grade debt securities	**927**	1,368
Unrated debt securities	**285**	227
Equity securities	**9**	26
	5,782	5,702
Provisions	**-**	(103)
ECL allowances	**(121)**	-
	5,661	5,599

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

	2018				*2017*
	Stage 1	***Stage 2***	***Stage 3***	***Total***	*Total*
Debt securities, gross	**5,534**	**137**	**102**	**5,773**	5,676
ECL allowances	**(13)**	**(6)**	**(102)**	**(121)**	(103)
	5,521	**131**	**-**	**5,652**	5,573

All figures in US$ Million

8 NON-TRADING INVESTMENTS (continued)

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

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

An analysis of changes in the ECL allowance is as follows:

	2018				*2017*
	Stage 1	***Stage 2***	***Stage 3***	***Total***	*Total*
As at 1 January	**14**	**4**	**103**	**121**	116
Transfers to stage 1	**1**	**(1)**	**-**	**-**	-
Transfers to stage 2	**-**	**-**	**-**	**-**	-
Transfers to stage 3	**-**	**-**	**-**	**-**	-
Net transfers between stages	**1**	**(1)**	**-**	**-**	-
Assets derecognised or repaid (excluding write-offs)	**-**	**-**	**-**	**-**	(14)
Charge for the period - net	**-**	**1**	**-**	**1**	1
Exchange adjustments and other movements	**(2)**	**2**	**(1)**	**(1)**	-
As at 31 December	**13**	**6**	**102**	**121**	103

The gross amount of non-trading investments individually determined to be impaired and classified under Stage 3, before deducting any individually assessed impairment losses, amounts to US$ 102 million (2017: US$ 119 million). Interest income received during the year on impaired investments classified under Stage 3 amounted to US$ Nil. (2017: US$ 1 million).

9 LOANS AND ADVANCES

Below is the classification of loans and advances:

	2018				*2017*
	Stage 1	***Stage 2***	***Stage 3***	***Total***	*Total*
i) By measurement classification					
At FVTPL					
- Wholesale	**19**	**-**	**-**	**19**	-
At FVOCI					
- Wholesale	**216**	**-**	**-**	**216**	-
At Amortised cost					
- Wholesale	**13,068**	**905**	**586**	**14,559**	15,312
- Retail	**590**	**33**	**31**	**654**	589
	13,893	**938**	**617**	**15,448**	15,901
ECL allowances/provisions	**(47)**	**(88)**	**(429)**	**(564)**	(572)
	13,846	**850**	**188**	**14,884**	15,329

All figures in US$ Million

9 LOANS AND ADVANCES (continued)

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

	Gross loans		*ECL allowances*		*Net loans*	
	2018	*2017*	***2018***	*2017*	***2018***	*2017*
Financial services	**3,299**	3,921	**20**	8	**3,279**	3,913
Other services	**3,210**	2,448	**87**	47	**3,123**	2,401
Manufacturing	**2,464**	2,127	**67**	33	**2,397**	2,094
Construction	**1,096**	1,265	**112**	59	**984**	1,206
Mining and quarrying	**337**	301	**2**	-	**335**	301
Transport	**888**	1,083	**18**	3	**870**	1,080
Personal/consumer finance	**549**	489	**26**	22	**523**	467
Credit cards	**11**	12	**-**	1	**11**	11
Commercial real estate financing	**507**	369	**1**	-	**506**	369
Residential mortgage	**188**	197	**1**	-	**187**	197
Trade	**1,241**	1,362	**165**	172	**1,076**	1,190
Agriculture, fishing and forestry	**1,207**	1,398	**29**	7	**1,178**	1,391
Technology, media and telecommunications	**267**	381	**33**	22	**234**	359
Government	**184**	548	**3**	2	**181**	546
	15,448	15,901	**564**	376	**14,884**	15,525
Collective impairment	**-**	-	**-**	196	**-**	(196)
	15,448	15,901	**564**	572	**14,884**	15,329

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

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

All figures in US$ Million

9 LOANS AND ADVANCES (continued)

An analysis of changes in the ECL allowance is as follows:

	2018				*2017*
	Stage 1	***Stage 2***	***Stage 3***	***Total***	*Total*
As at 1 January	**42**	**172**	**376**	**590**	571
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**	95
Recoveries / write back	**(2)**	**(26)**	**(20)**	**(48)**	-
Charge (write back) for the period - net	**(2)**	**(26)**	**113**	**85**	95
Amounts written-off	**-**	**-**	**(82)**	**(82)**	(88)
Exchange adjustments and other movements	**(4)**	**-**	**(25)**	**(29)**	(6)
As at 31 December	**47**	**88**	**429**	**564**	572

The gross amount of loans, individually determined to be impaired and classified under Stage 3 before deducting any individually assessed impairment allowance amounts to US$ 617 million (2017: US$ 554 million).

The fair value of collateral that the Group holds relating to loans individually determined to be impaired and classified under Stage 3 at 31 December 2018 amounts to US$ 232 million (2017: US$ 222 million).

At 31 December 2018, interest in suspense on past due loans under Stage 3 amounts to US$ 86 million (2017: US$ 82 million).

10 CREDIT LOSS EXPENSE ON FINANCIAL ASSETS

	2018	*2017*
Non-trading investments (note 8)	**1**	1
Loans and advances (note 9)	**85**	95
Credit commitments and contingent items (note 21)	**(6)**	-
Other financial assets	**(1)**	-
	79	96

11 OTHER ASSETS

	2018	*2017*
Interest receivable	**410**	445
Trade receivables	**243**	242
Positive fair value of derivatives (note 20)	**468**	197
Assets acquired on debt settlement	**82**	112
Deferred tax assets	**98**	86
Bank owned life insurance	**38**	37
Margin dealing accounts	**40**	29
Staff loans	**27**	25
Advances and prepayments	**30**	20
Investments in an associate	**17**	17
Others	**148**	108
	1,601	1,318

The negative fair value of derivatives amounting to US$ 444 million (2017: US$ 185 million) is included in other liabilities (note 13). Details of derivatives are given in note 20.

All figures in US$ Million

12 TAXATION ON FOREIGN OPERATIONS

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

	2018	*2017*
Consolidated statement of financial position		
Current tax liability	**25**	27
Deferred tax liability	**18**	31
	43	58
Consolidated statement of profit or loss		
Current tax on foreign operations	**33**	73
Deferred tax on foreign operations	**(17)**	(15)
	16	58
Analysis of tax charge		
At Bahrain (income tax rate of nil)	**-**	-
On profits of subsidiaries operating in other jurisdictions	**67**	62
Credit arising from tax treatment of hedging currency movements	**(51)**	(4)
Income tax expense reported in the consolidated statement of profit or loss	**16**	58

The effective tax rates on the profit of subsidiaries in MENA and United Kingdom were 29% (2017: 31%) and 19% (2017: 17%) as against the actual tax rates of 19% to 35% (2017: 11% to 36%) and 19% (2017: 19%) respectively. In the Bank's Brazilian subsidiary, the effective tax rate was nil (2017: 16%) as against the actual tax rate of 38% (2017: 40%).

As reflected above, the tax credit for the year includes US$ 51 million arising from the tax treatment of hedging currency movements (2017: tax credit of US$ 4 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 6% (2017: 19%).

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.

All figures in US$ Million

13 OTHER LIABILITIES

	2018	*2017*
Interest payable	**359**	427
Negative fair value of derivatives (note 20)	**444**	185
Employee related payables	**127**	130
Margin deposits including cash collateral	**62**	46
Cheques for collection	**5**	75
Deferred income	**29**	32
Provisions for credit commitments and contingent items	**52**	3
Accrued charges and other payables	**158**	165
	1,236	1,063

The positive fair value of derivatives amounting to US$ 468 million (2017: US$ 197 million) is included in other assets (note 11). Details of derivatives are given in note 20.

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 2018

Aggregate maturities	**Currency**	**Rate of Interest %**	***Parent bank***	***Subsidiaries***	***Total***
2019	EUR	*Euribor+1.10%*	**-**	**57**	**57**
2020*	US$	*7.875*	**-**	**132**	**132**
2020	US$	*Libor + 1.20%*	**-**	**175**	**175**
2020	US$	*Libor + 1.25%*	**-**	**75**	**75**
2020	US$	*3.008*	**-**	**5**	**5**
2021	US$	*Libor + 1.80%*	**231**	**-**	**231**
2022	US$	*Libor + 2.25%*	**1,330**	**-**	**1,330**
2023	TND	*9.40*	**-**	**7**	**7**
			1,561	**451**	**2,012**
Total obligations outstanding at 31 December 2017			1,720	428	2,148

* Subordinated

During the year ended 31 December 2018, the Bank repurchased a portion of its term loan borrowings with a nominal value of US$ 6 million (2017: US$ 199 million). The resultant net gain on the repurchase amounting to US$ nil (2017 : US$ 1 million) is included in "Other operating income". Refer note 18.

15 EQUITY

a) Share capital

	2018	*2017*
Authorised – 3,500 million shares of US$ 1 each (2017: 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 (2017: 3,110 million shares of US$ 1 each)	**3,110**	3,110

b) Treasury shares

During the year, the Group acquired 12,200,000 shares (2017: Nil) for a cash consideration of US$ 4.4 million (2017: Nil).

All figures in US$ Million

15 EQUITY (continued)

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 after obtaining approval of the Central Bank of Bahrain.

e) Cumulative changes in fair value

	2018	*2017*
At 1 January	**5**	(45)
Net movement in fair value during the year	**(42)**	16
At 31 December	**(37)**	(29)
Impact of adopting IFRS 9 (note 5)	**-**	34
At 31 December (restated)	**(37)**	5

16 INTEREST AND SIMILAR INCOME

	2018	*2017*
Loans and advances	**908**	864
Securities	**384**	407
Placements with banks and other financial institutions	**175**	232
Others	**5**	8
	1,472	1,511

17 INTEREST AND SIMILAR EXPENSE

	2018	*2017*
Deposits from banks	**549**	572
Deposits from customers	**264**	282
Borrowings	**94**	96
Certificates of deposit and others	**6**	5
	913	955

18 OTHER OPERATING INCOME

	2018	*2017*
Fee and commission income - net	**205**	194
Bureau processing income	**32**	37
Gain (loss) on dealing in derivatives - net	**28**	(14)
Gain on dealing in foreign currencies - net	**39**	54
Loss on hedging foreign currency movements	**(51)**	(4)
Gain on disposal of non-trading investments - net	**8**	12
(Loss) gain on trading securities - net	**(18)**	15
Gain on repurchase of subordinated debt (note 14)	**-**	1
Gain on sale of premises and equipment - net	**-**	5
Other - net	**15**	13
	258	313

Included in the fee and commission income is US$ 13 million (2017: US$ 13 million) of fee income relating to funds under management.

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.)*	
			2018	*2017*
			%	%
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*	**60.6**	60.7
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 services*	*Bahrain*	**56.6**	55.9

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.

	2018	*2017*
Proportion of equity interest held by non-controlling interests (%)	**39.4%**	39.3%
Dividends paid to non-controlling interests	**22**	24

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

	2018	*2017*
Summarised statement of profit or loss:		
Interest and similar income	**648**	820
Interest and similar expense	**(471)**	(594)
Other operating income	**85**	142
Credit loss expense on financial assets	**(39)**	(78)
Operating expenses	**(126)**	(132)
Profit before tax	**97**	158
Income tax	**17**	(25)
Profit for the year	**114**	133
Profit attributable to non-controlling interests	**45**	52
Total comprehensive (loss) income	**(38)**	112
Total comprehensive (loss) income attributable to non-controlling interests	**(15)**	44

All figures in US$ Million

19 GROUP INFORMATION (continued)

19.3 Material partly-owned subsidiaries (continued)

Banco ABC Brasil S.A. (continued)

	2018	*2017*
Summarised statement of financial position:		
Total assets	**7,757**	8,161
Total liabilities	**6,792**	7,132
Total equity	**965**	1,029
Equity attributable to non-controlling interests	**380**	404
Summarised cash flow information for the year ended:		
Operating activities	**(92)**	(55)
Investing activities	**108**	265
Financing activities	**(13)**	(207)
Net increase in cash and cash equivalents	**3**	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.

	2018			*2017*		
	Positive fair value	***Negative fair***	***Notional amount***	*Positive fair value*	*Negative fair*	*Notional amount*
Derivatives held for trading						
Interest rate swaps	**88**	**82**	**7,416**	60	45	4,956
Currency swaps	**27**	**14**	**507**	4	13	583
Forward foreign exchange contracts	**19**	**11**	**3,101**	11	7	4,127
Options	**314**	**298**	**6,661**	118	113	3,576
Futures	**2**	**8**	**3,208**	3	2	4,086
	450	**413**	**20,893**	196	180	17,328
Derivatives held as hedges						
Interest rate swaps	**15**	**26**	**2,303**	-	-	2,120
Currency swaps	**-**	**1**	**25**	-	-	-
Forward foreign exchange contracts	**3**	**4**	**560**	1	5	612
	18	**31**	**2,888**	1	5	2,732
	468	**444**	**23,781**	197	185	20,060
Risk weighted equivalents (credit and market risk)			**2,102**			1,738

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 and subordinated loan of a subsidiary.

For the year ended 31 December 2018, the Group recognised a net gain of US$ 26 million (2017: net gain of US$ 18 million) on hedging instruments. The total loss on hedged items attributable to the hedged risk amounted to US$ 26 million (2017: loss of US$ 18 million).

b) The Group uses deposits which are accounted for as hedges of net investment in foreign operations. As at 31 December 2018, the Group had deposits amounting to US$ 610 million (2017: US$ 649 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 three 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 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 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*	*10- 20 years*	*Total*
Notional								
2018	**2,509**	**2,473**	**1,505**	***4,413***	***8,757***	***3,015***	***1,109***	***23,781***
2017	3,215	2,038	1,812	*4,708*	*4,977*	*2,962*	*348*	*20,060*

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 the hypothetical derivative 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.

The Group enters into interest rate swaps that have similar critical terms as the hedged item, such as reference rate, reset dates, payment dates, maturities and notional amount. In cases, where the Group does not hedge 100% of its loans, the hedged item is identified as a proportion of the outstanding loans up to the notional amount of the swaps. As all critical terms matched during the year, the economic relationship was 100% effective.

Hedge ineffectiveness for interest rate swaps is assessed using the same principles as for hedges of foreign currency. It may occur due to:

- the credit value/debit value adjustment on the interest rate swaps which is not matched by the loan, and
- differences in critical terms between the interest rate swaps and loans

The ineffectiveness during 2018 or 2017 in relation to the interest rate swaps is however not significant to the Group.

All figures in US$ Million

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:

	2018	*2017*
Short-term self-liquidating trade and transaction-related contingent items	**3,662**	3,437
Direct credit substitutes and guarantees	**4,043**	3,979
Undrawn loans and other commitments	**2,272**	2,179
	9,977	9,595
Credit exposure after applying credit conversion factor	**4,173**	4,100
Risk weighted equivalents	**3,274**	3,282

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

	2018	*2017*
On demand	**2,430**	1,635
1 - 6 months	**3,095**	2,818
6 - 12 months	**1,946**	1,784
1 - 5 years	**2,453**	3,285
Over 5 years	**53**	73
	9,977	9,595

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

	2018				*2017*
	Stage 1	***Stage 2***	***Stage 3***	***Total***	*Total*
Credit commitments and contingencies	**3,996**	**160**	**17**	**4,173**	4,100
ECL allowances	**(14)**	**(22)**	**(16)**	**(52)**	(3)

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

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

All figures in US$ Million

21 CREDIT COMMITMENTS AND CONTINGENT ITEMS (continued)

An analysis of changes in the ECL allowance is as follows:

	2018				2017
	Stage 1	Stage 2	Stage 3	Total	Total
As at 1 January	**13**	**37**	**3**	**53**	2
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 period - net	**(1)**	**(8)**	**3**	**(6)**	-
Exchange adjustments and other movements	**-**	**(4)**	**9**	**5**	1
As at 31 December	**14**	**22**	**16**	**52**	3

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:

	2018		2017	
Long (short)	Currency	US$ equivalent	Currency	US$ equivalent
Brazilian Real	**2,269**	**585**	2,039	616
Pound Sterling	**4**	**6**	(5)	(7)
Egyptian Pound	**1,735**	**97**	1,763	99
Jordanian Dinar	**136**	**191**	185	261
Algerian Dinar	**15,422**	**130**	14,810	129
Tunisian Dinar	**74**	**25**	6	2
Euro	**1**	**2**	5	6
Bahrain Dinar	**8**	**20**	7	18

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 2018

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

Financial assets measured at fair value:

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

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**

23.2 31 December 2017

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

Financial assets measured at fair value:

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

All figures in US$ Million

23 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

23.2 31 December 2017 (continued)

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

Financial liabilities measured at fair value:

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

Fair values of financial instruments not carried at fair value

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

	Carrying value	*Fair value*
Financial assets		
Non-trading investments at amortised cost - gross	223	249
Financial liabilities		
Borrowings	2,148	2,159

Financial instruments in level 1

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the group is the current bid price. These instruments are included in Level 1.

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 2018 (31 December 2017: none).

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 and market risk, legal risk and strategic risk as well as other forms of risk inherent in its financial operations.

Over the last few years the Group has invested heavily into developing a 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 significant risks to the business and the design and implementation of appropriate internal controls to minimise them. This is done through the following board committees, senior management committees and the Credit & Risk Group in Head Office.

Within the broader governance infrastructure, the board committees carry the main responsibility of best practice management and risk oversight. At this level, the BRC oversees the definition of risk appetite, risk tolerance standards, and risk process standards to be kept in place. The BRC is also responsible to coordinate with other board committees for monitoring compliance with the requirements of the regulatory authorities in the 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 Group 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 the various countries in which the Group operates.

The GRC defines, develops and monitors the Group’s overarching risk management framework taking into account the Group’s strategy and business plans. The GRC is responsible for highlighting, discussing and monitoring key regulations, both local and international, as applicable to the businesses and geographies where the Group operates. The GRC is assisted by specialised sub-committees to manage credit risk (Group Credit Committee), operational risk (Group Operational Risk Committee) and operational resilience (Group Operational Resilience Committee).

The Group Asset and Liability Committee (“GALCO”) is responsible for defining long-term strategic plans and policy, as well as short-term tactical initiatives for prudently directing asset and liability allocation. GALCO monitors the Group’s liquidity and market risks, and the Group’s risk profile in the context of economic developments and market fluctuations. GALCO is assisted by tactical sub-committees for Capital & Liquidity Management.

The GCOC is responsible for strengthening the focus on compliance within the Group’s risk management framework.

The above management structure, supported by teams of risk and credit analysts and compliance officers, as well as the IT systems provide a coherent infrastructure to carry credit, risk 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.

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 (policy applicable from 1 January 2018) 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 within 12 months for the calculation of the 12 months ECL. However, if a Stage 1 loan that is expected to default in the 12 months from the date of the consolidated statement of financial position and is also expected to cure and subsequently default again, then all linked default events are taken into account. 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 (policy applicable from 1 January 2018) 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, 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; and
- Debtor’s listed debt or equity suspended at the primary exchange because of rumours or facts about financial difficulties.

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.

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.1 Credit risk impairment assessment (policy applicable from 1 January 2018) 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 (%)
1+ to 4-	Superior	>= 0.00% to <0.49%
5+ to 5-	Satisfactory	>= 0.49% to <1.52%
6+ to 6-	Satisfactory	>= 1.52% to <5.02%
7	Marginal	>= 5.02% to <17.32%
8	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 scenarios as appropriate.

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.1 Credit risk impairment assessment (policy applicable from 1 January 2018) 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

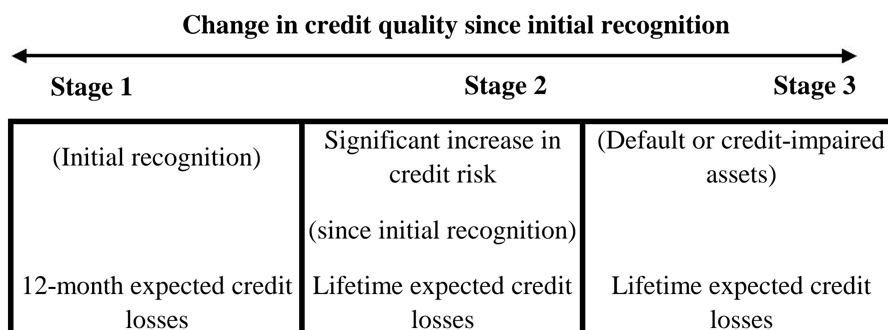
A backstop is applied and the financial instrument considered to have experienced SICR if the borrower is more than 30 days past due on its contractual payments.

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 significant increase in credit risk 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.

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.1 Credit risk impairment assessment (policy applicable from 1 January 2018) 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
- 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 and 6 months for transition from Stage 2 to 1. This period of 12 and 6 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.

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.1 Credit risk impairment assessment (policy applicable from 1 January 2018) 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. This is supported by historical analysis.

The 12-month and lifetime EADs are determined based on the expected payment profile, which varies by product type.

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.

The 12-month and lifetime LGDs are determined for secured and unsecured portions of instruments based on the factors which impact the recoveries made post default. These 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 secured 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 impact 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 a team of economists within its Credit Risk Department verifies the accuracy of inputs to the Group's ECL models including determining the weights attributable to the multiple scenarios. The following table sets out the key macroeconomic variables of ECL calculation and weightages used for scenarios.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

24.4.1 Credit risk impairment assessment (policy applicable from 1 January 2018) and mitigation (continued)

Economic variable assumptions (continued)

Key macroeconomic variables used	ECL scenario and assigned weightage
GDP	Base (40%)
Oil price	Upside (30%)
Equity index	Downside (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.

In addition to above, the Group also considers the impact of any regulatory, legislative or political changes, however, these are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on a quarterly basis.

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 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	
	2018	*2017*
Liquid funds	**1,575**	1,355
Trading debt securities	**961**	1,051
Placements with banks and other financial institutions	**2,991**	3,170
Securities bought under repurchase agreements	**1,668**	1,521
Non-trading debt investments	**5,652**	5,574
Loans and advances	**14,884**	15,329
Other credit exposures	**1,584**	1,301
	29,315	29,301
Credit commitments and contingent items (note 21)	**9,977**	9,595
Total	**39,292**	38,896

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 (continued)

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.

For more detail on the maximum exposure to credit risk for each class of financial instrument, references should be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown below.

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				
	2018				*2017*
	Stage 1	*Stage 2*	*Stage 3*	*Total*	*Total*
Western Europe	**3,095**	**136**	**1**	**3,232**	3,163
Arab World	**11,755**	**507**	**28**	**12,290**	11,614
Asia	**1,733**	**9**	**-**	**1,742**	2,189
North America	**3,257**	**-**	**20**	**3,277**	3,058
Latin America	**7,249**	**140**	**131**	**7,520**	8,125
Other	**1,028**	**218**	**8**	**1,254**	1,152
Total	**28,117**	**1,010**	**188**	**29,315**	29,301

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

	Liabilities and equity	
	2018	*2017*
Western Europe	**2,489**	2,157
Arab World	**18,879**	18,778
Asia	**468**	359
North America	**706**	977
Latin America	**6,046**	6,601
Other	**727**	429
Total	**29,315**	29,301

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

	Credit commitments and contingent items				
	2018				*2017*
	Stage 1	*Stage 2*	*Stage 3*	*Total*	*Total*
Western Europe	**1,723**	**59**	**30**	**1,812**	1,550
Arab World	**3,809**	**111**	**-**	**3,920**	3,803
Asia	**253**	**84**	**-**	**337**	281
North America	**631**	**64**	**-**	**695**	540
Latin America	**3,076**	**-**	**-**	**3,076**	3,380
Other	**120**	**16**	**1**	**137**	41
Total	**9,612**	**334**	**31**	**9,977**	9,595

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 financial assets, before and after taking into account cash collateral held or other credit enhancements, is as follows:

	Gross maximum exposure					***Net maximum exposure***	
	2018				*2017*	***2018***	*2017*
	Stage 1	***Stage 2***	***Stage 3***	***Total***	*Total*		
Financial services	**9,251**	**340**	**-**	**9,591**	9,580	**7,638**	8,048
Other services	**4,757**	**76**	**21**	**4,854**	4,811	**4,827**	4,783
Manufacturing	**2,955**	**154**	**72**	**3,181**	2,203	**3,136**	2,162
Construction	**837**	**41**	**34**	**912**	1,256	**823**	1,166
Mining and quarrying	**362**	**12**	**-**	**374**	307	**374**	307
Transport	**971**	**82**	**9**	**1,062**	1,136	**1,062**	1,136
Personal / Consumer finance	**585**	**32**	**7**	**624**	573	**624**	572
Credit cards	**10**	**-**	**-**	**10**	11	**10**	11
Commercial real estate financing	**431**	**76**	**-**	**507**	368	**507**	368
Residential mortgage	**186**	**-**	**1**	**187**	197	**187**	197
Trade	**1,420**	**121**	**1**	**1,542**	1,242	**1,534**	1,236
Agriculture, fishing and forestry	**1,129**	**42**	**35**	**1,206**	1,426	**1,206**	1,426
Technology, media and telecommunications	**381**	**-**	**8**	**389**	539	**389**	539
Government	**4,842**	**34**	**-**	**4,876**	5,652	**4,287**	5,482
Total	**28,117**	**1,010**	**188**	**29,315**	29,301	**26,604**	27,433

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

	Gross maximum exposure					***Net maximum exposure***	
	2018				*2017*	***2018***	*2017*
	Stage 1	***Stage 2***	***Stage 3***	***Total***	*Total*		
Financial services	**3,928**	**61**	**1**	**3,990**	3,214	**3,652**	3,049
Other services	**534**	**134**	**-**	**668**	2,114	**668**	2,109
Manufacturing	**1,323**	**61**	**-**	**1,384**	1,065	**1,374**	1,056
Construction	**602**	**62**	**30**	**694**	663	**693**	660
Mining and quarrying	**957**	**-**	**-**	**957**	203	**957**	203
Transport	**325**	**-**	**-**	**325**	332	**325**	332
Personal / Consumer finance	**36**	**-**	**-**	**36**	63	**36**	63
Commercial real estate financing	**189**	**-**	**-**	**189**	21	**189**	21
Trade	**379**	**16**	**-**	**395**	567	**391**	564
Agriculture, fishing and forestry	**190**	**-**	**-**	**190**	181	**190**	181
Technology, media and telecommunications	**272**	**-**	**-**	**272**	128	**271**	127
Government	**877**	**-**	**-**	**877**	1,044	**841**	1,037
Total	**9,612**	**334**	**31**	**9,977**	9,595	**9,587**	9,402

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.4 Credit risk (continued)

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 2018	***Neither past due nor impaired***				
	High grade	***Standard grade***	***Past due but not impaired***	***Past due and individually impaired***	***Total***
Liquid funds	**1,575**	**-**	**-**	**-**	**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**
	13,892	**15,180**	**55**	**188**	**29,315**

31 December 2017	*Neither past due nor impaired*				
	High grade	*Standard grade*	*Past due but not impaired*	*Past due and individually impaired*	*Total*
Liquid funds	1,355	-	-	-	1,355
Trading debt securities	229	822	-	-	1,051
Placements with banks and other financial institutions	1,872	1,298	-	-	3,170
Securities bought under repurchase agreements	100	1,421	-	-	1,521
Non-trading debt investments	4,052	1,520	-	2	5,574
Loans and advances	4,423	10,656	72	178	15,329
Other credit exposures	1,036	265	-	-	1,301
	13,067	15,982	72	180	29,301

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 2018

	Liquid funds	*Trading debt securities*	*Placements with banks and other financial institutions*	*Securities bought under repurchase agreements*	*Non-trading debt securities*	*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-	**149**	**525**	**389**	**925**	**505**	**4,583**
Rating grades 6+ to 6-	**65**	**-**	**679**	**627**	**758**	**3,263**
Rating grade 7	**-**	**-**	**-**	**13**	**-**	**214**
Carrying amount (net)	**1,566**	**961**	**2,971**	**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-	**2**	**-**	**-**	**-**	**-**	**82**
Rating grades 6+ to 6-	**7**	**-**	**20**	**-**	**131**	**442**
Rating grade 7	**-**	**-**	**-**	**-**	**-**	**131**
Rating grade 8	**-**	**-**	**-**	**-**	**-**	**155**
Carrying amount (net)	**9**	**-**	**20**	**-**	**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

	2018	*2017*
Loans and advances	**330**	239

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.

The following table provides information on financial assets that were modified while they had a loss allowance measured at an amount equal to lifetime ECL.

	2018	
	Gross carrying amount	***Corresponding ECL***
Gross carrying amount for which loss allowance measured using 12m ECL during the year	**9**	**-**

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$ 834 million. Predominantly, the loan to value ratios for these exposures are in the range of 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
Trading securities	
- Debt Securities	**961**
Trading derivatives	**450**
Hedging derivatives	**18**
Financial assets designated at FVTPL	
- Loans and advances to customers	**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.

24.7 Interest rate risk

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. 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.

	2018			
	Increase in basis points	***Sensitivity statement of profit or loss***	***Decrease in basis points***	***Sensitivity 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)**

	2017			
	Increase in basis points	*Sensitivity statement of profit or loss*	*Decrease in basis points*	*Sensitivity statement of profit or loss*
US Dollar	25	-	25	-
Euro	25	2	25	(2)
Pound Sterling	25	-	25	-
Brazilian Real	25	-	25	-
Others	25	1	25	(1)

All figures in US$ Million

24 RISK MANAGEMENT (continued)

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 2018 and 31 December 2017 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.

	2018			*2017*		
	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%**	**-**	**+/-29**	+/- 5%	-	+/-31
Egyptian Pound	**+/- 5%**	**-**	**+/-5**	+/- 5%	-	+/-4
Jordanian Dinar	**+/- 5%**	**-**	**+/-10**	+/- 5%	+/-4	+/-9
Algerian Dinar	**+/- 5%**	**-**	**+/-6**	+/- 5%	-	+/-6
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.

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

	2018		*2017*	
	% Change in equity price	***Effect on statement of profit or loss/ equity***	*% Change in equity price*	*Effect on statement of profit or loss/ equity*
Trading equities	**+/- 5%**	**+/-1**	+/- 5%	-
Equity securities at FVOCI	**+/- 5%**	**-**	+/- 5%	+/-1

24.10 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk in Bank ABC includes legal risk and Information Technology (IT) 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 Officer or local Head 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”) assists the Group Risk Committee with the management of operational risks across ABC Group and ensures that the affairs of the Group are conducted in a manner which is consistent with the Operational Risk Policy approved by the Board Risk Commitee.

All figures in US$ Million

24 RISK MANAGEMENT (continued)

24.10 Operational risk (continued)

The GORCO:

- Defines the policy for the management of operational risks and recommends this Policy for ultimate approval by the Board Risk Committee.
- Advises the Group Risk Committee and the Board Risk Committee with establishing, approving and periodically reviewing the tolerance for operational risks in ABC group.
- Monitors and reviews the operational risk exposures in the various business lines and subsidiaries.
- Defines the various components of the framework for the management of operational risks in ABC group and oversees the implementation of the framework across ABC group.
- Oversees the actions taken to maintain exposures in line with the operational risk profile.

The implementation of the framework for the management of operational risk is governed by the GORCO.

Local Operational Risk Committees oversee the implementation of the framework and the management of operational risk in all subsidiaries and branches of ABC Group.

The Group Operational Risk Management Department in Head Office is responsible for the development of the group-wide methodology, system support and overall quality control. The Group has implemented the following tools for the management of operational risks.

The Group has implemented the following tools for the management of operational risks:

- Internal loss data and incidents, near miss events
- Risk & Control Self-Assessments (bottom-up and top-down)
- Group-wide control standards
- Key Risk and Performance Indicators (group-wide and local)
- New product approval processes

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 had implemented a group-wide Governance, Risk and Compliance solution. This group-wide solution is being used by Audit, Risk and Compliance.

A wide range of reports, tailored to the needs of the different stakeholders, is available to provide information on the operational risk profile of Bank ABC 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 caused by operational risk events. In addition, the Group uses a quantitative and qualitative risk rating scale to classify actual and potential non-financial 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.

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 circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors 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 liquid assets 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 excess liquidity, its principal sources of liquidity being its deposit base, liquidity derived from its operations and inter-bank borrowings. The Liquidity Survival Horizon (LSH) is used to manage and monitor daily liquidity. The LSH represents the minimum number of days the Group can survive the combined outflow of all deposits and contractual drawdowns, under market value driven encashability scenarios.

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 2018 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 2018	***Within 1 month***	***1 - 3 months***	***3 - 6 months***	***6 - 12 months***	***1 - 5 years***	***5-10 years***	***10- 20 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**
Securities sold under repurchase agreements	**767**	**459**	**-**	**-**	**56**	**-**	**-**	**1,282**
Certificates of deposits	**4**	**7**	**3**	**5**	**23**	**-**	**-**	**42**
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)

At 31 December 2017	*Within 1 month*	*1 - 3 months*	*3 - 6 months*	*6 - 12 months*	*1 - 5 years*	*5-10 years*	*10- 20 years*	*Total*
Financial liabilities								
Deposits from customers	5,154	2,447	1,306	3,624	4,552	295	20	17,398
Deposits from banks	1,692	426	503	595	288	-	-	3,504
Securities sold under repurchase agreements	1,469	121	-	3	27	17	-	1,637
Certificates of deposits	1	3	6	6	12	-	-	28
Interest payable and other liabilities	778	31	61	91	92	9	-	1,062
Borrowings	-	-	-	173	2,136	-	-	2,309
Total non-derivative undiscounted financial liabilities on statement of financial position	9,094	3,028	1,876	4,492	7,107	321	20	25,938
ITEMS OFF STATEMENT OF FINANCIAL POSITION								
Gross settled foreign currency derivatives	1,900	1,036	850	1,325	202	25	-	5,338
Guarantees	3,707	-	-	-	-	-	-	3,707

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 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 securities	**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**	**-**		

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 2017	*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	1,100	60	68	30	1,258	130	-	-	-	-	130	1,388
Trading securities	-	24	-	693	717	334	-	-	-	-	334	1,051
Placements with banks and other financial institutions	2,360	541	176	93	3,170	-	-	-	-	-	-	3,170
Securities bought under repurchase agreements	1,421	100	-	-	1,521	-	-	-	-	-	-	1,521
Non-trading investments	41	287	227	675	1,230	3,042	1,076	170	56	25	4,369	5,599
Loans and advances	2,243	2,141	2,081	2,686	9,151	5,010	888	228	51	1	6,178	15,329
Others	11	25	10	127	173	149	15	2	-	1,102	1,268	1,441
Total assets	7,176	3,178	2,562	4,304	17,220	8,665	1,979	400	107	1,128	12,279	29,499
LIABILITIES, SHAREHOLDERS' EQUITY AND NON-CONTROLLING INTERESTS												
Deposits from customers	3,551	1,635	1,112	3,650	9,948	6,557	240	10	-	-	6,807	16,755
Deposits from banks	1,610	418	441	629	3,098	310	-	-	-	-	310	3,408
Certificates of deposit	1	3	6	6	16	11	-	-	-	-	11	27
Securities sold under repurchase agreements	1,466	117	-	3	1,586	25	17	-	-	-	42	1,628
Borrowings	-	-	-	150	150	1,998	-	-	-	-	1,998	2,148
Others	30	31	61	91	213	92	9	-	-	807	908	1,121
Shareholders' equity and non-controlling interests	-	-	-	-	-	-	-	-	-	4,412	4,412	4,412
Total liabilities, shareholders' equity and non-controlling interests	6,658	2,204	1,620	4,529	15,011	8,993	266	10	-	5,219	14,488	29,499
Net liquidity gap	518	974	942	(225)	2,209	(328)	1,713	390	107	(4,091)	(2,209)	-
Cumulative net liquidity gap	518	1,492	2,434	2,209		1,881	3,594	3,984	4,091	-		

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).

	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 on financial assets	**(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**

All figures in US$ Million

25 OPERATING SEGMENTS (continued)

	2017					
	MENA subsidiaries	*International wholesale banking*	*Group treasury*	*ABC Brasil*	*Other*	*Total*
Net interest income	124	160	20	226	26	556
Other operating income	41	65	31	143	33	313
Total operating income	165	225	51	369	59	869
Profit before impairment provisions	75	137	27	237	33	509
Impairment provisions - net	(1)	(17)	-	(78)	-	(96)
Profit before taxation and unallocated operating expenses	74	120	27	159	33	413
Taxation expense on foreign operations	(23)	(3)	-	(32)	-	(58)
Unallocated operating expenses						(102)
Profit for the year						253
Operating assets as at 31 December 2017	3,397	9,912	7,928	8,184	78	29,499
Operating liabilities as at 31 December 2017	2,899	-	15,194	6,983	11	25,087

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 2018 and 2017:

2018	***Bahrain***	***Europe***	***Brasil***	***Other***	***Total***
Total operating income	**232**	**120**	**262**	**203**	**817**
2017					
Total operating income	218	100	369	182	869

There were no revenues derived from transactions with a single external customer that amounted to 10% or more of the Group's revenue (2017: none).

26 REPURCHASE AND RESALE AGREEMENTS

Proceeds from assets sold under repurchase agreements at the year-end amounted to US$ 1,271 million (2017: US$ 1,628 million). The carrying value of securities sold under repurchase agreements at the year-end amounted to US$ 1,359 million (2017: US$ 1,628 million).

Amounts paid for assets purchased under resale agreements at the year-end amounted to US$ 1,668 million (2017: US$ 1,521 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$ 1,747 million (2017: US$ 1,523 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*	*2018*	*2017*
Deposits from customers	**3,126**	**670**	**7**	**3,803**	3,782
Borrowings	**1,505**	**-**	**-**	**1,505**	1,505
Short-term self-liquidating trade and transaction-related contingent items	**515**	**-**	**-**	**515**	331

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

	2018	*2017*
Commission income	**8**	7
Interest expense	**122**	107

Compensation of the key management personnel is as follows:

	2018	*2017*
Short term employee benefits	**18**	19
Post employment benefits	**3**	5
	21	24

28 FIDUCIARY ASSETS

Funds under management at the year-end amounted to US$ 14,927 million (2017: US$ 15,917 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$ 784 million (2017: US$ 772 million). Loans and advances, non-trading investments and placements include Islamic assets of US$ 1,167 million (2017: US$ 1,657 million), US$ 639 million (2017: US$ 599 million) and US$ 289 million (2017: US$ 286 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$ 407 million (2017: US$ 499 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 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.

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

31.1 Basic and diluted earnings per share

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

	2018	*2017*
Profit attributable to the shareholders of the parent	**202**	193
Weighted average number of shares outstanding during the year (millions)	**3,096**	3,110
Basic and diluted earnings per share (US$)	**0.07**	0.06

31.2 Proposed dividends and transfers

	2018	*2017*
Proposed cash dividend for 2018 of US$ 0.03 per share (2017: 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 2018 are based on standardised measurement methodology and in accordance with the CBB Basel III guidelines.

CAPITAL BASE		*2018*	*2017*
CET 1		**4,085**	4,196
AT 1		**49**	55
Total Tier 1 capital		**4,134**	4,251
Tier 2		**218**	253
Total capital base	[a]	**4,352**	4,504

RISK WEIGHTED EXPOSURES		*2018*	*2017*
Credit risk weighted assets and off balance sheet items		**20,719**	20,849
Market risk weighted assets and off balance sheet items		**1,680**	1,624
Operational risk weighted assets		**1,578**	1,572
Total risk weighted assets	[b]	**23,977**	24,045
Risk asset ratio	[a/b*100]	**18.2%**	18.7%
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, reserves, retained earnings, non controlling interests, profit for the year and cumulative changes in fair value
(b) 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.

The impact on retained earnings due to adoption of IFRS 9 has been included in full in 2018 for the purposes of calculation of CET 1.

33 CHANGES IN LIABILITIES ARISING FROM FINANCING ACTIVITIES

	1 January 2018	***Cash flow, net***	***Foreign exchange movement***	***Other***	***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**

	1 January 2017	*Cash flow, net*	*Foreign exchange movement*	*Other**	*31 December 2017*
Certificates of deposit	37	(8)	(2)	-	27
Borrowings	4,269	(1,462)	11	(670)	2,148
Total liabilities from financing activities	4,306	(1,470)	9	(670)	2,175

* Other relates to a loan from a major shareholder that was renewed at the time of maturity, as a deposit for two years maturing in June 2019.