ALUBAF Arab International Bank B.S.C. (c)

REPORT OF THE BOARD OF DIRECTORS, INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2018

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Alubaf Arab International Bank B.S.C(c)

Board of Directors' Report

On behalf of the Board of Directors', I am delighted to present audited financial statements for the year ended 31 December 2018.

The year 2018 has been another challenging year for the Banking industry, due to global geopolitical risks and uncertainty, in particular, in the region we operate. Amid such challenging environment, Alubaf stood resilient and adapted to the dynamics and complexity of challenges that impact the Banking sector.

The Bank delivered improved financial performance for the year ended 31 December 2018 and resulted in a Net profit of US$ 15 million, as compared to a net profit of US$ 10.8 million last year 2017, which is an increase of 39%, year on year.

Net profit for the quarter ended 31 December 2018 was US$ 2.9 million, as compared to US$ 4.7 million for the same period, last year 2017.

This increase in profit for 2018, was achieved, mainly due to improved asset quality and reduction on high risk weighted exposures. With gradual reduction on stressed assets and improved asset quality parameters, the income streams stabilized in 2018 from performing assets.

Interest income for 2018 was US$ 42.9 million, an increase of 8.4% over last year 2017, while, interest expenses increased by 37.8%, from US$ 10.2 million to US$ 14 million , due to hike in LIBOR rates for the year 2018. This resulted in reduction of Net interest income to US$ 28.8 million in 2018, compared to US$ 29.3 million in 2017.

Non- interest income from fee, commission and other income, increased by 14% for the year ended 31 December 2018, as compared to last year ended 2017, mainly due to increase in fee and commission.

On the expenses front, the staff costs grew by merely 3.5% for 2018, as compared to 2017. As for other operating expenses, the increase evidenced is 11.7% year on year, primarily expensed to strengthen control and processes that comply with regulatory requirements and obligations. Thus, Total cost to operating income ratio stood at 39.4% at yearend 31 December 2018.

The Net equity at 31 December 2018 declined by 5% compared to last year, mainly due to adoption of IFRS 9 effective 1 January 2018, which required expected credit loss provision for all exposures. However, this is partly offset with current year earnings.

The main driver for current year 2018 profit was improved asset profile and decrease in impairment provision by 45% in 2018, compared to last year 2017.

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P.O. Box: 11529, Kingdom of Bahrain
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T. +973 17 517722, F. +973 17 540094
Email:info@alubafbank.com, www.alubafbank.com
Authorised Capital: US$ 500 Million, Paid up Capital: US$ 250 Million
Licensed as a Conventional Wholesale Bank by the CBB

برج اليوباف، ضاحية السيف
ص ب: ١١٥٢٩ مملكة البحرين
س ت: ١٢٨١٩، Swift: ALUBBHBM
تليفون: ٩٧٣ ١٧٥١٧٧٢٢+
فاكس: ٩٧٣ ١٧٥٤٠٠٩٤+

اليوباف
alubaf
بنك اليوباف العربي الدولي ش.م.ب (م)
Alubaf Arab International Bank B.S.C (c)

The Bank achieved a Return on average equity of 4.9% for the year ended 2018, as compared to 4% for last year 2017. The Bank's liquid assets to total assets stood at 66% and Capital adequacy ratio stood at 43% at 31 December 2018, signifying the Bank's strengthened capital and liquidity position.

In recognition of the importance and support of its valued shareholders, the Board of directors are pleased to propose a dividend of US$ 1 per share, amounting to US$ 5 million, representing 2% of paid up share capital for the year 2018, after due appropriation of US$ 1.5 million from Net profit for the year 2018, towards transfer to Statutory reserve. This Proposed dividend for the year 2018, is subject to regulatory and shareholders' approval in Annual general meeting.

Looking ahead, despite the continued global geopolitical risks, the results for the year 2018 are encouraging, that reinforces confidence in growth prospects, given our strong capital and focused commitment to dynamically adapt to changes and uncertainties in economic scenario to better position and sustain a consistent growth to our shareholders in the years ahead.

Finally, I would like to thank all the members of the Board, the Shareholders, the Ministry of Industry, Commerce and Tourism in the Kingdom of Bahrain, Central Bank of Bahrain and all Correspondent Banks and our Customers for their continued support, cooperation and guidance.

I also extend my appreciation and thanks to all the employees for their professionalism and commitment for the Bank's continued growth and progress.

Moraja G. Solaiman
Chairman

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EY
Building a better working world

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF ALUBAF ARAB INTERNATIONAL BANK B.S.C. (c)

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying financial statements of ALUBAF Arab International Bank B.S.C. (c) ("the Bank"), which comprise the statement of financial position as at 31 December 2018, and the statements of profit or loss, comprehensive income, changes in equity and cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2018, and its financial performance and its 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 Financial Statements* section of our report. We are independent of the Bank 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.

Other information

Other information consists the Board of Directors' report, set out on pages 1 to 2 that was obtained at the date of this auditor's report. The Board of Directors is responsible for the other information.

Our opinion on the 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 financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, 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 financial statements

The Board of Directors is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as the Board of Directors determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF ALUBAF ARAB INTERNATIONAL BANK B.S.C. (c)

Report on the Audit of the Financial Statements (continued)

Responsibilities of the Board of Directors for the financial statements (continued)
In preparing the financial statements, the Board of Directors is responsible for assessing the Bank'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 Bank or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the 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 financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the 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 Bank'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 Bank'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 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 Bank to cease to continue as a going concern.

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF ALUBAF ARAB INTERNATIONAL BANK B.S.C. (c)

Report on the Audit of the Financial Statements (continued)

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

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

We communicate with Board of Directors 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.

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 financial statements are in agreement therewith;

b) the financial information contained in the Report of the Board of Directors is consistent with the 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 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 financial position; and

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

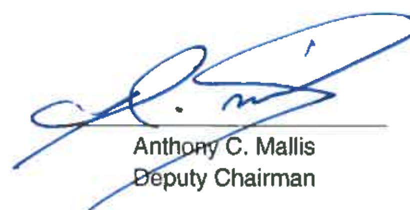
Partner's Registration No. 117
17 February 2019
Manama, Kingdom of Bahrain

STATEMENT OF FINANCIAL POSITION

As at 31 December 2018

	Note	**2018 US$ '000**	*2017 US$ '000*
ASSETS			
Cash and balances with central bank and other banks	5	**364,769**	298,349
Deposits with banks and other financial institutions	6	**339,105**	409,496
Investments classified as fair value through profit and loss	7	**14,517**	20,462
Investment securities	8	**205,597**	221,374
Loans and advances	9	**163,338**	150,256
Property, equipment and software	10	**9,758**	10,371
Interest receivable		**6,628**	6,744
Other assets		**1,176**	1,591
TOTAL ASSETS		**1,104,888**	1,118,643
LIABILITIES AND EQUITY			
Liabilities			
Deposits from banks and other financial institutions	11	**644,570**	569,557
Due to banks and other financial institutions	11	**87,783**	133,417
Due to customers	12	**65,642**	93,805
Interest payable		**1,634**	1,086
Other liabilities	13	**7,192**	6,927
Total liabilities		**806,821**	804,792
Equity			
Share capital	14	**250,000**	250,000
Statutory reserve	14	**22,757**	21,257
Retained earnings		**26,352**	40,399
Fair value reserve		**(6,042)**	(2,805)
Proposed dividend	15	**5,000**	5,000
Total equity		**298,067**	313,851
TOTAL LIABILITIES AND EQUITY		**1,104,888**	1,118,643

Talal Al Zain
Director



Anthony C. Mallis
Deputy Chairman

The attached notes 1 to 27 form part of these financial statements.

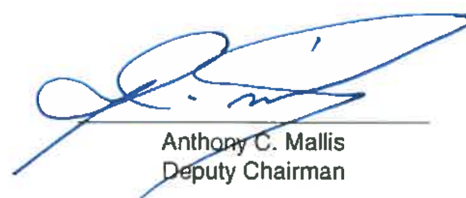
ALUBAF Arab International Bank B.S.C. (c)

STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2018

	Note	**2018** **US$ '000**	2017 US$ '000
Interest and similar income	16	**42,861**	39,541
Interest expense	17	**(14,068)**	(10,212)
Net interest and similar income		**28,793**	29,329
Fee and commission income	18	**4,856**	4,254
(Loss) gain on investments classified as FVTPL	19	**(383)**	18
Gain (loss) on investment securities - net		**270**	(153)
Foreign exchange gain - net		**752**	683
Dividend income		**2**	9
Other income		**97**	90
OPERATING INCOME		**34,387**	34,230
Provision for expected credit losses for the year	20	**(5,838)**	(10,537)
NET OPERATING INCOME		**28,549**	23,693
Staff costs		**7,798**	7,533
Depreciation	10	**1,004**	1,082
Other operating expenses	21	**4,747**	4,248
OPERATING EXPENSES		**13,549**	12,863
NET PROFIT FOR THE YEAR		**15,000**	10,830

Talal Al Zain
Director



Anthony C. Mallis
Deputy Chairman

The attached notes 1 to 27 form part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2018

	2018	*2017*
	US$ '000	*US$ '000*
NET PROFIT FOR THE YEAR	**15,000**	10,830
Other comprehensive income		
Other comprehensive income to be reclassified to profit or loss in subsequent periods:		
Unrealised fair value (loss) gain on investments classified as fair value through other comprehensive income (FVOCI)	**(4,321)**	744
Reversal of impairment on FVOCI	**(1,847)**	-
Other comprehensive (loss) income for the year	**(6,168)**	744
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**8,832**	11,574

The attached notes 1 to 27 form part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2018

	Note	*2018* *US$ '000*	*2017* *US$ '000*
OPERATING ACTIVITIES			
Net profit for the year		**15,000**	10,830
Adjustments for:			
Provision for expected credit losses for the year	20	**5,838**	10,537
Depreciation	10	**1,004**	1,082
Amortisation of investments carried at amortised cost		**536**	515
(Gain) loss on investment securities - net		**(270)**	153
Unrealised loss on investments classified as FVTPL		**325**	26
Gain on disposal of fixed asset		**(7)**	-
Amortisation of assets classified as loans and advances		**(848)**	(779)
Operating profit before changes in operating assets and liabilities		**21,578**	22,364
Changes in operating assets and liabilities:			
Deposits with banks and other financial institutions		**15,400**	46,702
Investments classified as fair value through profit and loss		**4,558**	1,925
Investment securities		**(2,769)**	-
Loans and advances		**(35,895)**	48,027
Interest receivable		**116**	(610)
Other assets		**415**	47
Deposits from banks and other financial institutions		**75,013**	(17,267)
Due to banks and other financial institutions		**(45,634)**	(22,898)
Due to customers		**(28,163)**	(35,950)
Interest payable		**548**	105
Other liabilities		**258**	2,143
Net cash flows from operating activities		**5,425**	44,588
INVESTING ACTIVITIES			
Purchase of investment securities		**(4,644)**	(25,531)
Proceeds from disposal/redemption of investment securities		**16,123**	8,000
Purchase of property, equipment and software	10	**(391)**	(304)
Proceeds from sale of property and equipment		**7**	-
Net cash flows from (used in) investing activities		**11,095**	(17,835)
FINANCING ACTIVITY			
Dividends paid	15	**(5,000)**	-
Net cash flows used in financing activity		**(5,000)**	-
NET MOVEMENT IN CASH AND CASH EQUIVALENTS		**11,520**	26,753
Cash and cash equivalents at 1 January		**677,834**	651,092
CASH AND CASH EQUIVALENTS AT 31 DECEMBER		**689,354**	677,845

The attached notes 1 to 27 form part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2018

	Note	Share capital US$ '000	Statutory reserve US$ '000	Retained earnings US$ '000	Fair value reserve US$'000	Proposed dividend US$'000	Total US$ '000
Balance as of 1 January 2018		250,000	21,257	40,399	(2,805)	5,000	313,851
Transition adjustment on adoption of IFRS 9		-	-	(22,547)	2,931	-	(19,616)
At 1 January 2018 - restated		**250,000**	**21,257**	**17,852**	**126**	**5,000**	**294,235**
Net profit for the year		-	-	15,000	-	-	15,000
Other comprehensive loss		-	-	-	(6,168)	-	(6,168)
Dividends paid	14	-	-	-	-	(5,000)	(5,000)
Proposed dividend for 2018	15	-	-	(5,000)	-	5,000	-
Transfer to Statutory reserve		-	1,500	(1,500)	-	-	-
Balance as of 31 December 2018		**250,000**	**22,757**	**26,352**	**(6,042)**	**5,000**	**298,067**
Balance as of 1 January 2017		250,000	20,174	35,652	(3,549)	-	302,277
Net profit for the year		-	-	10,830	-	-	10,830
Other comprehensive income		-	-	-	744	-	744
Dividends proposed for 2017	15	-	-	(5,000)	-	5,000	-
Transfer to Statutory reserve		-	1,083	(1,083)	-	-	-
Balance as of 31 December 2017		250,000	21,257	40,399	(2,805)	5,000	313,851

The attached notes 1 to 27 form part of these financial statements.

1 ACTIVITIES

ALUBAF Arab International Bank B.S.C. (c) (the "Bank") is a closed Bahraini joint stock company incorporated in the Kingdom of Bahrain and registered with the Ministry of Industry, Commerce and Tourism under Commercial Registration (CR) number 12819. The Bank operates under a wholesale banking license issued by the Central Bank of Bahrain (the "CBB"). The Bank's registered office is at Building 854, Road 3618, Avenue 436, Alubaf Tower, Al-Seef District, PO Box 11529, Manama, Kingdom of Bahrain.

The Bank is majority owned by Libyan Foreign Bank, a bank registered in Libya (refer to note 14 for more details).

The financial statements of the Bank for the year ended 31 December 2018 were authorised for issue in accordance with a resolution of the Board of Directors on 17 February 2019.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and are in conformity with the Bahrain Commercial Companies Law, the CBB and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and the relevant CBB directives.

Basis of measurement
The financial statements have been prepared on a historical cost basis, except for derivative financial instruments and investments classified as fair value through profit and loss or fair value through other comprehensive income that have been remeasured at fair value.

Functional and presentation currency
The financial statements are presented in United States Dollars (US$), being the Bank's functional currency. All values are rounded to the nearest thousand (US$ '000), except when otherwise indicated.

2.2 Significant accounting policies

Financial instruments

Date of recognition
Financial assets and liabilities, with the exception of loans and advances are initially recognised on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. Loans and advances are recognised when funds are transferred to the customers' accounts.

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 2.2 and 2.3.

At initial recognition, the Bank 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 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 Bank accounts for the Day 1 profit or loss, as described below.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Significant accounting policies (continued)

Financial instruments (continued)

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.

Financial assets

2.2.1 Debt type instruments - Classification and subsequent measurement
Before 1 January 2018, the Bank classified its financial assets as loans and receivables (amortised cost), FVTPL, available-for-sale or held-to-maturity (amortised cost), as explained in the annual financial statements for the year ended 31 December 2017.

From 1 January 2018, the Bank 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 Bank'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 Bank classifies its debt instruments into one of the following three measurement categories:

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

- Fair value through other comprehensive income (FVOCI): Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent SPPI, and that are not designated at FVTPL, are measured at fair value through other comprehensive income (FVOCI). Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in 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.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Significant accounting policies (continued)

Financial assets (continued)

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

- 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 Bank 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 profit or loss and presented in the statement of profit or loss within 'Other operating income' as a 'Gain on trading securities' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Other operating income' as a 'Gain on disposal of non-trading investments'. Interest income from these financial assets is included in 'Interest and similar income' using the EIR method.

Business model
The Bank 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 Bank manages the assets in order to generate cash flows. That is, whether the Bank'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 a '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;
- 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 Bank'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 Bank's original expectations, the Bank 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.

SPPI test
The Bank assesses the contractual terms of financial assets 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.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Significant accounting policies (continued)

Financial assets (continued)

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

SPPI test (continued)
In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank 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 Bank 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 Bank'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 Bank reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period other than the reclassifications made on the initial adoption of IFRS 9 at the date of transition.

2.2.2 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 Bank 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 profit or loss, including on disposal. Equity investments at FVOCI are not subject to impairment assessment. All other equity investments which the Bank 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 'Other operating income' as a 'Gain on disposal of non-trading investments' in the statement of profit or loss.

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

Modified or forbearance of loans
The Bank 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 Bank 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 Bank 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.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Significant accounting policies (continued)

Financial assets (continued)

2.2.2 Equity type instruments - classification and subsequent measurement (continued)

Modified or forbearance of loans (continued)

- 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 Bank 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 Bank also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the customer being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Bank recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognises a modification gain or loss in 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 Bank'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.

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 Bank transfers substantially all the risks and rewards of ownership, or (ii) the Bank neither transfers nor retains substantially all the risks and rewards of ownership and the Bank has not retained control.

The Bank 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 Bank:

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

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Significant accounting policies (continued)

Financial liabilities

Classification and subsequent measurement
In both the current and prior period, financial liabilities are classified and 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 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 Bank recognises any expense incurred on the financial liability; and

- Financial guarantee contracts and loan commitments.

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 Bank 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.

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

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

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Significant accounting policies (continued)

Financial guarantee contracts and loan commitments
The Bank issues financial guarantees, letters of credit and loan commitments.

Financial guarantees are initially recognised in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the 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 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 Bank 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 in the statement of financial position.

Derivative financial instruments
The Bank makes use of derivative instruments, such as forward foreign exchange contracts.

Derivatives are initially recognised, and subsequently measured, at fair value with transaction costs taken directly to the statement of profit or loss. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative. Derivatives with positive fair values (unrealised gains) are included in other assets and derivatives with negative fair values (unrealised losses) are included in other liabilities in the statement of financial position.

Cash and cash equivalents
For the purpose of the statement of cash flows, cash and cash equivalents comprise cash and balances with banks, treasury bills and deposits with banks and other financial institutions with original maturities of 3 months or less.

Property, equipment and software
Property, equipment and software are stated at cost, net of accumulated depreciation and accumulated impairment losses, if any. Expenditure incurred to replace a component of an item of property, equipment and software that is accounted for separately is capitalised and the carrying amount of the component that is replaced is written off. When significant parts of property, equipment and software are required to be replaced at intervals, the Bank depreciates them separately based on their specific useful lives. Land and capital work in progress are not depreciated. Repairs and maintenance costs are recognised in the statement of profit or loss as incurred.

Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, as follows:

Assets	*Estimated useful life in years*
Building	15
Furniture, equipment and vehicles	3 to 5
Software	3 to 5

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Significant accounting policies (continued)

Property, equipment and software (continued)
An item of property and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the statement of profit or loss when the asset is derecognised.

The residual values, useful lives and methods of depreciation of property, equipment and software are reviewed at each financial year end and adjusted prospectively, if appropriate.

Impairment of non-financial assets
The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount, with the difference being recognised as an impairment in the statement of profit or loss.

Renegotiated loans
In the ordinary course of its business, the Bank seeks to restructure loans. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

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 a provision is presented in the statement of profit or loss net of any reimbursement.

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, when appropriate, the risks specific to the liability. When discounting is used, the increase in the provision due to the passage of time is recognised in the statement of profit or loss.

Employees' end of service benefits
The Bank provides end of service benefits to its non - Bahraini employees. The entitlement to these benefits is based upon the employee's final salary and length of service. The expected costs of these benefits are accrued over the period of employment. The Bank also makes contributions to the Social Insurance Organisation (SIO) Scheme calculated as a percentage of the employees' salaries. The Bank's obligations are limited to these contributions, which are expensed when due.

Contingent liabilities
Contingent liabilities are not recognised in the financial statements, but are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Significant accounting policies (continued)

Share capital, statutory reserve and dividend

Share capital
Ordinary shares issued by the Bank are classified as equity. The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instruments.

Statutory reserve
The Bahrain Commercial Companies Law requires that 10% of the annual profit be appropriated to a statutory reserve which is normally distributable only on dissolution. Appropriations may cease when the reserve reaches 50% of the paid up share capital.

Dividend
The Bank recognises a liability to make cash or non-cash distributions to equity holders when the distribution is authorised and the distribution is no longer at the discretion of the Bank. As per the Bahrain Commercial Companies Law, a distribution is authorised when it is approved by the shareholders. A corresponding amount is recognised directly in equity.

Fair value measurement
The Bank measures financial instruments, such as investments and derivatives at fair value at the date of statement of financial position. Fair value related disclosures for financial instruments and non-financial assets that are measured at fair value or where fair values are disclosed, are disclosed in note 23.5.

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.

The principal or the most advantageous market must be accessible by the Bank.

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 interest.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are 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 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable; and
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Bank 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.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Significant accounting policies (continued)

Fair value measurement (continued)
For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

Revenue recognition
Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment. The following specific recognition criteria must also be met before revenue is recognised:

Interest income
For all financial instruments measured at amortised cost and interest-bearing financial assets classified as fair value through other comprehensive income, interest income is recorded using the effective interest rate (EIR). EIR is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability. The recognition of interest income is suspended when the loans become impaired, such as when overdue by more than 90 days.

Fee and commission income
Fee and commission income are recognised when earned.

Foreign exchange gain
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 Bank'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 statement of profit or loss.

Dividend income
Dividend income is recognised when the Bank's right to receive the payment is established, which is generally when shareholders approve the dividend.

Share based payments

Cash-settled share based payments
The cost of cash-settled share based payment transactions is measured initially at fair value at the grant date using an appropriate valuation model. This fair value is expensed over the period until the vesting date with recognition of a corresponding liability. The liability is remeasured to fair value at each reporting date up to, and including the settlement date, with changes in fair value recognised in the statement of income.

Foreign currencies
The Bank's financial statements are presented in United States Dollars (US$), which is the Bank's functional currency.

Transactions in foreign currencies are initially recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency spot rates of exchange at the reporting date. Differences arising on settlement or translation of monetary items are recognised in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates 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 is determined. The gain or loss arising on translation of non-monetary items measured at fair value is treated in line with the recognition of the gain or loss on the change in fair value of the item (i.e., translation differences on items whose fair value gain or loss is recognised in other comprehensive income (OCI) or profit or loss are recognised in OCI or profit or loss, respectively).

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 Changes in accounting policies and disclosures

i) New and amended standards and interpretations effective as of 1 January 2018
The accounting policies adopted are consistent with those of the previous financial year, except for the following IASB's new and amended standards and interpretations which are effective as of 1 January 2018. The adoption of these standards and interpretations did not have any effect on the Bank's financial position, financial performance or disclosures.

IFRS 9 Financial Instruments

Introduction
In July 2014, the IASB issued IFRS 9 Financial Instruments (IFRS 9), the standard that will replace IAS 39 Financial instruments: recognition and measurement for annual periods on or after 1 January 2018, with early adoption permitted. The Bank set up a multidisciplinary working team ('the Working Team') with members from its Risk, Finance and Credit Unit teams to prepare for IFRS 9 implementation ('the Project'). The Project is sponsored by the Head of Risk and Financial Control, who regularly report to the Bank's Board Risk Committee and is managed within the Bank's transformation framework. The Project has clear individual work streams. The Bank is currently in final testing stage of IFRS 9 implementation project with initial assessment, design and build stage already completed.

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 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.

Having implemented IFRS 9, the Bank has concluded that:

- The majority of placement 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 expected to be measured at amortised cost under IFRS 9;

- Financial assets and liabilities held for trading and financial assets designated at FVTPL are expected to continue to be measured at FVTPL;

- The majority of the debt securities classified as available for sale under IAS 39 are expected to be measured at FVOCI. Some securities, however, will be 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 expected to continue to be measured at amortised cost.

For an explanation of how the Bank classifies financial assets and liabilities under IFRS 9, refer respective sections in note 3.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 Changes in accounting policies and disclosures

i) New and amended standards and interpretations effective as of 1 January 2018 (continued)

IFRS 9 Financial Instruments (continued)

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 Bank 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. The Bank 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 Bank 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 Bank has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in note 4.

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 Bank for the year ended 31 December 2018.

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

IFRS 15 outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue guidance, which is found currently across several standards and interpretations within IFRS. It established a new five-step model that 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 Bank has opted for the modified retrospective application permitted by IFRS 15 upon adoption of the new standard. Modified retrospective application also requires the recognition of the cumulative impact of adoption of IFRS 15 on all contracts as at 1 January 2018 in equity. There were no adjustments to opening retained earnings and other account balances on the adoption of IFRS 15.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 Changes in accounting policies and disclosures

i) New and amended standards and interpretations effective as of 1 January 2018 (continued)

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 Bank's financial statements.

ii) 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 Bank's financial statements are disclosed below. This listing is of standards and interpretations issued, which the Bank reasonably expect to be applicable at a future date. The Bank intends to adopt these standards, if applicable, when they become effective.

IFRS 16 Leases
Leases - Revised guidance on single model accounting for leases (effective for annual periods beginning on or after 1 January 2019, with earlier adoption permitted if IFRS 15 'Revenue from Contracts with Customers' has also been applied.

The standard introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value.

A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. A lessee measures right-of-use asset similarly to other non-financial assets (such as property, plant and equipment) and lease liabilities similarly to other financial liabilities. Therefore, a lessee recognises depreciation of the right-of-use asset and interest on the lease liability, and also classifies cash repayments of the lease liability into a principal portion and an interest portion and presents them in the statement of cash flows applying IAS 7 Statement of Cash Flows.

IFRS 16 contains expanded disclosure requirements for lessees. Lessees will need to apply judgement in deciding upon the information to disclose to meet the objective of providing a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. IFRS 16 also requires enhanced disclosures to be provided by lessors that will improve information disclosed about a lessor's risk exposure, particularly to residual value risk.

IFRS 16 supersedes the following Standards and Interpretations:

a) IAS 17 Leases;
b) IFRIC 4 Determining whether an Arrangement contains a Lease;
c) SIC-15 Operating Leases – Incentives; and
d) SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 Changes in accounting policies and disclosures (continued)

ii) Standards issued but not yet effective (continued)

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.

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 Bank will apply interpretation from its effective date. Since the Bank operates in a complex multinational tax environment, applying the Interpretation may affect its financial statements and the required disclosures. In addition, the Bank 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 financial statements of the Bank.

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 Bank.

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.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 Changes in accounting policies and disclosures (continued)

ii) Standards issued but not yet effective (continued)

Annual improvements 2015-2017 cycle (issued in December 2017) (continued)

IAS 12 Income taxes (continued)
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 Bank's current practice is in line with these amendments, the Bank does not expect any effect on its 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 Bank's current practice is in line with these amendments, the Bank does not expect any effect on its financial statements.

3 SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the Bank's 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. Uncertainity 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 Bank'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 Bank'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 financial statements with substantial management judgement and/or estimates are collated below with respect to judgements or estimates involved.

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

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 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.

3 SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (continued)

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 Bank 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 Bank 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 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 Bank.

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'.

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 Bank 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 Bank'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.

Classification of financial assets
Management decides on acquisition of a financial asset whether it should be classified as "fair value through profit or loss", "fair value through other comprehensive income" or "at amortised cost". The classification of each investment reflects management's intention in relation to each investment and is subject to different accounting treatments based on such classification.

4 TRANSITION DISCLOSURES

The Bank 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.

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.

4.1 The Bank 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*
			US$'000	*US$'000*	*US$'000*	*US$'000*	
Financial assets at amortised cost							
Cash and balances with Central banks and other banks		Amortised cost (receivables)	298,349	-	(11)	298,338	Amortised cost
Deposits with banks and other financial institutions		Amortised cost (receivables)	409,496	-	(80)	409,416	Amortised cost
Loans and advances		Amortised cost (loans and receivables)	150,256	-	(17,823)	132,433	Amortised cost
Non-trading investments – Held to maturity		HTM	105,064	(105,064)	-	-	
Transfers to debt instruments at amortised cost	*(E)*		-	*(105,064)*	-	-	
Non-trading investments – debt instruments at amortised cost		Amortised cost (loans and receivables)	-	108,257	(1,930)	106,327	Amortised cost
Transfers to amortised cost (IFRS 9)	*(B)*			*13,263*			
Transfers from held to maturity (IAS 39)	*(E)*			*105,064*			
Transfers to FVTPL (IFRS 9)	*(A)*			*(10,070)*			
Total financial assets measured at amortised cost			**963,165**	**3,193**	**(19,844)**	**946,514**	

4 TRANSITION DISCLOSURES (continued)

	Note	31 December 2017 IAS 39 category	31 December 2017 IAS 39 Carrying amount	Reclassification	Remeasurement	1 January 2018 IFRS 9 carrying amount	1 January 2018 IFRS 9 category
			US$'000	US$'000	US$'000	US$'000	
Financial assets at FVTPL							
Investments classified as fair value through profit and loss		Fair value through profit or loss	20,462	(1,298)	235	19,399	FVTPL
Transfers from held to maturity (IAS 39)	*(A)*			*10,070*			
Transfers from available-for-sale (IAS 39)	*(C)*			*4,963*			
Transfers to amortised cost (IFRS 9)	*(B)*			*(13,263)*			
Transfers to FVOCI (IFRS 9)	*(D)*			*(3,068)*			
Total financial assets at FVTPL			**20,462**	**(1,298)**	**235**	**19,399**	
Financial assets at FVOCI							
Non-trading investments – debt securities under AFS category		AFS	116,310	(116,310)	-	-	
Transfers to FVOCI (debt securities)	*(E)*		-	*(116,310)*	-	-	
Non-trading investments – FVOCI (debt securities)			-	114,415	(2,931)	111,484	FVOCI
Transfer to FVOCI (debt securities)	*(E)*			*116,310*			
Transfers from FVTPL (IFRS 9)	*(D)*			*3,068*			
Transfers to FVTPL (IFRS 9)	*(C)*			*(4,963)*			
Total financial assets at FVOCI			**116,310**	**(1,895)**	**(2,931)**	**111,484**	
Total financial assets			**1,099,937**	**-**	**(22,540)**	**1,077,397**	
Non-financial assets							
Other assets			18,706	-	-	18,706	
Total assets			**1,118,643**	**-**	**(22,540)**	**1,096,103**	
Financial liabilities							
Other liabilities - Off balance sheet exposures			(29,523)	-	(7)	(29,530)	
Net impact of remeasurements			**1,089,120**	**-**	**(22,547)**	**1,066,573**	

The total remeasurement loss of US$ 22,547 thousand was recognised in opening retained earnings 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 Bank as shown in the table above:

(A) Debt instruments previously classified as held to maturity but which fail the SPPI test
The Bank holds a portfolio of debt instruments that failed to meet the SPPI requirement for the amortised cost classification under IFRS 9. As a result, these instruments, which amounted to US$ 10,070 thousand were classified as FVTPL on the date of initial application.

4 TRANSITION DISCLOSURES (continued)

(B) Debt instruments previously classified as trading

The Bank was previously holding a portfolio of debt instruments that was held for trading. These instruments passed the SPPI requirements and the Bank has reassessed its business model for holding these instruments to be "hold to collect". As a result, these instruments which amounted to US$ 13,263 thousand were classified as amortised cost on the date of initial application.

(C) Debt instruments previously classified as available-for-sale

The Bank has elected to designate certain of its investments at a carrying value of US$ 4,963 thousand 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.

(D) Debt instruments previously classified as held-for-trading

The Bank was previously holding a portfolio of debt instruments that was held for trading. These instruments passed the SPPI requirements and the Bank has reassessed its business model for holding these instruments to be "hold to collect and sell". As a result, these instruments which amounted to US$ 3,068 thousand were classified as FVOCI on the date of initial application.

(E) 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.

4.2 Impact on retained earnings and other reserves

	Retained earnings	***Cumulative changes in fair value***
	US$'000	*US$'000*
Closing balance under IAS 39 (31 December 2017)	40,399	(2,805)
Reclassification of instruments from Amortised cost to FVTPL	235	-
Reclassification of instruments from FVOCI to FVTPL	(458)	458
Recognition of expected credit losses under IFRS 9:		
- Liquid funds	(11)	-
- Investment securities	(4,403)	2,473
- Loans and advances	(17,823)	-
- Placements with banks and other financial institutions	(80)	-
- Other liabilities - Off balance sheet exposures	(7)	-
	(22,324)	2,473
Opening balance under IFRS 9 (1 January 2018)	17,852	126

4 TRANSITION DISCLOSURES (continued)

4.3 Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

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

Measurement category	*Loan loss allowance under IAS 39*	*Reclassification*	*Remeasurement*	*ECL under IFRS 9*
	US$'000	*US$'000*	*US$'000*	*US$'000*
Loans and receivables (IAS 39) / Financial assets at amortised cost (IFRS 9)				
Cash and balances with Central banks and other banks	-	-	11	11
Deposits with banks and other financial institutions	-	-	80	80
Loans and advances	80,627	-	17,823	98,450
	80,627	**-**	**17,914**	**98,541**
Non-trading investments				
FVOCI (debt securities)	-	458	2,473	2,931
Debt instruments at amortised cost	-	(235)	1,930	1,695
	-	**223**	**4,403**	**4,626**
Credit commitments and contingent items	-	-	7	7
Total	**80,627**	**223**	**22,324**	**103,174**

5 CASH AND BALANCES WITH CENTRAL BANK AND OTHER BANKS

	2018 ***US$ '000***	*2017* *US$ '000*
Cash	**3**	5
Money at call and short notice	**63,255**	49,852
Treasury bills - balances with Central Bank	**301,521**	248,492
Provision for expected credit losses (note 5.1)	**(10)**	-
Cash and balances with central bank and other banks	**364,769**	298,349
Deposits with banks and other financial institutions with original maturities of 90 days or less (note 6)	**324,585**	379,496
Cash and cash equivalents	**689,354**	677,845

Note 5.1

Movement in provision for expected credit losses were as follows:

	2018 ***Stage 1 12-month ECL US$ '000***
Balance at 1 January - on adoption of IFRS 9	**11**
Recoveries / write-backs	(1)
At 31 December 2018	**10**

6 DEPOSITS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

Deposits with banks and other financial institutions represent interest bearing money market deposits held with banks and other financial institutions as at the statement of financial position date as follows:

	2018 US$ '000	*2017 US$ '000*
Deposits with original maturities of 90 days or less (note 5)	**324,585**	379,496
Deposits with original maturities of over 90 days	**14,714**	30,000
	339,299	409,496
Provision for expected credit losses (note 6.1)	**(194)**	-
	339,105	409,496

Note 6.1
Movement in provision for expected credit losses were as follows:

	2018 Stage 1 12-month ECL US$ '000
Balance at 1 January - on adoption of IFRS 9	**80**
Provided during the period	**114**
At 31 December 2018	**194**

7 INVESTMENTS CLASSIFIED AS FAIR VALUE THROUGH PROFIT AND LOSS

	2018 US$ '000	*2017 US$ '000*
Quoted:		
- Debt securities	**14,517**	20,335
- Equity securities	**-**	127
	14,517	20,462

8 INVESTMENT SECURITIES

	31 December 2018 (Audited)		
	FVOCI * US$'000	***Amortised cost * US$'000***	***Total US$'000***
Quoted investments			
- Sovereign debt securities	**96,722**	**49,374**	**146,096**
- Banks and Corporate debt securities	**16,281**	**44,545**	**60,826**
Total quoted investments	**113,003**	**93,919**	**206,922**
Provision for expected credit losses (note 8.1)	**(626)**	**(1,325)**	**(1,951)**
Reclassifying provision relating to FVOCI to OCI	**626**	**-**	**626**
Total investment securities	**113,003**	**92,594**	**205,597**

As at 31 December 2018, investments classified in stage 2 amounted to US$ 54,186 thousand for FVOCI and US$ 37,434 thousand for amortised cost.

* Titles have been changed to align to IFRS 9 classification.

8 INVESTMENT SECURITIES (continued)

	31 December 2017 (Audited)		
	Available-for-sale US$'000	*Held-to-maturity US$'000*	*Total US$'000*
Quoted investments			
- Sovereign debt securities	95,501	42,420	137,921
- Banks and Corporate debt securities	20,809	62,644	83,453
Total quoted investments	116,310	105,064	221,374
Provision for impairment on investment securities	-	-	-
Total investment securities	116,310	105,064	221,374

Note 8.1

Movements in provision for expected credit losses of 'FVOCI' investments were as follows:

	31 December 2018 (FVOCI)		
	Stage 1: 12-month ECL US$ '000	***Lifetime ECL not credit-impaired US$ '000***	***Total ECL US$ '000***
Balance at 1 January - on adoption of IFRS 9	**332**	**2,141**	**2,473**
Changes due to financial assets recognised in opening balance that have:			
Transfer to 12 month ECL	-	-	-
Transfer to lifetime ECL not credit- impaired	(10)	10	-
Transfer to lifetime ECL credit- impaired	-	-	-
Provided during the period	-	-	-
Write-backs	(4)	(1,843)	(1,847)
At 31 December 2018	**318**	**308**	**626**

Movements in provision for expected credit losses of 'amortised cost' investments were as follows:

	31 December 2018 (Amortised cost)		
	Stage 1: 12-month ECL US$ '000	***Lifetime ECL not credit-impaired US$ '000***	***Total ECL US$ '000***
Balance at 1 January - on adoption of IFRS 9	**272**	**1,658**	**1,930**
Changes due to financial assets recognised in opening balance that have:			
Transfer to 12 month ECL	1,331	(1,331)	-
Transfer to lifetime ECL not credit- impaired	(81)	81	-
Transfer to lifetime ECL credit- impaired	-	-	-
Provided during the period	-	772	772
Recoveries / write-backs	(1,377)	-	(1,377)
At 31 December 2018	**145**	**1,180**	**1,325**

9 LOANS AND ADVANCES

Loans and advances are stated net of provision for expected credit losses. The table below discloses the gross loans and provision for expected credit losses excluding interest in suspense amounting to US$ 21,299 thousand as of 31 December 2018 (2017: US$ 14,190 thousand).

	31 December 2018				
	Stage 1: 12-month ECL	*Stage 2: Lifetime ECL not credit-impaired*	*Stage 3: Lifetime ECL credit-impaired*	*Total*	*31 December 2017*
	US$ 000	*US$ 000*	*US$ 000*	*US$ 000*	*US$ 000*
Letters of credit - financing and discounting	30,770	-	63,258	**94,028**	57,168
Sovereign loans	46,242	-	32,314	**78,556**	84,693
Commercial loans	66,879	3,123	6,326	**76,328**	69,652
Factoring	-	20,184	-	**20,184**	19,370
	143,891	**23,307**	**101,898**	**269,096**	230,883
Provision for expected credit losses (note 9.1)	**(3,651)**	**(2,636)**	**(99,471)**	**(105,758)**	(80,627)
	140,240	**20,671**	**2,427**	**163,338**	150,256

Note 9.1

Movements in provision for expected credit losses were as follows:

	31 December 2018			
	General Provision		*Specific Provision*	
	Stage 1: 12-month ECL	*Stage 2: Lifetime ECL not credit-impaired*	*Stage 3: Lifetime ECL credit-impaired*	*Total ECL*
	US$ '000	*US$ '000*	*US$ '000*	*US$ '000*
Balance at 31 December 2017	**-**	**3,737**	**76,890**	**80,627**
Balance at 1 January 2018 - on adoption of IFRS 9	**2,856**	**14,873**	**94**	**17,823**
Changes due to financial assets recognised in opening balance that have:				
Transfer to 12 month ECL	-	-	-	-
Transfer to lifetime ECL not credit- impaired	(42)	42	-	-
Transfer to lifetime ECL credit- impaired	-	(18,610)	18,610	-
Provided during the period	837	2,594	4,149	7,580
Recoveries / write-backs	-	-	-	-
Write off during the period	-	-	-	-
Exchange differences	-	-	(272)	(272)
At 31 December 2018	**3,651**	**2,636**	**99,471**	**105,758**

9 LOANS AND ADVANCES (continued)

	31 December 2017		
	Specific provision US$ '000	*Collective provision US$ '000*	*Total US$ '000*
At 1 January	65,952	3,500	69,452
Provided during the year	10,239	2,500	12,739
Recoveries during the year	(2,202)	-	(2,202)
Net charge for the year	8,037	2,500	10,537
Transfer to specific provision	2,263	(2,263)	-
Write off during the year	(92)	-	(92)
Exchange difference	730	-	730
At 31 December	76,890	3,737	80,627

The total value of collateral held by the Bank against its loans and advances exposure amounts to US$ 1,500 thousand as at 31 December 2018 with no cash collateral (31 December 2017: US$ 4,977 thousand of which US$ 3,177 thousand was held as cash collateral).

Impaired loans during the year

	2018 US$ '000	*2017 US$ '000*
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**101,898**	78,748

Facilities renegotiated during the year
During the year, no facilities were renegotiated by the Bank (2017: same).

10 PROPERTY, EQUIPMENT AND SOFTWARE

	Land US$ '000	*Building US$ '000*	*Furniture, equipment and motor vehicles US$ '000*	*Software US$ '000*	*Capital work in progress US$ '000*	*Total US$ '000*
Cost:						
At 1 January 2018	4,233	7,652	3,862	1,214	18	16,979
Additions/transfers during the year	-	-	139	240	12	391
Disposal during the year	-	-	(326)	-	-	(326)
At 31 December 2018	**4,233**	**7,652**	**3,675**	**1,454**	**30**	**17,044**
Depreciation:						
At 1 January 2018	-	2,528	3,183	897	-	6,608
Charge for the year	-	509	383	112	-	1,004
Relating to disposal	-	-	(326)	-	-	(326)
At 31 December 2018	**-**	**3,037**	**3,240**	**1,009**	**-**	**7,286**
Net book value:						
At 31 December 2018	**4,233**	**4,615**	**435**	**445**	**30**	**9,758**
At 31 December 2017	4,233	5,124	679	317	18	10,371

The land relates to the building on which the Banks' premises is constructed.

11 DEPOSITS FROM AND DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

11.1 Deposits from banks and other financial institutions

Deposits from banks and other financial institutions represent interest bearing money market deposits held with the Bank as at the statement of financial position date.

11.2 Due to banks and other financial institutions

Due to banks and other financial institutions comprise the following current account balances and cash collateral held with the Bank in relation to the letters of credit and letters of guarantee issued as at the statement of financial position date:

	2018 ***US$ '000***	*2017* *US$ '000*
Current account balances	**56,598**	58,645
Cash collateral held	**31,185**	74,772
	87,783	133,417

12 DUE TO CUSTOMERS

Due to customers represent current account balances and cash collateral of corporate customers held with the Bank in relation to the letters of credit and letters of guarantee as at the statement of financial position date.

	2018 ***US$ '000***	*2017* *US$ '000*
Current account balances	**61,531**	73,668
Cash collateral held	**4,111**	20,137
	65,642	93,805

13 OTHER LIABILITIES

	2018 ***US$ '000***	*2017* *US$ '000*
Accrued expenses	**5,752**	5,509
Provision for expected credit losses against off balance sheet exposures	**604**	-
Due to former directors and employees	**370**	316
Agency fee payable	**104**	647
Unearned fee income	**57**	50
Others	**305**	405
	7,192	6,927

Note 13.1

Movement in provision for expected credit losses against off balance sheet exposures were as follows:

	2018 ***Stage 1*** ***12-month*** ***ECL*** ***US$ '000***
Balance at 1 January - on adoption of IFRS 9	**7**
Provided during the period	**597**
At 31 December 2018	**604**

Accrued expenses include US$ 446 thousand (2017: US$ 239 thousand) of liability relating to cash settled share based payments.

13 OTHER LIABILITIES (continued)

The Bank has established an Employee Phantom Share Scheme (EPSS) in compliance with the sound remuneration rules issued by the Central Bank of Bahrain. Under the scheme, certain eligible employees of the Bank become entitled to share based compensation. Under the EPSS, each eligible employee is issued with a phantom share award which entitles the holder to receive one phantom share at the delivery date. The share awards will vest over 3 years with one third award vesting at the end of the subsequent 3 years. The eligible employee has to retain the shares for a period of 6 months post the award date prior to encashing the vested awards. Phantom units are ultimately cash settled based on the audited net book value of the Bank at the vesting dates.

The cost of the phantom units are initially measured at net-book-value per share of the Bank at the grant date and expensed in the statement of income with a corresponding liability being recognised. The liability is remeasured to its net-book-value per share of the Bank at each reporting date up to the date of settlement with changes in fair value recognised in the statement of profit or loss.

14 SHARE CAPITAL

	2018	*2017*
	US$ '000	*US$ '000*
Authorised:		
10,000,000 (2017: 10,000,000) ordinary shares of US$ 50 each	**500,000**	500,000

	2018	*2017*
	US$ '000	*US$ '000*
Issued and fully paid up :		
5,000,000 (2017: 5,000,000) ordinary shares of US$ 50 each	**250,000**	250,000

Shareholders

	2018		*2017*	
	Percentage holding (%)	***US$ '000***	*Percentage holding (%)*	*US$ '000*
Libyan Foreign Bank	**99.50**	**248,750**	99.50	248,750
National Bank of Yemen	**0.28**	**689**	0.28	689
Yemen Bank for Reconstruction and Development	**0.22**	**561**	0.22	561
	100.00	**250,000**	100.00	250,000

Statutory reserve

As required by the Bahrain Commercial Companies Law and the Bank's articles of association, a statutory reserve has been created by transfer of 10% of its annual profit. The Bank may resolve to discontinue such transfers when the reserve totals 50% of the paid up capital. The reserve is not distributable except in such circumstances as stipulated in the BCCL and following approval of the Central Bank of Bahrain.

15 PROPOSED DIVIDEND

During the year, the dividend for the year ended 31 December 2018 amounting to US$ 5 million (US$ 1 per share) is proposed subject to regulatory approvals and the approval of the shareholders in the Annual General Meeting (during the year a dividend of US$ 5 million was paid for the year ended 31 December 2017).

16 INTEREST AND SIMILAR INCOME

	2018	*2017*
	US$ '000	*US$ '000*
Deposits with banks, other financial institutions and balance with central bank	**17,666**	11,455
Loans and advances	**13,373**	15,872
Investment securities	**11,036**	11,163
Investments classified as fair value through profit and loss	**786**	1,051
	42,861	39,541

17 INTEREST EXPENSE

	2018 US$ '000	2017 US$ '000
Deposits from and due to banks and other financial institutions	**13,743**	10,051
Due to customers	**325**	161
	14,068	10,212

18 FEE AND COMMISSION INCOME

	2018 US$ '000	2017 US$ '000
Commission income on letters of credit	**3,565**	2,736
Agency and factoring income	**1,241**	1,383
Commission income on letters of guarantee	**35**	135
Bank charges and other income	**15**	-
	4,856	4,254

19 (LOSS) GAIN ON INVESTMENTS CLASSIFIED AS FVTPL

	2018 US$ '000	2017 US$ '000
Changes in fair value of investments classified as FVTPL	**(325)**	(26)
Realised (loss) gain during the year - net	**(58)**	44
	(383)	18

20 PROVISION FOR EXPECTED CREDIT LOSSES FOR THE YEAR

	2018 US$'000	2017 US$'000
Reverasl of provision against nostros (note 5.1)	**(1)**	-
Provision against money market (note 6.1)	**114**	-
Provision against investment securities (note 8.1)	**(2,452)**	-
Provision against loans and advances (note 9.1)	**7,580**	10,537
Provision against off balance sheet (note 13.1)	**597**	-
	5,838	10,537

21 OTHER OPERATING EXPNESES

	2018 US$ '000	2017 US$ '000
Professional services	**2,314**	1,686
Administration and marketing expenses	**1,515**	1,500
Board of Directors' remuneration and expenses (note 25)	**854**	808
Fees and other charges	**64**	254
	4,747	4,248

22 COMMITMENTS AND CONTINGENT LIABILITIES

	2018 *US$ '000*	*2017* *US$ '000*
Credit related contingencies		
Letters of credit	**121,029**	29,462
Letters of guarantee	**2,098**	61
Provision for expected credit losses (note 13)	**(604)**	-
	122,523	29,523
Other		
Forward foreign exchange contracts (note 24)	**4**	11,749
	122,527	41,272

23 RISK MANAGEMENT

23.1 Introduction

Risk is inherent in the Bank's activities and is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The main risks to which the Bank is exposed are credit risk, liquidity risk, market risk and operational risk.

a) Risk management structure

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

Audit Risk and Compliance Committee

The Audit Risk and Compliance Committee (ARCC) of the Board is responsible for assessing the quality and integrity of financial reporting, effectiveness of systems monitoring financial and disclosure compliance with legal and regulatory requirements, supervision of compliance function and soundness of internal controls. The ARCC also obtains regular updates from management and the Bank's compliance officer regarding compliance matters, which may have a material impact on the Bank's financial statements and reviews the findings of any examinations by regulatory agencies.

Management Risk Committee

The Management Risk Committee has the overall responsibility for establishing the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Asset Liability Management Committee

The Asset Liability Management Committee's (ALCO) objective is to prudently direct and manage asset and liability allocation to achieve the Bank's strategic goals. The ALCO monitors the Bank's liquidity risks by ensuring that the Bank's activities are in line with the risk/reward guidelines approved by the Board.

Internal Audit

Internal control processes throughout the Bank are audited at least annually by the Internal Audit Department, based on the risk-based audit plan approved by the ARCC. Internal audit staff examine both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management and reports its findings and recommendations to the ARCC.

23 RISK MANAGEMENT (continued)

23.1 Introduction (continued)

b) Risk measurement and reporting systems

Monitoring and controlling risks is primarily performed based on limits approved by the Board. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that it is willing to accept, with additional emphasis on selected industries. The Bank also monitors and measures the overall risk-bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

c) Credit concentration risk

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographical 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 Bank's performance to developments affecting a particular industry or geographical location.

In order to manage credit concentration risk, the Bank's policies and procedures include guidelines to maintain a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

23.2 Credit risk

Credit risk is the risk that a customer or counterparty will fail to meet a commitment, resulting in financial loss to the Bank. Such risk arises from lending, treasury and other activities undertaken by the Bank. Credit risk is actively monitored in accordance with the credit policies which clearly define delegated lending authorities, and procedures. The Bank manages its credit risk by monitoring concentration of exposures by geographic location and adhering to approved limits. The Bank limits its risk on off balance sheet items with adequate collateral.

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

The table below shows the maximum exposure to credit risk for the components of the statement of financial position. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements. The net exposure represents gross exposure net of cash collateral against letters of credit.

	Gross maximum exposure 2018 US$ '000	***Net maximum exposure 2018 US$ '000***	*Gross maximum exposure 2017 US$ '000*	*Net maximum exposure 2017 US$ '000*
Balances with banks	**364,766**	**364,766**	298,344	298,344
Deposits with banks and other financial institutions	**339,105**	**339,105**	409,496	409,496
Investments classified as fair value through profit and loss	**14,517**	**14,517**	20,335	20,335
Investment securities	**205,597**	**205,597**	221,374	221,374
Loans and advances	**163,338**	**163,338**	150,256	147,079
Interest receivable	**6,628**	**6,628**	6,744	6,744
Other assets	**738**	**738**	1,243	1,243
Total funded credit risk exposure	**1,094,689**	**1,094,689**	1,107,792	1,104,615
Unfunded exposure on credit related contingencies	**122,523**	**95,087**	29,523	7,529
Total funded and unfunded credit risk exposures	**1,217,212**	**1,189,776**	1,137,315	1,112,144

23 RISK MANAGEMENT (continued)

23.2 Credit risk (continued)

The amount, type and valuation of collateral are based on guidelines specified in the risk management framework. The main types of collaterals accepted include cash collateral, residential and commercial real estate and securities.

b. Credit quality per class of financial assets

The table below presents an analysis of the financial assets exposed to credit risk and external rating designation at 31 December 2018 and 31 December 2017. The credit quality is graded based on external credit rating agencies - Standard & Poor, Fitch and Moody's and internal ratings are categorised as follows:

(i) High standard - Where external credit rating agency ratings are A and above
(ii) Standard - Where external credit rating agency ratings are below A and unrated.
(iii) Watch list - Where the facility is not past due but recoverability is being monitored.
(iv) Past due and impaired - Where interest or principal sum of loan is due for more than 90 days.

	Neither past due nor impaired					
	High standard grade US$ '000	*Standard grade US$ '000*	*Past due but not impaired US$ '000*	*Past due and individually impaired US$ '000*	*Provision for expected US$ '000*	*Total US$ '000*
At 31 December 2018						
Balances with banks	54,993	309,783	-	-	(10)	364,766
Deposits with banks and other financial institutions	35,000	304,299	-	-	(194)	339,105
Investments classified as fair value through profit and loss	5,012	9,505	-	-	-	14,517
Investment securities	16,578	190,344	-	-	(1,325)	205,597
Loans and advances	-	147,014	20,184	101,898	(105,758)	163,338
Interest receivable	279	6,114	235	-	-	6,628
Other assets	-	738	-	-	-	738
Funded exposures	111,862	967,797	20,419	101,898	(107,287)	1,094,689
Credit related contingencies	285	122,842	-	-	(604)	122,523
Gross unfunded exposures	285	122,842	-	-	(604)	122,523
Net funded and unfunded exposures	112,147	1,090,639	20,419	101,898	(107,891)	1,217,212

23 RISK MANAGEMENT (continued)

23.2 Credit risk (continued)

b. Credit quality per class of financial assets (continued)

	Neither past due nor impaired					
	High standard grade US$ '000	*Standard grade US$ '000*	*Past due but not impaired US$ '000*	*Past due and individually impaired US$ '000*	*Provision for loan losses US$ '000*	*Total US$ '000*
At 31 December 2017						
Balances with banks	8,450	289,894	-	-	-	298,344
Deposits with banks and other financial institutions	63,000	346,496	-	-	-	409,496
Investments held for trading	3,068	17,267	-	-	-	20,335
Non-trading investments	8,495	212,879	-	-	-	221,374
Loans and advances	-	148,398	-	78,748	(76,890)	150,256
Interest receivable	117	6,627	-	-	-	6,744
Other assets	-	1,243	-	-	-	1,243
Funded exposure	83,130	1,022,804	-	78,748	(76,890)	1,107,792
Credit related contingencies	-	29,523	-	-	-	29,523
Gross unfunded exposures	-	29,523	-	-	-	29,523
Net funded and unfunded exposures	83,130	1,052,327	-	78,748	(76,890)	1,137,315

Aging analysis of past due but not impaired financial assets

	Less than 30 days 2018 US$ '000 *	***31 to 60 days 2018 US$ '000***	***61 to 90 days 2018 US$ '000***	***More than 90 days 2018 US$ '000***	***Total 2018 US$ '000***
Loans and advances	**12,581**	**7,603**	**-**	**-**	**20,184**

	Less than 30 days 2017 US$ '000	*31 to 60 days 2017 US$ '000*	*61 to 90 days 2017 US$ '000*	*More than 90 days 2017 US$ '000*	*Total 2017 US$ '000*
Loans and advances	-	-	-	-	-

* This amount is not matured as at 31 December 2018 but considered as past due but not impaired (stage 2).

23 RISK MANAGEMENT (continued)

23.2 Credit risk (continued)

c. Concentration of maximum exposure to credit risk

The geographical distribution of gross credit exposures (net of provision for impairment) is presented below:

At 31 December 2018

	Bahrain US$ '000	Other GCC countries US$ '000	Other Middle-East and African countries US$ '000	Europe US$ '000	Rest of the world US$ '000	Provision for expected credit losses US$ '000	Total US$ '000
Balances with banks	301,754	9,450	2,214	11,118	40,240	(10)	364,766
Deposits with banks and other financial institutions	144,082	70,000	-	105,217	20,000	(194)	339,105
Investments classified as fair value through profit and loss	4,873	5,012	-	4,632	-	-	14,517
Investment securities	98,474	46,712	19,995	36,713	5,028	(1,325)	205,597
Loans and advances	-	3,123	195,761	65,884	4,328	(105,758)	163,338
Interest receivable	2,433	575	2,156	1,381	83	-	6,628
Other assets	564	-	174	-	-	-	738
Gross funded exposures	**552,180**	**134,872**	**220,300**	**224,945**	**69,679**	**(107,287)**	**1,094,689**
Credit related contingencies	-	20,911	101,922	10	284	(604)	122,523
Gross unfunded exposures	-	**20,911**	**101,922**	**10**	**284**	**(604)**	**122,523**
Gross funded and unfunded exposures	**552,180**	**155,783**	**322,222**	**224,955**	**69,963**	**(107,891)**	**1,217,212**

At 31 December 2017

	Bahrain US$ '000	Other GCC countries US$ '000	Other Middle-East and African countries US$ '000	Europe US$ '000	Rest of the world US$ '000	Total US$ '000
Balances with banks	252,385	1,754	2,004	42,154	47	298,344
Deposits with banks and other financial institutions	232,975	71,000	-	85,521	20,000	409,496
Investments held for trading	13,263	4,072	-	3,000	-	20,335
Non-trading investments	91,901	51,274	20,498	47,796	9,905	221,374
Loans and advances	-	3,129	102,958	44,169	-	150,256
Interest receivable	2,414	499	2,082	1,568	181	6,744
Other assets	930	-	193	120	-	1,243
Gross funded exposures	593,868	131,728	127,735	224,328	30,133	1,107,792
Credit related contingencies	-	11	29,512	-	-	29,523
Gross unfunded exposures	-	11	29,512	-	-	29,523
Gross funded and unfunded exposures	593,868	131,739	157,247	224,328	30,133	1,137,315

23 RISK MANAGEMENT (continued)

23.2 Credit risk (continued)

c. Concentration of maximum exposure to credit risk (continued)

Sectoral classification of gross credit exposures is presented below:

At 31 December 2018	*Sovereign US$ '000*	*Banks and financial institutions US$ '000*	*Commercial, business and others US$ '000*	*Provision for expected credit losses US$ '000*	*Total US$ '000*
Balances with banks	301,521	63,255	-	(10)	364,766
Deposits with banks and other financial institutions	-	339,299	-	(194)	339,105
Investments classified as fair value through profit and loss	-	9,885	4,632	-	14,517
Investment securities	143,596	32,862	30,464	(1,325)	205,597
Loans and advances	78,557	118,221	72,318	(105,758)	163,338
Interest receivable	4,076	1,462	1,090	-	6,628
Other assets	-	213	525	-	738
Gross funded exposures	527,750	565,197	109,029	(107,287)	1,094,689
Credit related contingencies	-	102,216	20,911	(604)	122,523
Gross unfunded exposures	-	102,216	20,911	(604)	122,523
Gross funded and unfunded exposures	527,750	667,413	129,940	(107,891)	1,217,212

At 31 December 2017	*Sovereign US$ '000*	*Banks and financial institutions US$ '000*	*Commercial, business and others US$ '000*	*Total US$ '000*
Balances with banks	248,492	49,852	-	298,344
Deposits with banks and other financial institutions	-	409,496	-	409,496
Investments held for trading	13,262	6,371	702	20,335
Non-trading investments	137,921	42,524	40,929	221,374
Loans and advances	84,692	16,410	49,154	150,256
Interest receivable	4,375	1,026	1,343	6,744
Other assets	-	-	1,243	1,243
Gross funded exposures	488,742	525,679	93,371	1,107,792
Credit related contingencies	3,911	25,601	11	29,523
Gross unfunded exposures	3,911	25,601	11	29,523
Gross of funded and unfunded exposures	492,653	551,280	93,382	1,137,315

23.3 Market risk

Market risk is the risk of potential financial loss that may arise from adverse changes in the value of a financial instrument or portfolio of financial instruments due to movements in interest rates, foreign exchange rates and equity prices. This risk arises from asset - liability mismatches, changes that occur in the yield curve and foreign exchange rates.

23 RISK MANAGEMENT (continued)

23.3 Market risk (continued)

23.3.1 Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities that mature or reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through a number of means. The Bank's interest rate sensitivity position as of 31 December, is as follows:

Sensitivity analysis - interest rate risk

	Impact on statement of profit or loss	
	2018	*2017*
	US$ '000	*US$ '000*
25 bps increase/decrease		
AED	± 120	± 76
US Dollar	± 97	± 228
Euro	± 34	± 1
SAR	± 26	± 7

23.3.2 Currency risk

Currency risk arise from the movement of the rate of exchange over a period of time. The Bank's currency risk is mainly towards assets and liabilities denominated in GBP and Euro. The following table demonstrates the sensitivity to a reasonable possible change in foreign exchange rates, with all other variables held constant, on the Bank's statement of profit or loss:

	Change in rate	*Effect on statement of profit or loss for the year*	
		2018	*2017*
		US$ '000	*US$ '000*
Euro	± 5%	**8**	39
GBP	± 5%	**1**	367

As other currency exposures are insignificant and GCC currencies to which the Bank is exposed are pegged to the US Dollar, their balances are not considered to represent significant currency risk.

23.3.3 Equity price risk

Equity price risk is the risk that the fair value of equities decreases as a result of changes in the value of individual companies' shares. The effect on profit and equity, as a result of a change in fair value of trading equity instruments, due to a reasonably possible change in equity prices, with all other variables held constant, is as follows:

	Change in equity prices	*Effect on net income and equity for the year*	
		2018	*2017*
		US$ '000	*US$ '000*
Investments classified as fair value through profit and loss	± 10%	**-**	13

23.4 Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind, and monitors liquidity on a daily basis. This incorporates an assessment of expected cash flow and the availability of high grade collateral which would be used to secure additional funding if required.

23 RISK MANAGEMENT (continued)

23.4 Liquidity risk (continued)

The maturity profile of the assets and liabilities at **31 December 2018** given below reflects the management's best estimates of the maturities of assets and liabilities that have been determined on the basis of the remaining period at the date of the statement of financial position.

At 31 December 2018	*Up to 1 year*						*Provision for*	
	Up to 1 month US$ '000	*1 to 3 months US$ '000*	*3 to 12 months US$ '000*	*Total US$ '000*	*More than 1 year US$ '000*	*No specific maturity US$ '000*	*expected credit losses US$ '000*	*Total US$ '000*
ASSETS								
Cash, balances with banks and Central Bank	182,366	182,413	-	364,779	-	-	(10)	364,769
Deposits with banks and other financial institutions	324,299	15,000	-	339,299	-	-	(194)	339,105
Investments classified as fair value through profit and loss	14,517	-	-	14,517	-	-	-	14,517
Investment securities	-	2,500	11,801	14,301	192,621	-	(1,325)	205,597
Loans and advances	4,777	8,612	72,212	85,601	183,495	-	(105,758)	163,338
Property, equipment and software	-	-	-	-	-	9,758	-	9,758
Interest receivable	4,234	1,338	1,056	6,628	-	-	-	6,628
Other assets	34	655	13	702	474	-	-	1,176
Total assets	530,227	210,518	85,082	825,827	376,590	9,758	(107,287)	1,104,888
LIABILITIES								
Deposits from banks and other financial institutions	251,925	178,645	214,000	644,570	-	-	-	644,570
Due to banks and other financial institutions	87,783	-	-	87,783	-	-	-	87,783
Due to customers	65,642	-	-	65,642	-	-	-	65,642
Interest payable	240	322	1,072	1,634	-	-	-	1,634
Other liabilities	767	4,444	-	5,211	1,377	-	604	7,192
Total liabilities	406,357	183,411	215,072	804,840	1,377	-	604	806,821
Net liquidity gap	123,870	27,107	(129,990)	20,987	375,213	9,758	(107,891)	298,067
Cumulative liquidity gap	123,870	150,977	20,987	-	396,200	405,958	298,067	-

23 RISK MANAGEMENT (continued)

23.4 Liquidity risk (continued)

At 31 December 2017	*Up to 1 year*						
	Up to 1 month US$ '000	*1 to 3 months US$ '000*	*3 to 12 months US$ '000*	*Total US$ '000*	*More than 1 year US$ '000*	*No specific maturity US$ '000*	*Total US$ '000*
ASSETS							
Cash, balances with banks and Central Bank	136,575	149,283	12,491	298,349	-	-	298,349
Deposits with banks and other financial institutions	354,496	55,000	-	409,496	-	-	409,496
Investments classified as fair value through profit and loss	20,462	-	-	20,462	-	-	20,462
Investment securities	-	-	1,000	1,000	220,374	-	221,374
Loans and advances	5,518	31,725	15,013	52,256	98,000	-	150,256
Property, equipment and software	-	-	-	-	-	10,371	10,371
Interest receivable	4,087	1,883	774	6,744	-	-	6,744
Other assets	69	654	63	786	805	-	1,591
Total assets	521,207	238,545	29,341	789,093	319,179	10,371	1,118,643
LIABILITIES							
Deposits from banks and other financial institutions	185,094	180,463	4,000	369,557	200,000	-	569,557
Due to banks and other financial institutions	133,417	-	-	133,417	-	-	133,417
Due to customers	73,805	20,000	-	93,805	-	-	93,805
Interest payable	55	240	791	1,086	-	-	1,086
Other liabilities	803	4,969	-	5,772	1,155	-	6,927
Total liabilities	393,174	205,672	4,791	603,637	201,155	-	804,792
Net liquidity gap	128,033	32,873	24,550	185,456	118,024	10,371	313,851
Cumulative liquidity gap	128,033	160,906	185,456	-	303,480	313,851	-

23 RISK MANAGEMENT (continued)

23.4 Liquidity risk (continued)

The maturity profile of the financial and contingent liabilities as at **31 December 2018** based on contractual undiscounted repayment amounts is as follows:

At 31 December 2018	*Up to 1 year*							
	Up to 1 month US$ '000	*1 to 3 months US$ '000*	*3 to 12 months US$ '000*	*Total US$ '000*	*More than 1 year US$ '000*	*No specific maturity US$ '000*	*Provision for expected credit losses US$ '000*	*Total US$ '000*
Liabilities								
Deposits from banks and financial institutions	252,029	179,366	222,537	653,932	-	-	-	653,932
Due to banks and other financial institutions	87,787	-	-	87,787	-	-	-	87,787
Due to customers	65,662	-	-	65,662	-	-	-	65,662
Total undiscounted liabilities	405,478	179,366	222,537	807,381	-	-	-	807,381
Derivatives:								
Forward foreign exchange contracts (note 24)	4	-	-	4	-	-	-	4
Commitments and contingent liabilities								
Letters of credit	19,954	52,296	26,106	98,356	22,673	-	(603)	120,426
Letters of guarantee	2,027	11	50	2,088	10	-	(1)	2,097
	21,981	52,307	26,156	100,444	22,683	-	(604)	122,523

23 RISK MANAGEMENT (continued)

23.4 Liquidity risk (continued)

At 31 December 2017	*Up to 1 year*						
	Up to 1 month US$ '000	*1 to 3 months US$ '000*	*3 to 12 months US$ '000*	*Total US$ '000*	*More than 1 year US$ '000*	*No specific maturity US$ '000*	*Total US$ '000*
Liabilities							
Deposits from banks and financial institutions	185,239	180,887	4,028	370,154	206,860	-	577,014
Due to banks and other financial institutions	133,421	-	-	133,421	-	-	133,421
Due to customers	73,807	20,002	-	93,809	-	-	93,809
Total undiscounted liabilities	392,467	200,889	4,028	597,384	206,860	-	804,244
Derivatives:							
Forward foreign exchange contracts (note 24)	11,749	-	-	11,749	-	-	11,749
Commitments and contingent liabilities							
Letters of credit	2,611	21,926	4,925	29,462	-	-	29,462
Letters of guarantee	-	-	61	61	-	-	61
Undrawn loan commitments	-	-	-	-	-	-	-
	2,611	21,926	4,986	29,523	-	-	29,523

23 RISK MANAGEMENT (continued)

23.5 Fair value of financial instruments

Fair value hierarchy - financial instruments measured at fair value

The following table provides the fair value measurement hierarchy of the Bank's financial instruments measured at fair value:

At 31 December 2018

	Level 1 ***US$ '000***	***Level 2*** ***US$ '000***	***Total*** ***US$ '000***
Investments classified as fair value through profit and loss	**14,517**	**-**	**14,517**
Investments classified as fair value through other comprehensive income	**113,003**	**-**	**113,003**
Derivative financial instruments	**-**	**4**	**4**
	127,520	**4**	**127,524**

At 31 December 2017

	Level 1 *US$ '000*	*Level 2* *US$ '000*	*Total* *US$ '000*
Investments classified as fair value through profit and loss	20,462	-	20,462
Available-for-sale investments	116,310	-	116,310
Derivative financial instruments	-	(42)	(42)
	136,772	(42)	136,730

The Bank had no investments measured at fair value qualifying for level 3 of fair value heirarchy as at 31 December 2018 and as at 31 December 2017.

Transfers between level 1, level 2 and level 3

During the year ended 31 December 2018, there were no transfers between level 1 and level 2 fair value measurements, and no transfers into or out of level 3 fair value measurement (2017: nil).

Fair value hierarchy - financial instruments not measured at fair value

The following table provides the fair value measurement hierarchy of the Bank's financial instruments not measured at fair value:

At 31 December 2018

	Level 1 ***US$ '000***	***Level 2*** ***US$ '000***	***Level 3*** ***US$ '000***	***Total fair value*** ***US$ '000***	***Carrying value*** ***US$ '000***
Amortised cost investments	**91,263**	**-**	**-**	**91,263**	**92,594**
Loans and advances	**49,571**	**-**	**-**	**49,571**	**46,242**
	140,834	**-**	**-**	**140,834**	**138,836**

At 31 December 2017

	Level 1 *US$ '000*	*Level 2* *US$ '000*	*Level 3* *US$ '000*	*Total fair value* *US$ '000*	*Carrying value* *US$ '000*
Held-to-maturity investments	106,859	-	-	106,859	105,064
Loans and advances	53,143	-	-	53,143	45,394
	160,002	-	-	160,002	150,458

- Except for Level 3 classified held-to-maturity investments, fair values of held-to-maturity investments and loans are determined based on quoted prices in active markets.

23 RISK MANAGEMENT (continued)

23.6 Fair value of financial instruments (continued)

Balances with banks, deposits with banks and other financial institutions, loans and advances (other than those disclosed in the table above), interest receivable, other assets, deposits from banks and other financial institutions, due to banks and other financial institutions, due to customers, interest payable and other liabilities are generally short term in nature. Management has assessed that the fair values of these approximate their carrying values as of 31 December 2018 and 31 December 2017.

24 DERIVATIVE FINANCIAL INSTRUMENTS

In the ordinary course of business, the Bank enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instruments, reference rates or indices.

These include forward exchange contracts which create rights and obligation that have the effect of transferring between the parties of the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, a derivative financial instrument gives one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favourable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instruments, as prices in financial markets change those terms may become either favourable or unfavourable.

The table below shows the net fair values of derivative financial instruments together with the notional amount. These contracts are settled on a net basis. Depending on currency movements, the contracts may result in either a net asset or a net liability. The following table shows the material outstanding contracts as at 31 December:

	2018		*2017*	
	Notional amount US$ '000	***Gain / (loss) US$ '000***	*Notional amount US$ '000*	*Gain / (loss) US$ '000*
Forward foreign exchange contracts	**4**	**4**	11,749	(42)

25 RELATED PARTY BALANCES AND TRANSACTIONS

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

Transactions with related parties included in the statement of profit or loss and statement of financial position are as follows:The related party balances included in the consolidated financial statements are as follows:

	31 December 2018				*31 December 2017*			
	Shareholders	***Key management personnel/ Board members***	***Other related parties***	***Total***	*Shareholders*	*Key management personnel/ Board members*	*Other related parties*	*Total*
	US$ '000	***US$ '000***	***US$ '000***	***US$ '000***	*US$ '000*	*US$ '000*	*US$ '000*	*US$ '000*
Statement of profit or loss								
Interest income	**2**	**-**	**212**	**214**	-	-	74	74
Interest expense	**12,526**	**-**	**555**	**13,081**	9,249	-	386	9,635
Fee and commission income	**52**	**-**	**97**	**149**	948	-	20	968
Statement of financial position								
Assets								
Cash and balances with banks	**324**	**-**	**5,583**	**5,907**	116	-	28,021	28,137
Deposit with banks and financial institutions	**-**	**-**	**9,714**	**9,714**	-	-	-	-
Loans and advances	**-**	**-**	**4,629**	**4,629**	-	-	4,799	4,799
Interest receivable	**-**	**-**	**44**	**44**	-	-	40	40
Other assets	**-**	**50**	**-**	**50**	-	58	-	58
Liabilities								
Deposits from banks and other financial institutions	**449,719**	**-**	**25,000**	**474,719**	402,821	-	27,367	430,188
Due to banks and other financial institutions	**1,676**	**-**	**2,104**	**3,780**	3,685	-	7,098	10,783
Interest payable	**1,440**	**-**	**18**	**1,458**	956	-	15	971
Other liabilities	**104**	**292**	**-**	**396**	71	398	-	469
Assets under management (note 26)	**21,967**	**-**	**-**	**21,967**	23,061	-	-	23,061
Contingent liabilities								
Letters of credit and letters of guarantee	**1,840**	**-**	**3,856**	**5,696**	46	-	5,975	6,021
Forward foreign exchange contracts	**-**	**-**	**-**	**-**	-	-	5,445	5,445

25 TRANSACTIONS WITH RELATED PARTIES (continued)

Compensation paid to the Board of Directors and key management personnel:

	2018 ***US$ 000***	*2017* *US$ 000*
Short term benefits	**3,788**	4,041
End of term benefits	**217**	251
Total compensation	**4,005**	4,292

Short term benefits include Board of Directors' sitting fees and provision for bonus accrual of US$ 705 thousand (2017: US$ 680 thousand) and reimbursement of travel, accommodation and other expenses amounting to US$ 149 thousand (2017: US$ 128 thousand). The accrual is subject to approval by the Bank's shareholders in the next Annual General Meeting.

Short term benefits also include compensation paid to key management personnel as salary, allowances and provision for bonus accrual.

26 ASSETS UNDER MANAGEMENT

The Bank provides trade finance services to certain customers, which involve the Bank acting as an agent of the assets in a fiduciary capacity. Assets that are held in financing capacity are not included in these financial statements. At 31 December 2018, the Bank had fiduciary assets under management of US$ 21,967 thousand (2017:US$ 35,059 thousand).

27 CAPITAL ADEQUACY

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

In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities.

The risk asset ratio, calculated in accordance with the capital adequacy guidelines, under Basel III, approved by the Central Bank of Bahrain is as follows:

	2018 ***US$ 000***	*2017* *US$ 000*
Capital base:		
Tier 1 capital	**296,278**	313,123
Tier 2 capital	**7,840**	3,737
Total capital base (a)	**304,118**	316,860
Risk weighted assets (b)	**709,897**	853,781
Capital adequacy (a/b * 100)	**42.84%**	37.11%
Minimum requirement	**12.50%**	12.50%