

**Bahrain Middle East Bank B.S.C.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**31 DECEMBER 2016**



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## **INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BAHRAIN MIDDLE EAST BANK B.S.C.**

### **Report on the Audit of the Consolidated Financial Statements**

#### *Opinion*

We have audited the accompanying consolidated financial statements of Bahrain Middle East Bank B.S.C. ("the Bank") and its subsidiary (together "the Group"), which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated statements of income, comprehensive income, cash flows and changes in equity for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

#### *Basis for opinion*

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### *Key audit matters*

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the year ended 31 December 2016. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

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

**INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF  
BAHRAIN MIDDLE EAST BANK B.S.C. (continued)**

*Key audit matters (continued)*

<b>1. Impairment of carrying value of loans and advances</b>	
Refer to note 6 to the consolidated financial statements	
<b>Key audit matter / risk</b>	<b>How the key audit matter was addressed in the audit</b>
<p>The Directors exercise significant judgment using subjective assumptions when determining both the timing and the amounts of the impairment provision of loans and advances. Because loans and advances form major portion of the Group's assets and due to the significance of judgment used in estimating both the specific and collective provisions of loans and advances, this audit area is considered a key audit risk. As at 31 December 2016, the gross loans and advances amounted to USD 125.4 million and related impairment provision amounted to USD 1.4 million. The basis of the impairment provision policy is presented in the accounting policies and in note 4 to the financial statements.</p>	<p>We have performed test of controls over the loans and advances related processes to confirm the operating effectiveness of the key controls in place which identify the impaired loans and advances against which provisions are required.</p> <p>We tested a sample of loans and advances to assess whether an event of impairment has been identified on a timely basis by performing substantive audit procedures. We evaluated the reasonableness of the underlying data and assumptions used by management in determining the provisions.</p> <p>For the collective impairment provision, we obtained an understanding of the methodology used by the management to determine the collective provisions, assessed the underlying assumptions and the sufficiency of the data used by management.</p> <p>We also assessed whether the financial statement disclosures appropriately reflect the requirements of IFRS.</p> <p>Refer to the critical accounting estimates and judgements, disclosures of loans and advances and financial risk management on notes 4, note 6 and note 25 to the consolidated financial statements.</p>

**INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF  
BAHRAIN MIDDLE EAST BANK B.S.C. (continued)**

*Key audit matters (continued)*

<b>2. Maturity of deposits from financial institution</b> Refer to note 9 and note 25 to the consolidated financial statements	
<b>Key audit matter / risk</b>	<b>How the key audit matter was addressed in the audit</b>
The Bank has deposits of US\$ 126.5 million from a single financial institution in the region since September 2010, with a monthly maturity and rollover. Because these deposits represent 92% of the total liabilities of the Group, this audit area is considered a key audit risk.	<p>We have circularised deposits confirmations to the financial institution to check the completeness and existence of the balances.</p> <p>We have assessed the management's liquidity projections, challenged the assumptions and the input from their past experience used in the assumptions, further we have verified the deal tickets to check the maturities of the deposits to see if these are rolled over on maturities. We also checked the rollover of these deposits subsequent to 31 December 2016 and before 31 January 2017.</p> <p>We also assessed whether the financial statements disclosures appropriately reflect the requirements of IFRS. Refer to note 9 and 25 to the consolidated financial statements.</p>

*Other information included in the Group's 2016 annual report*

Other information consists of the information included in the Annual Report, other than the consolidated financial statements and our auditor's report thereon. The Board of Directors is responsible for the other information.

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

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

*Responsibilities of the Board of Directors for the consolidated financial statements*

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

## **INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BAHRAIN MIDDLE EAST BANK B.S.C. (continued)**

### *Responsibilities of the Board of Directors for the consolidated financial statements (continued)*

In preparing the consolidated financial statements, the Board of Directors is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors either intends to liquidate Group or to cease operations, or has no realistic alternative but to do so.

### *Auditor's Responsibilities for the audit of the consolidated financial statements*

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

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 consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.
- Conclude on the appropriateness of the Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

**INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF  
BAHRAIN MIDDLE EAST BANK B.S.C. (continued)**

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

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

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

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

**INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF  
BAHRAIN MIDDLE EAST BANK B.S.C. (continued)**

**Report on Other Legal and Regulatory Requirements**

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

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the Report of the Board of Directors is consistent with the consolidated financial statements;
- c) we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and the CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2016 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position; and
- d) satisfactory explanations and information have been provided to us by Management in response to all our requests.

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



Partner's registration no. 115  
31 January 2017  
Manama, Kingdom of Bahrain

# Bahrain Middle East Bank B.S.C.

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2016

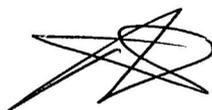
	Note	2016 US\$ '000	2015 US\$ '000
<b>ASSETS</b>			
Balances with banks and financial institutions		40,374	28,373
Treasury bills and placements with financial institutions	5	4,207	19,998
Investments at fair value through profit or loss		1,149	161
Loans and advances	6	123,958	110,705
Available-for-sale investments	7	5,021	9,530
Held-to-maturity investment		179	216
Other assets	8	2,464	2,889
<b>TOTAL ASSETS</b>		<b>177,352</b>	<b>171,872</b>
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES</b>			
Deposits from financial institutions	9	126,567	125,098
Deposits from customers	10	8,405	8,726
Other liabilities	11	2,443	2,786
<b>Total liabilities</b>		<b>137,415</b>	<b>136,610</b>
<b>EQUITY</b>			
Share capital	12	60,501	60,501
Accumulated losses		(21,481)	(26,554)
Fair value reserve		917	1,315
<b>Total equity</b>		<b>39,937</b>	<b>35,262</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>177,352</b>	<b>171,872</b>



Wilson S Benjamin  
Chairman



Sheikh Abdullah A.K Al Sabah  
Vice Chairman



Ritchie Skelding  
Chief Executive Officer

The attached notes 1 to 28 form part of these consolidated financial statements

**Bahrain Middle East Bank B.S.C.**  
**CONSOLIDATED STATEMENT OF INCOME**  
For the year ended 31 December 2016

	Note	2016 US\$ '000	2015 US\$ '000
<b>OPERATING INCOME</b>			
Interest income	14	10,699	11,417
Interest expense	15	(965)	(1,487)
<b>Net interest income</b>		<b>9,734</b>	9,930
Investment banking income	16	1,149	2,170
Other income		368	345
Foreign exchange (loss) gain		(94)	121
<b>Total operating income</b>		<b>11,157</b>	12,566
<b>OPERATING EXPENSES</b>			
Staff expenses		4,127	3,977
Premises expenses		329	389
Other operating expenses	17	1,214	1,122
<b>Total operating expenses</b>		<b>5,670</b>	5,488
<b>NET PROFIT FOR THE YEAR BEFORE IMPAIRMENT PROVISIONS</b>			
		<b>5,487</b>	7,078
Impairment provisions - net	18	(414)	(1,999)
<b>NET PROFIT FOR THE YEAR</b>		<b>5,073</b>	5,079
<b>BASIC AND DILUTED EARNINGS PER SHARE (IN US\$ CENTS)</b>			
	19	<b>2.10</b>	2.10

Wilson S Benjamin  
Chairman

Sheikh Abdullah A.K Al Sabah  
Vice Chairman

Ritchie Skelding  
Chief Executive Officer

Bahrain Middle East Bank B.S.C.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2016

	<b>2016</b> <b>US\$ '000</b>	2015 US\$ '000
<b>NET PROFIT FOR THE YEAR</b>	<b>5,073</b>	5,079
<b>Other comprehensive (loss) income:</b>		
Other comprehensive (loss) income to be reclassified to profit or loss in subsequent periods:		
Fair value reserves (available-for-sale investments):		
Net amount transferred to statement of income on sale/impairment	<b>21</b>	(707)
Net changes in fair value during the year	<b>(419)</b>	(114)
<b>Total other comprehensive loss for the year</b>	<b>(398)</b>	(821)
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<b>4,675</b>	4,258

The attached notes 1 to 28 form part of these consolidated financial statements

# Bahrain Middle East Bank B.S.C.

## CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2016

	Note	2016 US\$ '000	2015 US\$ '000
<b>OPERATING ACTIVITIES</b>			
Net profit for the year		5,073	5,079
Adjustments for:			
Impairment provisions - net	18	414	1,999
Depreciation and amortisation		43	50
Changes in operating assets and liabilities:			
Treasury bills and placements with financial institutions		-	3,000
Investments at fair value through profit or loss		(988)	427
Loans and advances		(13,096)	5,363
Available-for-sale investments		3,540	(2,610)
Held-to-maturity investment		37	11
Other assets		382	(234)
Deposits from financial institutions		1,469	320
Deposits from customers		(321)	(6,301)
Other liabilities		(343)	751
Net cash (used in) from operating activities		<b>(3,790)</b>	7,855
<b>INVESTING ACTIVITY</b>			
Purchase of furniture and equipment		-	(92)
Net cash used in investing activity		-	(92)
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>		<b>(3,790)</b>	7,763
Cash and cash equivalents at 1 January		<b>48,371</b>	40,608
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>		<b>44,581</b>	48,371
<b>CASH AND CASH EQUIVALENTS COMPRISE:</b>			
Balances with banks and financial institutions		<b>40,374</b>	28,373
Treasury bills and placements with financial institutions with original maturities of three months or less		<b>4,207</b>	19,998
		<b>44,581</b>	48,371

The attached notes 1 to 28 form part of these consolidated financial statements

Bahrain Middle East Bank B.S.C.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2016

	<i>Share capital US\$ '000</i>	<i>Accumulated losses US\$ '000</i>	<i>Fair value reserve US\$ '000</i>	<i>Total equity US\$ '000</i>
Balance at 1 January 2016	60,501	(26,554)	1,315	35,262
Total comprehensive income (loss) for the year	-	5,073	(398)	4,675
<b>Balance at 31 December 2016</b>	<b>60,501</b>	<b>(21,481)</b>	<b>917</b>	<b>39,937</b>
Balance at 1 January 2015	60,501	(31,633)	2,136	31,004
Total comprehensive income (loss) for the year	-	5,079	(821)	4,258
Balance at 31 December 2015	60,501	(26,554)	1,315	35,262

The attached notes 1 to 28 form part of these consolidated financial statements

At 31 December 2016

## **1 ACTIVITIES**

Bahrain Middle East Bank B.S.C. ("the Bank") is a Bahraini Shareholding Company incorporated in the Kingdom of Bahrain. On 9 April 2007, the Central Bank of Bahrain ("the CBB") issued a Conventional Wholesale Banking license to the Bank. The commercial registration ("CR") number of the Bank is 12266. The Bank is listed on the Bahrain Bourse under the ticker 'BMB'. The principal activities of the Bank and its subsidiaries (together "the Group") are trade finance and corporate advisory in the digital media and e-commerce sectors.

The registered office of the Bank is BMB Centre, Building 135, Road 1702, Block 317, Diplomatic Area, Manama, Kingdom of Bahrain.

These consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 31 January 2017.

## **2 BASIS OF CONSOLIDATION**

These consolidated financial statements incorporate the financial statements of the Bank, its subsidiary and the investment holding companies of the Bank as at 31 December 2016.

The Bank's principal and wholly owned subsidiary is BMB Property Services W.L.L., incorporated in the Kingdom of Bahrain and engaged in building management.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

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

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

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

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

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

## 2 BASIS OF CONSOLIDATION (continued)

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

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

## 3 BASIS OF PREPARATION

### 3.1 Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and are in conformity with the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse and the terms of the Bank's memorandum and articles of association.

### 3.2 Accounting convention

The consolidated financial statements are prepared on a historical cost basis, except for investments at fair value through profit or loss and available-for-sale investments, that have been measured at fair value.

The consolidated financial statements are presented in United States Dollars ("US\$"), this being the functional currency of the Group, and are rounded to the nearest thousand unless otherwise stated.

## 4 SIGNIFICANT ACCOUNTING POLICIES

### 4.1 New and amended standards and interpretations issued and effective

The accounting policies adopted are consistent with those of the previous financial year, except for the following relevant new standards and amendments to IFRS effective as of 1 January 2016:

#### *Amendments to IAS 27: Equity Method in Separate Financial Statements*

The amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying IFRS and electing to change to the equity method in their separate financial statements have to apply that change retrospectively. These amendments do not have any impact on the Group's consolidated financial statements.

#### *Annual Improvements 2012-2014 Cycle*

These improvements are effective for annual periods beginning on or after 1 January 2016 and are not expected to have a material impact on the Group. They include:

- IFRS 5 Non-current Assets Held for Sale and Discontinued Operations;
- IFRS 7 Financial Instruments: Disclosures;
- IAS 19 Employee Benefits; and
- IAS 34 Interim Financial Reporting.

**4 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.1 New and amended standards and interpretations issued and effective (continued)**

*Amendments to IAS 1 Disclosure Initiative*

The amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:

- The materiality requirements in IAS 1;
- That specific line items in the statements of profit or loss and OCI and the statement of financial position may be disaggregated;
- That entities have flexibility as to the order in which they present the notes to consolidated financial statements; and
- That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statements of profit or loss and OCI. These amendments do not have any impact on the Group.

*Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception*

The amendments address issues that have arisen in applying the investment entities exception under IFRS 10 Consolidated Financial Statements. The amendments to IFRS 10 clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value.

Furthermore, the amendments to IFRS 10 clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 Investments in Associates and Joint Ventures allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries.

These amendments are applied retrospectively and do not have any impact on the Group as the Group does not apply the consolidation exception.

**4.2 New standards and amendments issued but not yet effective**

Standards issued but not yet effective up to the date of issuance of the Group's consolidated financial statements are listed below. This listing is of relevant standards and interpretations issued, which the Group reasonably expects to be applicable at a future date. The Group intends to adopt those standards (where applicable) when they become effective:

***IFRS 9 Financial Instruments***

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions. The Group plans to adopt the new standard on the required effective date.

**4 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.2 New standards and amendments issued but not yet effective (continued)**

***IFRS 9 Financial Instruments (continued)***

During 2016, the Group has performed a high-level impact assessment of all three aspects of IFRS 9. This preliminary assessment is based on currently available information and may be subject to changes arising from further detailed analyses or additional reasonable and supportable information being made available to the Group in the future. Overall, the Group expects no significant impact on its balance sheet and equity on implementation of IFRS 9.

***IFRS 15 Revenue from Contracts with Customers***

IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognising revenue.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2018 with early adoption permitted. The Group is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

In addition to the above, the IASB issued the following new standards and amendments which are not expected to have a material impact on the Group:

- Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture;
- Amendments to IAS 7: Disclosure Initiative;
- Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses;
- Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions; and
- IFRS 16 Leases.

**4.3 Foreign currencies**

The assets and liabilities of foreign subsidiaries are translated into US\$ at the rates of exchange prevailing at the reporting date. The income and expenses of foreign subsidiaries are translated into US\$ at the rates of exchange prevailing on the dates of the transactions.

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Income and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated statement of income.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into the functional currency at the spot exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date that the fair value was determined. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on translation are recognised in the consolidated statement of income.

**4 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.4 Financial instruments**

**i) Financial assets**

**Initial recognition and measurement**

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss ("FVTPL"), loans and receivables, held-to-maturity investments or available-for-sale investments, as appropriate. The Group determines the classification of its financial assets at initial recognition.

All financial assets are recognised initially at fair value plus transaction costs, except in the case of financial assets recorded at fair value through profit or loss.

Purchase or sale of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognised on the trade date, i.e., the date that the Group commits to purchase or sell the asset.

**Subsequent measurement**

The subsequent measurement of financial assets depends on their classification as described below:

*Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss ("FVTPL") include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term.

Financial assets at fair value through profit or loss are carried in the consolidated statement of financial position at fair value with net changes in fair value presented in the consolidated statement of income.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate (EIR) method, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as 'interest income' in the consolidated statement of income. The losses arising from impairment are recognised in the consolidated statement of income.

*Held-to-maturity investments*

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity when the Group has the positive intention and ability to hold them to maturity. After initial measurement, held-to-maturity investments are measured at amortised cost using the EIR, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as 'interest income' in the consolidated statement of income. The losses arising from impairment are recognised in the consolidated statement of income.

*Available-for-sale investments*

Available-for-sale ("AFS") investments are those that are neither classified as held for trading nor designated at fair value through profit or loss. Debt securities in this category are those that are intended to be held for an indefinite period of time and that may be sold in response to needs for liquidity or in response to changes in the market conditions.

After initial measurement, AFS investments are measured at fair value with unrealised gains or losses recognised as other comprehensive income in the fair value reserve until the investment is derecognised or impaired, at which time the cumulative gain or loss is reclassified from the fair value reserve to the consolidated statement of income. Interest earned whilst holding AFS investments is reported as 'interest income' using the EIR method.

At 31 December 2016

**4 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.4 Financial instruments (continued)**

**i) Financial assets (continued)**

**Derecognition**

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired;
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and
- either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset.

**ii) Impairment 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 may be impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

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 will 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. If such evidence exists, an impairment loss is recognised in the consolidated statement of income.

*Financial assets carried at amortised cost*

For financial assets carried at amortised cost, judgment is made by the management in the estimation of the amount and timing of future cash flows along with making judgments about the financial situation of the underlying asset and realizable value of collateral. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, determined appropriately, is recognised in the consolidated statement of income. Impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate.

The impaired financial assets together with the associated impairment provisions are written off when there is no realistic prospect of future recovery, after obtaining required regulatory approvals. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the impairment provisions. If an amount written off earlier is later recovered, the recovery is credited to the consolidated statement of income.

**4 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.4 Financial instruments (continued)**

**ii) Impairment of financial assets (continued)**

*Available-for-sale financial investments*

For available-for-sale financial assets, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

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

**iii) Renegotiated loans**

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. 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 continuously 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.

**iv) Financial liabilities**

The Group's financial liabilities comprise deposits from financial institutions, deposits from customers and other liabilities.

**Initial recognition and measurement**

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, or loans and borrowings, as appropriate. The Group determines the classification of its financial liabilities at initial recognition. All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings, net of directly attributable transaction costs.

**Subsequent measurement**

The measurement of financial liabilities depends on their classification as described below:

*Financial liabilities at fair value through profit or loss*

Financial liabilities at fair value through profit or loss comprises of financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. Gains or losses on these instruments are recognised in the consolidated statement of income.

*Borrowings*

After initial recognition, interest bearing borrowings are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in the consolidated statement of income when the liabilities are derecognised as well as through the EIR amortisation process.

*Financial guarantee contracts*

Financial guarantee contracts are recognised initially as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the reporting date and the amount recognised less cumulative amortisation.

**4 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.4 Financial instruments (continued)**

**iv) Financial liabilities (continued)**

**Derecognition**

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the consolidated statement of income.

**v) Offsetting of financial instruments**

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statement of financial position if (i) there is a currently enforceable legal right to offset the recognised amounts and (ii) there is an intention to settle on a net basis in order to realise the assets and settle the liabilities simultaneously.

**vi) Fair values**

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 accessible by the Group.

The fair value of an asset or a liability is measured using the assumption that market participants would use when pricing the asset or liability, and that market participants act in their economic best interest.

The fair value of financial instruments that are quoted in an active market is determined by reference to market bid prices at the close of business on the statement of financial position date.

In case of unquoted investments, the Group uses the net asset values provided by the fund managers or 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.

**4.5 Payables, accruals and provisions**

Provision for employee benefit costs is made in accordance with contractual and statutory obligations and other benefit plans approved by the Board of Directors.

Provisions are recognised when the Group has a present obligation as a result of a past event, when 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.

**4.6 Dividends and any other appropriations**

Proposed dividends are disclosed as appropriations within equity until the time they are approved by the shareholders. On approval by shareholders, these are transferred to liabilities until paid out.

Any other appropriations from equity can only be recognised subject to the approval of the shareholders, against the appropriation for shareholders in equity. These are subsequently transferred to liabilities once approved by the shareholders.

At 31 December 2016

**4 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.7 Treasury shares**

Treasury shares are stated at acquisition cost and are shown as a deduction to equity. Any surplus arising from the subsequent sale of treasury shares at a price greater than cost is taken directly to equity and not through the consolidated statement of income. Any deficit arising from the subsequent sale of treasury shares at a price lower than cost is charged first against the cumulative surplus from past transactions in treasury shares, and where such surplus is insufficient, then any difference is charged to accumulated losses.

**4.8 Segment reporting**

An operating segment is a component of the Group that (i) engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, (ii) whose operating results are reviewed regularly by the Chief Executive Officer (being the chief operating decision maker) to make decisions about resources allocated to each segment and assess its performance, and (iii) for which discrete financial information is available.

**4.9 Cash and cash equivalents**

Cash and cash equivalents comprise cash and short term funds, treasury bills, placements with financial institutions and other liquid assets that are readily convertible into cash and are subject to insignificant risk of changes in value with an original maturity of three months or less.

**4.10 Assets under management**

Clients' assets are managed in a fiduciary capacity and the Group has no entitlement to these assets. Clients bear all of the risks and earn a majority of the rewards on their investments, subject to normal management fee arrangements. Accordingly, these assets are not included in the Group's consolidated statement of financial position.

**4.11 Income and expenses**

Interest income is recognised using the effective yield method.

Fee and commission income is recognised when services are rendered.

Investment income from FVTPL investments is recognised on the basis of changes in fair value for the period. Capital gains realised on FVTPL investments are recognised by comparing the sale price against the previously reported fair value, net of expenses and costs payable in respect of the realisation.

Realised capital gains or losses on available-for-sale investments are taken to the consolidated statement of income at the time of derecognition.

Interest expenses is recognised using the EIR method.

**4.12 Significant accounting judgements and estimates**

In the process of applying the Group's accounting policies, management has exercised judgement and estimates as mentioned below, in determining the amounts recognised in the consolidated financial statements.

*Fair value measurement*

When the fair value of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, their fair value is determined using net asset values provided by the fund managers or using valuation techniques, such as the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgement is required in establishing fair values. The judgements include considerations of inputs such as country risk, illiquidity discounts, etc. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

At 31 December 2016

**4 SIGNIFICANT ACCOUNTING POLICIES (continued)****4.12 Significant accounting judgements and estimates (continued)***Impairment of loans and advances*

The Group regularly reviews its loans and advances to assess whether a provision for impairment should be recorded in the consolidated statement of income. In particular, considerable judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgement and uncertainty, and actual results may differ resulting in future changes to such provisions.

*Impairment of available-for-sale investments*

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

*Going concern*

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

**5 TREASURY BILLS AND PLACEMENTS WITH FINANCIAL INSTITUTIONS**

Placements with financial institutions include US\$ 1,976 thousand (2015: US\$ 2,293 thousand) placed with a third party retail bank in the Kingdom of Bahrain; representing amounts held on account of sub-participants in private equity funds and for the purposes of honoring their capital calls to fund managers.

**6 LOANS AND ADVANCES**

	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Trade finance	<b>118,861</b>	104,108
Installment sale receivable	<b>3,533</b>	6,533
Corporate loan	<b>3,000</b>	3,000
	<b>125,394</b>	113,641
Less: Provision for loan losses	<b>(1,436)</b>	(2,936)
	<b>123,958</b>	110,705

The breakup of provision for loan losses is as follows:

	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Specific provision	-	1,500
Collective provision	<b>1,436</b>	1,436
	<b>1,436</b>	2,936
Gross amount of loans, individually determined to be impaired	-	4,669

Trade finance loans relate to insurance backed trade finance transactions as undertaken by the Bank.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**6 LOANS AND ADVANCES (continued)**

Installment sale receivable relates to a sale agreement entered by the Bank to sell its investment in a piece of land in the State of Kuwait on an installment sale basis. This loan facility was last amended on 4 January 2016. The revised repayment of the principal started from February 2016 with final maturity in June 2017. The loan is secured by corporate guarantees from a shareholder and also from an associate of the shareholder (refer note 22).

**7 AVAILABLE-FOR-SALE INVESTMENTS**

	2016 US\$ '000	2015 US\$ '000
<i>Equity and managed funds investments:</i>		
Unquoted equity fund investments	5,021	6,638
Unquoted strategic investments	-	237
	<u>5,021</u>	<u>6,875</u>
<i>Debt securities:</i>		
Quoted government sukuk	-	2,655
	<u>5,021</u>	<u>9,530</u>

**8 OTHER ASSETS**

	2016 US\$ '000	2015 US\$ '000
Accrued interest receivable	2,080	2,248
Prepayments	186	214
Furniture and equipment	40	83
Others	158	344
	<u>2,464</u>	<u>2,889</u>

**9 DEPOSITS FROM FINANCIAL INSTITUTIONS**

These represent deposits from financial institutions in the region, which carry fixed interest rates.

**10 DEPOSITS FROM CUSTOMERS**

	2016 US\$ '000	2015 US\$ '000
Cash collateral deposits against trade finance loans	4,386	4,342
Customer participation in funds	1,976	2,293
Others	2,043	2,091
	<u>8,405</u>	<u>8,726</u>

Customer participation in funds represents amounts received from customers to be invested in private equity funds administered by the Bank, placed with a third party retail bank in the Kingdom of Bahrain. These funds, although treated as part of customer deposits, are retained by the Bank until draw-downs are made by private equity fund managers. Customer participation in funds includes US\$ 266 thousand (2015: US\$ 293 thousand) in deposits held on behalf of BMB Technology and Telecommunications Fund.

Others consist of deposit amounts from corporates and individual customers.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**11 OTHER LIABILITIES**

	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Accrued interest payable	<b>18</b>	849
Accrued expenses	<b>1,472</b>	1,467
Employees' leaving indemnity	<b>400</b>	337
Provision against litigation	<b>300</b>	-
Others	<b>253</b>	133
	<b>2,443</b>	2,786

**12 SHARE CAPITAL**

	<b>2016</b>		<b>2015</b>	
	<b>Number</b>	<b>Amount</b>	<b>Number</b>	<b>Amount</b>
	<b>'000</b>	<b>US\$ '000</b>	<b>'000</b>	<b>US\$ '000</b>
<b>Authorized</b>				
Ordinary shares of US\$ 0.25 each	<b>2,000,000</b>	<b>500,000</b>	2,000,000	500,000
<b>Issued and fully paid</b>				
Ordinary shares of US\$ 0.25 each	<b>242,003</b>	<b>60,501</b>	242,003	60,501

**Treasury shares**

At 31 December 2016, the Bank owned 6 of its own shares (31 December 2015: 6 shares). The value of these shares is deducted from the shareholders' equity.

**13 STATUTORY RESERVE**

The Bahrain Commercial Companies Law requires 10% of the net profit for the year to be transferred to a statutory reserve until such reserve equals 50% of the paid up capital. The reserve cannot be utilised for the purpose of distribution, except in such circumstances as stipulated in the Bahrain Commercial Companies Law. Transfer to statutory reserve has not been made during the year in view of the accumulated losses as of 31 December 2016.

**14 INTEREST INCOME**

	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Loans and advances	<b>10,130</b>	11,171
Treasury bills and placements with financial institutions	<b>505</b>	178
Government and other bonds	<b>64</b>	68
	<b>10,699</b>	11,417

**15 INTEREST EXPENSE**

	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Deposits from financial institutions	<b>886</b>	1,168
Deposits from customers	<b>79</b>	319
	<b>965</b>	1,487

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**16 INVESTMENT BANKING INCOME**

	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Fee and commission income	850	1,492
Gain from available-for-sale investments - net	30	852
Loss from investments at fair value through profit or loss - net	(315)	(174)
Gain on sale of written-off assets	584	-
	<b>1,149</b>	<b>2,170</b>

**17 OTHER OPERATING EXPENSES**

	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Legal and professional expenses	312	295
Provision against litigation	300	-
Insurance and regulatory charges	214	235
Communication expenses	126	153
Business development expenses	87	117
Others	175	322
	<b>1,214</b>	<b>1,122</b>

**18 IMPAIRMENT PROVISIONS**

	<b>2016</b>		
	<i>Loans and advances</i>	<i>Available- for-sale investments</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
At 1 January 2016	2,936	10,813	13,749
Charge for the year	-	571	571
Recovery	(157)	-	(157)
Written-off	(1,343)	(8,367)	(9,710)
Foreign exchange movements	-	(17)	(17)
<b>At 31 December 2016</b>	<b>1,436</b>	<b>3,000</b>	<b>4,436</b>
	<b>2015</b>		
	<i>Loans and advances</i>	<i>Available- for-sale investments</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
At 1 January 2015	2,066	14,554	16,620
Charge for the year	1,720	1,053	2,773
Recovery	(774)	-	(774)
Written-off	-	(4,669)	(4,669)
Foreign exchange movements	(76)	(125)	(201)
<b>At 31 December 2015</b>	<b>2,936</b>	<b>10,813</b>	<b>13,749</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**19 BASIC AND DILUTED EARNINGS PER SHARE**

Basic and diluted earnings per share for the year are calculated by dividing the net profit for the year by the weighted average number of shares outstanding during the year as follows:

	<b>2016</b>	2015
Net profit for the year attributable to the owners of the Bank (US\$ '000)	<b>5,073</b>	5,079
Weighted average number of shares outstanding during the year	<b>242,003</b>	242,003
Basic and diluted earnings per share (US\$ cents)	<b>2.10</b>	2.10

The Bank did not have any outstanding share options or warrants which could have a dilution effect on the earnings per share.

**20 OPERATING SEGMENTS****Segment information**

For management purposes, the Group is organised into three major business segments:

<b>Financing</b>	- Financing and trade finance
<b>Investing</b>	- Investments in listed bonds, equities and private equity funds
<b>Other operating segments</b>	- Corporate advisory and building management, etc.

The Group's business segments are broken down by key business activities and those with clearly identifiable revenue streams and expenses. The segmentation is in line with segments internally reported to the Chief Executive Officer, who is the chief decision maker.

Segment information for the year ended 31 December 2016 is as follows:

	<i>Financing</i> US\$ '000	<i>Investing</i> US\$ '000	<i>Others</i> US\$ '000	<i>Total</i> US\$ '000
Interest income	10,635	64	-	10,699
Interest expense	(965)	-	-	(965)
Investment banking income	169	299	681	1,149
Other income	-	-	368	368
Foreign exchange loss	-	-	(94)	(94)
Results from operations	<b>9,839</b>	<b>363</b>	<b>955</b>	<b>11,157</b>
Impairment provisions - net	157	(571)	-	(414)
Unallocated corporate expenses	-	-	-	(5,670)
<b>Net profit (loss) for the year</b>	<b>9,996</b>	<b>(208)</b>	<b>955</b>	<b>5,073</b>
<b>Reportable segment assets</b>	<b>170,619</b>	<b>6,349</b>	<b>384</b>	<b>177,352</b>
<b>Reportable segment liabilities</b>	<b>134,990</b>	<b>-</b>	<b>2,425</b>	<b>137,415</b>
<b>Equity</b>				<b>39,937</b>
<b>Total liabilities and equity</b>				<b>177,352</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**20 OPERATING SEGMENTS (continued)**

Segment information for the year ended 31 December 2015 is as follows:

	<i>Financing</i> <i>US\$ '000</i>	<i>Investing</i> <i>US\$ '000</i>	<i>Others</i> <i>US\$ '000</i>	<i>Total</i> <i>US\$ '000</i>
Interest income	11,349	68	-	11,417
Interest expense	(1,487)	-	-	(1,487)
Investment banking income	1,315	678	177	2,170
Other income	-	-	345	345
Foreign exchange gain	-	-	121	121
Results from operations	11,177	746	643	12,566
Impairment provisions - net	(946)	(1,053)	-	(1,999)
Unallocated corporate expenses	-	-	-	(5,488)
Net profit (loss) for the year	10,231	(307)	643	5,079
Reportable segment assets	161,259	9,972	641	171,872
Reportable segment liabilities	134,673	-	1,937	136,610
Equity				35,262
Total liabilities and equity				171,872

**Geographic information**

Although the Group's two main business segments are managed on a worldwide basis, they operate in three main geographical areas. The Group's exposure to credit risk is concentrated in these areas: Europe (Primarily Western Europe), North America (United States of America and Canada) and Gulf Cooperation Council ("GCC"). The following table shows the distribution of the Group's revenue and assets by geographical segment, allocated based on the location in which the assets and liabilities are located, for the years ended 31 December 2016 and 31 December 2015:

	<b>2016</b>		<b>2015</b>	
	<i>Total</i> <i>income</i> <i>US\$ '000</i>	<i>Total</i> <i>assets</i> <i>US\$ '000</i>	<i>Total</i> <i>income</i> <i>US\$ '000</i>	<i>Total</i> <i>assets</i> <i>US\$ '000</i>
Europe	9,989	123,331	10,295	105,089
North America	951	40,030	1,083	11,542
GCC	1,070	13,982	1,161	47,533
Rest of the world	112	9	1,514	7,708
<b>Total</b>	<b>12,122</b>	<b>177,352</b>	<b>14,053</b>	<b>171,872</b>

31 December 2016

**21 REMUNERATION**

The remuneration paid out to the Board Members, approved persons in business lines, approved persons in control functions, other material risk takers and other staff with details on amounts, deferrals and instrument type is outlined below:

Total remuneration	2016		2015		2014	
	Fixed	Variable	Fixed	Variable	Fixed	Variable
	US\$ '000					
Members of Board of Directors - Sitting fees	99	-	102	-	82	-
Members of Board of Directors - Other remuneration	12	-	-	-	-	-
Approved persons in business lines	1,109	1,128	1,095	1,146	1,087	-
Approved persons in control functions	665	542	657	350	470	104
Other material risk takers	91	-	136	28	121	18
Other staff not included in above categories	1,114	133	1,107	141	945	78
<b>Total variable remuneration</b>						
	2016		2015		2014	
	Cash	Equity	Cash	Equity	Cash	Equity
	US\$ '000					
Members of Board of Directors	-	-	-	-	-	-
Approved persons in business lines	564	564	573	573	-	-
Approved persons in control functions	354	188	159	191	104	-
Other material risk takers	-	-	28	-	18	-
Other staff not included in above categories	133	-	141	-	78	-

In the previous year, the Group had initiated a share incentive plan under which eligible employees receive a portion of their annual performance-based incentive compensation in the form of shares vesting over a period of three years. These shares were granted to the employees at US\$ 15 cents per share. There are 10,112,017 shares (2015: 5,094,273) in the incentive plan. All these shares have commenced vesting, but have not fully vested as at 31 December 2016. An income statement charge of US\$ 64 thousand (2015: Nil) was taken by the Group based on management's best estimate of the number of shares that are likely to vest.

Included in the variable remuneration to be paid in cash, is US\$ 114 thousand (2015: US\$ 123 thousand), which is deferred cash incentive and will vest over a period of three years based on certain conditions.

The start and end date of the vesting period is based on continued employment as well as satisfaction of certain performance conditions. The determination of the amount of expense to be recognised as compensation expense in any year is estimated based on a model that takes into account the probability weighted vesting of the shares at the fair value on the grant date using the historical pattern of employee tenure. These estimates are updated regularly based on actual information.

**22 RELATED PARTY TRANSACTIONS AND BALANCES**

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include entities over which the Bank exercises significant influence, major shareholders, directors, key management personnel of the Bank and entities owned, controlled, jointly controlled or significantly influenced by such parties.

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**22 RELATED PARTY TRANSACTIONS AND BALANCES (continued)**

Key management personnel of the Group are those persons having authority and responsibility for planning, directing and controlling the activities of the Group. Key management personnel comprise the Board of Directors, Chief Executive Officer, Chief Financial Officer and Heads of Departments. Transactions entered during the year and balances as at 31 December 2016 and 31 December 2015 are set out below:

All related party transactions are on terms equivalent to arm's length transactions and are approved by the Board of Directors.

<i>Key management personnel</i>		<i>Shareholders and their related parties</i>	
<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>

**Statement of financial position****Liabilities**

Deposits	-	-	<b>139</b>	304
Other liabilities - employee leaving indemnity	<b>225</b>	195	-	-

**Statement of income**

Investment banking income	-	-	<b>11</b>	39
Interest expense	-	-	-	92

**Key management compensation**

Compensation to key management personnel, including directors, included in the consolidated statement of income is as follows:

	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Salaries and other short-term employee benefits	<b>1,687</b>	1,683
Employee leaving indemnity	<b>30</b>	27
	<b>1,717</b>	1,710
Directors' remuneration	<b>111</b>	102

**Guarantee**

The Bank has received a corporate guarantee from a shareholder with regard to the Bank's installment sale receivable (refer note 6), and an additional guarantee from an associate of the shareholder.

**23 CAPITAL MANAGEMENT**

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

To manage its capital, the Bank employs standards mentioned in the Basel III Framework, a risk adjusted measure of capital adequacy (a Capital Adequacy Ratio or "CAR") based on the local regulatory implementation of the Basel Committee on Banking Supervision's capital adequacy guidelines.

The Bank has adopted the Standardised Approach for Credit Risk and Market Risk, and the Basic Indicator Approach for Operational Risk to determine the capital requirements.

# Bahrain Middle East Bank B.S.C.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

### 23 CAPITAL MANAGEMENT (continued)

The Capital Adequacy Ratio of the Bank as at 31 December 2016 and 31 December 2015 is as follows:

Regulatory capital	2016 US\$ '000	2015 US\$ '000
<b><u>Common Equity Tier 1 (CET1) and Total Tier 1 (T1)</u></b>		
Share capital	60,501	60,501
Accumulated losses	(21,656)	(26,742)
Fair value reserve on available-for-sale investments	917	1,211
<b>Total (a)</b>	<b>39,762</b>	<b>34,970</b>
<b><u>Tier 2 (T2)</u></b>		
Collective impairment provision	1,436	1,436
<b>Tier 2 (T2) (b)</b>	<b>1,436</b>	<b>1,436</b>
<b>Total capital (c) = (a) + (b)</b>	<b>41,198</b>	<b>36,406</b>

<u>Risk weighted exposures</u>	2016			2015		
	<i>Principal amounts</i>	<i>Risk weighted equivalents</i>	<i>Capital requirement</i>	<i>Principal amounts</i>	<i>Risk weighted equivalents</i>	<i>Capital requirement</i>
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Claims on sovereigns	53	-	-	5,352	-	-
Claims on banks	44,301	20,854	2,607	45,395	13,817	1,727
Claims on corporates*	119,751	113,068	14,134	106,578	110,662	13,833
Investments in securities	6,251	8,952	1,119	7,012	10,518	1,315
Other assets	2,362	2,362	295	2,674	2,674	334
<u>Off-balance sheet items</u>						
Commitments and contingent liabilities	5,811	5,811	726	6,218	6,218	777
<b>Credit risk weighted exposures</b>		<b>151,047</b>	<b>18,881</b>		<b>143,889</b>	<b>17,986</b>
<b>Market risk weighted exposure</b>		<b>2,488</b>	<b>311</b>		<b>1,225</b>	<b>153</b>
<b>Operational risk weighted exposure</b>		<b>19,788</b>	<b>2,474</b>		<b>16,546</b>	<b>2,068</b>
<b>Total risk weighted exposures (d)</b>		<b>173,323</b>	<b>21,666</b>		<b>161,660</b>	<b>20,207</b>
<u>Capital ratios</u>						
<b>CET 1 and T1 capital (a) / (d)</b>		<b>22.9%</b>			<b>21.6%</b>	
<b>Total capital (c) / (d)</b>		<b>23.8%</b>			<b>22.5%</b>	
<b>Minimum required as per CBB regulatory guidelines under Basel III</b>		<b>12.5%</b>			<b>12.5%</b>	

\*Substantially all claims on corporates are insured by a major international insurance company with long term credit rating of 'A3' (Moody's). As of 31 December 2016, the Bank has utilised insurance wrap of US\$ 6.2 million (2015: US\$ 5.5 million) and eligible financial collateral of US\$ 4.4 million (2015: US\$ 4.3 million), which is reflected in the credit risk weighted exposures.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 24 CLASSIFICATION OF FINANCIAL INSTRUMENTS

	31 December 2016				
	<i>Fair value through profit or loss</i>	<i>Held-to-maturity</i>	<i>Available-for-sale</i>	<i>Amortised cost</i>	<i>Total</i>
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
<b>Assets</b>					
Balances with banks and financial institutions	-	-	-	40,374	40,374
Treasury bills and placements with financial institutions	-	-	-	4,207	4,207
Investments at fair value through profit or loss	1,149	-	-	-	1,149
Loans and advances	-	-	-	123,958	123,958
Available-for-sale investments	-	-	5,021	-	5,021
Held-to-maturity investment	-	179	-	-	179
Other assets	-	-	-	2,238	2,238
<b>Total financial assets</b>	<b>1,149</b>	<b>179</b>	<b>5,021</b>	<b>170,777</b>	<b>177,126</b>
<b>Liabilities</b>					
Deposits from financial institutions	-	-	-	126,567	126,567
Deposits from customers	-	-	-	8,405	8,405
Other liabilities	-	-	-	2,043	2,043
<b>Total financial liabilities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>137,015</b>	<b>137,015</b>
	31 December 2015				
	<i>Fair value through profit or loss</i>	<i>Held-to-maturity</i>	<i>Available-for-sale</i>	<i>Amortised cost</i>	<i>Total</i>
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
<b>Assets</b>					
Balances with banks and financial institutions	-	-	-	28,373	28,373
Treasury bills and placements with financial institutions	-	-	-	19,998	19,998
Investments at fair value through profit or loss	161	-	-	-	161
Loans and advances	-	-	-	110,705	110,705
Available-for-sale investments	-	-	9,530	-	9,530
Held-to-maturity investment	-	216	-	-	216
Other assets	-	-	-	2,592	2,592
<b>Total financial assets</b>	<b>161</b>	<b>216</b>	<b>9,530</b>	<b>161,668</b>	<b>171,575</b>
<b>Liabilities</b>					
Deposits from financial institutions	-	-	-	125,098	125,098
Deposits from customers	-	-	-	8,726	8,726
Other liabilities	-	-	-	2,316	2,316
<b>Total financial liabilities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>136,140</b>	<b>136,140</b>

## 25 FINANCIAL RISK MANAGEMENT

In the normal course of its business, the Group is exposed to various risks related to the nature of the activities in which it engages. The principal sources of risk are credit risk, market risk (comprising of interest rate risk, currency risk and equity price risk), liquidity risk, operating and legal risk.

At the Group, the management of financial and other risks is based on the establishment of an appropriate risk governance structure, comprising:

- clearly defined exposure and risk limits by geography, sector and counterparty;
- day to day monitoring and management of liquidity risk;
- investment evaluation criteria based on quantitative and qualitative approaches;
- robust operating policies and procedures, including those for specific allocation of risk limits to individual obligors and/or transactions;
- on-going review of exposures, excesses and risks by an independent personnel;
- assessment of regulatory compliance by an independent personnel; and
- periodic internal audits of the control environment.

Risk limits are at the heart of this process. The Group begins by setting maximum exposure limits as a percentage of capital for major lines of business. Within these macro limits, sub limits are set by geography, obligor type/credit grade, instrument, tenor, etc. For trading activities additional controls such as VaR, duration, maximum intraday and inter-day exposures, "stop losses", etc. are applied as well. Individual transactions then take place within these sub-limits.

In addition to the existence of various risk limits, overall risk discipline is maintained by the requirement that the Group (a) maintains a Basel III Capital Adequacy Ratio in excess of the regulatory required minimum and (b) considers the impact on the Group's liquidity position of any major transaction or new business initiative.

Risk management at the Bank begins at the Board of Directors level. The Board of Directors exercise oversight and final approval of the risk management process. It operates through two Board Committees, the Executive Committee ("EXCO") and the Audit Committee ("AC"). With input provided by the Group's Executive Management Committee ("EMC") that also acts as the Risk Management Committee. The EXCO proposes the overall risk management strategy of the Group. Based on its recommendation, the Board of Directors approve the aggregate levels of risk the Group can assume as well as reviewing and approving the Group's risk management policies, risk limits and risk control framework. Among its duties, the AC is charged with reviewing and approving the Group's policies and procedures as well as overseeing both the internal and external audits of the Group, including matters related to anti-money laundering and terrorism finance.

The Board delegates certain authority to the EXCO to implement the risk control decisions. To carry out these responsibilities, the EXCO operates through the EMC.

The EMC is chaired by the Chief Executive Officer and comprises members of the senior management. It serves as the Group's credit committee and asset liability management committee. On an on-going basis, the EMC monitors the environment in which the Group operates and the risks to which it is exposed and adjusts the Group's operations as appropriate.

Risk Management ("RM") plays a key role in this process. RM is independent of the Group's trading and business areas and reports directly to the Audit Committee. It is responsible for identifying and quantifying risk exposures, recommending appropriate limits and monitoring usage of them. As part of its duties, the RM prepares a variety of daily risk reports, including stress tests, for senior management and the EMC.

Internal Audit, which is independent and also reports to the Audit Committee assists in the risk management process. In particular, Internal Audit is charged with a periodic review of the effectiveness of Group's policies and internal controls.



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**25 FINANCIAL RISK MANAGEMENT (continued)****a) Credit risk (continued)****Credit quality by class of financial assets**

The Group manages the credit quality of financial assets using internal credit ratings. The Group estimates the probability of default through its risk grading system which employs a ten-grade scale. The credit worthiness is measured in descending order, with '1' having the least probability of default and '10' having the highest probability of default.

The Group utilizes both quantitative and qualitative assessment of the credit risks in order to approximate the probability of default of a given counterparty. The ten grade scale system is by design aligned with External Credit Assessment Institutions (ECAI) own credit rating schematics in order to simplify and streamline the process. This also allows for direct comparisons or translations to be made from an ECAI's rating into the Group's internal rating scale. All of the Group's assets fall under Standard grade, except for those disclosed as impaired in the above table.

The following table shows the relationship between Group's internal rating system and ECAI's (i.e. Moody's and S&P) ratings.

<b>Categories</b>	<b>Internal rating</b>	<b>ECAI equivalent</b>
Standard - there is a very high likelihood of the asset being recovered and therefore, represents low risk to the Group.	1 to 7	AAA to B-
Sub-standard – inadequately protected by the paying capacity of the obligor or possibility that the Group will sustain some loss if the deficiencies are not corrected.	8	CCC-
Doubtful – highly vulnerable credit position	9	C-
Loss – already in default or expected to be in default	10	Below C-

**Analysis of risk concentration**

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

The following tables summarize the Group's geographical and industry sector exposures and any potential risk concentrations arising there from. Maximum credit risk exposures are detailed without considering the effects, if any, of collateral or other credit mitigation techniques on the Group's assets, liabilities and credit related contingent items.

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25 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Geographical region

	31 December 2016				
	Europe US\$ '000	North America US\$ '000	GCC US\$ '000	Rest of the world US\$ '000	Total US\$ '000
Balances with banks and financial institutions	3,203	32,113	5,049	9	40,374
Treasury bills and placements with financial institutions	-	-	4,207	-	4,207
Investments at fair value through profit or loss	-	300	849	-	1,149
Loans and advances	117,883	2,582	3,493	-	123,958
Available-for-sale investments	-	5,021	-	-	5,021
Held-to-maturity investment	179	-	-	-	179
Other assets	2,066	14	158	-	2,238
<b>Total</b>	<b>123,331</b>	<b>40,030</b>	<b>13,756</b>	<b>9</b>	<b>177,126</b>
<b>Off-balance sheet items</b>	<b>1,739</b>	<b>2,783</b>	<b>2,579</b>	<b>-</b>	<b>7,101</b>

	31 December 2015				
	Europe US\$ '000	North America US\$ '000	GCC US\$ '000	Rest of the world US\$ '000	Total US\$ '000
Balances with banks and financial institutions	2,112	4,294	21,962	5	28,373
Treasury bills and placements with financial institutions	-	-	15,498	4,500	19,998
Investments at fair value through profit or loss	-	161	-	-	161
Loans and advances	100,375	782	6,467	3,081	110,705
Available-for-sale investments	347	6,292	2,891	-	9,530
Held-to-maturity investment	216	-	-	-	216
Other assets	2,039	13	418	122	2,592
<b>Total</b>	<b>105,089</b>	<b>11,542</b>	<b>47,236</b>	<b>7,708</b>	<b>171,575</b>
<b>Off-balance sheet items</b>	<b>1,989</b>	<b>2,940</b>	<b>2,579</b>	<b>-</b>	<b>7,508</b>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

25 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Industry sector

	31 December 2016				
	<i>Banking</i>		<i>Consumer</i>		
	<i>/ Finance</i>	<i>Government</i>	<i>Goods</i>	<i>Others</i>	<i>Total</i>
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
<b>Assets</b>					
Balances with banks and financial institutions	40,374	-	-	-	40,374
Treasury bills and placements with financial institutions	4,207	-	-	-	4,207
Investments at fair value through profit or loss	300	-	-	849	1,149
Loans and advances	2,966	-	105,358	15,634	123,958
Available-for-sale investments	5,021	-	-	-	5,021
Held-to-maturity investment	-	-	-	179	179
Other assets	23	66	1,803	346	2,238
<b>Total</b>	<b>52,891</b>	<b>66</b>	<b>107,161</b>	<b>17,008</b>	<b>177,126</b>

<b>Off-balance sheet items</b>	<b>4,522</b>	<b>-</b>	<b>-</b>	<b>2,579</b>	<b>7,101</b>
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	31 December 2015				
	<i>Banking</i>		<i>Consumer</i>		
	<i>/ Finance</i>	<i>Government</i>	<i>Goods</i>	<i>Others</i>	<i>Total</i>
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
<b>Assets</b>					
Balances with banks and financial institutions	28,373	-	-	-	28,373
Treasury bills and placements with financial institutions	17,354	2,644	-	-	19,998
Investments at fair value through profit or loss	161	-	-	-	161
Loans and advances	2,962	-	89,629	18,114	110,705
Available-for-sale investments	6,638	2,655	-	237	9,530
Held-to-maturity investment	-	-	-	216	216
Other assets	26	131	1,909	526	2,592
<b>Total assets</b>	<b>55,514</b>	<b>5,430</b>	<b>91,538</b>	<b>19,093</b>	<b>171,575</b>
<b>Off-balance sheet items</b>	<b>4,929</b>	<b>-</b>	<b>-</b>	<b>2,579</b>	<b>7,508</b>

At 31 December 2016

**25 FINANCIAL RISK MANAGEMENT (continued)****b) Market risk**

Market risk is defined as potential adverse changes in the fair value or future cash flows of a trading position or portfolio of financial instruments resulting from the movement of market variables, such as interest rates, currency rates, equity and commodity prices, market indices as well as volatilities and correlations between markets.

The principal market related risks to which the Group is exposed are interest rate risk, foreign currency risk and equity price risk.

**i) Interest rate risk**

Interest rate risk is the risk that changes in market interest rates will affect the future cash flows or the fair values of financial instruments. The Group closely monitors interest rate movements, and seeks to limit its exposure to such movements by managing the interest rate repricing structure of its assets and liabilities. The Group actively manages its interest rate repricing gap exposure, with a bias towards fixed rates and with exposure limits that are approved by the Board of Directors. The Group does not typically take interest rate trading positions and all its interest rate risk is typically in the banking book.

All of the Group's interest earning assets and interest bearing liabilities carry fixed rates of interest, hence, there is no sensitivity to interest rate risk.

**ii) Currency risk**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Majority of the Group's assets and liabilities are denominated in US Dollar, Qatari Riyal, Bahraini Dinar, Euro and Great Britain Pound. As the Qatari Riyal and Bahraini Dinar are pegged to the US dollar, there is minimal sensitivity to currency risk.

The table below shows the sensitivity to the Group's net profit and equity for a movement of +5% in Euro and Great Britain Pound against the US\$, with all other variables held constant. An equivalent decrease in each of these currencies against the US\$ would result in an equivalent but opposite impact.

<b>Currency</b>	<i>Sensitivity to net profit and equity</i>	
	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Euro	<b>27</b>	39
Great Britain Pound	<b>10</b>	20
	<b>37</b>	59

**iii) Equity price risk**

Equity price risk is the risk that the fair value of equities decreases as the result of changes in the level of equity indices or individual stocks. The Group is exposed to equity price risk on its investments at fair value through profit or loss and available-for-sale investments.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**25 FINANCIAL RISK MANAGEMENT (continued)****b) Market risk (continued)****iii) Equity price risk (continued)**

The following table depicts the sensitivity to the Group's net profit and equity for a movement of +5% in the equity prices or net asset values of investments at fair value through profit or loss, with all other variables held constant. An equivalent decrease would result in an equivalent but opposite impact.

	<i>Sensitivity to net profit and equity</i>	
	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Investments at fair value through profit or loss	<b>57</b>	<b>8</b>

The Group's exposure to available-for-sale investments mainly represents investments in unquoted equity funds.

Private equity risk is the risk that the Group will not be able to sell its investments at a profit within the intended time period, which might be due to the investment itself, macro trends in markets for IPO's and mergers and acquisition activity.

The Group manages risks at the specific investment level by (i) investing primarily through managed third party funds whose managers have a demonstrated successful track record, by diversifying its investments across (ii) fund managers, (iii) different stages in the investment cycle (various stages of venture capital, buy-out, etc.), and (iv) geographical locations and industries.

A change of +10% in the carrying value of available-for-sale investments as at 31 December 2016, with all other variables held constant, would result an increase in comprehensive income and equity by US\$ 0.50 million (2015: US\$ 0.95 million). An equivalent decrease would result in a decrease in comprehensive income and equity by US\$ 0.26 million (2015: US\$ 0.72 million) and a decrease of US\$ 0.24 million (2015: US\$ 0.23 million) in net profit.

*Market risk capital charge*

The capital requirement for market risk using the Standardised Approach as at 31 December 2016 and 31 December 2015 was as follows:

	<b>Capital requirement</b>			
	<b>At 31</b>			
	<b>December</b>	<b>Maximum</b>	<b>Minimum</b>	<b>Average</b>
	<b>2016</b>	<b>value</b>	<b>value</b>	<b>value</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
Foreign exchange risk	<b>98</b>	<b>184</b>	<b>98</b>	<b>141</b>
Equity position risk	<b>213</b>	<b>327</b>	<b>213</b>	<b>270</b>

	<b>Capital requirement</b>			
	<b>At 31</b>			
	<b>December</b>	<b>Maximum</b>	<b>Minimum</b>	<b>Average</b>
	<b>2015</b>	<b>value</b>	<b>value</b>	<b>value</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
Foreign exchange risk	<b>153</b>	<b>164</b>	<b>113</b>	<b>139</b>

At 31 December 2016

**25 FINANCIAL RISK MANAGEMENT (continued)****c) Liquidity risk**

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. It also represents the risk that the Group will be unable to realize its assets in a timely fashion for prices close to their carrying values.

In its investing activities, the Group seeks to diversify its assets across instruments and markets and to avoid obligor concentrations. This is particularly the case for investments in unlisted private equity funds where the Group has consciously implemented a strategy of reducing the Group's average individual investment size.

Liquidity is managed on a daily basis and senior management closely monitors significant daily changes to the liquidity position. In evaluating the liquidity position, the Group also takes into account the possible call of un-drawn commitments on its investment portfolio.

Held-to-maturity investment matures in 2028. The Group has a contractual maturity of deposits to a single counterparty amounting to US\$ 126.5 million (2015: US\$ 125.0 million) in the first quarter of 2017. However, based on management's estimation, these deposits are expected to be rolled over for a longer period, as in the past. The Bank is confident to meet its obligations, as they fall due.

The table below presents the maturity profile of the Group's assets and liabilities based on remaining contractual maturities:

	31 December 2016					Total US\$ '000
	Up to 3 months US\$ '000	> 3 months up to 6 months US\$ '000	> 6 months up to 12 months US\$ '000	> 1 year up to 5 years US\$ '000	Over 5 years US\$ '000	
<b>Assets</b>						
Balances with banks and financial institutions	40,374	-	-	-	-	40,374
Treasury bills and placements with financial institutions	4,207	-	-	-	-	4,207
Investments at fair value through profit or loss	1,149	-	-	-	-	1,149
Loans and advances	71,081	35,874	14,037	2,966	-	123,958
Available-for-sale investments	1,004	1,506	2,511	-	-	5,021
Held-to-maturity investment	-	-	-	-	179	179
Other assets	1,884	343	131	40	66	2,464
<b>Total assets</b>	<b>119,699</b>	<b>37,723</b>	<b>16,679</b>	<b>3,006</b>	<b>245</b>	<b>177,352</b>
<b>Liabilities</b>						
Deposits from financial institutions	126,567	-	-	-	-	126,567
Deposits from customers	8,405	-	-	-	-	8,405
Other liabilities	1,253	-	889	301	-	2,443
<b>Total liabilities</b>	<b>136,225</b>	<b>-</b>	<b>889</b>	<b>301</b>	<b>-</b>	<b>137,415</b>
<b>Net liquidity gap</b>	<b>(16,526)</b>	<b>37,723</b>	<b>15,790</b>	<b>2,705</b>	<b>245</b>	<b>39,937</b>
<b>Cumulative liquidity gap</b>	<b>(16,526)</b>	<b>21,197</b>	<b>36,987</b>	<b>39,692</b>	<b>39,937</b>	<b>39,937</b>

# Bahrain Middle East Bank B.S.C.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

### 25 FINANCIAL RISK MANAGEMENT (continued)

#### c) Liquidity risk (continued)

	31 December 2015					Total US\$ '000
	Up to 3 months US\$ '000	> 3 months up to 6 months US\$ '000	> 6 months up to 12 months US\$ '000	> 1 year up to 5 years US\$ '000	Over 5 years US\$ '000	
<b>Assets</b>						
Balances with banks and financial institutions	28,373	-	-	-	-	28,373
Treasury bills and placements with financial institutions	19,998	-	-	-	-	19,998
Investments at fair value through profit or loss	161	-	-	-	-	161
Loans and advances	70,192	32,086	1,975	6,452	-	110,705
Available-for-sale investments	4,030	2,063	3,437	-	-	9,530
Held-to-maturity investment	-	-	-	-	216	216
Other assets	2,199	397	138	89	66	2,889
<b>Total assets</b>	<b>124,953</b>	<b>34,546</b>	<b>5,550</b>	<b>6,541</b>	<b>282</b>	<b>171,872</b>
<b>Liabilities</b>						
Deposits from financial institutions	53	125,045	-	-	-	125,098
Deposits from customers	3,017	-	5,709	-	-	8,726
Other liabilities	1,410	848	528	-	-	2,786
<b>Total liabilities</b>	<b>4,480</b>	<b>125,893</b>	<b>6,237</b>	<b>-</b>	<b>-</b>	<b>136,610</b>
<b>Net liquidity gap</b>	<b>120,473</b>	<b>(91,347)</b>	<b>(687)</b>	<b>6,541</b>	<b>282</b>	<b>35,262</b>
<b>Cumulative liquidity gap</b>	<b>120,473</b>	<b>29,126</b>	<b>28,439</b>	<b>34,980</b>	<b>35,262</b>	<b>35,262</b>

#### Contractual maturity of financial liabilities on an undiscounted basis

The table below presents the cash flows payable by the Group relating to its financial liabilities upon their respective earliest contractual maturities at the statement of financial position date. The amounts disclosed in the table are the contractual undiscounted cash flows (i.e. nominal plus interest) determined by using the forward yield curve for the relevant periods.

	31 December 2016					Total US\$ '000
	Up to 3 months US\$ '000	> 3 months up to 6 months US\$ '000	> 6 months up to 12 months US\$ '000	> 1 year up to 5 years US\$ '000	Over 5 years US\$ '000	
<b>Liabilities</b>						
Deposits from financial institutions	126,571	-	-	-	-	126,571
Deposits from customers	8,405	-	-	-	-	8,405
Other liabilities	1,253	-	489	301	-	2,043
<b>Total undiscounted financial liabilities</b>	<b>136,229</b>	<b>-</b>	<b>489</b>	<b>301</b>	<b>-</b>	<b>137,019</b>

At 31 December 2016

**25 FINANCIAL RISK MANAGEMENT (continued)****c) Liquidity risk (continued)**

	31 December 2015					Total US\$ '000
	Up to 3 months US\$ '000	> 3 months up to 6 months US\$ '000	> 6 months up to 12 months US\$ '000	> 1 year up to 5 years US\$ '000	Over 5 years US\$ '000	
<i>Liabilities</i>						
Deposits from financial institutions	53	125,433	-	-	-	125,486
Deposits from customers	3,017	-	5,829	-	-	8,846
Other liabilities	1,278	848	190	-	-	2,316
Total undiscounted financial liabilities	4,348	126,281	6,019	-	-	136,648

**d) Operating and legal risk**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The Group's risk framework contains Operational Risk policy designed to monitor and review operational risks. The policy requires the tracking of risk events, key risk indicators and loss events and for department heads and risk managers to periodically review those reports. Business Continuity Planning and Succession Planning are also integral parts of the Risk Framework of the Group.

Currently, the Group conducts its business from a single location. The Bank does not operate a retail banking franchise. Accordingly, the number of client relationships and volume of transactions at the Group are lower than at such retail institutions. These factors mitigate to some extent the operational risks to which the Group is exposed, both in terms of volumes of transactions and the liquidity of the assets underlying these transactions (e.g. the Group does not offer cash deposit/withdrawal services, ATMs, credit cards, etc.).

The Group's operations are conducted according to well-defined procedures. These procedures include a comprehensive system of internal controls, including segregation of duties and other internal checks, which are designed to prevent either inadvertent staff errors or malfeasance prior to the release of a transaction.

Legal risk includes the risk of non-compliance with applicable laws or regulations, the illegality or unenforceability of counterparty obligations under contracts and additional unintended exposure or liability resulting from the failure to structure transactions or contracts properly. Legal risks are mitigated through legal counsel review of transactions and documentation, as appropriate. Where possible, the Group uses standard formats for transaction documentation.

To protect the Group from involvement in money laundering or terrorist finance activities, the Group has implemented a comprehensive set of policies and procedures. Adherence to the Group's policies and procedures is reinforced through periodic staff training and internal and external reviews, as well as internal and external review by auditors.

To further mitigate operational and legal risks, the Group purchases a variety of insurance.

At 31 December 2016

**26 COMMITMENTS AND CONTINGENT LIABILITIES**

Commitments mainly include commitments to participate in investments. Undrawn investment commitments comprise contractual commitments to investments made in equity funds. These amounts are called by fund managers, generally for a period of between four and six years.

The outstanding commitments and contingent liabilities at 31 December were as follows:

	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Undrawn investment commitments in equity funds	<b>4,522</b>	4,929
Other commitments	<b>2,579</b>	2,579

At 31 December 2016, the Bank had undrawn investment commitments to private equity funds of US\$ 4,522 thousand (31 December 2015: US\$ 4,929 thousand). Of these, the Group's proprietary commitments amounted to US\$ 2,812 thousand (31 December 2015: US\$ 3,065 thousand) and the balance relates to co-investors of the Bank who have committed to sub-participate along with the Bank.

Other commitments represent unclaimed dividend amounts written back by the Bank in 2011. However, as per regulatory requirements, these amounts have been disclosed as a contingent item.

The Group is engaged in litigation cases involving claims made by and against the Group relating to its ex-employees and certain third parties. The Board, after reviewing the claims pending against the Group and based on the advice of the relevant professional legal advisors, are satisfied that the outcome of these claims will not have a material adverse effect on the financial position of the Group. The Group has recognised an income statement charge of US\$ 300 thousand (2015: Nil) against these legal claims (refer note 17).

**27 ASSETS UNDER MANAGEMENT**

Assets under management amount to US\$ 7,227 thousand (2015: US\$ 42,626 thousand) as of 31 December 2016. Assets under management include BMB Technology and Telecommunications Investment Company (under liquidation), a US focused venture capital fund of funds, customer sub-participations in private equity funds managed by the Group and other client funds managed on a discretionary basis.

**28 FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Group's financial instruments are accounted for under the historical cost convention except for the measurement at fair value of investments at fair value through profit or loss and available-for-sale investments. Fair value is the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Consequently, differences can arise between the book amounts and the fair value estimates.

At 31 December 2016

**28 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)****Fair value hierarchy**

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Group's market assumptions. These two types of inputs have created the following fair value hierarchy:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Valuation techniques based on observable inputs, either directly or indirectly. This category includes instruments valued using quoted market prices in active markets for similar instruments, quoted prices for identical or similar instruments in markets that are considered less than active or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3 - Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation (i.e. net asset value received from administrator / fund managers).

This hierarchy requires the use of observable market data when available. The Group considers relevant and observable market prices in its valuations where possible.

The following table shows the carrying amounts and fair values of financial instruments, including their levels in the fair value hierarchy. It does not include fair value information for financial instruments not measured at fair value if the carrying amount is a reasonable approximation of fair value:

	<b>31 December 2016</b>				<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total fair values</b>	<b>carrying amount</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
<b>Financial assets measured at fair value</b>					
Investments at fair value through profit or loss	849	-	300	1,149	1,149
Available-for-sale investments	-	-	5,021	5,021	5,021
<b>Financial assets not measured at fair value</b>					
Held-to-maturity investment	-	-	149	149	179
	<b>31 December 2015</b>				<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total fair values</b>	<b>carrying amount</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
<b>Financial assets measured at fair value</b>					
Investments at fair value through profit or loss	-	-	161	161	161
Available-for-sale investments	2,655	-	6,875	9,530	9,530
<b>Financial assets not measured at fair value</b>					
Held-to-maturity investment	-	-	176	176	216

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**28 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)****Fair value hierarchy (continued)**

Management has assessed that the fair values of financial assets comprising of balances with banks and financial institutions, placements with financial institutions, loans and advances and other assets, and financial liabilities comprising of deposits from financial institutions, deposits from customers and other liabilities approximate their carrying amounts.

For held-to-maturity investment, fair value is lower than the carrying amount; however this shortfall in fair value is not relevant except in a forced sale situation since the Bank has the intention to hold held-to-maturity investment until maturity when it would recover full nominal amount.

The fair value of held-to-maturity investment is based on last quoted market prices at the reporting date or on the present value of future cash flows.

Movements in level 3 investments measured at fair value are as follows:

	<b>2016</b>	<b>2015</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
At 1 January	<b>7,036</b>	9,029
Net fair value movement	<b>(184)</b>	(291)
Additions	<b>5</b>	150
Exits (at cost)	<b>(895)</b>	(577)
Fair value transferred to statement of income on disposals / impairment	<b>(641)</b>	(1,275)
At 31 December	<b>5,321</b>	7,036

Level 3 available-for-sale investments represent private equity funds where the underlying fund managers exercise judgements in valuation of investments.

During the year, there were no transfers between Level 1 and Level 2 fair value hierarchy, and no transfers into and out of Level 3 fair value hierarchy.