BBK B.S.C.

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2018

Building a better
working world

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BBK B.S.C.

Report on the Audit of the Consolidated Financial Statements

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

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2018, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing ("ISA"). 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 2018. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

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

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BBK B.S.C. (continued)

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

Key audit matters (continued)

<table>
<tr><th colspan="2">Impairment of carrying value of loans and advances</th></tr>
<tr><th>Key audit matter</th><th>How the key audit matter was addressed in the audit</th></tr>
<tr><td>The process for estimating impairment provision on credit risk associated with loans and advances in accordance with IFRS 9 Financial instruments (IFRS 9) is a significant and complex area. IFRS 9 requires use of the Expected Credit Loss (ECL) model for the purposes of calculating impairment provision. ECL model requires the Group to exercise significant judgment using subjective assumptions when determining both the timing and the amounts of ECL for loans and advances. Due to the complexity of requirements under IFRS 9, significant judgments applied and the Group's exposure to loans and advances forming a major portion of the Group's assets, the audit of ECL for loans and advances is a key area of focus.

As at 31 December 2018, the Group's gross loans and advances amounted to BD 1,897 million and the related ECL amounted to BD 124 million, comprising BD 37 million of ECL against Stage 1 and 2 exposures and BD 87 million against exposures classified under Stage 3. The basis of calculation of ECL is disclosed in the summary of significant accounting policies and note 32 to the consolidated financial statements.</td><td>Our approach included testing the controls associated with the relevant processes for estimating ECL and performing substantive procedures on such estimates. Our procedures, among others, focused on following:
• We assessed:
    o the Group's IFRS 9 based impairment provisioning policy including significant increase in credit risk criteria with the requirements of IFRS 9;
    o Group's ECL modeling techniques and methodology against the requirements of IFRS 9; and
    o the theoretical soundness and tested the mathematical integrity of the models.
• We obtained an understanding of the design and tested the operating effectiveness of relevant controls over ECL model, including model build and approval, ongoing monitoring / validation, model governance and mathematical accuracy. We have also checked completeness and accuracy of the data used and the reasonableness of the management assumptions;
• We understood and assessed the significant modeling assumptions for exposures as well as overlays with a focus on:
    o Key modeling assumptions adopted by the Group; and
    o Basis for and data used to determine overlays.
• For a sample of exposures, we performed procedures to evaluate:
    o Appropriateness of exposure at default, probability of default and loss given default (including collateral values used) in the calculation of ECL;
    o Timely identification of exposures with a significant increase in credit risk and appropriateness of the Group's staging; and
    o ECL calculation.</td></tr>
</table>

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

Key audit matters (continued)

Impairment of carrying value of loans and advances (continued)	
Key audit matter	**How the key audit matter was addressed in the audit**
	• For forward looking information used by the Group's management in its ECL calculations, we held discussions with management and checked internal approvals by management for economic outlook used for purposes of calculating ECL; • In addition, to obtain comfort on the overall model and significant assumptions used in applying IFRS 9, we reviewed the independent validation report prepared by the Group's consultant. Further, we performed procedures to ensure the competence, capabilities, objectivity and independence of the Group's consultant; and • We considered the adequacy of the disclosures in the consolidated financial statements in relation to impairment of loans and advances as required under IFRS 9. We also involved our internal specialists where their specific expertise was required. Refer to the significant accounting estimates and judgments, disclosures of loans and advances and credit quality in notes 3.4, 7 and 32 to the consolidated financial statements.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BBK B.S.C. (continued)

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

Other information included in the Group's 2018 Annual Report
Other information consists of the information included in the Group's 2018 Annual Report, other than the consolidated financial statements and our auditor's report thereon. The Board of Directors is responsible for the other information. Prior to the date of this auditor's report, we obtained the Board of Directors' report, which will form part of the annual report, and the remaining sections of the annual report are expected to be made available to us after that date.

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

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

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

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

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

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

Auditor's responsibilities for the audit of the consolidated financial statements (continued)
As part of an audit in accordance with ISA, 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.

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

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

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

**INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF
BBK B.S.C. (continued)**

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

Auditor's responsibilities for the audit of the consolidated financial statements (continued)
We also provide the Group's Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

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

Report on Other Legal and Regulatory Requirements

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

a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
b) the financial information contained in the report of the Board of Directors' is consistent with the consolidated financial statements;
c) we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2018 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position; and
d) satisfactory explanations and information have been provided to us by Management in response to all our requests.

The partner in charge of the audit resulting in this independent auditor's report is Mr. Essa Al-Jowder.

Ernst + Young

Partner's registration no. 45
18 February 2019
Manama, Kingdom of Bahrain

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2018

	Notes	2018 BD '000	2017 BD '000
ASSETS			
Cash and balances with central banks	4	**191,028**	469,436
Treasury bills	5	**410,380**	427,130
Deposits and amounts due from banks and other financial institutions	6	**239,174**	223,824
Loans and advances to customers	7	**1,772,528**	1,740,651
Investment securities	8	**800,263**	748,985
Investments in associated companies and joint ventures	9	**62,935**	46,958
Interest receivable and other assets	10	**77,849**	79,680
Premises and equipment	11	**27,543**	26,436
TOTAL ASSETS		**3,581,700**	3,763,100
LIABILITIES AND EQUITY			
Liabilities			
Deposits and amounts due to banks and other financial institutions		**258,676**	193,472
Borrowings under repurchase agreement		**198,997**	161,314
Term borrowings	12	**144,542**	199,012
Customers' current, savings and other deposits	13	**2,374,480**	2,623,577
Interest payable and other liabilities	14	**104,566**	84,890
Total liabilities		**3,081,261**	3,262,265
Equity			
Share capital	15	**108,165**	108,165
Treasury stock	15	**(2,521)**	(998)
Perpetual tier 1 convertible capital securities	15	**86,098**	86,098
Share premium	15	**41,016**	41,016
Statutory reserve	15	**54,082**	54,082
General reserve	15	**54,082**	54,082
Cumulative changes in fair values	16	**(25,105)**	(8,349)
Foreign currency translation adjustments		**(11,711)**	(9,271)
Retained earnings		**148,967**	134,632
Proposed appropriations	17	**44,617**	39,161
Attributable to the owners of the Bank		**497,690**	498,618
Non-controlling interest		**2,749**	2,217
Total equity		**500,439**	500,835
TOTAL LIABILITIES AND EQUITY		**3,581,700**	3,763,100

Murad Ali Murad	Jassem Hasan Zainal	Reyadh Yousif Sater
Chairman	Deputy Chairman	Chief Executive

The attached notes 1 to 45 form part of these consolidated financial statements

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

Year ended 31 December 2018

	Notes	*2018* *BD '000*	*2017* *BD '000*
Interest and similar income	18a	**165,828**	136,983
Interest and similar expense	18b	**(55,878)**	(46,077)
Net interest and similar income		**109,950**	90,906
Fee and commission income - net	19	**28,187**	31,094
Other income	20	**18,925**	15,540
Total operating income		**157,062**	137,540
Staff costs		**(36,408)**	(34,659)
Depreciation	11	**(3,654)**	(3,435)
Other expenses		**(17,664)**	(15,914)
Total operating expenses		**(57,726)**	(54,008)
Net provision for impairment / ECL on loans and advances to customers	7	**(35,048)**	(28,912)
Net provision for impairment / ECL on investments	8	**(313)**	(98)
Net operating income		**63,975**	54,522
Share of profit from associated companies and joint ventures	9	**4,142**	5,519
PROFIT FOR THE YEAR BEFORE TAXATION		**68,117**	60,041
Net tax provision	21	**(408)**	(810)
PROFIT FOR THE YEAR AFTER TAXATION		**67,709**	59,231
Attributable to:			
Owners of the Bank		**67,118**	58,685
Non-controlling interest		**591**	546
		67,709	59,231
Basic earnings per share (BD)	22	**0.056**	0.048
Diluted earnings per share (BD)	22	**0.052**	0.045

Murad Ali Murad
Chairman

Jassem Hasan Zainal
Deputy Chairman

Reyadh Yousif Sater
Chief Executive

The attached notes 1 to 45 form part of these consolidated financial statements

CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME

Year ended 31 December 2018

	Note	***2018 BD '000***	*2017 BD '000*
Profit for the year		**67,709**	59,231
Other comprehensive (loss) income:			
Items that will not be reclassified to profit or loss			
Fair value through other comprehensive income reserve (equity instruments)		**6,496**	(8,466)
Items that are or may be reclassified subsequently to profit or loss			
Movement in translation reserve:			
Foreign currency translation adjustments		**(2,440)**	2,287
Movement in hedging reserve:			
Effective portion of changes in fair value	16	**443**	284
Movement in fair value reserve:			
Net change in fair value	16	**(21,266)**	15,603
Net amount transferred to profit or loss	16	**(2,936)**	(3,427)
Other comprehensive (loss) income for the year		**(19,703)**	6,281
Total comprehensive income for the year		**48,006**	65,512
Attributable to:			
Owners of the Bank		**47,415**	64,966
Non-controlling interest		**591**	546
		48,006	65,512

BBK B.S.C.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2018

		Attributable to the owners of the Bank and capital securities' holders												
	Notes	*Share capital BD '000*	*Treasury stock BD '000*	*Perpetual tier 1 convertible capital securities BD '000*	*Share premium BD '000*	*Statutory reserve BD '000*	*General reserve BD '000*	*Cumulative changes in fair values BD '000*	*Foreign currency translation adjustments BD '000*	*Retained earnings BD '000*	*Proposed appropriations BD '000*	*Total BD '000*	*Non-controlling interest BD '000*	*Total equity BD '000*
Balance at 1 January 2017		108,165	(1,206)	86,098	39,919	54,082	54,082	(13,669)	(11,558)	122,830	33,666	472,409	1,806	474,215
Profit for the year		-	-	-	-	-	-	-	-	58,685	-	58,685	546	59,231
Other comprehensive income		-	-	-	-	-	-	5,320	2,287	(1,326)	-	6,281	-	6,281
Total comprehensive income		-	-	-	-	-	-	5,320	2,287	57,359	-	64,966	546	65,512
Share - based payments	40	-	-	-	-	-	-	-	-	699	-	699	-	699
Distribution on perpetual tier 1 convertible capital securities		-	-	-	-	-	-	-	-	(7,103)	-	(7,103)	-	(7,103)
Dividends paid	17	-	-	-	-	-	-	-	-	-	(32,266)	(32,266)	(135)	(32,401)
Donations	17	-	-	-	-	-	-	-	-	-	(1,400)	(1,400)	-	(1,400)
Movement in treasury stock	15	-	208	-	1,097	-	-	-	-	-	-	1,305	-	1,305
Unclaimed dividends	15	-	-	-	-	-	-	-	-	8	-	8	-	8
Proposed appropriations	17	-	-	-	-	-	-	-	-	(39,161)	39,161	-	-	-
Balance at 31 December 2017		108,165	(998)	86,098	41,016	54,082	54,082	(8,349)	(9,271)	134,632	39,161	498,618	2,217	500,835
Profit for the year		-	-	-	-	-	-	-	-	67,118	-	67,118	591	**67,709**
Other comprehensive loss		-	-	-	-	-	-	(16,756)	(2,440)	(507)	-	(19,703)	-	**(19,703)**
Total comprehensive income		-	-	-	-	-	-	(16,756)	(2,440)	66,611	-	47,415	591	**48,006**
Share - based payments	40	-	-	-	-	-	-	-	-	(578)	-	(578)	-	**(578)**
Distribution on perpetual tier 1 convertible capital securities		-	-	-	-	-	-	-	-	(7,103)	-	(7,103)	-	**(7,103)**
Dividends paid	17	-	-	-	-	-	-	-	-	-	(37,761)	(37,761)	(210)	**(37,971)**
Donations	17	-	-	-	-	-	-	-	-	-	(1,400)	(1,400)	-	**(1,400)**
Movement in treasury stock	15	-	(1,523)	-	-	-	-	-	-	-	-	(1,523)	-	**(1,523)**
Movement in non-controlling interest		-	-	-	-	-	-	-	-	-	-	-	151	**151**
Unclaimed dividends	15	-	-	-	-	-	-	-	-	22	-	22	-	**22**
Proposed appropriations	17	-	-	-	-	-	-	-	-	(44,617)	44,617	-	-	**-**
Balance at 31 December 2018		**108,165**	**(2,521)**	**86,098**	**41,016**	**54,082**	**54,082**	**(25,105)**	**(11,711)**	**148,967**	**44,617**	**497,690**	**2,749**	**500,439**

The attached notes 1 to 45 form part of these consolidated financial statements

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2018

	Notes	**2018 BD '000**	*2017 BD '000*
OPERATING ACTIVITIES			
Profit for the year before taxation		**68,117**	60,041
Adjustments for non-cash items:			
Net provision for impairment / ECL relating to:			
Loans and advances to customers	7	**35,048**	28,912
Investment securities	8	**313**	98
Share of profit from associated companies and joint ventures	9	**(4,142)**	(5,519)
Depreciation	11	**3,654**	3,435
Realised gains on sale of investment securities	20	**(3,249)**	(3,965)
Accrual on term borrowings		**745**	1,412
Operating profit before changes in operating assets and liabilities		**100,486**	84,414
(Increase) decrease in operating assets			
Mandatory reserve deposits with central banks		**4,696**	(2,952)
Treasury bills having original maturity of 90 days or more		**16,750**	(25,495)
Deposits and amounts due from banks and other financial institutions		**(9,198)**	17,824
Loans and advances to customers		**(66,925)**	(2,425)
Interest receivable and other assets		**(7,342)**	(14,627)
Increase (decrease) in operating liabilities			
Deposits and amounts due to banks and other financial institutions		**65,204**	(66,439)
Borrowings under repurchase agreements		**37,683**	(22,703)
Customers' current, savings and other deposits		**(249,097)**	129,862
Interest payable and other liabilities		**15,615**	299
Income tax paid		**(16)**	(100)
Net cash (used in) from operating activities		**(92,144)**	97,658
INVESTING ACTIVITIES			
Purchase of investment securities		**(407,548)**	(250,123)
Redemption / sale of investment securities		**354,205**	275,668
Net investment in associated companies	9	**(14,654)**	500
Dividends received from associated companies	9	**3,074**	2,394
Other movements in investment in associated companies	9	**288**	(68)
Purchase of premises and equipment		**(4,761)**	(5,688)
Net cash (used in) from investing activities		**(69,396)**	22,683
FINANCING ACTIVITIES			
Payment of dividend and donations	17	**(39,161)**	(33,666)
Term borrowings		**(55,215)**	(8,509)
Payment of interest on perpetual tier 1 convertible capital securities		**(7,103)**	(7,103)
Movement in treasury stock		**(1,523)**	1,305
Movement in share-based payments		**(578)**	699
Net cash used in financing activities		**(103,580)**	(47,274)
Foreign currency translation adjustments - net		**(2,440)**	2,287
NET CHANGE IN CASH AND CASH EQUIVALENTS		**(267,560)**	75,354
Cash and cash equivalents at beginning of the year		**612,958**	537,604
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	24	**345,398**	612,958
Additional Information:			
Interest received		**163,650**	138,393
Interest paid		**46,611**	44,654

The attached notes 1 to 45 form part of these consolidated financial statements

1 ACTIVITIES

BBK B.S.C. (the "Bank"), a public shareholding company, was incorporated in the Kingdom of Bahrain by an Amiri Decree in March 1971 and registered with the Ministry of Industry, Commerce and Tourism under Commercial Registration number 1234 dated 16 March 1971. The Bank operates in Bahrain under a commercial banking license issued by the Central Bank of Bahrain ("CBB") and its shares are listed at Bahrain Bourse.

The Bank is engaged in commercial banking activities through its branches in the Kingdom of Bahrain, State of Kuwait and Republic of India, and credit card operations and business process outsourcing services through its subsidiaries. The Bank's registered office is at 43 Government Avenue, P O Box 597, Manama, Kingdom of Bahrain.

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors of the Bank on 18 February 2019.

2 BASIS OF PREPARATION

Statement of compliance
These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) and in conformity with the Bahrain Commercial Companies Law and the CBB 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.

Accounting convention
These consolidated financial statements are prepared on a historical cost basis, except for derivative financial instruments, investment securities at fair value through other comprehensive income, trading investments and financial assets designated at fair value through profit or loss, that have been measured at fair value. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and are otherwise carried at cost, are adjusted to record changes in fair values attributable to risks that are being hedged.

The consolidated financial statements are prepared in Bahraini Dinars, which is the functional and presentation currency of the Bank.

Basis of consolidation
These consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries (the "Group"). The year end of the Bank and all of its subsidiaries is 31 December. The Bank has the following principal subsidiaries:

Name	*Ownership*	*Country of incorporation*	*Activity*
CrediMax B.S.C. (c)	100%	Kingdom of Bahrain	Credit card operations
Invita Company B.S.C. (c)	100%	Kingdom of Bahrain	Business process

CrediMax B.S.C. (c) owns 55% (2017: 55%) of the share capital of Global Payment Services W.L.L., which is established in the Kingdom of Bahrain and engaged in processing and backup services relating to credit, debit and charge cards.

Invita Company B.S.C. (c) owns 60% (2017: 60%) interest in Invita Kuwait K.S.C.C., which is established in the State of Kuwait and engaged in business processing and outsourcing services. It also owns 70% (2017: Nil) stake in Invita Claims Management Company, which is established in the Kingdom of Bahrain and engaged in Third Party Administrators (TPA) services.

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:

2 BASIS OF PREPARATION (continued)

Basis of consolidation (continued)

- 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. Income and expenses of a subsidiary acquired or disposed off during the year are included in the 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 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, liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated on consolidation.

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

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

3 ACCOUNTING POLICIES

3.1 New Standards and Interpretations issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's consolidated financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

- IFRS 16 Leases (effective 1 January 2019)
- IFRIC Interpretation 23 Uncertainty over Income Tax Treatment (effective 1 January 2019)
- Amendments to IFRS 9 Prepayment features with negative compensation (effective 1 January 2019)

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

- IFRS 3 Business combinations (effective 1 January 2019)
- IAS 12 Income taxes (effective 1 January 2019)
- IAS 23 Borrowing costs (effective 1 January 2019)

The Group does not expect any significant impact on the Groups' financial position and results for the standards that are not yet adopted.

3 ACCOUNTING POLICIES (continued)

3.2 New Standards and Interpretations issued and effective

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in previous year, except for the adoption of the following new standards or amendments to existing standards, applicable to the Group, and which are effective for annual periods beginning on or after 1 January 2018:

- IFRS 7 (revised) Financial instruments: Disclosures (IFRS 7R)
- IFRS 15 Revenue from Contracts with Customers
- IFRIC Interpretation 22 Foreign currency transactions and advance considerations

The above new standards, interpretations and amendments to IFRSs which are effective for annual accounting periods starting from 1 January 2018, did not have any material impact on the accounting policies, financial position or performance of the Group. However, the adoption of IFRS 7R resulted in additionnal disclosures.

3.3 Summary of significant accounting policies

(a) Financial assets and financial liabilities

i. Recognition and initial measurement

All “regular way” purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss (FVTPL), transaction costs that are directly attributable to its acquisition or issue.

ii. Classification

Financial assets

On initial recognition, a financial asset is classified as at amortised cost, fair value through other comprehensive income (FVOCI) or FVTPL. A financial asset is measured at amortised cost if it meets both the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and

- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and

- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(a) Financial assets and financial liabilities (continued)

ii. Classification (continued)

Financial assets designation at fair value through profit or loss
The Group designated certain financial assets as at FVTPL because the assets were managed, evaluated and reported internally on a fair value basis.

Business model assessment
The Group makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- The stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, realising cash flows through the sale of the assets and holding it for liquidity purposes;

- The risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed; and

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

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

Assessment whether contractual cash flows are solely payments of principal and interest
For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition, which may change over the life of the financial asset. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

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

- Contingent events that would change the amount and timing of cash flows;
- Leverage features;
- Prepayment and extension terms;
- Terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- Features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

Reclassifications
Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Group changes its business model for managing financial assets.

Financial liabilities
The Group classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(a) Financial assets and financial liabilities (continued)

iii. Derecognition

Financial assets
If the terms of a financial asset are modified, the Group evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss.

A financial asset (in whole or in part) is derecognised where:
- the rights to receive cash flows from the asset have expired; or
- 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 ownership or (b) when it has neither transferred or retained substantially all the risks and rewards and when it no longer has control over the financial asset, but has transferred control of the asset.

Financial liabilities
The Group derecognises a financial liability when its contractual obligations are discharged or cancelled ,or expire.

(b) Deposits and due from banks and other financial institutions
These are stated at cost, adjusted for effective fair value hedges (if any), less any amounts written off and related expected credit losses.

(c) Loans and advances
Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method, and adjusted for effective fair value hedges (if any) and net of interest suspended, expected credit losses and any amounts written off.

(d) Investment securities
The investment securities includes:
- Debt investment securities measured at amortised cost; these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest rate method;
- Debt and equity investment securities mandatorily measured at FVTPL or designated as at FVTPL; these are carried at fair value with changes recognised immediately in profit or loss;
- Debt securities measured at FVOCI; and
- Equity investment securities designated as at FVOCI.

For debt securities measured at FVOCI, gains and losses are recognised in OCI, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:
- Interest revenue using the effective interest rate method;
- Expected Credit Loss (ECL) and reversals; and
- Foreign exchange gains and losses.

When debt security measured at FVOCI is impaired or derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from statement of changes in equity to statement of profit or loss.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(d) Investment securities (continued)
The Group elects to present in OCI changes in the fair value of certain investments in equity instruments. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable.

Gains and losses on such equity instruments are never reclassified to profit or loss, and no impairment is recognised in profit or loss. Dividends are recognised in profit or loss, unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in OCI. Cumulative gains and losses recognised in OCI are transferred to retained earnings on disposal of the investment.

(e) Fair value measurement
The Group measures financial instruments, such as, derivatives at fair value at each balance sheet date.

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

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability, the principal or the most advantageous market must be accessible to by the Group.

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

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

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

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

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

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

For the purpose of fair value disclosures, the Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the assets or liabilities and the level of the fair value hierarchy as explained above.

(f) Impairment of financial assets
The Group recognises allowances for ECL on the following financial instruments that are not measured at FVTPL:

- Financial assets that are debt instruments;
- Loans and advances at amortised cost;
- Financial guarantee contracts issued; and
- Loan commitments issued.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(f) Impairment of financial assets (continued)
No impairment loss is recognised on equity investments.

The Group measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition.

(g) Measurement of ECL
ECL is a probability-weighted estimate of credit losses. It is measured as follows:

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

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

iii) Undrawn loan commitments and letter of credit: as the present value of the difference between the contractual cash flows that are due to the Group if the commitment is drawn down and the cash flows that the Group expects to receive; and

iv) Financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Group expects to recover.

The determination of the IFRS 9 provision results from a two-step approach:

As step 1, the facilities will have to be allocated to one of the three impairment stages by determining whether a significant increase in credit risk has occurred since initial recognition or whether the facility has been credit impaired.

As step 2, the expected credit loss is calculated i.e., 12-month expected loss for all facilities in Stage 1 and lifetime expected credit loss for all facilities in Stage 2. The facilities in Stage 3 are covered by specific provisions.

(h) Credit-impaired financial assets
At each reporting date, the Group assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

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

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

In making an assessment of whether an investment in sovereign debt, other than that of the home country sovereign (i.e. Bahrain), is credit-impaired, the Group considers the following factors:

- The market's assessment of creditworthiness as reflected in the bond yields; or
- The rating agencies' assessments of creditworthiness.

The exposure to the home country sovereign i.e. Bahrain is considered to be low risk and fully recoverable and hence no ECL is measured. Refer to note 32 for further details.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

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

- Financial assets measured at amortised cost: as a deduction from the gross carrying amount of such assets;
- Loan commitments and financial guarantee contracts: as a provision;
- Where a financial instrument includes both a drawn and an undrawn component, and the Group has identified the ECL on the loan commitment / off balance sheet component separately from those on the drawn component, the Group presents a loss allowance for drawn components. The amount is presented as a deduction from the gross carrying amount of the drawn component. Loss allowance for undrawn components is presented as a provision in other liabilities; and
- For debt instruments measured at FVOCI, no loss allowance is recognised in the statement of financial position because the carrying amount of such assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve as a provision.

(j) Write-off
Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. However, financial assets that are written-off could still be subject to enforcement activities in order to comply with the Group’s procedures for recovery of amounts due.

(k) 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.

(l) Term borrowings
Financial instruments or their components issued by the Group, which are not designated at fair value through consolidated statement of profit or loss, are classified as liabilities under 'term borrowings', where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

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

(m) Investment in associated companies and joint ventures
The Group’s investments in its associate and joint venture are accounted for using the equity method. Under the equity method, the investment in an associate or a joint venture is initially recognised at cost.

The carrying amount of the investment is adjusted to recognise changes in the Group’s share of net assets of the associate or joint venture since the acquisition date. Goodwill relating to the associate or joint venture is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

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

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(m) Investment in associated companies and joint ventures (continued)
The considerations made in determining significant influence or joint control are similar to those necessary to determine control over subsidiaries.

The statement of profit or loss reflects the Group's share of the results of operations of the associate or joint venture. Any change in OCI of those investees is presented as part of the Group's OCI. In addition, when there has been a change recognised directly in the equity of the associate or joint venture, the Group recognises its share of any changes, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the associate or joint venture are eliminated to the extent of the interest in the associate or joint venture.

The aggregate of the Group's share of profit or loss of an associate and a joint venture is charged to the statement of profit or loss outside operating profit and represents profit or loss after tax and non-controlling interests in the subsidiaries of the associate or joint ventures.

The financial statements of the associate or joint venture are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investment in associates or joint ventures. At each reporting date, the Group determines whether there is objective evidence that the investment in the associate or joint venture is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate or joint venture and its carrying value and recognises the loss in the consolidated statement of profit or loss.

Upon loss of significant influence over the associate or joint control over the joint venture, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate or joint venture upon loss of significant influence or joint control and the fair value of the retained investment and proceeds from disposal is recognised in the consolidated statement of profit or loss.

(n) Premises and equipment
All items of premises and equipment are initially recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment, other than freehold land which is deemed to have an indefinite life.

(o) Collateral pending sale
The Group occasionally acquires real estate in settlement of certain loans and advances to customers. Such real estate is stated at the lower of the carrying value of the related facility and the current fair value of the collateral acquired, assessed on an individual basis. If the current fair value for any individual asset is lower, a provision is created. Gains or losses on disposal, and unrealised losses on revaluation, are recognised in the consolidated statement of profit or loss.

(p) Deposits
These are carried at amortised cost, less amonts repaid.

(q) Repurchase and resale agreements
Securities sold under agreements to repurchase at a specified future date are not derecognised from the consolidated statement of financial position as the Group retains substantially all the risks and rewards of ownership. The corresponding cash received is recognised in the consolidated statement of financial position as an asset with a corresponding obligation to return it, including accrued interest as a liability reflecting the transaction's economic substance as a loan to the Group. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of the agreement using the effective interest rate. When the counterparty has the right to sell or repledge the securities, the Group reclassifies those securities in its consolidated statement of financial position, as appropriate.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(q) Repurchase and resale agreements (continued)
Conversely, securities purchased under agreements to resell at a specified future date are not recognised in the consolidated statement of financial position. The consideration paid, including accrued interest, is recorded in the consolidated statement of financial position, reflecting the transaction's economic substance as a loan by the Group. The difference between the purchase and resale prices is recorded as interest income and is accrued over the life of the agreement using the effective interest rate. If securities purchased under agreement to resell are subsequently sold to third parties, the obligation to return the securities is recorded as a short sale and measured at fair value with any gains or losses included in 'net interest income'.

(r) Taxation
There is no tax on corporate income in the Kingdom of Bahrain. Taxation on foreign operations is provided in accordance with the fiscal regulations of the respective countries in which the Group operates.

In India, the Bank makes provision for income tax after considering both current and deferred taxes. The tax effect of timing differences between the book profit and taxable profits are reflected through deferred tax asset (DTA) / deferred tax liability (DTL). Current tax is determined in accordance with the provisions of Income Tax Act, 1961 and rules framed there under after considering the contested past adjustments on a prudent basis based on management estimates.

(s) Employees' end of service benefits
Costs relating to employees' end of service benefits are accrued in accordance with actuarial and other valuations as required by regulations applicable in each jurisdiction where the Group operates.

(t) Share-based payment transactions
For equity-settled shared-based payment transactions, the Group measures the services received and the corresponding increase in equity at the fair value of the services received by reference to the fair value of the equity instruments granted. The fair value of those equity instruments is measured at grant date. The fair value so calculated at the grant date is recognised as an expense in the consolidated statement of profit or loss over the vesting period, with a corresponding credit to retained earnings. When an employee leaves the Group during the vesting period the shares granted stand forfeited and any amount recognised in respect of these forfeited shares is reversed through the consolidated statement of profit or loss.

(u) Provisions
Provisions are recognised when the Group has a present obligation (legal or constructive) and the costs to settle the obligation are both probable and able to be reliably measured.

(v) Treasury stock
Treasury stock is deducted from equity and is stated at consideration paid. No gain or loss is recognised in the consolidated statement of profit or loss on the purchase, sale, issue or cancellation of own equity instruments.

(w) Non-controlling interests
Non-controlling interests represents the portion of profit or loss and net assets in the subsidiaries not attributable to the Bank's equity shareholders. Any change in Group's ownership interest in the subsidiary that does not result in a loss of control is accounted for as an equity transaction.

(x) Perpetual Tier 1 capital securities
Perpetual Tier 1 capital securities of the Group are recognised under equity in the consolidated statement of financial position and the corresponding distribution on those securities are accounted as a debit to retained earnings.

(y) Proposed dividends
Proposed dividends are included as part of equity and only recognised as liabilities when approved by the shareholders. The payment of a dividend also requires the prior approval of the CBB.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(z) Financial guarantees
In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. All such guarantees are treated as memorandum liabilities and are disclosed as part of contingent liabilities. Financial guarantees are initially recognised in the consolidated financial statements at fair value, in ‘other liabilities’, being the premium received. Subsequent to initial recognition, the Group’s liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee. Any increase in the liability relating to financial guarantees is taken to the consolidated statement of profit or loss. The premium received is recognised in the consolidated statement of profit or loss in on a straight line basis over the life of the guarantee.

(aa) Derivatives
The Group enters into derivative instruments including futures, forwards, swaps, and options in the foreign exchange and capital markets. Derivatives are stated at fair value. Derivatives with positive market values are included in 'other assets' and derivatives with negative market values are included in 'other liabilities' in the consolidated statement of financial position.

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

(ab) Hedge accounting
The Group makes use of derivative instruments to manage exposures to interest rate and foreign currency risks. In order to manage particular risks, the Group applies hedge accounting for transactions which meet the specified criteria.

Hedge accounting model introduced under IFRS 9 is designed to better align hedge accounting with risk management activities; permit a greater variety of hedging instruments and risks eligible for hedge accounting; and removed rule based thresholds for testing hedge effectiveness by bringing principle based criteria. Retrospective assessment of hedge effectiveness is no longer required and current accounting treatments of fair value, cashflow and net investment hedge accounting have been retained.

IFRS 9 provides an accounting choice to continue to apply IAS 39 hedge accounting rules until the IASB finalizes its macro hedge accounting project. The Group has adopted IFRS 9 hedge accounting and has determined that all hedge relationships that were designated as effective hedging relationships under IAS 39 would continue to qualify for hedge accounting under IFRS 9.

At inception of the hedging relationship, the management undertakes a formal designation and documentation. This includes the Group’s risk management objective underlying, the hedging relationship and how that fits within the overall risk management strategy. The documentation also includes an identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess whether the hedging relationship meets the hedge effectiveness requirements. IFRS 9 also requires documentation of the hedge ratio and potential sources of ineffectiveness.

A hedging relationship qualifies for hedge accounting if it meets all of the following effectiveness requirements:
- there is ‘an economic relationship’ between the hedged item and the hedging instrument;
- the effect of credit risk does not ‘dominate the value changes’ that result from that economic relationship; and
- the hedge ratio of the hedging relationship is the same as that resulting from the quantity of hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item.

The Group performs a hedge effectiveness assessment in a similar manner as at the inception of the hedging relationship and subsequently on every reporting period.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(ab) Hedge accounting (continued)

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

i) Fair value hedges
In relation to fair value hedges, which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument to fair value is recognised immediately in the consolidated statement of profit or loss. The hedged item is adjusted for fair value changes and the difference relating to the risk being hedged is recognised in the consolidated statement of profit or loss.

ii) Cash flow hedges
In relation to cash flow hedges which meet the conditions for hedge accounting, the portion of any gain or loss on the hedging instrument, that is determined to be an effective hedge is recognised initially in the consolidated statement of changes in equity and the ineffective portion is recognised in the consolidated statement of profit or loss. The gains or losses on effective cash flow hedges recognised initially in the consolidated statement of changes in equity are either transferred to the consolidated statement of profit or loss in the period in which the hedged transaction impacts the consolidated statement of profit or loss or included in the initial measurement of the cost of the related asset or liability.

For hedges which do not qualify for hedge accounting, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated statement of profit or loss.

Discontinuation of hedges
A hedging relationship is discontinued in its entirety when as a whole it ceases to meet the qualifying criteria of the hedging relationship. Voluntary discontinuation when the qualifying criteria are met is prohibited. In the event of discontinuation, any subsequent changes in fair value of the hedging instrument are recognized in the consolidated statement of profit or loss. For effective fair value hedges of financial instruments with fixed maturities any adjustment arising from hedge accounting is amortised over the remaining term to maturity. For effective cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in the consolidated statement of changes in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of profit or loss.

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

(ad) Offsetting
Financial assets and financial liabilities are only offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognised amounts and the Group intends to settle on a net basis.

(ae) Recognition of income and expenses
Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

Interest income and loan commitment fees, which are considered an integral part of the effective yield of a financial asset, are recognised using the effective yield method unless collectability is in doubt. The recognition of interest income is suspended when loans become non-performing i.e. are classified under Stage 2 (when overdue by more than ninety days). Notional interest is recognised on impaired loans and other financial assets based on the rate used to discount future cash flows to their net present value based on the original effective interest rate.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(ae) Recognition of income and expenses (continued)
Interest expense is recognised using the effective yield method.

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees.

Other fees receivable are recognised when earned. Dividend income is recognised when the right to receive payment is established.

The Group recognises dividend income when the right to receive payment is established.

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

(af) Foreign currencies

(i) Transactions and balances
Transactions in foreign currencies are initially recorded at the functional currency rate of exchange ruling at the date of transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange at the statement of financial position date. All differences arising on non-trading activities are recorded in the consolidated statement of profit and loss, with the exception of differences on foreign currency borrowings that provide an effective hedge against a net investment in a foreign operation. These differences are taken directly to equity until the disposal of the net investment, at which time they are recognised in the consolidated statement of profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations and translated at closing rate.

(ii) Group companies
As at the reporting date, the assets and liabilities of subsidiaries and overseas branches are translated into the Group's presentation currency at the rate of exchange as at the statement of financial position date, and their statements of profit or loss are translated at the weighted average exchange rates for the year. Exchange differences arising on translation are taken directly to a separate component of equity through the consolidated statement of comprehensive income. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the consolidated statement of profit or loss.

(ag) Cash and cash equivalents
Cash and cash equivalents comprise cash and balances with central banks (excluding mandatory reserve deposits), treasury bills, deposits and due from banks and other financial institutions having original maturities of ninety days or less.

3.4 Significant accounting judgments and estimates
In the process of applying the Group's accounting policies, management has exercised judgment and estimates in determining the amounts recognised in the consolidated financial statements. The most significant uses of judgment and estimates are as follows:

3 ACCOUNTING POLICIES (continued)

3.4 Significant accounting judgments and estimates (continued)

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

Fair value of financial instruments
Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, these are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgment is applied to establish fair values. These judgment include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities.

Business model
In making an assessment of whether a business model's objective is to hold assets in order to collect contractual cash flows, the Group considers at which level of its business activities such assessment should be made. Generally, a business model is a matter of fact which can be evidenced by the way business is managed and the information provided to management.

In determining whether its business model for managing financial assets is to hold assets in order to collect contractual cash flows, the Group considers:
- Management's stated policies and objectives for the portfolio and the operation of those policies in practice;
- Management's evaluation of the performance of the portfolio; and
- Management's strategy in terms of earning contractual interest revenues or generating capital gains.

Impairment of financial instruments
Assessment of whether credit risk on the financial asset has increased significantly since initial recognition and incorporation of forward-looking information in the measurement of ECL. Refer to note 32 for further details.

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

The Group's ECL calculation are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. A number of significant judgments are also required in applying the accounting requirements for measuring ECL, such as:
- Internal credit rating model, which assigns PDs to the individual ratings;
- The Group calculates PiT PD estimates under three scenarios, a base case, good case and bad case. An appropriate probability weighted ECL is then calculated by assigning probabilities, based on current market conditions, to each scenario;
- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs;
- Selection and relative weightings of forward-looking scenarios to derive the economic inputs into the ECL models;
- Establishing groups of similar financial assets for the purposes of measuring ECL; and
- Determining relevant period of exposure with respect to the revolving facilities and facilities undergoing restructuring at the time of the reporting date.

4 CASH AND BALANCES WITH CENTRAL BANKS

	2018	*2017*
	BD '000	*BD '000*
Cash in hand and vaults	**20,334**	18,597
Current accounts and placements with central banks	**95,088**	370,537
Mandatory reserve deposits with central banks	**75,606**	80,302
	191,028	469,436

Mandatory reserve deposits are not available for use in the Group's day to day operations.

5 TREASURY BILLS

These are short-term treasury bills issued by the Government of the Kingdom of Bahrain which are carried at amortised cost and Republic of India which are carried at FVOCI amounting to BD 405,802 thousand and BD 4,578 thousand (31 December 2017: BD 418,093 thousand and BD 9,037 thousand) respectively. As at 31 December 2018, the ECL on the same is BD 0.100 thousand (31 December 2017: BD 0.351 thousand).

At 31 December 2018, treasury bills issued by Government of the Kingdom of Bahrain includes short-term Islamic Sukuk amounting to BD Nil (31 December 2017: BD 5,000 thousand).

6 DEPOSITS AND AMOUNTS DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	2018	*2017*
	BD '000	*BD '000*
Deposits with banks and other financial institutions	**195,077**	190,416
Other amounts due from banks (Nostro and Current Accounts)	**44,098**	33,409
Less: Allowance for impairment / ECL	**(1)**	(1)
	239,174	223,824

7 LOANS AND ADVANCES TO CUSTOMERS

	2018	*2017*
	BD '000	*BD '000*
Loans and advances to customers at amortised cost:		
Commercial loans and overdrafts	**1,343,052**	1,337,637
Consumer loans	**553,539**	515,341
	1,896,591	1,852,978
Less: Allowance for impairment / ECL	**(124,063)**	(112,327)
	1,772,528	1,740,651

7 LOANS AND ADVANCES TO CUSTOMERS (continued)

Movements in allowance for impairment / ECL are as follows:

i) Commercial loans and overdrafts

	2018			
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit - impaired BD '000	Stage 3: Lifetime ECL credit - impaired BD '000	Total BD '000
Balance at 1 January	4,629	30,933	58,026	93,588
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	80	(80)	-	-
- Transferred to lifetime ECL not credit - impaired	(204)	204	-	-
- Transferred to lifetime ECL credit - impaired	(20)	(38,724)	38,744	-
Net remeasurement of loss allowance	1,768	27,451	10,514	39,733
Recoveries / write-backs	-	-	(6,086)	(6,086)
Amounts written off during the year	-	-	(18,949)	(18,949)
Foreign exchange and other movements	-	1,041	(563)	478
Balance at 31 December	6,253	20,825	81,686	108,764

	2017			
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit - impaired BD '000	Stage 3: Lifetime ECL credit - impaired BD '000	Total BD '000
Balance at 1 January	2,623	38,597	67,331	108,551
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	1,600	(1,600)	-	-
- Transferred to lifetime ECL not credit - impaired	(208)	12,099	(11,891)	-
- Transferred to lifetime ECL credit - impaired	(16)	(25,062)	25,078	-
Net remeasurement of loss allowance	630	6,684	24,052	31,366
Recoveries / write-backs	-	-	(4,690)	(4,690)
Amounts written off during the year	-	-	(42,575)	(42,575)
Foreign exchange and other movements	-	215	721	936
Balance at 31 December	4,629	30,933	58,026	93,588

ii) Consumer loans

	2018			
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit - impaired BD '000	Stage 3: Lifetime ECL credit - impaired BD '000	Total BD '000
Balance at 1 January	4,152	6,351	8,236	18,739
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	986	(986)	-	-
- Transferred to lifetime ECL not credit - impaired	(59)	59	-	-
- Transferred to lifetime ECL credit - impaired	(1)	(103)	104	-
Net remeasurement of loss allowance	-	(645)	3,038	2,393
Recoveries / write-backs	-	-	(992)	(992)
Amounts written off during the year	-	-	(4,841)	(4,841)
Balance at 31 December	5,078	4,676	5,545	15,299

7 LOANS AND ADVANCES TO CUSTOMERS (continued)

ii) Consumer loans (continued)

	2017			
	Stage 1: 12-month ECL	*Stage 2: Lifetime ECL not credit - impaired*	*Stage 3: Lifetime ECL credit - impaired*	*Total*
	BD '000	*BD '000*	*BD '000*	*BD '000*
Balance at 1 January	2,951	5,085	10,315	18,351
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	440	(440)	-	-
- Transferred to lifetime ECL not credit - impaired	(38)	38	-	-
Net remeasurement of loss allowance	799	1,668	912	3,379
Recoveries / write-backs	-	-	(1,143)	(1,143)
Amounts written off during the year	-	-	(2,322)	(2,322)
Foreign exchange and other movements	-	-	474	474
Balance at 31 December	4,152	6,351	8,236	18,739

At 31 December 2018, interest in suspense on past due loans that are fully impaired amounted to BD 15,907 thousand (31 December 2017: BD 15,049 thousand) are treated as a memorandum account.

The fair value of the collateral consisting of cash, securities and real estate that the Group holds relating to loans individually determined to be impaired at 31 December 2018 amounts to BD 59,819 thousand (31 December 2017: BD 25,712 thousand).

At 31 December 2018, loans and advances include Islamic financing facilities provided by the Group to corporates amounting to BD 98,605 thousand (31 December 2017: BD 108,525 thousand). These mainly consists of Murabaha and Ijarah financing facilities.

8 INVESTMENT SECURITIES

	FVTPL	***FVOCI ****	***Amortised cost***	***2018 Total***
	BD '000	***BD '000***	***BD '000***	***BD '000***
Quoted investments				
Government bonds	**-**	**275,678**	**20,164**	**295,842**
Other bonds	**677**	**311,238**	**-**	**311,915**
Equities	**-**	**38,264**	**-**	**38,264**
	677	**625,180**	**20,164**	**646,021**
Unquoted investments				
Government bonds	**-**	**-**	**125,672**	**125,672**
Other bonds	**75**	**-**	**-**	**75**
Equities	**-**	**28,166**	**-**	**28,166**
Managed funds	**819**	**-**	**-**	**819**
	894	**28,166**	**125,672**	**154,732**
	1,571	**653,346**	**145,836**	**800,753**
Less: ECL on investments	**-**	**(485)**	**(5)**	**(490)**
Balance at 31 December 2018	**1,571**	**652,861**	**145,831**	**800,263**

8 INVESTMENT SECURITIES (continued)

	FVTPL	*FVOCI **	*Amortised cost*	*2017 Total*
	BD '000	*BD '000*	*BD '000*	*BD '000*
Quoted investments				
Government bonds	-	354,128	13,400	367,528
Other bonds	3,184	206,804	-	209,988
Equities	-	35,242	-	35,242
	3,184	596,174	13,400	612,758
Unquoted investments				
Government bonds	-	-	105,458	105,458
Other bonds	82	584	69	735
Equities	-	29,457	-	29,457
Managed funds	1,196	-	-	1,196
	1,278	30,041	105,527	136,846
	4,462	626,215	118,927	749,604
Less: ECL on investments	-	(615)	(4)	(619)
Balance at 31 December 2017	4,462	625,600	118,923	748,985

* At 31 December 2018, investment securities include government bonds and other bonds of BD 286,105 thousand (31 December 2017: BD 229,726 thousand), which are pledged against the borrowings under repurchase agreements.

At 31 December 2018, investment securities include long-term Islamic Sukuk amounting to BD 72,660 thousand (31 December 2017: BD 79,481 thousand).

Movements in allowance for impairment / ECL of investment securities are as follows:

	2018			
	Stage 1: 12-month ECL*	***Stage 2: Lifetime ECL not credit - impaired***	***Stage 3: Lifetime ECL credit - impaired***	***Total***
	BD '000	***BD '000***	***BD '000***	***BD '000***
Government and other bonds at FVOCI or amortized cost				
Balance at 1 January	**87**	**532**	**-**	**619**
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	**81**	**(81)**	**-**	**-**
- Transferred to lifetime ECL not credit - impaired	**(17)**	**17**	**-**	**-**
Net remeasurement of loss allowance	**8**	**305**	**-**	**313**
Financial assets that have been derecognised	**(10)**	**(199)**	**-**	**(209)**
Foreign exchange and other movements	**-**	**(233)**	**-**	**(233)**
Balance at 31 December	**149**	**341**	**-**	**490**

8 INVESTMENT SECURITIES (continued)

	2017			
	*Stage 1: 12-month ECL**	*Stage 2: Lifetime ECL not credit - impaired*	*Stage 3: Lifetime ECL credit - impaired*	*Total*
	BD '000	*BD '000*	*BD '000*	*BD '000*
Government and other bonds at FVOCI or amortized cost				
Balance at 1 January	164	445	-	609
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	92	(92)	-	-
- Transferred to lifetime ECL not credit - impaired	(44)	44	-	-
Net remeasurement of loss allowance	(87)	185	-	98
Financial assets that have been derecognised	(38)	(50)	-	(88)
Foreign exchange and other movements	-	-	-	-
Balance at 31 December	87	532	-	619

The loss allowance of the FVOCI is not recognised in the consolidated statement of financial position because the carrying amount of debt investment securities at FVOCI is at their fair value.

* The above table includes ECL of government and other bonds measured at amortized cost of BD 5 thousand (31 December 2017: BD 4 thousand).

9 INVESTMENTS IN ASSOCIATED COMPANIES AND JOINT VENTURES

The Group has a 23.03% (2017: 23.03%) equity interest in Bahrain Commercial Facilities Company B.S.C. ("BCFC"), incorporated in the Kingdom of Bahrain, which is engaged in consumer financing, insurance, dealing in real estate and automobiles.

The Group has a 50% (2017: 50%) stake in Sakana Holistic Housing Solutions B.S.C. (c) ("Sakana"), a jointly controlled company incorporated in the Kingdom of Bahrain which is engaged in Islamic real estate financing, which is under liquidation.

The Group has a 22% (2017: 22%) shareholding in The Benefit Company B.S.C. (c) incorporated in the Kingdom of Bahrain, which is engaged in ancillary services to provide payment systems and other related financial services for the benefit of commercial banks and their customers in the Kingdom of Bahrain.

The Group has a 40% (2017: 40%) stake in BBK Geojit securities K.S.C., a jointly controlled company incorporated in the State of Kuwait.

The Group has a 24.27% (2017: 24.27%) stake in Bahrain Liquidity Fund, an investment vehicle established in the Kingdom of Bahrain to enhance liquidity in the market and to close the valuation gap between securities listed on Bahrain Bourse and their regional peers.

The Group has a 50% (2017: 50%) stake in Aegila Capital Management Limited, a joint venture company incorporated in the United Kingdom which is engaged in capital market advisory services for alternative investments with particular focus in the real estate.

The Group has a 50% (2017: Nil) stake in Magnum Partners Holding Limited, a joint venture company incorporated in Jersey to indirectly acquire real estate investment in Netherlands.

The Group has a 25% (2017: Nil) stake in Evoque Holdings Jersey Limited, a joint venture company incorporated in Jersey to indirectly acquire real estate investment in Germany.

9 INVESTMENTS IN ASSOCIATED COMPANIES AND JOINT VENTURES (continued)

	2018 ***BD '000***	*2017* *BD '000*
Carrying amount of investment in associated companies and joint ventures		
At 1 January	**46,958**	43,923
Acquisitions during the year	**15,204**	-
Share of profit	**4,142**	5,519
Dividends received from associated companies	**(3,074)**	(2,394)
Change in unrealised fair values - associated companies (note 16)	**543**	342
Change in foreign exchange translation adjustments	**(288)**	68
Capital distribution	**(550)**	(500)
At 31 December	**62,935**	46,958

The following tables illustrate the summarised financial information of the Group's interest in its associated companies and joint ventures:

	2018 ***BD '000***	*2017* *BD '000*
Share of associated companies and joint ventures statements of financial position		
Current and non-current assets	**118,882**	102,965
Current and non-current liabilities	**(55,947)**	(56,007)
Net assets	**62,935**	46,958
Share of associated companies and joint ventures revenues		
Revenue	**12,555**	11,650

Investment in associated companies and joint ventures includes the Group investment in BCFC which is considered to be a material associate. The following table illustrates the financial information of the Group's investment in BCFC:

	2018 ***BD '000***	*2017* *BD '000*
Net interest income	**24,987**	23,569
Gross profit on automotive sales	**7,212**	6,497
Other operating income	**13,087**	11,805
Total operating income	**45,286**	41,871
Operating expenses	**(21,063)**	(19,081)
Other expenses	**(2,773)**	(3,568)
Profit for the year	**21,450**	19,222
Group's share of profit for the year	**4,940**	4,427

9 INVESTMENTS IN ASSOCIATED COMPANIES AND JOINT VENTURES (continued)

	2018 ***BD '000***	*2017* *BD '000*
Assets		
Cash and balances with banks	**4,725**	2,868
Loans and advances to customers	**304,913**	290,606
Inventories	**28,981**	38,196
Other assets	**52,057**	47,911
Total assets	**390,676**	379,581
Liabilities		
Bank overdrafts	**959**	1,598
Trade and other payables	**19,452**	18,483
Bank term loans	**184,118**	184,344
Bonds issued	**39,953**	39,882
Total liabilities	**244,482**	244,307
Donation reserve	**(910)**	(679)
Equity	**145,284**	134,595
Proportion of the Group's ownership	**23.03%**	23.03%
	33,459	30,997

The figures reported above for BCFC are based on 30 September 2018 reviewed financial statements adjusted for expected performance in the last quarter ended 31 December 2018 (2017: same).

The market value of the Group's investment in BCFC is BD 28,966 thousand (2017: BD 25,957 thousand) compared to the carrying value of BD 33,459 thousand (2017: BD 30,997 thousand) as at 31 December 2018.

10 INTEREST RECEIVABLE AND OTHER ASSETS

	2018 ***BD '000***	*2017* *BD '000*
Accounts receivable	**23,116**	29,458
Interest receivable	**15,551**	13,373
Collateral pending sale	**13,530**	9,439
Positive fair value of derivatives (note 27)	**11,268**	7,714
Prepaid expenses	**1,206**	1,677
Deferred tax asset (note 21)	**1,092**	1,631
Others	**12,086**	16,388
	77,849	79,680

11 PREMISES AND EQUIPMENT

	Freehold land BD '000	***Properties and buildings BD '000***	***Furniture and equipment BD '000***	***Capital work in progress BD '000***	***Total BD '000***
Net book value at 31 December 2018	**8,849**	**11,899**	**6,570**	**225**	**27,543**

	Freehold land BD '000	*Properties and buildings BD '000*	*Furniture and equipment BD '000*	*Capital work in progress BD '000*	*Total BD '000*
Net book value at 31 December 2017	8,849	11,173	5,310	1,104	26,436

The depreciation charge for the year amounted to BD 3,654 thousand (2017: BD 3,435 thousand).

12 TERM BORROWINGS

The term borrowings were obtained for general financing purposes and comprise:

Rate of interest	Maturity Year	***2018 BD '000***	*2017 BD '000*
Libor + 1.75%	2018	**-**	48,212
3.50%	2020	**144,542**	150,800
		144,542	199,012

13 CUSTOMERS' CURRENT, SAVINGS AND OTHER DEPOSITS

	2018 BD '000	*2017 BD '000*
Term deposits	**1,259,419**	1,392,623
Savings accounts	**571,318**	532,588
Current accounts	**484,704**	628,389
Other accounts	**59,039**	69,977
	2,374,480	2,623,577

14 INTEREST PAYABLE AND OTHER LIABILITIES

	2018 BD '000	*2017 BD '000*
Accrued expenses	**37,559**	38,182
Interest payable	**24,095**	14,828
Accounts payable	**14,249**	14,815
Allowance for impairment / ECL*	**986**	1,408
Negative fair value of derivatives (note 27)	**4,801**	6,639
Others	**22,876**	9,018
	104,566	84,890

* This represents allowance for impairment / ECL on financial contracts issued as of 31 December.

15 EQUITY

	2018	*2017*
	BD ’000	*BD ’000*
(i) Share capital		
Authorised		
1,500,000,000 shares of BD 0.100 each	**150,000**	150,000
Issued and fully paid		
1,081,647,952 shares (2017: 1,081,647,952 shares) of BD 0.100 each	**108,165**	108,165

(ii) Treasury stock

Treasury stock represents the purchase of its own shares by the Bank. At the end of the year, the Bank held 6,213,641 (2017: 2,774,562) of its own shares.

	2018	*2017*
	BD ’000	*BD ’000*
Consideration paid	**(2,521)**	(998)

(iii) Share premium

The share premium arising on issue of ordinary shares is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law (BCCL) and following the approval of the CBB.

(iv) Employee Performance Share Plan

The Group has an Employee Performance Share Plan under which shares are granted to certain eligible employees (refer to note 40).

(v) Unclaimed dividends

During the year, the Group transferred BD 22 thousand (2017: BD 8 thousand) to equity as unclaimed dividends by the shareholders. As per the Group policy and procedures, any unclaimed dividends in excess of 10 years are transferred to equity, however are available to the respective shareholder for any future claims.

(vi) Perpetual tier 1 convertible capital

During the year 2016, the Bank completed an issue of BD 86,098 thousand Basel III compliant Additional Tier I Convertible Perpetual Capital Securities. Distribution Payment Amounts shall be payable subject to and in accordance with terms and conditions on the outstanding nominal amount of the Capital Securities at rate of 8.25 per cent per annum. These securities are recognised under equity in the consolidated statement of financial position and the corresponding coupon on those securities are accounted as appropriation of profits. Expenses relating to this issuance have been included in retained earnings during 2016. Securities’ holders will not have a right to claim the coupon and such event will not be considered as event of default.

(vii) Statutory reserve

The statutory reserve has been created in accordance with the BCCL. The Bank transfers 10% of its annual profits to its statutory reserve till such time as the reserve equals 50% of the issued share capital of the Bank. During the year, the Bank had not transferred to statutory reserve (2017: Nil) as the statutory reserve equals 50% of the issued share capital. The reserve is not available for distribution, except in circumstances as stipulated in the BCCL and following the approval from the CBB.

(viii) General reserve

The general reserve has been built up in accordance with the provisions of the Bank’s articles of association and underlines the shareholders’ commitment to enhance the strong equity base of the Bank. The general reserve is distributable subject to the approval from the CBB.

16 CUMULATIVE CHANGES IN FAIR VALUES

	2018	*2017*
	BD ’000	*BD ’000*
Fair value through other comprehensive income		
At 1 January	**(8,573)**	(13,609)
Transfer to retained earnings on sale / write off of equity securities	**507**	1,325
Transfer to profit or loss on sale of investment securities	**(3,249)**	(3,525)
Transferred to profit or loss on impairment	**313**	98
Fair value changes on investment securities carried at FVOCI	**(14,770)**	7,138
At 31 December	**(25,772)**	(8,573)
Cash flow hedges		
At 1 January	**224**	(60)
Change in unrealised fair values	**(100)**	(58)
Change in unrealised fair values - associated companies (note 9)	**543**	342
At 31 December	**667**	224
	(25,105)	(8,349)

17 PROPOSED APPROPRIATIONS

	2018	*2017*
	BD ’000	*BD ’000*
Cash dividend	**43,017**	37,761
Donations	**1,600**	1,400
	44,617	39,161

The Board of Directors has proposed cash dividend of BD 0.040 per share (2017: BD 0.035 per share), net of treasury stock as of 31 December 2018. The Bank paid dividend of BD 0.035 per share (2017: BD 0.030 per share).

The above appropriations will be submitted for approval at the Annual General Assembly of the Shareholders to be held on 20 March 2019. The payment of dividend is also subject to the approval of the CBB.

18 NET INTEREST AND SIMILAR INCOME

	2018	*2017*
	BD ’000	*BD ’000*
a) INTEREST AND SIMILAR INCOME		
Loans and advances to customers	**107,691**	94,030
Investment securities	**33,455**	25,349
Treasury bills	**16,032**	10,943
Deposits and amounts due from banks and other financial institutions	**8,650**	6,661
	165,828	136,983
b) INTEREST AND SIMILAR EXPENSE		
Customers' deposits	**(39,577)**	(28,842)
Deposits and amounts due to banks and other financial institutions	**(16,301)**	(17,235)
	(55,878)	(46,077)
Net interest and similar income	**109,950**	90,906

19 FEE AND COMMISSION INCOME - NET

	_2018_ **_BD '000_**	_2017_ _BD '000_
Fee and commission income	**49,161**	49,253
Fee and commission expense	**(20,974)**	(18,159)
	28,187	31,094

Included in fee and commission income is BD 70 thousand (2017: BD 42 thousand) relating to trust and other fiduciary activities.

20 OTHER INCOME

	_2018_ **_BD '000_**	_2017_ _BD '000_
Dividend income	**6,216**	3,828
Gain on foreign exchange	**5,302**	5,214
Realised gains on investment securities	**3,249**	3,965
Others	**4,158**	2,533
	18,925	15,540

21 TAXATION

	_2018_ **_BD '000_**	_2017_ _BD '000_
Consolidated statement of financial position		
Deferred tax asset (note 10)	**1,092**	1,631
Consolidated statement of profit or loss		
Current tax expense on foreign operations	**-**	94
Deferred tax expense on foreign operations	**408**	716
	408	810

Current tax is measured at the amount expected to be paid in respect of taxable income for the year in accordance with the Income Tax Act, 1961. Deferred tax assets and liabilities are recognised for the future tax consequences of timing differences being the difference between the taxable income and the accounting income that originate in one period and are capable of reversal in one or more subsequent period. Deferred tax assets on account of timing differences are recognised only to the extent there is reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

The Group's tax expense includes all direct taxes that are accrued on taxable profits of entities to the authorities in the respective countries of incorporation, in accordance with the tax laws prevailing in those jurisdictions. Consequently, it is not practical to provide a reconciliation between the accounting and taxable profits together with the details of effective tax rates. Effective tax rate for the current year ended 31 December 2018 is 43.68% (2017: 43.26%). In the current year, tax is payable as per Minimum Alternate Tax (MAT), under Section 115J of the Income Tax Act, 1961.

22 BASIC AND DILUTED EARNINGS PER SHARE

Basic earnings per share
Basic earnings per share for the year are calculated by dividing the profit for the year attributable to the owners of the Bank less distribution on perpetual tier 1 convertible capital securities, by the weighted average number of shares outstanding during the year.

Diluted earnings per share
Diluted earnings per share for the year are calculated by dividing the profit for the year attributable to the owners of the Bank less distribution on perpetual tier 1 convertible capital securities, by the weighted average number of shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion into ordinary shares.

	2018	*2017*
Profit for the year attributable to the owners of the Bank (BD '000)	**67,118**	58,685
Less: Distribution on perpetual tier 1 convertible capital securities (BD '000)	**(7,103)**	(7,103)
Adjusted net profit for the year attributable to the owners of the Bank (BD '000)	**60,015**	51,582
Weighted average number of shares, net of treasury stock, outstanding during the year	**1,076,676,556**	1,077,809,434
Basic earnings per share (BD)	**0.056**	0.048
Weighted average number of ordinary shares adjusted for the effect of dilution	**1,291,920,336**	1,293,053,214
Diluted earnings per share (BD)	**0.052**	0.045

23 OPERATING SEGMENTS

Segment information
For management purposes, the Group is organised into four major business segments:

Retail banking - Principally handling individual customers' deposits and providing consumer finance type loans, overdrafts, credit facilities and funds transfer facilities, credit cards and foreign exchange.

Corporate banking - Principally handling loans and other credit facilities, deposit and current accounts for corporate and institutional customers in Bahrain.

International banking - Principally handling loans and other credit facilities, deposit and current accounts for international corporate and institutional customers. This also covers the operations of the overseas units.

Investment, treasury and other activities - Principally providing money market, trading and treasury services as well as the management of the Group's funding operations. Investment activities involve handling investments in local and international markets, investment advisory services and funds management. Other activities also include business process outsourcing services.

These segments are the basis on which the Group reports its information to the chief operating decision maker. Transactions between segments are generally recorded at estimated market rates on an arm's length basis. Interest is charged / credited to business segments based on a transfer pricing rate which approximates the marginal cost of funds on a matched funded basis.

23 OPERATING SEGMENTS (continued)

Segment information for the year ended 31 December 2018 was as follows:

	Retail banking BD '000	*Corporate banking BD '000*	*International banking BD '000*	*Investment, treasury and other activities BD '000*	*Total BD '000*
Interest income	**32,270**	**41,417**	**41,420**	**50,721**	**165,828**
Interest expense	**(3,636)**	**(10,896)**	**(12,686)**	**(28,660)**	**(55,878)**
Internal fund transfer price	**3,348**	**(2,135)**	**(7,843)**	**6,630**	**-**
Net interest income	**31,982**	**28,386**	**20,891**	**28,691**	**109,950**
Other operating income	**21,223**	**3,481**	**5,197**	**17,211**	**47,112**
Operating income before share of profit from associated companies and joint ventures	**53,205**	**31,867**	**26,088**	**45,902**	**157,062**
Net provision for impairment on loans and advances to customers	**328**	**(26,433)**	**(8,943)**	**-**	**(35,048)**
Net provision for impairment on investments	**-**	**-**	**-**	**(313)**	**(313)**
Segment result	**26,191**	**(9,197)**	**1,779**	**44,794**	**63,567**
Share of profit from associated companies and joint ventures	**4,466**	**-**	**-**	**(324)**	**4,142**
Profit for the year					**67,709**
Profit attributable to non-controlling interest					**(591)**
Profit for the year attributable to the owners of the Bank					**67,118**
Segment assets	**643,060**	**661,296**	**992,669**	**1,175,918**	**3,472,943**
Investment in associated companies and joint ventures	**37,934**	**-**	**-**	**25,001**	**62,935**
Common assets					**45,822**
Total assets					**3,581,700**
Segment liabilities	**823,768**	**702,141**	**803,339**	**693,246**	**3,022,494**
Common liabilities					**58,767**
Total liabilities					**3,081,261**

23 OPERATING SEGMENTS (continued)

Segment information for the year ended 31 December 2017 was as follows:

	Retail banking BD '000	*Corporate banking BD '000*	*International banking BD '000*	*Investment, treasury and other activities BD '000*	*Total BD '000*
Interest income	29,080	37,107	32,379	38,417	136,983
Interest expense	(3,159)	(10,094)	(8,937)	(23,887)	(46,077)
Internal fund transfer price	(1,715)	(1,686)	(6,167)	9,568	-
Net interest income	24,206	25,327	17,275	24,098	90,906
Other operating income	23,246	4,399	5,619	13,370	46,634
Operating income before share of profit from associated companies and joint ventures	47,452	29,726	22,894	37,468	137,540
Net provision for impairment on loans and advances to customers	(5,082)	(18,089)	(5,741)	-	(28,912)
Net provision for impairment on investments	-	-	-	(98)	(98)
Segment result	17,093	(2,344)	1,987	36,976	53,712
Share of profit from associated companies and joint ventures	5,448	-	-	71	5,519
Profit for the year					59,231
Profit attributable to non-controlling interest					(546)
Profit for the year attributable to the owners of the Bank					58,685
Segment assets	588,906	681,463	1,250,222	1,152,594	3,673,185
Investment in associated companies and joint ventures	35,377	-	-	11,581	46,958
Common assets					42,957
Total assets					3,763,100
Segment liabilities	791,506	856,957	980,667	584,234	3,213,364
Common liabilities					48,901
Total liabilities					3,262,265

Geographic information

The Group operates in two geographic markets: Domestic (Bahrain), Others (Middle East / Africa, Europe, North America and Asia). The following tables show the distribution of the Group's revenue and non-current assets by geographical segment, allocated based on the location in which the assets and liabilities are located, for the years ended 31 December 2018 and 2017:

	Domestic BD '000	***Others BD '000***	***Total BD '000***
31 December 2018			
Net interest income	**94,996**	**14,954**	**109,950**
Share of profit from associated companies and joint ventures	**4,466**	**(324)**	**4,142**
Other income	**43,639**	**3,473**	**47,112**
	143,101	**18,103**	**161,204**
Non-current assets*	**22,513**	**5,030**	**27,543**

23 OPERATING SEGMENTS (continued)

Geographic information (continued)

	Domestic BD '000	*Others BD '000*	*Total BD '000*
31 December 2017			
Net interest income	80,040	10,866	90,906
Share of profit from associated companies and joint ventures	5,448	71	5,519
Other income	43,092	3,542	46,634
	128,580	14,479	143,059
Non-current assets*	21,380	5,056	26,436

* Non-current assets represents premises and equipment.

24 CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the consolidated statement of cash flows includes the following as at 31 December:

	2018 BD '000	*2017 BD '000*
Cash in hand and vaults (note 4)	**20,334**	18,597
Current accounts and placements with central banks (note 4)	**95,088**	370,537
Deposits and amounts due from banks and other financial institutions having original maturities of ninety days or less	**229,976**	223,824
	345,398	612,958

25 RELATED PARTY TRANSACTIONS

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

Amounts outstanding as of the statement of financial position date in respect of transactions entered into with related parties were as follows:

	Major shareholders BD '000	*Associated companies and joint ventures BD '000*	*Directors and key management personnel BD '000*	*Total BD '000*
2018				
Loans and advances to customers	**-**	**23,312**	**3,020**	**26,332**
Investments in associated companies and joint ventures	**-**	**62,935**	-	**62,935**
Customers' current, savings and other deposits	**185,440**	**3,082**	**6,838**	**195,360**
2017				
Loans and advances to customers	-	24,812	3,132	27,944
Investments in associated companies and joint ventures	-	46,958	-	46,958
Customers' current, savings and other deposits	216,848	3,848	8,004	228,700

For the years ended 31 December 2018 and 2017, the Group has not recorded any impairment provision / ECL on the amounts due from related parties.

25 RELATED PARTY TRANSACTIONS (continued)

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

	Major shareholders BD '000	*Associated companies and joint ventures BD '000*	*Directors and key management personnel BD '000*	*Total BD '000*
2018				
Interest income	**-**	**1,378**	**27**	**1,405**
Interest expense	**6,107**	**63**	**102**	**6,272**
Share of profit from associated companies and joint ventures	-	**4,142**	-	**4,142**
2017				
Interest income	-	992	30	1,022
Interest expense	3,561	71	119	3,751
Share of profit from associated companies and joint ventures	-	5,519	-	5,519

Compensation of the key management personnel is as follows:

	2018 BD '000	*2017 BD '000*
Employee benefits	**10,969**	11,260

For key management personnel interest in an employee share incentive scheme (refer to note 40).

26 MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The maturity profile of the assets and liabilities at 31 December 2018 and 2017 given below has been determined on the basis of the remaining period at the statement of financial position date to the contractual maturity date, except in the case of customer deposits. The liquidity profile of customer deposits has been determined on the basis of the effective maturities indicated by the Group's deposit retention history.

31 December 2018 — ***BD '000***

	Within 1 month	*1 to 3 months*	*3 to 6 months*	*6 to 12 months*	*Subtotal*	*1 to 5 years*	*5 to 10 years*	*10 to 20 years*	*More than 20 years*	*Total*
Assets										
Cash and balances with central banks	115,422	-	-	-	115,422	-	-	-	75,606	191,028
Treasury bills	62,576	123,292	99,185	125,327	410,380	-	-	-	-	410,380
Deposits and amounts due from banks and other financial institutions	195,224	37,735	-	6,215	239,174	-	-	-	-	239,174
Loans and advances to customers	247,176	143,168	108,928	136,032	635,304	812,032	236,200	29,031	59,961	1,772,528
Investment securities	33,636	24,724	29,669	18,729	106,758	299,725	260,265	28,325	105,190	800,263
Investments in associated companies and joint venture	-	-	-	-	-	-	-	-	62,935	62,935
Interest receivable and other assets	64,319	-	-	-	64,319	13,530	-	-	-	77,849
Premises and equipment	-	-	-	-	-	24,470	280	1,150	1,643	27,543
Total assets	718,353	328,919	237,782	286,303	1,571,357	1,149,757	496,745	58,506	305,335	3,581,700
Liabilities										
Deposits and amounts due to banks and other financial institutions	156,763	79,267	22,646	-	258,676	-	-	-	-	258,676
Borrowings under repurchase agreement	-	-	1,996	-	1,996	197,001	-	-	-	198,997
Term borrowings	-	-	-	-	-	144,542	-	-	-	144,542
Customers' current, savings and other deposits	258,525	34,925	87,692	99,156	480,298	16,102	-	-	1,878,080	2,374,480
Interest payable and other liabilities	104,566	-	-	-	104,566	-	-	-	-	104,566
Total liabilities	519,854	114,192	112,334	99,156	845,536	357,645	-	-	1,878,080	3,081,261
Net	198,499	214,727	125,448	187,147	725,821	792,112	496,745	58,506	(1,572,745)	500,439
Cumulative	198,499	413,226	538,674	725,821		1,517,933	2,014,678	2,073,184	500,439	

26 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

31 December 2017 *BD '000*

	Within 1 month	*1 to 3 months*	*3 to 6 months*	*6 to 12 months*	*Subtotal*	*1 to 5 years*	*5 to 10 years*	*10 to 20 years*	*More than 20 years*	*Total*
Assets										
Cash and balances with central banks	389,127	-	-	-	389,127	-	-	-	80,309	469,436
Treasury bills	49,929	135,727	124,197	117,277	427,130	-	-	-	-	427,130
Deposits and amounts due from banks and other financial institutions	185,205	38,619	-	-	223,824	-	-	-	-	223,824
Loans and advances to customers	247,871	158,996	121,825	160,358	689,050	729,709	237,247	45,105	39,540	1,740,651
Investment securities	29,085	29,727	12,182	7,547	78,541	305,248	226,442	26,891	111,863	748,985
Investments in associated companies and joint venture	-	-	-	-	-	-	-	-	46,958	46,958
Interest receivable and other assets	70,241	-	-	-	70,241	9,439	-	-	-	79,680
Premises and equipment	-	-	-	-	-	23,163	304	1,257	1,712	26,436
Total assets	971,458	363,069	258,204	285,182	1,877,913	1,067,559	463,993	73,253	280,382	3,763,100
Liabilities										
Deposits and amounts due to banks and other financial institutions	168,761	24,711	-	-	193,472	-	-	-	-	193,472
Borrowings under repurchase agreement	-	-	-	40,804	40,804	120,510	-	-	-	161,314
Term borrowings	-	-	48,212	-	48,212	150,800	-	-	-	199,012
Customers' current, savings and other deposits	344,710	76,611	56,839	35,405	513,565	53,550	-	-	2,056,462	2,623,577
Interest payable and other liabilities	84,890	-	-	-	84,890	-	-	-	-	84,890
Total liabilities	598,361	101,322	105,051	76,209	880,943	324,860	-	-	2,056,462	3,262,265
Net	373,097	261,747	153,153	208,973	996,970	742,699	463,993	73,253	(1,776,080)	500,835
Cumulative	373,097	634,844	787,997	996,970		1,739,669	2,203,662	2,276,915	500,835	

27 DERIVATIVES

A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in the price of one or more underlying financial instrument, reference rate or index. In the ordinary course of business, the Group enters into various types of transactions that involve derivative financial instruments. The use of derivatives is governed by the Group's policies approved by the Board of Directors. The Group enters into derivative contracts for the purpose of reducing risks from potential movements in foreign exchange rates and interest rates inherent in the Group's non-trading assets and liabilities. The Group also enters into derivative contracts for the purpose of trading.

The table below shows the positive and negative fair values of derivative financial instruments together with their notional amounts. The notional amount is the amount of a derivative’s underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at year end but are neither indicative of the market risk nor credit risk.

31 December 2018	***Positive fair value BD ’000***	***Negative fair value BD ’000***	***Notional amount BD ’000***
Derivatives held for trading			
Forward foreign exchange contracts	**468**	**458**	**125,773**
Derivatives held as fair value hedges			
Interest rate swaps	**10,800**	**4,343**	**586,804**
	11,268	**4,801**	**712,577**

31 December 2017	*Positive fair value BD ’000*	*Negative fair value BD ’000*	*Notional amount BD ’000*
Derivatives held for trading:			
Forward foreign exchange contracts	147	647	104,161
Derivatives held as fair value hedges:			
Interest rate swaps	7,467	5,992	535,170
Derivatives held as cash flow hedges:			
Interest rate swaps	100	-	49,010
	7,714	6,639	688,341

Derivative product types

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

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

27 DERIVATIVES (continued)

Derivative product types (continued)

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

Derivatives held or issued for trading purposes

Most of the Group's derivative trading activities relate to back-to-back customer deals. In addition, the Group takes certain foreign exchange positions with the expectation of profiting from favorable movements in prices, rates or indices. Also, included under this category are derivatives which do not meet IFRS 9 hedging requirements.

Derivatives held or issued for hedging purposes

The Group has put in place systems for the measurement and management of risk. Part of the risk management process involves managing the Group's exposure to fluctuations in foreign exchange rates (currency risk) and interest rates through asset and liability management activities. It is the Group's policy to reduce its exposure to currency and interest rate risks to acceptable levels as determined by the Board of Directors. For strategies adopted to manage interest rate and currency risk, please refer notes 35 and 36 respectively.

As part of its asset and liability management, the Group uses derivatives for hedging currency and interest rate movements. This is achieved by hedging specific financial instruments, forecasted transactions as well as strategic hedging against consolidated statement of financial position exposures. In all such cases, the objective of the hedging relationship, details of the hedged item and hedging instrument are documented and the transactions are accounted for as fair value or cash flow hedges, as the case may be.

Fair value hedges

Fair value hedges are used by the Group to protect it against changes in the fair value of financial assets and financial liabilities due to movements in exchange rates and interest rates. The financial instruments hedged for interest rate risk include loans, fair value through other comprehensive income debt securities, debt issued and other borrowed funds. The Group uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks, and interest rate swaps to hedge interest rate risk.

In these hedge relationships, the main sources of ineffectiveness is the maturity mis-matches or the hedging instruments. The hedged instruments are subject to different counterparty risks, resulting in a change to hedge effectiveness measurement elements.

At 31 December 2018, the Group held the following interest rate swaps as hedging instruments in fair value hedges of interest risk:

	Less than 1 month	*1–3 months*	*3 months – 1 year*	*1–5 years*	*More than 5 years*
Interest rate risk					
Hedge of Investment Securities					
31 December 2018					
Nominal amount (BD '000)	**3,770**	**-**	**14,401**	**255,500**	**313,133**
Average fixed interest rate	**3%**	**0%**	**5%**	**5%**	**6%**
31 December 2017					
Nominal amount (BD '000)	-	471	15,080	250,387	269,232
Average fixed interest rate	0%	3%	3%	5%	5%

27 DERIVATIVES (continued)

Fair value hedges (continued)

The line item in the statement of financial position where the hedging instrument included is "Interest receivable and other assets".

The amounts relating to items designated as hedged items were as follows:

	2018		2017	
	Carrying amount BD ’000	***Accumulated fair value hedge adjustments on the hedged item included in the carrying amount BD ’000***	*Carrying amount BD ’000*	*Accumulated fair value hedge adjustments on the hedged item included in the carrying amount BD ’000*
Bonds (Investment securities)	**574,355**	**(7,964)**	521,316	(4,047)

For the year ended 31 December 2018, the Group recognised a net loss of BD 1.4 thousand (2017: net loss of BD 0.5 thousand), representing the loss on the hedging instruments. The total gain on hedged items attributable to the hedged risk amounted to BD 299 thousand (2017: loss of BD 190 thousand).

Cash flow hedges

At 31 December 2018, the Group did not hold any instruments to hedge exposures to changes in interest rates and foreign currency. As at 31 December 2017, the Group held the following instruments to hedge exposures to changes in interest rates and foreign currency:

	3 months– 1 year	*1–5 years*
Interest rate risk		
Interest rate swaps		
31 December 2017		
Nominal amount (BD '000)	49,010	-
Average fixed interest rate	3%	0%

The line item in the statement of financial position where the hedging instrument is included is "Interest payable and other liabilities".

The amounts relating to items designated as hedged items were as follows:

	2018		2017	
	Carrying amount BD ’000	***Cash flow Reserve BD ’000***	*Carrying amount BD ’000*	*Cash flow Reserve BD ’000*
Term Borrowings	**-**	**-**	49,010	100

28 COMMITMENTS AND CONTINGENT LIABILITIES

Credit-related commitments

Credit-related commitments include commitments to extend credit, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Group's customers.

Commitments to extend credit represent the unused portions of contractual commitments to make loans and revolving credits, principally in the form of loans and advances, guarantees and letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of loss, which cannot readily be quantified, is expected to be considerably less than the total unused commitment as most of the commitments to extend credit are contingent upon the customer maintaining specific credit standards. Commitments generally have fixed expiration dates of less than one year or other termination clauses. Since commitments may expire without being drawn upon, the total contracted amounts do not necessarily represent future cash requirements.

Letters of credit, guarantees (including standby letters of credit) and acceptances commit the Group to make payments on behalf of customers contingent upon certain conditions. Standby letters of credit, which are included under guarantees, would have market risk if issued or extended at a fixed rate of interest. However, these contracts are primarily made at a floating rate.

The Group has the following credit related commitments:

31 December 2018	***On demand BD '000***	***Less than 3 months BD '000***	***3 to 12 months BD '000***	***Total BD '000***
Contingencies				
Letters of credit	**2,374**	**16,082**	**13,903**	**32,359**
Guarantees	**231,625**	**-**	**-**	**231,625**
				263,984
Commitments				
Undrawn loan commitments	**120,649**	**-**	**-**	**120,649**
				120,649
				384,633

31 December 2017	*On demand BD '000*	*Less than 3 months BD '000*	*3 to 12 months BD '000*	*Total BD '000*
Contingencies				
Letters of credit	1,307	17,481	18,467	37,255
Guarantees	230,620	-	-	230,620
				267,875
Commitments				
Undrawn loan commitments	117,670	-	-	117,670
				117,670
				385,545

The Group does not expect all its commitments to be drawn before the expiry of the commitment.

28 COMMITMENTS AND CONTINGENT LIABILITIES (continued)

Operating lease commitments – Group as lessee

The Group has entered into commercial leases on premises. Future minimum lease payments under non-cancelable operating leases as at 31 December are as follows:

	2018	*2017*
	BD '000	*BD '000*
Within one year	**785**	815
After one year but not more than five years	**1,720**	1,939
More than five years	**3,603**	4,039
	6,108	6,793

29 RISK MANAGEMENT

Efficient and timely management of risks involved in the Group's activities is critical for the financial soundness and profitability of the Group. Risk management involves the identifying, measuring, monitoring and managing of risks on a regular basis. The objective of risk management is to increase shareholders' value and achieve a return on equity that is commensurate with the risks assumed. To achieve this objective, the Group employs leading risk management practices and recruits skilled and experienced staff.

As with other financial institutions, the Group faces a range of risks in its business and operations including (i) credit risk; (ii) market risk (comprising of interest rate risk, currency risk and equity price risk); (iii) liquidity risk, (iv) legal risk and (v) operational risk, as detailed below.

The Board of Directors of the Bank has overall responsibility for managing risks within the Bank. Whilst the Board approves and periodically reviews risk management policies and strategies based on the recommendations of the Board Risk Committee, the management establishes procedures to implement the policies and strategies. The Risk Management Committee (RMC), the Country Risk Committee (CRC) and Asset and Liability Management Committee (ALMC), comprising Executive and Senior Management, are high level management committees responsible for the overall management of the risk profile of the Group. RMC discusses important risk related issues, policies, procedures and reviews implementation of its decisions. ALMC reviews issues relating to the statement of financial position at a micro level and also reviews issues relating to Asset Liability mismatches and liquidity. The Country Risk Committee (CRC) reviews country risk, business strategies and macro economic conditions with reference to the countries identified for doing business. The Operational Risk Management Committee (ORMC) manages the overall operational risk for the Bank by instituting CBB guidelines and Basel standards and carrying out required oversight.

The Risk & Credit Management Division (RCMD) is responsible for oversight of risk management within the Bank. It is responsible for looking into risk characteristics inherent in new and existing products, activities, countries, regions, industries and making necessary recommendations to the appropriate authorities. It is also responsible for introducing or amending risk policies, procedures and exposure limits to mitigate these risks with approval from Board Risk Committee and Board or the Risk Management Committee, as applicable. The RCMD also establishes systems and processes for monitoring market and operational risks, and is also responsible for introducing risk management tools. The RCMD processes credit applications and ensures that the provisions of credit risk policies are complied with. The RCMD generates regular reports on credit risk exposures, performs credit rating reviews and monitors credit limits. The Designated Credit Officer / Designated Investment Officer in RCMD is one of the signatories in the credit / investment approval chain and provides independent view on credit & investment proposals. The Chief Risk Officer is the Head of RCMD and reports directly to the Board Risk Committee, thereby ensuring the independence of the risk management process. In addition to the above, RCMD in collaboration with Financial Control & Planning Division, prepares the Risk Appetite & the ICAAP document for the Bank. The ICAAP document assesses the Pillar 2 risks at length and prescribes the required level of capital buffer for the Bank. RCMD is also responsible for ensuring adherence to regulatory and statutory requirements related to risk management such as introducing use of IFRS 9 guidelines, ICAAP etc. in the Bank.

29 RISK MANAGEMENT (continued)

The internal audit department assess whether the policies and procedures are complied with and, if necessary, suggest ways of further improving internal guidelines and procedures. The various risks to which the Group is exposed to and how the Group manages them is discussed in the notes below.

30 CREDIT RISK AND CONCENTRATION OF CREDIT RISK

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and thereby cause the other party to incur a financial loss. Concentration of credit risk arises when a number of counterparties are engaged in similar business activities, or activities in the same geographical region, or have similar economic features, fail to meet contractual obligations, due to them being affected by changes in economic, political or other conditions.

Credit risk in derivative financial instruments arises from potential counterparty default on contractual obligations and it is limited to the positive fair value in favor of the Group.

The Group attempts to control credit risk by monitoring credit exposures continuously, limiting transactions with specific counterparties, assessing the creditworthiness of counterparties, diversifying lending activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses, and by obtaining security wherever necessary and appropriate. In addition to monitoring credit limits, the Group manages credit exposures by entering into netting agreements and collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposures.

The Group has well defined policies and procedures for identifying, measuring, monitoring and controlling credit risk in all of the Group's activities, at the level of individual credit as well as at a portfolio level. Credit limits are approved after a thorough assessment of the creditworthiness of the borrower or counterparty, including the purpose and structure of the credit, and its source of repayment. Credit proposals are reviewed by the RCMD, which is independent of business units, before approval of the appropriate approving authority is obtained. The Bank has a tiered approval authority level matrix depending on the extent of risk, comprising individuals with proven credit & investment credentials, Management Credit Committee and Board Committees. All policies relating to credit are reviewed by the Board Risk Committee and approved by the Board of Directors. An Executive Committee, consisting of Board of Directors, reviews and approves larger credits. In addition, all larger credits in excess of the approval authority of the Executive Committee are approved by the Board of Directors.

The Group devises specific business and risk strategies relating to corporate, retail, investments and treasury areas, within the ambit of the Group's risk policies and procedures. Any additional risks associated with such strategies are discussed in the RMC meetings and necessary risk control measures are applied through amendments to policies, procedures and circulars. The Group also draws up a comprehensive Risk Management Strategy every year and monitors the progress of that strategy.

Day-to-day monitoring of individual borrower or counterparty exposure is the responsibility of the respective business unit. The Group’s Credit Administration Unit, a part of the RCMD, ensures that credit facilities are released after appropriate approval and against proper documentation. It also monitors excesses over limits, past dues, expired credits and escalates exceptions if any, for corrective action.

Counterparty credit limits are established for all customers after careful assessment of their creditworthiness and approval (as per the levels of authority prescribed in the policy). These are also subject to large credit exposure limit criteria of the CBB and the local regulators in overseas locations. Standard procedures, outlined in the Group’s Risk Procedures Manual, require that all credit proposals be subjected to a detailed screening by a Designated Credit Officer / Designated Investment Officer who is part of a three signature approval process and functions independent of the business units.

The credit growth, quality and portfolio composition are monitored continuously to maximize the risk adjusted return and reduce the level of incidence of impairment and accretion of marginal credits. The Group monitors concentration risk by establishing limits for maximum exposure to individual borrower or counterparty, country, bank and industry. Such limits are also stipulated for certain products. These limits are approved after detailed analysis and are reviewed and monitored regularly.

30 CREDIT RISK AND CONCENTRATION OF CREDIT RISK (continued)

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

	2018	*2017*
	BD '000	*BD '000*
Balances with central banks	**170,694**	450,839
Treasury bills	**410,380**	427,130
Deposits and amounts due from banks and other financial institutions	**239,174**	223,824
Loans and advances to customers	**1,772,528**	1,740,651
Investment securities	**733,014**	683,090
Interest receivable and other assets	**62,021**	66,933
	3,387,811	3,592,467
Contingent liabilities	**263,984**	267,875
Commitments	**120,649**	117,670
	384,633	385,545
	3,772,444	3,978,012

31 CONCENTRATION RISK

The distribution of assets, liabilities and credit commitments and contingencies by geographic region and industry sector is as follows:

	2018			*2017*		
	Assets BD '000	***Liabilities BD '000***	***Credit commitments and contingencies BD '000***	*Assets BD '000*	*Liabilities BD '000*	*Credit commitments and contingencies BD '000*
Gulf Co-operation Council countries	**2,968,454**	**2,581,019**	**327,549**	3,222,728	2,756,671	340,220
North America	**42,340**	**12,538**	**258**	37,547	6,776	11
Europe	**250,740**	**337,751**	**6,073**	217,202	351,458	3,428
Asia	**259,918**	**134,574**	**49,307**	224,268	133,420	41,550
Others	**60,248**	**15,379**	**1,445**	61,355	13,940	336
	3,581,700	**3,081,261**	**384,632**	3,763,100	3,262,265	385,545
Trading and manufacturing	**673,005**	**102,187**	**186,349**	619,928	226,838	180,861
Banks and other financial institutions	**695,749**	**1,344,115**	**25,024**	655,062	1,240,487	27,018
Construction and real estate	**385,094**	**69,872**	**135,120**	392,225	62,305	128,840
Government and public sector	**1,013,544**	**368,843**	**1,413**	1,368,621	498,373	3,485
Individuals	**496,662**	**934,255**	**428**	441,848	914,531	624
Others	**317,646**	**261,989**	**36,298**	285,416	319,731	44,717
	3,581,700	**3,081,261**	**384,632**	3,763,100	3,262,265	385,545

32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS

The credit quality of financial assets is managed by the Group using internal and external credit risk ratings.

The Group follows an internal rating mechanism for grading relationships under loans and advances.

The Group utilises a scale ranging from 1 to 10 for credit relationships, with 1 to 8 denoting performing grades and 9 and 10 as non-performing grades, in line with Basel III guidelines. Grades 1 to 3 represent high grade (undoubted through to good credit risk), 4 to 6 represent standard grade (satisfactory through to adequate credit risk) and 7 to 8 represent sub-standard grade (satisfactory through to high credit risk).

The Group's rating method comprises 19 rating levels for debt instruments. The master scale maps the external credit ratings of rating agencies for debt instruments in to high, standard, substandard and past due or individually impaired. Grades 1 to 7 represent high grade (AAA to A-), 8 to 16 represent standard grade (BBB+ to B-) and 17 to 19 represent sub-standard grade (CCC+ to CCC-).

The Group endeavors continuously to improve upon the internal credit risk rating methodologies and credit risk management policies and practices to reflect the true underlying credit risk of the portfolio and the credit culture in the Group.

All lending relationships are reviewed at least once in a year and more frequently in the case of non-performing assets.

32.1 Credit quality analysis

The following table sets out information about the credit quality of financial assets measured at amortised cost and FVOCI debt investments. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively.

	31 December 2018			
	Stage 1: 12 - month ECL BD '000	*Stage 2: Lifetime ECL not credit - impaired BD '000*	*Stage 3: Lifetime ECL credit - impaired BD '000*	*Total BD '000*
Loans and advances to customers				
Commercial loans and overdrafts at amortised cost				
High (Grade 1 to 3)	**237,343**	**5,473**	**-**	**242,816**
Standard (Grade 4 to 6)	**669,365**	**156,423**	**-**	**825,788**
Substandard (Grade 7 to 8)	**9,558**	**124,530**	**-**	**134,088**
Non-performing (Grade 9 to 10)	**-**	**-**	**140,360**	**140,360**
	916,266	**286,426**	**140,360**	**1,343,052**
Loss allowance / ECL	**(6,253)**	**(20,825)**	**(81,686)**	**(108,764)**
Net carrying amount	**910,013**	**265,601**	**58,674**	**1,234,288**

32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)

32.1 Credit quality analysis (continued)

	31 December 2017			
	Stage 1: 12 - month ECL BD '000	*Stage 2: Lifetime ECL not credit - impaired BD '000*	*Stage 3: Lifetime ECL credit - impaired BD '000*	*Total BD '000*
Loans and advances to customers				
Commercial loans and overdrafts at amortised cost				
High (Grade 1 to 3)	174,550	751	-	175,301
Standard (Grade 4 to 6)	725,813	202,911	-	928,724
Substandard (Grade 7 to 8)	16,464	120,795	-	137,259
Non-performing (Grade 9 to 10)	-	-	96,353	96,353
	916,827	324,457	96,353	1,337,637
Loss allowance / ECL	(4,629)	(30,933)	(58,026)	(93,588)
Net carrying amount	912,198	293,524	38,327	1,244,049

	31 December 2018			
	Stage 1: 12 - month ECL BD '000	***Stage 2: Lifetime ECL not credit - impaired BD '000***	***Stage 3: Lifetime ECL credit - impaired BD '000***	***Total BD '000***
Loans and advances to customers				
Consumer loans at amortised cost				
High (Grade 1 to 3)	**523,768**	**-**	**-**	**523,768**
Standard (Grade 4 to 6)	**-**	**8,403**	**-**	**8,403**
Substandard (Grade 7 to 8)	**-**	**10,939**	**-**	**10,939**
Non-performing (Grade 9 to 10)	**-**	**-**	**10,429**	**10,429**
	523,768	**19,342**	**10,429**	**553,539**
Loss allowance / ECL	**(5,078)**	**(4,676)**	**(5,545)**	**(15,299)**
Net carrying amount	**518,690**	**14,666**	**4,884**	**538,240**

	31 December 2017			
	Stage 1: 12 - month ECL BD '000	*Stage 2: Lifetime ECL not credit - impaired BD '000*	*Stage 3: Lifetime ECL credit - impaired BD '000*	*Total BD '000*
Loans and advances to customers				
Consumer loans at amortised cost				
High (Grade 1 to 3)	478,888	-	-	478,888
Standard (Grade 4 to 6)	-	12,544	-	12,544
Substandard (Grade 7 to 8)	-	12,731	-	12,731
Non-performing (Grade 9 to 10)	-	-	11,178	11,178
	478,888	25,275	11,178	515,341
Loss allowance / ECL	(4,152)	(6,351)	(8,236)	(18,739)
Net carrying amount	474,736	18,924	2,942	496,602

32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)

32.1 Credit quality analysis (continued)

	31 December 2018			
	Stage 1: 12 - month ECL BD '000	*Stage 2: Lifetime ECL not credit - impaired BD '000*	*Stage 3: Lifetime ECL credit - impaired ** BD '000*	*Total BD '000*
Debt investment securities at FVOCI				
High (AAA to A-)	**144,526**	**-**	**-**	**144,526**
Standard (BBB+ to B-) *	**308,837**	**138,131**	**-**	**446,968**
Total	**453,363**	**138,131**	**-**	**591,494**
Loss allowance / ECL	**(145)**	**(340)**	**-**	**(485)**
Net carrying amount	**453,218**	**137,791**	**-**	**591,009**
Debt investment securities at amortised cost *				
High (AAA to A-)	**74,254**	**-**	**-**	**74,254**
Standard (BBB+ to B-) *	**458,595**	**18,789**	**-**	**477,384**
Total	**532,849**	**18,789**	**-**	**551,638**
Loss allowance / ECL	**(5)**	**-**	**-**	**(5)**
Net carrying amount	**532,844**	**18,789**	**-**	**551,633**
Loan commitments & financial guarantees				
High (Grade 1 to 3)	**112,954**	**-**	**-**	**112,954**
Standard (Grade 4 to 6)	**160,720**	**43,158**	**-**	**203,878**
Substandard (Grade 7 to 8)	**635**	**61,296**	**-**	**61,931**
Non-performing (Grade 9 to 10)	**-**	**-**	**5,870**	**5,870**
Total	**274,309**	**104,454**	**5,870**	**384,633**
Loss allowance / ECL	**(525)**	**(461)**	**-**	**(986)**
Net carrying amount	**273,784**	**103,993**	**5,870**	**383,647**

** These off-balance sheet exposures mainly include performance guarantees.

32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)

32.1 Credit quality analysis (continued)

	31 December 2017			
	Stage 1: 12 - month ECL BD '000	*Stage 2: Lifetime ECL not credit - impaired BD '000*	*Stage 3: Lifetime ECL credit - impaired BD '000*	*Total BD '000*
Debt investment securities at FVOCI				
High (AAA to A-)	169,790	-	-	169,790
Standard (BBB+ to B-) *	239,283	161,480	-	400,763
Total	409,073	161,480	-	570,553
Loss allowance / ECL	(83)	(532)	-	(615)
Net carrying amount	408,990	160,948	-	569,938
Debt investment securities at amortised cost				
High (AAA to A-)	64,251	-	-	64,251
Standard (BBB+ to B-) *	449,049	23,720	-	472,769
Total	513,300	23,720	-	537,020
Loss allowance / ECL	(4)	-	-	(4)
Carrying amount	513,296	23,720	-	537,016
Loan commitments & financial guarantees				
High (Grade 1 to 3)	112,579	-	-	112,579
Standard (Grade 4 to 6)	192,760	31,459	-	224,219
Substandard (Grade 7 to 8)	6,887	40,407	-	47,294
Non-performing (Grade 9 to 10)	-	6	1,447	1,453
Total	312,226	71,872	1,447	385,545
Loss allowance / ECL	(564)	(844)	-	(1,408)
Net carrying amount	311,662	71,028	1,447	384,137

* Standard grade includes unrated investments amounting to BD 6,149 thousand (2017: BD 1,469 thousand).

The following table sets out the credit analysis for non-trading financial assets measured at FVTPL:

	2018 BD '000	*2017 BD '000*
Debt investment securities		
High (AAA to A-)	**-**	3,266
Standard (BBB+ to B-)	**752**	-
Total carrying amount	**752**	3,266

32.2 Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For commercial lending, charges over real estate properties and bank guarantees;
- For retail lending, mortgages over residential properties;
- Cash collaterals such as bank deposits; and
- Marketable securities.

32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)

32.2 Collateral and other credit enhancements (continued)

The Group also obtains guarantees from parent companies for loans to their subsidiaries.

The Group monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for business use.

The Group holds collateral and other credit enhancements against certain of its credit exposures. The following table sets out the principal types of collateral held against different types of financial assets.

	2018	*2017*
	BD '000	*BD '000*
Derivative assets held for risk management	**9,165**	11,383
Loans and advances:		
- Cash	**60,916**	116,792
- Mortgage lending	**978,694**	806,957
- Financial Instruments	**42,409**	34,686
- Others*	**80,571**	8,684

* Others include assignments of right, bank guarantees, general documents, insurance policies, offering letters, promissory notes, term loan agreements and tugs and ships.

32.3 Inputs, assumptions and techniques used for estimating impairment

(a) Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Group's historical experience and expert credit assessment and including forward-looking information.

(b) Credit risk grades

The Group allocates each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgment. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower. Credit risk grades are defined and calibrated such that the risk of default occurring increases exponentially as the credit risk deteriorates. Each exposure is allocated to a credit risk grade at initial recognition based on available information about the borrower. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade.

(c) Generating the term structure of Probability of Default (PD)

Credit risk grades are a primary input into the determination of the term structure of PD for exposures. The Group collects performance and default information about its Credit risk exposures analysed by credit risk grading for Corporate and days-past-due for Retail portfolio. The Group employs statistical models to analyse the data collected and generate estimates of PD of exposures and how these are expected to change as a result of the passage of time. This analysis includes the identification and calibration of relationships between changes in default rates and changes in key macro-economic factors, across various geographies in which the Bank has taken exposures. For most exposures, the key macro-economic indicators include: GDP Growth, Real Interest Rates, Unemployment, Domestic Credit Growth, Oil Prices, Central Government Revenue as Percentage of GDP and Central Government Expenditure as Percentage of GDP.

32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)

32.3 Inputs, assumptions and techniques used for estimating impairment (continued)

(d) Determining whether credit risk has increased significantly

In determining whether credit risk has increased significantly since initial recognition, the Group uses its internal credit risk grading system, external risk ratings, delinquency status of accounts, expert credit judgement and, where possible, relevant historical experience. The Group may also determine that an exposure has undergone a significant increase in credit risk based on particular qualitative indicators that it considers are indicative of such, and whose effect may not otherwise be fully reflected in its quantitative analysis on a timely basis. As a backstop, the Group considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due.

The Group monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- The criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- The criteria do not align with the point in time when an asset becomes 30 days past due; and
- There is no unwarranted volatility in loss allowance from transfers between 12-month PD (Stage 1) and lifetime PD (Stage 2).

(e) Renegotiated / Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognised and the renegotiated loan recognised as a new loan at fair value. Where possible, the Group seeks to restructure loans rather than to take possession of collateral, if available. This may involve extending the payment arrangements and documenting the agreement of new loan conditions. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur.

The accounts which are restructured due to credit reasons in the past 12 months will be classified under Stage 2. The 12 month period is sufficient to test the adequacy of the cash flows and to test satisfactory performance under the revised terms of restructuring.

(f) Definition of default and cure

The Group considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. Objective evidence that a financial asset is credit-impaired may include a breach of contract, such as default or delinquency in interest or principal payments, indications that it is probable that the borrower will enter bankruptcy or other significant financial reorganisation, the disappearance of an active market, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the Group. Financial assets are written off after all restructuring and collection activities have taken place and there is no realistic prospect of recovery.

The Group considers a financial asset to be in default when:

- The borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as realising security (if any security is held);
- The borrower is past due more than 90 days on any credit obligation to the Group; and
- The borrower is rated 9 or 10 as per the Group's credit rating model.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances. The definition of default largely aligns with that applied by the Group for regulatory capital purposes.

A financial instrument is considered as ‘cured’ and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least twelve consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)

32.3 Inputs, assumptions and techniques used for estimating impairment (continued)

(g) Incorporation of forward-looking information

The Group employs statistical models to incorporate macro-economic factors on historical default rates. In case none of the above macroeconomic parameters are statistically significant or the results of forecasted PD's are significantly deviated from the present forecast of the economic conditions, qualitative PD overlays shall be used by management after analyzing the portfolio as per the diagnostic tool.

Incorporating forward looking information increases the level of judgment as to how changes in these macroeconomic factors will affect the Expected Credit Loss (ECL) applicable to the Stage 1 and Stage 2 exposures which are considered as performing (Stage 3 are the exposures under the default category). The methodologies and assumptions involved, including any forecasts of future economic conditions, are reviewed periodically.

(h) Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

i) Probability of default (PD);
ii) Loss given default (LGD); and
iii) Exposure at default (EAD).

These parameters are generally derived from internally developed statistical models and other historical data. They are adjusted to reflect forward-looking information as described above.

PD estimates are estimates at a certain date, which are calculated based on statistical rating models. These statistical models are based on internally compiled data comprising both quantitative and qualitative factors. Market data is used to derive the PD for banks and sovereign counterparties. If a counterparty or exposure migrates between rating PDs are estimated considering the residual maturities of exposures and estimated prepayment rates.

LGD is the magnitude of the likely loss if there is a default. The Group estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the forecasted collateral value and recovery costs of any collateral that is integral to the financial asset.

LGD estimations are estimations of :
1- Cure Rate: Defined as the ratio of accounts which have fallen to default and have managed to move backward to the performing accounts.
2- Recovery Rate: Defined as the ratio of liquidation value to market value of the underlying collateral at the time of default would also account for expected recovery rate from a general claim on the individual's assets for the unsecured portion of the exposure.
3- Discounting Rate: Defined as the opportunity cost of the recovery value not being realized on the day of default adjusted for-time value.

EAD represents the expected exposure in the event of a default. The Group derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract including amortisation. The EAD of a financial asset is its gross carrying amount. For lending commitments and financial guarantees, the EAD includes the amount drawn, as well as potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts.

The contractual life have been considered as maturity for ECL computation for the assets with fixed maturity whereas, for revolving and overdraft loans a maturity of 3 years (Stage 2) and 1 year (Stage 1) shall be considered based upon the stage under which asset lies.

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics and counterparty type that include:

i) Credit risk gradings;
ii) Product type; and
iii) Geographic location of the borrower.

32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)

32.3 Inputs, assumptions and techniques used for estimating impairment (continued)

(h) Measurement of ECL (continued)

The groupings are subject to regular review to ensure that exposures within a particular group remain appropriately homogeneous.

For portfolios in respect of which the Group has limited historical data, external benchmark information is used to supplement the internally available data. The portfolios for which external benchmark information represents a significant input into measurement of ECL are as follows.

i) Banks and financial institutions;
ii) Sovereign; and
iii) Investment securities (debt instruments).

33 CARRYING AMOUNT OF FINANCIAL ASSETS WHOSE TERMS HAVE BEEN RENEGOTIATED

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

The table below shows the carrying amount for financial assets by class that are renegotiated during the year:

	2018	*2017*
	BD '000	*BD '000*
Loans and advances to customers		
Commercial loans	**42,151**	83,884
Consumer loans	**3,099**	5,855
	45,250	89,739

34 MARKET RISK

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

The Group has clearly defined policies for conducting investments (including trading investments) and foreign exchange business which stipulates limits for these activities. Investments are made strictly in accordance with investment acceptance criteria. The Group does not undertake any commodity trading activities. For management of market risk arising from movement in interest rates, refer to note 35.

The Group uses an internal Value-at-Risk (VaR) model for measuring general market risk in the trading book of the Group and all foreign exchange positions. The internal model was approved by the Central Bank of Bahrain. VaR is calculated using a 99% confidence level for a 10 day holding period. This implies a 1% possibility of the loss exceeding the VaR amount calculated by the model. As at 31 December, VaR calculated based on the above parameters was as follows:

	2018	*2017*
	BD '000	*BD '000*
Foreign exchange	**199**	147
Interest rate	**2**	2
	201	149

34 MARKET RISK (continued)

The Bank's Risk Management Department conducts backtesting in accordance with the Market Risk Capital Adequacy Regulations issued by the Central Bank of Bahrain to ensure that the VaR model and assumptions used for computing VaR numbers are reliable. Backtesting of 1 day VaR as per actual profit and loss (comparing 1 day VaR with the average actual daily profit and loss) and also hypothetical back testing (comparing 1 day VaR with derived profit and loss of static positions) is carried out on a daily basis as stipulated in the Central Bank of Bahrain Rule book. The objective is to ensure that the assumptions used for computing VaR are reasonable and provide a VaR number that is a good indicator of possible losses in trading positions. During the year, the backtesting produced satisfactory results.

The Group also conducts stress testing to identify events or influences that could greatly impact material trading positions taken by the Group. As per the CBB requirements, validation of the internal model is conducted by the Internal Audit Department of the Bank as well as by an external consultant.

35 INTEREST RATE RISK

Interest rate risk is the exposure of the Group's financial condition to adverse movements of interest rates. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off statement of financial position instruments that mature or re-price in a given period. Excessive interest rate risk can pose a significant threat to the Group's earnings and capital base. Accordingly, an effective risk management process that maintains interest rate risk within prudent levels is essential to the safety and soundness of the Group.

It is the Group's policy to keep its assets and liabilities mismatches at stable and acceptable levels to maintain a steady net interest income. The Group monitors interest rate risk based on gap/ duration limits. The Group also uses ‘what if’ scenarios for projecting net interest income and economic value of equity of the Group. The Group uses derivative instruments such as interest rate swaps, and foreign exchange agreements to manage interest rate risk. Whilst day to day management of interest rate risk is responsibility of the Global Treasurer, ALMC also reviews the interest rate risk reports periodically.

Based on the consolidated statement of financial position as at 31 December 2018 an increase of 200 basis points in interest rates, with all variables held constant, will result in an increase in the net interest income, for the following next 12 months, by approximately BD 22,568 thousand (2017: increase by BD 17,738 thousand). However, further downward movement of interest rates by 200 basis points might not be practical assumption in the current environment, given the current low levels of interest rates, and hence capping the downward movement of interest rates at 0%, the negative impact on the net interest income as at 31 December 2018 of BD 22,452 thousand (2017: BD 16,115 thousand). On the other hand, the scope for interest rates increase from its current levels is most probable which the Bank shall benefit.

Rate Shock Forecasting (+200 bps)	***2018 BD ’000***	*2017 BD ’000*	***Rate Shock Forecasting (-200 bps)***	***2018 BD ’000***	*2017 BD ’000*
BHD	**12,010**	11,557	BHD	**12,010**	11,557
USD	**10,448**	5,468	USD	**10,448**	4,269
KWD	**919**	1,471	KWD	**803**	1,047
Others	**(809)**	(758)	Others	**(809)**	(758)
Total	**22,568**	17,738	**Total**	**22,452**	16,115

An increase of 200 basis point in interest rates, with all other variables held constant, will result in a negative impact on capital of approximately 4.6% amounting to BD 24,160 thousand (2017: 7.2%, BD 37,955 thousand). Similarly, a decrease of 200 basis point in interest rates, with all other variables held constant, will result in a positive impact on capital of approximately 4.6% amounting to BD 24,160 thousand (2017: 7.2%, BD 37,955 thousand).

36 CURRENCY RISK

Currency risk is the risk that the functional currency value of a financial instrument will fluctuate due to changes in foreign exchange rates. The functional currency of the Group is the Bahraini Dinar.

The Group had the following significant non-strategic net exposures denominated in foreign currencies as of the consolidated statement of financial position date:

	2018 BD '000 equivalent long (short)	*2017 BD '000 equivalent long (short)*
US dollar	**82,825**	63,540
Euro	**3,387**	147
GCC currencies (excluding Kuwaiti dinar)	**12,695**	2,886
Kuwaiti dinar	**(614)**	1,039
Others	**(1,127)**	285

As the Bahraini dinar and other GCC currencies (except the Kuwaiti dinar) are pegged to the US dollar (US$), positions in US$ and other GCC currencies are not considered to represent a significant currency risk. For currency sensitivity impact refer to VaR (note 34).

The Board of Directors has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on a daily basis to ensure that they are maintained within established limits. The Group uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks.

37 EQUITY PRICE RISK

Equity price risk is the risk that the fair values of equities or managed funds decrease as a result of changes in the corresponding value of equity indices or the value of individual equity stocks. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

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

	Trading Equities		*Effect on equity*		
	2018 BD '000	*2017 BD '000*	*% in Index*	***Total 2018 BD '000***	*Total 2017 BD '000*
Bahrain Bourse	**11,460**	9,160	± 15%	**1,719**	1,374
Other stock exchanges	**26,804**	26,082	± 15%	**4,021**	3,912
				5,740	5,286

38 LIQUIDITY RISK

Liquidity risk is the risk that the Group will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. To guard against this risk, the Group has diversified funding sources, assets are managed with liquidity in mind and liquidity positions are monitored, maintaining a healthy balance of cash, cash equivalents, and readily marketable securities. In addition, the Group maintains various statutory deposits with central banks and has taken lines of credit from various banks and financial institutions.

38 LIQUIDITY RISK (continued)

The Bank has in place a liquidity risk policy, which describes the roles and responsibilities of ALMC and Treasury, and stipulates the broad guidelines with regard to minimum liquid assets to be maintained by the Bank, gap limits for time bucket of the maturity ladder, cumulative outflow of cash limits for time buckets and various liquidity ratios to be maintained which are approved by the ALMC based on the Annual Liquidity Strategy.

It is the Bank's policy to keep its assets in high-quality liquid assets such as inter-bank placements, treasury bills and government bonds, to ensure that funds are available to meet maturing liabilities, undrawn facilities and deposit withdrawals as they fall due for payment. A substantial proportion of the Bank's deposits is made up of retail current, savings and fixed deposit accounts which, though payable on demand or at short notice, have traditionally formed part of a stable deposit base and a source of core funding.

The day to day management of liquidity risk is the responsibility of the Global Treasurer, who monitors the sources and maturities of assets and liabilities closely and ensures that limits stipulated by the ALMC are complied with, and that funding is not concentrated from any one source.

The Bank also draws up contingency plans to deal with extraordinary conditions of liquidity risk after comprehensive scenario analysis.

38 LIQUIDITY RISK (continued)

The table below summarizes the maturity profile of the Group's financial liabilities (including interest) based on contractual undiscounted repayment obligations.

31 December 2018	BD '000									
	On Demand	*Within 1 month*	*1 to 3 months*	*3 to 6 months*	*6 to 12 months*	*1 to 5 years*	*5 to 10 years*	*10 to 20 years*	*than 20 years*	*Total*
Deposits and due to banks and other financial institutions	109,761	47,093	70,732	32,712	159	1,207	-	-	-	261,664
Borrowings under repurchase agreement	-	591	783	3,929	3,325	208,582	-	-	-	217,210
Term borrowings	-	-	2,558	-	2,558	147,113	-	-	-	152,229
Customers' current, savings and other deposits	1,104,193	243,049	161,670	366,735	446,086	100,772	2	-	-	2,422,507
Total undiscounted financial liabilities	1,213,954	290,733	235,743	403,376	452,128	457,674	2	-	-	3,053,610
Letter of Guarantees	231,625	-	-	-	-	-	-	-	-	231,625
Undrawn loan commitments	120,649	-	-	-	-	-	-	-	-	120,649
Derivative financial instruments										
Contractual amounts payable	-	(7,187)	(4,673)	(15,555)	(22,613)	(359,318)	(303,932)	(57,353)	(56,614)	(827,245)
Contractual amounts receivable	-	7,276	4,694	16,247	23,955	366,896	305,595	57,505	56,610	838,778
	-	89	21	692	1,342	7,578	1,663	152	(4)	11,533

31 December 2017	BD '000									
	On Demand	*Within 1 month*	*1 to 3 months*	*3 to 6 months*	*6 to 12 months*	*1 to 5 years*	*5 to 10 years*	*10 to 20 years*	*More than 20 years*	*Total*
Deposits and due to banks and other financial institutions	66,154	103,880	25,108	59	46	282	-	-	-	195,529
Borrowings under repurchase agreement	-	552	492	1,230	43,155	128,652	-	-	-	174,081
Term borrowings	-	-	2,947	48,637	2,668	158,820	-	-	-	213,072
Customers' current, savings and other deposits	1,249,748	354,293	297,100	277,695	214,300	272,698	6	-	-	2,665,840
Total undiscounted financial liabilities	1,315,902	458,725	325,647	327,621	260,169	560,452	6	-	-	3,248,522
Letter of Guarantees	230,620	-	-	-	-	-	-	-	-	230,620
Undrawn loan commitments	117,670	-	-	-	-	-	-	-	-	117,670
Derivative financial instruments										
Contractual amounts payable	-	(2,789)	(4,839)	(63,630)	(20,888)	(339,168)	(239,130)	(58,546)	(69,590)	(798,580)
Contractual amounts receivable	-	2,411	4,231	63,076	19,707	331,190	233,521	52,771	66,053	772,960
	-	(378)	(608)	(554)	(1,181)	(7,978)	(5,609)	(5,775)	(3,537)	(25,620)

39 FAIR VALUES OF FINANCIAL INSTRUMENTS

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The significant inputs for valuation of equities classified under Level 3 are annual growth rate of cash flows and discount rates and for funds it is the illiquidity discount. Lower growth rate and higher discount rate, illiquidity discount will result in a lower fair value. The impact on the consolidated statement of financial position or the consolidated statement of shareholders' equity would be immaterial if the relevant risk variables used to fair value the unquoted securities were altered by five per cent. There was no material changes in the valuation techniques used for the purpose of measuring fair value of investment securities as compared to the previous year.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy at 31 December 2018 and 2017:

31 December 2018	***Level 1***	***Level 2***	***Level 3***	***Total***
	BD'000	***BD'000***	***BD'000***	***BD'000***
Financial assets				
Bonds	**587,108**	**-**	**75**	**587,183**
Equities	**38,264**	**6,478**	**21,688**	**66,430**
Managed funds	**-**	**819**	**-**	**819**
Derivatives held for trading	**-**	**468**	**-**	**468**
Derivatives held as fair value hedges	**-**	**10,800**	**-**	**10,800**
	625,372	**18,565**	**21,763**	**665,700**
Financial liabilities				
Derivatives held for trading	**-**	**458**	**-**	**458**
Derivatives held as fair value hedges	**-**	**4,343**	**-**	**4,343**
	-	**4,801**	**-**	**4,801**

31 December 2017	*Level 1*	*Level 2*	*Level 3*	*Total*
	BD'000	*BD'000*	*BD'000*	*BD'000*
Financial assets				
Bonds	563,502	-	666	564,168
Equities	35,242	6,737	22,720	64,699
Managed funds	-	1,196	-	1,196
Derivatives held for trading	-	147	-	147
Derivatives held as fair value hedges	-	7,467	-	7,467
Derivatives held as cash flow hedges	-	100	-	100
	598,744	15,647	23,386	637,777
Financial liabilities				
Derivatives held for trading	-	647	-	647
Derivatives held as fair value hedges	-	5,992	-	5,992
	-	6,639	-	6,639

39 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Transfers between Level 1, Level 2 and Level 3
During the reporting year ended 31 December 2018, there were no transfers into or out of Level 3 fair value measurements.

The table below sets out the estimated carrying values and fair values of those on and off statement of financial position financial instruments carried at amortised cost where fair values are different from the carrying amounts shown in the consolidated financial statements:

	2018			*2017*		
	Carrying value BD '000	***Fair value BD '000***	***Difference BD '000***	*Carrying value BD '000*	*Fair value BD '000*	*Difference BD '000*
Financial liabilities						
Term borrowings	**144,542**	**140,617**	**(3,925)**	199,012	193,941	(5,071)
Financial assets						
Investment securities	**145,831**	**144,141**	**(1,690)**	118,923	117,233	(1,690)

The above financial liabilities and assets are Level 1 fair value.

The fair value of financial assets and financial liabilities approximate their carrying values, other than those disclosed in the table above.

40 SHARE - BASED PAYMENTS

The expense recognised for employee services received during the year is shown in the following table:

	2018 BD '000	*2017 BD '000*
Expense arising from equity-settled share-based payment transactions	**81**	1,242
Shares vested during the year	**(659)**	(543)

During 2010, the Nomination and Remuneration Committee of the Bank modified the employees stock option plans for the previously granted stock options. The existing plan was discontinued with effect from 31 March 2010. In 2014, the Bank adopted regulations concerning sound remuneration practices issued by the CBB and consequently revised its variable remuneration framework. The revised policy framework and incentive components were approved by the shareholders in their Annual General Meeting on 10 March 2015.

The new share plan has been combined with the newly revised remuneration framework mandated by the CBB and is revered to as Short-Term Incentive Plan (STIP) & Long-Term Incentive Plan (LTIP). Details of the plan are described below:

Short-Term & Long-Term Shares Incentive Plan
Long Term Incentive Shares are granted to Senior Managers and above, with more than 12 months service at the date of grant and meeting certain performance criteria. The shares granted are subject to the satisfaction of conditions relating to the Bank's net profit over a three year period and the employee being in employment at the end of the 3 year period (vesting period). Short Term Incentive Shares are granted to employees in line with CBB's Sound Remuneration Guidelines.

The Bank utilizes its existing treasury shares for both plans and may also choose to issue new shares to settle the share plan in the future. The price of the shares granted was equal to the market price of the Bank's shares on the grant date. As at 31 December 2018, there has been a transfer of 1,028,457 shares (2017: 4,636,928 shares) from treasury stock to BBK Employee Benefit Trust to meet the number of shares required for the STIP and LTIP.

41 CAPITAL ADEQUACY

The risk asset ratio calculated in accordance with the capital adequacy guidelines approved by the CBB, for the Group is as follows:

	2018	2017
	BD '000	*BD '000*
CET1 capital	**404,573**	408,784
Additional Tier 1 capital	**86,098**	86,098
Tier 2 capital	**29,729**	29,578
Total capital base (a)	**520,400**	524,460
Credit risk weighted exposure	**2,378,282**	2,366,212
Operational risk weighted exposure	**242,277**	226,425
Market risk weighted exposure	**37,613**	28,050
Total risk weighted exposure (b)	**2,658,172**	2,620,687
Capital adequacy (a/b*100)	**19.58%**	20.01%
Minimum requirement	**14.00%**	12.50%

Capital management

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

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

Basel III and capital management

The Bank has adopted the new Basel III Capital Adequacy Framework (Basel III) with effect from 1 January 2015 as per the guidelines issued by the CBB, which is enhancing the Bank's risk management process, supervisory review, disclosure standards and capital management.

The Bank has adopted the Standardized Approach in case of Credit Risk, the Internal Model Approach for Market Risk and the Basic Indicator Approach for Operational Risk.

The Bank has established its Internal Capital Adequacy Assessment Process (ICAAP) to provide policy guidance in Capital Planning and Capital Management. The Bank also uses Risk Adjusted Return on Capital (RAROC) model in its decision making process.

42 LEGAL AND OPERATIONAL RISK

Legal risk

Legal risk is the risk relating to losses due to legal or regulatory action that invalidates or otherwise precludes performance by the end user or its counterparty under the terms of the contract or related netting agreements.

The Group has developed preventive controls and formalised procedures to identify legal risks so that potential losses arising from non-adherence to laws and regulations, negative publicity, etc. are significantly reduced. The Group also has well established legal procedures to scrutinise product offerings and manage risks arising out of its transactions.

As at 31 December 2018, there was a legal case pending against the Group aggregating to BD 795 thousand (2017: BD 795 thousand). Based on the opinion of the Group's legal advisors, the management believes that no liability is likely to arise from these cases.

42 LEGAL AND OPERATIONAL RISK (continued)

Operational risk

Operational risk is the exposure to loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Group has clearly defined operations procedures for each of its products and services. It also has advanced computer systems that enable it to run operations with speed and accuracy.

The Operational Risk Department operates independently from other units of the Bank and reports to the Chief Risk Officer. It conducts regular reviews of all business areas of the Bank and reports control deficiencies and exceptions to the Bank's policies and procedures. It also recommends measures to mitigate operational risk, which are implemented by management immediately.

The Bank also has a contingency plan to take care of any failure of its computer systems. Regular back-ups are made for all important datasets, and stored outside the Bank’s premises. This ensures that in case of any system failure, the Bank will be able to continue its operations without losing critical data or business transactions. As part of its disaster recovery plan, the Bank has established a back-up site which would and operate during an emergency.

The Bank has a specific Business Continuity Plan ("BCP") unit. The main objective of the BCP is to ensure that in the event of full or partial disaster, the Bank should be able to continue providing essential services to customers, minimizing any adverse effects on the Bank’s business, through business impact analysis, business restoration plans and procedures, for the identified critical functions.

The Bank is using an operational risk management solution for monitoring operational risk, conducting risk and control self assessments and capturing operational loss data in accordance with Basel III / CBB guidelines.

The Bank's subsidiaries have similar contingency plans for their operations.

43 DEPOSIT PROTECTION SCHEME

Deposits held with the Bahrain operations of the Bank are covered by the Deposit Protection Scheme established by the CBB regulation concerning the establishment of the Deposit Protection Scheme and Deposit Protection Board. This scheme covers eligible "natural persons" (individuals) up to a maximum of BD 20,000 as set by the CBB requirements. A periodic contribution as mandated by CBB is paid by the Bank under the scheme.

44 STAFF SAVING SCHEME

This scheme is a contribution saving fund between the Bank and the employees of the Bank. It was introduced in January 1996 with the objective of providing the employees with a cash benefit upon resignation, retirement or death. Participation in the scheme is discretionary and the employee may contribute any amount. The Bank guarantees a corresponding contribution of an amount that is 3% higher provided that total Bank contribution is not in excess of 10% of the employees' salary. The employee becomes eligible for the full amount of the Bank contribution once the employee has completed 5 years of service, otherwise the entitlement is proportionately calculated. The scheme is managed by a committee, consisting of members from management and representatives nominated and selected by staff.

As at 31 December 2018, the total contribution fund including the earned income stands at BD 17,219 thousand (2017: BD 17,044 thousand). Out of the total fund amount, payment of the principal amount equal to BD 15,087 thousand (2017: BD 14,927 thousand) consisting of the respective staff and Bank’s contribution is guaranteed by the Bank to employees participating in the scheme within the applicable law. Out of the principal amount, BD 8,233 thousand (2017: BD 6,069 thousand) is invested in Bahraini Sovereign Bonds.

45 CLASSIFICATION OF ASSETS AND LIABILITIES

The following table provides a reconciliation between line items in the statement of financial position and categories of financial instruments.

31 December 2018	***Designated as at FVTPL BD '000***	***FVOCI – debt instrument BD '000***	***FVOCI – equity instruments BD '000***	***Amortised cost / others BD '000***	***Total BD '000***
Cash and balances with central banks	**-**	**-**	**-**	**191,028**	**191,028**
Treasury bills	**-**	**4,578**	**-**	**405,802**	**410,380**
Deposits and amounts due from banks and other financial institutions	**-**	**-**	**-**	**239,174**	**239,174**
Loans and advances to customers	**-**	**-**	**-**	**1,772,528**	**1,772,528**
Investment securities	**1,571**	**586,431**	**66,430**	**145,831**	**800,263**
Investments in associated companies and joint ventures	**-**	**-**	**-**	**62,935**	**62,935**
Interest receivable and other assets	**-**	**-**	**-**	**77,849**	**77,849**
Premises and equipment	**-**	**-**	**-**	**27,543**	**27,543**
Total assets	**1,571**	**591,009**	**66,430**	**2,922,690**	**3,581,700**
Deposits and amounts due to banks and other financial institutions	**-**	**-**	**-**	**258,676**	**258,676**
Borrowings under repurchase agreement	**-**	**-**	**-**	**198,997**	**198,997**
Term borrowings	**-**	**-**	**-**	**144,542**	**144,542**
Customers' current, savings and other deposits	**-**	**-**	**-**	**2,374,480**	**2,374,480**
Interest payable and other liabilities	**-**	**-**	**-**	**104,566**	**104,566**
Total liabilities	**-**	**-**	**-**	**3,081,261**	**3,081,261**

31 December 2017	*Designated as at FVTPL BD '000*	*FVOCI – debt instruments BD '000*	*FVOCI – equity instruments BD '000*	*Amortised cost / others BD '000*	*Total BD '000*
Cash and balances with central banks	-	-	-	469,436	469,436
Treasury bills	-	9,037	-	418,093	427,130
Deposits and amounts due from banks and other financial institutions	-	-	-	223,824	223,824
Loans and advances to customers	-	-	-	1,740,651	1,740,651
Investment securities	4,462	560,901	64,699	118,923	748,985
Investments in associated companies and joint ventures	-	-	-	46,958	46,958
Interest receivable and other assets	-	-	-	79,680	79,680
Premises and equipment	-	-	-	26,436	26,436
Total assets	4,462	569,938	64,699	3,124,001	3,763,100
Deposits and amounts due to banks and other financial institutions	-	-	-	193,472	193,472
Borrowings under repurchase agreement	-	-	-	161,314	161,314
Term borrowings	-	-	-	199,012	199,012
Customers' current, savings and other deposits	-	-	-	2,623,577	2,623,577
Interest payable and other liabilities	-	-	-	84,890	84,890
Total liabilities	-	-	-	3,262,265	3,262,265