

Arab Banking Corporation (B.S.C.)

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2017

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

Report on the audit of the consolidated financial statements

Opinion

We have audited the consolidated financial statements of Arab Banking Corporation (B.S.C.) ("the Bank") and its subsidiaries (together "the Group"), which comprise the consolidated statement of financial position as at 31 December 2017 and the consolidated statements of profit or loss, comprehensive income, cash flows and changes in equity for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

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

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements for the year ended 31 December 2017. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

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

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

Report on the audit of the consolidated financial statements (continued)

Key audit matters (continued)

Impairment provision for loans and advances

Key audit matter	How the key audit matter was addressed in the audit
<p>Risk: The Group exercises significant judgement using subjective assumptions when determining both the timing and the amounts of the impairment provision for loans and advances. Because of the significance of this judgement and the Group's exposure to loans and advances forming a major portion of the Group's assets, the audit of impairment provision for loans is a key area of focus. As at 31 December 2017, the gross loans and advances amounted to US\$ 15,901 million against which specific impairment provision of US\$ 376 million and collective impairment provision of US\$ 196 million were recorded. The basis of the impairment provision policy is presented in the summary of significant accounting policies and in note 8 to the consolidated financial statements.</p>	<p>For the relevant credit processes, we have performed test of controls over the monitoring processes of loans and advances to confirm the operating effectiveness of the key controls in place which identify the impaired loans and advances against which impairment provisions are required. We also performed test of controls over the Group's internal credit rating system.</p> <p>Where impairment provision was individually calculated, we tested a sample of loans and advances to ascertain whether the loss event (that is the point at which impairment is recognised) had been identified by performing substantive audit procedures in connection with impairment provisions recognised. Where impairment had been identified, we examined the forecasts of future cash flows prepared by the management to support the calculation of impairment provision, challenging the assumptions and comparing estimates to external evidence where available.</p> <p>For the collective impairment provision, we obtained an understanding of the methodology used by the Group to determine the collective impairment provisions, assessed the reasonableness of the underlying assumptions and the sufficiency of the data used by management.</p> <p>We also assessed whether the consolidated financial statements disclosures appropriately reflect the Group's exposure to credit risk.</p> <p>Refer to the critical accounting estimates and judgements, disclosures of loans and advances and credit risk management in notes 4, 8 and 23 to the consolidated financial statements.</p>

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

Report on the audit of the consolidated financial statements (continued)

Other information included in the Group's 2017 annual report

Other information consists of the information included in the Group's 2017 annual report, other than the consolidated financial statements and our auditor's report thereon. The Board of Directors is responsible for the other information. Prior to the date of this auditors' report, we obtained the Directors report which forms part of the annual report, and the remaining sections of the annual report are expected to be made available to us after that date.

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

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

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

Responsibilities of the Board of Directors for the consolidated financial statements

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

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

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

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

Report on the audit of the consolidated financial statements (continued)

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

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

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

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

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

Report on the audit of the consolidated financial statements (continued)

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

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

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

Report on other legal and regulatory requirements

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

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the 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 2017 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position; and
- d) satisfactory explanations and information have been provided to us by management in response to all our requests.

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



Partner's registration no: 117
11 February 2018
Manama, Kingdom of Bahrain

Arab Banking Corporation (B.S.C.)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 December 2017

All figures in US\$ Million

	<i>Note</i>	2017	2016
ASSETS			
Liquid funds	6	1,388	1,831
Trading securities		1,051	711
Placements with banks and other financial institutions		3,170	4,130
Securities bought under repurchase agreements	25	1,521	1,556
Non-trading securities	7	5,599	5,635
Loans and advances	8	15,329	14,683
Interest receivable		445	430
Other assets	10	873	1,053
Premises and equipment		123	112
TOTAL ASSETS		29,499	30,141
LIABILITIES			
Deposits from customers		16,755	14,270
Deposits from banks		3,408	5,870
Certificates of deposit		27	37
Securities sold under repurchase agreements	25	1,628	169
Interest payable		427	369
Taxation	11	58	94
Other liabilities	12	636	803
TERM NOTES, BONDS AND OTHER TERM FINANCING	13	2,148	4,269
Total liabilities		25,087	25,881
EQUITY			
Share capital	14	3,110	3,110
Statutory reserve		481	462
Retained earnings		939	859
Other reserves		(600)	(605)
EQUITY ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		3,930	3,826
Non-controlling interests		482	434
Total equity		4,412	4,260
TOTAL LIABILITIES AND EQUITY		29,499	30,141

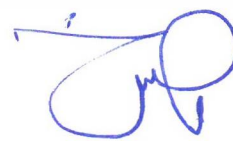
The consolidated financial statements were authorised for issue by the Board of Directors on 11 February 2018 and signed on their behalf by the Chairman, Deputy Chairman and the Group Chief Executive Officer.



Saddek El Kaber
Chairman



Hilal Mishari Al Mutairi
Deputy Chairman



Khaled Kawan
Group Chief Executive Officer

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


Arab Banking Corporation (B.S.C.)


CONSOLIDATED STATEMENT OF PROFIT OR LOSS

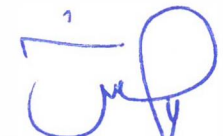
Year ended 31 December 2017

All figures in US\$ Million

	<i>Note</i>	2017	2016
OPERATING INCOME			
Interest and similar income	15	1,511	1,358
Interest and similar expense	16	(955)	(820)
Net interest income		556	538
Other operating income	17	313	327
Total operating income		869	865
Impairment provisions - net	9	(96)	(92)
NET OPERATING INCOME AFTER PROVISIONS		773	773
OPERATING EXPENSES			
Staff		311	291
Premises and equipment		37	33
Other		114	112
Total operating expenses		462	436
PROFIT BEFORE TAXATION		311	337
Taxation on foreign operations	11	(58)	(103)
PROFIT FOR THE YEAR		253	234
Profit attributable to non-controlling interests		(60)	(51)
PROFIT ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		193	183
BASIC AND DILUTED EARNINGS PER SHARE (EXPRESSED IN US\$)			
	30	0.06	0.06


Saddek El Kaber
Chairman


Hilal Mishari Al Mutairi
Deputy Chairman


Khaled Kawan
Group Chief Executive Officer

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

Arab Banking Corporation (B.S.C.)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2017

		All figures in US\$ Million	
	Note	2017	2016
PROFIT FOR THE YEAR		253	234
Other comprehensive income:			
Other comprehensive income that could be reclassified (or recycled) to profit or loss in subsequent periods:			
Net fair value movements during the year after impairment effect	14	16	(3)
Amortisation of fair value shortfall on reclassified securities	14	-	2
Unrealised loss on exchange translation in foreign subsidiaries		(23)	(61)
		(7)	(62)
Other comprehensive income that cannot be reclassified (or recycled) to profit or loss in subsequent periods:			
Net change in pension fund reserve		2	(12)
		2	(12)
Total other comprehensive loss for the year		(5)	(74)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		248	160
Total comprehensive income attributable to non-controlling interests		(50)	(108)
TOTAL COMPREHENSIVE INCOME ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		198	52

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

Arab Banking Corporation (B.S.C.)

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2017

All figures in US\$ Million

	Note	2017	2016
OPERATING ACTIVITIES			
Profit for the year		253	234
Adjustments for:			
Impairment provisions - net	9	96	92
Depreciation and amortisation		20	18
Gain on sale of premises and equipment - net		(5)	-
Gain on disposal of non-trading securities - net	17	(12)	(18)
Amortisation of fair value shortfall on reclassified securities	14	-	2
Changes in operating assets and liabilities:			
Treasury bills and other eligible bills		73	(90)
Trading securities		(356)	(87)
Placements with banks and other financial institutions		1,059	(258)
Securities bought under repurchase agreements		15	117
Loans and advances		(579)	(901)
Interest receivable and other assets		158	(106)
Deposits from customers		1,601	784
Deposits from banks		(2,552)	1,437
Securities sold under repurchase agreements		1,467	(412)
Interest payable and other liabilities		(59)	79
Other non-cash movements		(84)	(142)
Net cash from operating activities		<u>1,095</u>	<u>749</u>
INVESTING ACTIVITIES			
Purchase of non-trading securities		(2,185)	(4,908)
Sale and redemption of non-trading securities		2,321	4,689
Purchase of premises and equipment		(28)	(19)
Sale of premises and equipment		13	2
Investment in subsidiaries - net		4	3
Net cash from (used in) investing activities		<u>125</u>	<u>(233)</u>
FINANCING ACTIVITIES			
Issue of certificates of deposit - net		(8)	(3)
Issue of term notes, bonds and other term financing		175	400
Repayment of term notes, bonds and other term financing		(1,438)	(53)
Repurchase of term notes, bonds and other term financing	13	(199)	(16)
Dividend paid to the Group shareholders		(93)	-
Dividend paid to non-controlling interests		(29)	(27)
Net cash (used in) from financing activities		<u>(1,592)</u>	<u>301</u>
Net change in cash and cash equivalents		(372)	817
Effect of exchange rate changes on cash and cash equivalents		2	(78)
Cash and cash equivalents at beginning of the year		1,530	791
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	6	<u><u>1,160</u></u>	<u><u>1,530</u></u>

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

Arab Banking Corporation (B.S.C.)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2017

	Equity attributable to the shareholders of the parent							All figures in US\$ Million		
	Share capital	Statutory reserve	Retained earnings*	General reserve	Other reserves			Total	Non-controlling interests	Total equity
					Foreign exchange	Cumulative	Pension			
					translation adjustments	changes in fair value	fund reserve			
At 31 December 2015	3,110	444	693	100	(507)	(44)	(23)	3,773	335	4,108
Profit for the year	-	-	183	-	-	-	-	183	51	234
Other comprehensive (loss) income for the year	-	-	-	-	(118)	(1)	(12)	(131)	57	(74)
Total comprehensive income (loss) for the year	-	-	183	-	(118)	(1)	(12)	52	108	160
Transfers during the year	-	18	(18)	-	-	-	-	-	-	-
Other equity movements in subsidiaries	-	-	1	-	-	-	-	1	(9)	(8)
At 31 December 2016	3,110	462	859	100	(625)	(45)	(35)	3,826	434	4,260
Profit for the year	-	-	193	-	-	-	-	193	60	253
Other comprehensive (loss) income for the year	-	-	-	-	(13)	16	2	5	(10)	(5)
Total comprehensive income (loss) for the year	-	-	193	-	(13)	16	2	198	50	248
Dividend	-	-	(93)	-	-	-	-	(93)	-	(93)
Transfers during the year	-	19	(19)	-	-	-	-	-	-	-
Other equity movements in subsidiaries	-	-	(1)	-	-	-	-	(1)	(2)	(3)
At 31 December 2017	3,110	481	939	100	(638)	(29)	(33)	3,930	482	4,412

* Retained earnings include non-distributable reserves arising from consolidation of subsidiaries amounting to US\$ 424 million (2016: US\$ 419 million).

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

1 INCORPORATION AND ACTIVITIES

Arab Banking Corporation (B.S.C.) ['the Bank'] is incorporated in the Kingdom of Bahrain by an Amiri decree and operates under a wholesale banking licence issued by the Central Bank of Bahrain [CBB]. The Bank is a Bahraini Shareholding Company with limited liability and is listed on the Bahrain Bourse. The Central Bank of Libya is the ultimate parent of the Bank and its subsidiaries (together 'the Group').

The Bank's registered office is at ABC Tower, Diplomatic Area, P.O. Box 5698, Manama, Kingdom of Bahrain. The Bank is registered under commercial registration number 10299 issued by the Ministry of Industry, Commerce and Tourism, Kingdom of Bahrain.

The Group offers a range of international wholesale banking services including Corporate Banking & Financial Institutions, Project & Structured Finance, Syndications, Treasury, Trade Finance services and Islamic Banking. Retail banking services are only provided in the MENA region.

2 BASIS OF PREPARATION

2.1 Statement of compliance

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

2.2 Accounting convention

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

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

2.3 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Group and its subsidiaries as at 31 December 2017. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

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

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

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

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

2 BASIS OF PREPARATION (continued)

2.3 Basis of consolidation (continued)

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

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

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

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS

3.1 Standards effective for the year

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in previous year, except for the adoption of the following amendments to IFRS, applicable to the Group, and which are effective from 1 January 2017:

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosure of changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). The Group has provided the information for both the current and the comparative period in note 32.

Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of deductible temporary difference related to unrealised losses. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount. The Group applied amendments retrospectively. However, their application has no effect on the Group's financial position and performance as the Group has no deductible temporary differences or assets that are in the scope of the amendments.

Annual Improvements Cycle - 2014-2016

These improvements include:

Amendments to IFRS 12 Disclosure of Interests in Other Entities: Clarification of the scope of disclosure requirements in IFRS 12

The amendments clarify that the disclosure requirements in IFRS 12, other than those in paragraphs B10–B16, apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified (or included in a disposal group that is classified) as held for sale. As at 31 December 2017, the Group did not have any held for sale assets and that these amendments did not affect the Group's consolidated financial statements.

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.2 Standards issued but not yet effective

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

IFRS 9 Financial Instruments

Introduction

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

Based on 31 December 2017 data and the current implementation status of IFRS 9 as described in further detail below, the Group estimates the adoption of IFRS 9 to lead to an overall reduction in the Group's total shareholders' equity of approximately 1%. This reduction is predominately driven by the impairment requirements of IFRS 9.

Classification and measurement

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

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

Having completed its assessment, the Group has concluded that:

- The majority of placement with banks and other financial institutions, loans and advances to customers and securities bought under repurchase agreements that are classified as loans and receivables under IAS 39 are expected to be measured at amortised cost under IFRS 9;
- Financial assets and liabilities held for trading and financial assets designated at FVTPL are expected to continue to be measured at FVTPL;

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.2 Standards issued but not yet effective (continued)

IFRS 9 Financial Instruments (continued)

Classification and measurement (continued)

- The majority of the debt securities classified as available for sale under IAS 39 are expected to be measured at FVOCI. Some securities, however, will be classified as FVTPL, either because of their contractual cash flow characteristics or the business model within which they are held;
- Debt securities classified as held to maturity are expected to continue to be measured at amortised cost.

Hedge accounting

IFRS 9's hedge accounting requirements are designed to align the accounting more closely to the risk management framework; permit a greater variety of hedging instruments; and remove or simplify some of the rule-based requirements in IAS 39. The elements of hedge accounting: fair value, cash flow and net investment hedges are retained. There is an option in IFRS 9 for an accounting policy choice to continue with the IAS 39 hedge accounting framework; the Group currently anticipates not applying this option. The Group is not expecting significant changes due to new hedge requirements.

Impairment of financial assets

Overview

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

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

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

In comparison to IAS 39, the Group expects the impairment charge under IFRS 9 to be more volatile than under IAS 39 and to result in an increase in the total level of current impairment allowances.

The Group groups its loans into Stage 1, Stage 2 and Stage 3, based on the applied impairment methodology, as described below:

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

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.2 Standards issued but not yet effective (continued)

IFRS 9 Financial Instruments (continued)

Impairment of financial assets (continued)

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

For 'low risk' FVOCI debt securities and loans and advances, the Group intends to apply a policy which assumes that the credit risk on the instrument has not increased significantly since initial recognition and will calculate ECL as explained in Stage 1 below. Such instruments will generally include investment grade securities / loans where the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. The Group will not consider instruments / loans to have low credit risk simply because of the value of collateral.

Stage 1

Under IAS 39 the Group has been recording collective provision based on regulatory guidelines. These are designed to reflect impairment losses that had been incurred in the performing portfolio but have not been identified. Under IFRS 9, the impairment of financial assets that are not considered to have suffered a significant increase in their credit risk will be measured on a 12-month ECL basis.

Stage 2

IFRS 9 requires financial assets to be classified in Stage 2 when their credit risk has increased significantly since their initial recognition. For these assets, a loss allowance needs to be recognised based on their lifetime ECLs. Since this is a new concept compared to IAS 39, it will result in increased allowance as most such assets are not considered to be credit-impaired under IAS 39.

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

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

When estimating lifetime ECLs for undrawn loan commitments, the Group will:

- Estimate the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment; and
- Calculate the present value of cash shortfalls between the contractual cash flows that are due to the entity if the holder of the loan commitment draws down that expected portion of the loan and the cash flows that the entity expects to receive if that expected portion of the loan is drawn down.

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.2 Standards issued but not yet effective (continued)

IFRS 9 Financial Instruments (continued)

Impairment of financial assets (continued)

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

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

Stage 3

Financial assets will be included in Stage 3 when there is objective evidence that the loan is credit impaired. The criteria of such objective evidence are the same as under the current IAS 39 methodology. Accordingly, the Group expects the population to be generally the same under both standards.

Loans in Stage 3, where the Group calculated the IAS 39 impairment on an individual basis will continue to be calculated on the same basis.

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

Forward looking information

The Group will incorporate forward-looking information in the measurement of ECLs.

The Group considers forward-looking information such as macroeconomic factors (e.g., GDP growth, oil prices, country's equity indices, unemployment and interest rates) and economic forecasts. To evaluate a range of possible outcomes, the Group intends to formulate three scenarios: a base case, an upward and a downward scenario. The base case scenario represents the more likely outcome resulting from the Group's normal financial planning and budgeting process, while the upward and downward scenarios represent more optimistic or pessimistic outcomes. For each scenario, the Group will derive an ECL and apply a probability weighted approach to determine the impairment allowance.

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

Limitation of estimation techniques

The models applied by the Group may not always capture all characteristics of the market at a point in time as they cannot be recalibrated at the same pace as changes in market conditions. Interim adjustments are expected to be made until the base models are updated. Although the Group will use data that is as current as possible, models used to calculate ECLs will be based on data that is up to date except for certain factors for which the data will be updated once it is available and adjustments will be made for significant events occurring prior to the reporting date. The governance over such adjustments is still in development.

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.2 Standards issued but not yet effective (continued)

IFRS 9 Financial Instruments (continued)

Impairment of financial assets (continued)

Experienced credit adjustment

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

IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers, effective for periods beginning on 1 January 2018 with early adoption permitted. IFRS 15 defines principles for recognising revenue and will be applicable to all contracts with customers. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (e.g., IFRS 9, and IFRS 16 Leases).

Revenue under IFRS 15 will need to be recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard will also specify a comprehensive set of disclosure requirements regarding the nature, extent and timing as well as any uncertainty of revenue and corresponding cash flows with customers.

The Group is not early adopting IFRS 15 and does not expect that it will have a significant impact on the consolidated financial statements.

Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely, but an entity that early adopts the amendments must apply them prospectively. The Group will apply these amendments when they become effective.

IFRS 16 Leases

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

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date. Lessees must adopt IFRS 16 using either a full retrospective or a modified retrospective approach.

The Group does not anticipate early adopting IFRS 16 and is currently evaluating its impact.

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.2 Standards issued but not yet effective (continued)

Annual Improvements 2014-2016 Cycle (issued in December 2016)

These improvements include:

IAS 28 Investments in Associates and Joint Ventures - Clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice

The amendments clarify that:

- An entity that is a venture capital organisation, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at fair value through profit or loss.
- If an entity, that is not itself an investment entity, has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which: (a) the investment entity associate or joint venture is initially recognised; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent.

The amendments should be applied retrospectively and are effective from 1 January 2018, with earlier application permitted. If an entity applies those amendments for an earlier period, it must disclose that fact. These amendments are not applicable to the Group.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the transaction date for each payment or receipt of advance consideration. Entities may apply the amendments on a fully retrospective basis. Alternatively, an entity may apply the Interpretation prospectively to all assets, expenses and income in its scope that are initially recognised on or after:

- The beginning of the reporting period in which the entity first applies the interpretation or
- The beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the interpretation.

The Interpretation is effective for annual periods beginning on or after 1 January 2018. Early application of interpretation is permitted and must be disclosed. However, since the Group's current practice is in line with the Interpretation, the Group does not expect any effect on its consolidated financial statements.

3 NEW AND AMENDED STANDARDS AND INTERPRETATIONS (continued)

3.2 Standards issued but not yet effective (continued)

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 and does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses the following:

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

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Liquid funds

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

Cash and cash equivalents

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

Trading securities

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

Placements with banks and other financial institutions

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

Non-trading securities

These are classified as follows:

- Held to maturity;
- Available-for-sale; and
- Other non-trading securities.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Non-trading securities (continued)

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

Held to maturity

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

Available-for-sale

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

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

Other non-trading securities

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

Loans and advances

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

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

Derecognition of financial assets and financial liabilities

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) 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 the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Derecognition of financial assets and financial liabilities (continued)

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Investments in associates

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

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

Premises and equipment

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

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

Impairment and uncollectability of financial assets

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

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

Financial assets carried at amortised cost and loans and receivables

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment and uncollectability of financial assets (continued)

Financial assets carried at amortised cost and loans and receivables (continued)

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

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

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

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

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

Available-for-sale financial assets

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

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment and uncollectability of financial assets (continued)

Available-for-sale financial assets (continued)

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

Deposits

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

Repurchase and reverse repurchase agreements

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

Provisions

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

Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. 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 in 'impairment provisions - net'. The premium received is recognised in the consolidated statement of profit or loss in 'other income' on a straight line basis over the life of the guarantee.

Employee pension and other end of service benefits

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recognition of income and expenses

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

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

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

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. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan. When it is unlikely that a loan will be drawn down, the loan commitment fees are recognised over the commitment period on a straight line basis.

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

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

Fair value measurement

The Group measures financial instruments at fair value at each balance sheet date.

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

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair value measurement (continued)

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

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

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

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

- Level 1 valuation: Directly observable quotes for the same instrument (market prices).
- Level 2 valuation: Directly observable proxies for the same instrument accessible at valuation date (mark-to-model with market data).
- Level 3 valuation: Derived proxies (interpolation of proxies) for similar instruments that have not been observed (mark-to-model with deduced proxies).

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

Taxation on foreign operations

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

Foreign currencies

Transactions and balances

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

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

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

Group companies

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Trade and settlement date accounting

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

Derivatives and hedge accounting

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

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

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

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

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

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

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivatives and hedge accounting (continued)

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

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

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

Fiduciary assets

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

Offsetting

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

Term notes, bonds and other term financing

Issued financial instruments (or their components) are classified as liabilities under 'Term notes, bonds and other term financing', 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.

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

Significant accounting judgments, estimates and assumptions

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:

Going concern

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Significant accounting judgments, estimates and assumptions (continued)

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but if this is not available, judgment is required to establish fair values. Refer to note 22 for further disclosures.

Impairment losses on loans and advances

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

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

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

The impairment loss on loans and advances is disclosed in more detail in note 8.

Impairment losses on available-for-sale investments

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

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

All figures in US\$ Million

5 CLASSIFICATION OF FINANCIAL INSTRUMENTS

As at 31 December, financial instruments have been classified for the purpose of measurement under IAS 39 Financial Instruments: Recognition and Measurement as follows:

At 31 December 2017	Held for trading	Available-for-sale	Amortised cost/ Loans and receivables	Total
ASSETS				
Liquid funds	-	-	1,388	1,388
Trading securities	1,051	-	-	1,051
Placements with banks and other financial institutions	-	-	3,170	3,170
Securities bought under repurchase agreements	-	-	1,521	1,521
Non-trading securities *	-	5,368	231	5,599
Loans and advances	-	-	15,329	15,329
Interest receivable and other assets	196	-	1,105	1,301
	<u>1,247</u>	<u>5,368</u>	<u>22,744</u>	<u>29,359</u>
	Held for trading	Available-for-sale	Amortised cost	Total
LIABILITIES				
Deposits from customers	-	-	16,755	16,755
Deposits from banks	-	-	3,408	3,408
Certificates of deposit	-	-	27	27
Securities sold under repurchase agreements	-	-	1,628	1,628
Interest payable, taxation and other liabilities	180	-	941	1,121
Term notes, Bonds and other term financing	-	-	2,148	2,148
	<u>180</u>	<u>-</u>	<u>24,907</u>	<u>25,087</u>

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5 CLASSIFICATION OF FINANCIAL INSTRUMENTS (continued)

At 31 December 2016	Held for trading	Available-for-sale	Amortised cost/ Loans and receivables	Total
ASSETS				
Liquid funds	-	-	1,831	1,831
Trading securities	711	-	-	711
Placements with banks and other financial institutions	-	-	4,130	4,130
Securities bought under repurchase agreements	-	-	1,556	1,556
Non-trading securities *	-	4,631	1,004	5,635
Loans and advances	-	-	14,683	14,683
Interest receivable and other assets	435	-	1,030	1,465
	<u>1,146</u>	<u>4,631</u>	<u>24,234</u>	<u>30,011</u>
	Held for trading	Available-for-sale	Amortised cost	Total
LIABILITIES				
Deposits from customers	-	-	14,270	14,270
Deposits from banks	-	-	5,870	5,870
Certificates of deposit	-	-	37	37
Securities sold under repurchase agreements	-	-	169	169
Interest payable, taxation and other liabilities	369	-	897	1,266
Term notes, Bonds and other term financing	-	-	4,269	4,269
	<u>369</u>	<u>-</u>	<u>25,512</u>	<u>25,881</u>

* Included in the above are other non-trading securities amounting to US\$ nil (2016: US\$ 90 million) which were reclassified effective 1 July 2008.

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6 LIQUID FUNDS

	2017	2016
Cash on hand	33	37
Balances due from banks	263	242
Deposits with central banks	779	1,201
Treasury bills and other eligible bills with original maturities of three months or less	85	50
Cash and cash equivalents	1,160	1,530
Treasury bills and other eligible bills with original maturities of more than three months	228	301
	1,388	1,831

7 NON-TRADING SECURITIES

	2017			2016		
	Quoted	Unquoted*	Total	Quoted	Unquoted*	Total
Available-for-sale						
Debt securities	4,931	528	5,459	4,152	577	4,729
Equity securities	15	25	40	14	25	39
Held to maturity						
Debt securities	169	48	217	888	5	893
Other non-trading securities carried at amortised cost **	-	-	-	90	-	90
	5,115	601	5,716	5,144	607	5,751
Provisions against non-trading securities	(14)	(103)	(117)	(14)	(102)	(116)
	5,101	498	5,599	5,130	505	5,635

* Includes unquoted equity securities carried at cost amounting to US\$ 14 million (2016: US\$ 15 million) net of impairment provisions.

** The Group had identified assets, eligible under the 2008 amendment to IAS 39, for which it had a clear intent to hold for the foreseeable future. The assets were reclassified with retrospective effect as on 1 July 2008 in accordance with the amendment to IAS 39 and were reflected as other non-trading securities carried at amortised cost. All of these assets matured during the year.

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7 NON-TRADING SECURITIES (continued)

Provisions against non-trading securities are primarily due to the impact on collateralized debt obligations (mainly in North America) which were fully provided for in 2008.

The external ratings distribution of non-trading securities is given below:

	2017	2016
AAA rated debt securities	1,118	921
AA to A rated debt securities	1,874	1,744
Other investment grade debt securities	1,089	1,359
Other non-investment grade debt securities	1,368	1,550
Unrated debt securities	227	138
Equity securities	40	39
	<u>5,716</u>	<u>5,751</u>
Provisions against non-trading securities	(117)	(116)
	<u>5,599</u>	<u>5,635</u>

The movement in impairment provisions against non-trading securities during the year is as follows:

	2017	2016
At 1 January	116	120
Charge for the year	1	3
Write-offs	-	(7)
At 31 December	<u>117</u>	<u>116</u>

The gross amount of non-trading securities individually determined to be impaired, before deducting any individually assessed impairment losses, amounts to US\$ 119 million (2016: US\$ 119 million). Interest income received during the year on impaired securities amounted to US\$ 1 million. (2016: US\$ 1 million).

8 LOANS AND ADVANCES

Below is the classification of loans and advances by segment - net:

	2017	2016
i) By segment		
Corporate	14,290	13,838
Small and Medium Enterprises (SME)	1,022	880
Retail	589	536
	<u>15,901</u>	<u>15,254</u>
Loan loss provisions	(572)	(571)
	<u>15,329</u>	<u>14,683</u>

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8 LOANS AND ADVANCES (continued)

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

	2017	2016
i) By industrial sector		
Financial services	3,921	4,091
Other services	2,817	2,778
Manufacturing	2,127	3,609
Construction	1,265	1,007
Mining and quarrying	301	600
Transport	1,083	861
Personal/Consumer finance	698	641
Trade	1,362	754
Agriculture, fishing and forestry	1,398	398
Technology, media and telecommunications	381	216
Government	548	299
	15,901	15,254
Loan loss provisions	(572)	(571)
	15,329	14,683
	2017	2016
ii) Loan loss provisions by industrial sector		
Financial services	8	93
Other services	47	28
Manufacturing	33	63
Construction	59	44
Mining and quarrying	-	23
Transport	3	-
Personal/Consumer finance	23	21
Trade	172	77
Agriculture, fishing and forestry	7	7
Technology, media and telecommunications	22	22
Government	2	2
Collective impairment	196	191
	572	571

The movement in loan loss provisions during the year is as follows:

	Specific impairment		Collective impairment	
	2017	2016	2017	2016
At 1 January	380	408	191	183
Charge for the year	128	102	5	10
Write backs / recoveries	(38)	(23)	-	-
Write-offs	(88)	(49)	-	-
Foreign exchange translation and other adjustments	(6)	(58)	-	(2)
At 31 December	376	380	196	191

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8 LOANS AND ADVANCES (continued)

The gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance amounts to US\$ 554 million (2016: US\$ 632 million).

The fair value of collateral that the Group holds relating to loans individually determined to be impaired at 31 December 2017 amounts to US\$ 222 million (2016: US\$ 313 million).

At 31 December 2017, interest in suspense on past due loans amounts to US\$ 82 million (2016: US\$ 64 million).

9 IMPAIRMENT PROVISIONS - NET

During the year the Group has made the following provisions for impairment - net:

	2017	2016
Non-trading securities (note 7)	(1)	(3)
Loans and advances (note 8)	(95)	(89)
	<u>(96)</u>	<u>(92)</u>

10 OTHER ASSETS

	2017	2016
Trade receivables	242	236
Positive fair value of derivatives (note 19)	197	435
Assets acquired on debt settlement	112	43
Deferred tax assets	86	107
Bank owned life insurance	37	36
Margin dealing accounts	29	15
Staff loans	25	27
Advances and prepayments	20	28
Investments in associates	17	18
Others	108	108
	<u>873</u>	<u>1,053</u>

The negative fair value of derivatives amounting to US\$ 185 million (2016: US\$ 394 million) is included in other liabilities (note 12). Details of derivatives are given in note 19.

11 TAXATION ON FOREIGN OPERATIONS

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

	2017	2016
Consolidated statement of financial position		
Current tax liability	27	24
Deferred tax liability	31	70
	<u>58</u>	<u>94</u>
Consolidated statement of profit or loss		
Current tax on foreign operations	73	69
Deferred tax on foreign operations	(15)	34
	<u>58</u>	<u>103</u>
Analysis of tax charge		
At Bahrain (income tax rate of nil)	-	-
On profits of subsidiaries operating in other jurisdictions	62	54
(Credit) charge arising from tax treatment of hedging currency movements	(4)	49
	<u>58</u>	<u>103</u>
Income tax expense reported in the consolidated statement of profit or loss	<u>58</u>	<u>103</u>

The effective tax rates on the profit of subsidiaries in MENA and United Kingdom were 31% (2016: 27%) and 17% (2016: 14%) as against the actual tax rates of 11% to 36% (2016: 17.5% to 42.5%) and 19% (2016: 20%) respectively. In the bank's Brazilian subsidiary, the effective tax rate was 16% (2016: 38%) as against the actual tax rate of 40% (2016: 45%).

As reflected above, the tax credit for the year includes US\$ 4 million arising from the tax treatment of hedging currency movements (2016: tax charge of US\$ 49 million) on a certain transaction. For the purpose of determining the tax expense for the year, the accounting profit has been adjusted for tax purposes. After giving effect to these adjustments at the group level, the average effective tax rate is 19% (2016: 31%).

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

12 OTHER LIABILITIES

	2017	2016
Negative fair value of derivatives (note 19)	185	394
Employee related payables	130	113
Margin deposits including cash collateral	46	41
Cheques for collection	75	27
Deferred income	32	22
Accrued charges and other payables	168	206
	<u>636</u>	<u>803</u>

The positive fair value of derivatives amounting to US\$ 197 million (2016: US\$ 435 million) is included in other assets (note 10). Details of derivatives are given in note 19.

13 TERM NOTES, BONDS AND OTHER TERM FINANCING

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

Total obligations outstanding at 31 December 2017

	Currency	Rate of Interest	Parent bank	Subsidiaries	Total
Aggregate maturities					
2018	US\$	Libor + 1.24%	50	-	50
2018	US\$	Libor + 1.25%	50	-	50
2018	US\$	Libor + 0.90%	-	50	50
2019	EUR	Euribor+1.10%	-	60	60
2020*	US\$	7.875	-	143	143
2020	US\$	Libor + 1.20%	-	175	175
2021	US\$	Libor + 1.80%	290	-	290
2022	US\$	Libor + 2.25%	1,330	-	1,330
			1,720	428	2,148
Total obligations outstanding at 31 December 2016			3,653	616	4,269

* Subordinated

During the year ended 31 December 2017, the Bank repurchased a portion of its term loan borrowings with a nominal value of US\$ 199 million (2016: US\$ 16 million). The resultant net gain on the repurchase amounting to US\$ 1 million (2016 : nil) is included in "Other operating income". Refer note 17.

14 EQUITY

a) Share capital

	2017	2016
Authorised – 3,500 million shares of US\$ 1 each (2016: 3,500 million shares of US\$ 1 each)	3,500	3,500
Issued, subscribed and fully paid – 3,110 million shares of US\$ 1 each (2016: 3,110 million shares of US\$ 1 each)	3,110	3,110

b) Statutory reserve

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

c) General reserve

The general reserve underlines the shareholders' commitment to enhance the strong equity base of the Bank. There are no restrictions on the distribution of this reserve after obtaining approval of the Central Bank of Bahrain.

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14 EQUITY (continued)

d) Cumulative changes in fair value

	2017	2016
At 1 January	(45)	(44)
Transferred to consolidated statement of profit or loss on disposal	(11)	(17)
Net movement in fair value during the year	27	14
Amortisation of fair value shortfall on reclassified securities	-	2
At 31 December	<u>(29)</u>	<u>(45)</u>

15 INTEREST AND SIMILAR INCOME

	2017	2016
Loans and advances	864	742
Securities	407	380
Placements with banks and other financial institutions	232	228
Others	8	8
	<u>1,511</u>	<u>1,358</u>

16 INTEREST AND SIMILAR EXPENSE

	2017	2016
Deposits from banks	572	489
Deposits from customers	282	205
Term notes, bonds and other term financing	96	123
Certificates of deposit and others	5	3
	<u>955</u>	<u>820</u>

17 OTHER OPERATING INCOME

	2017	2016
Fee and commission income - net	194	192
Bureau processing income	37	43
Loss on dealing in derivatives - net	(14)	(20)
Gain on dealing in foreign currencies - net	50	87
Gain on disposal of non-trading securities - net	12	18
Gain (loss) on trading securities - net	15	(3)
Gain on repurchase of subordinated debt (note 13)	1	-
Gain on sale of premises and equipment - net	5	-
Other - net	13	10
	<u>313</u>	<u>327</u>

Included in the fee and commission income is US\$ 13 million (2016: US\$ 13 million) of fee income relating to trust and other fiduciary activities.

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18 GROUP INFORMATION

18.1 Information about subsidiaries

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

	Principal activities	Country of incorporation	Interest of Arab Banking Corporation (B.S.C.)	
			2017	2016
			%	%
ABC International Bank Plc	Banking	United Kingdom	100.0	100.0
ABC Islamic Bank (E.C.)	Banking	Bahrain	100.0	100.0
Arab Banking Corporation (ABC) - Jordan	Banking	Jordan	87.0	87.0
Banco ABC Brasil S.A.	Banking	Brazil	60.7	61.0
ABC Algeria	Banking	Algeria	87.7	87.7
Arab Banking Corporation - Egypt [S.A.E.]	Banking	Egypt	99.8	99.8
ABC Tunisie	Banking	Tunisia	100.0	100.0
Arab Financial Services Company B.S.C. (c)	Credit card services	Bahrain	55.9	54.7

18.2 Significant restrictions

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

18.3 Material partly-owned subsidiaries

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

Banco ABC Brasil S.A.

	2017	2016
Proportion of equity interest held by non-controlling interests (%)	39.3	39.0
Dividends paid to non-controlling interests	24	23

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

	2017	2016
Summarised statement of profit or loss:		
Interest and similar income	820	733
Interest and similar expense	(594)	(518)
Other operating income	142	154
Impairment provisions - net	(78)	(78)
Operating expenses	(132)	(113)
Profit before tax	158	178
Income tax	(25)	(67)
Profit for the year	133	111
Profit attributable to non-controlling interests	52	43
Total comprehensive income	112	151
Total comprehensive income attributable to non-controlling interests	44	59

18 GROUP INFORMATION (continued)

18.3 Material partly-owned subsidiaries (continued)

Banco ABC Brasil S.A. (continued)

	2017	2016
Summarised statement of financial position:		
Total assets	8,161	7,793
Total liabilities	7,132	6,875
Total equity	1,029	918
Equity attributable to non-controlling interests	404	358
Summarised cash flow information for the year ended:		
Operating activities	(55)	221
Investing activities	265	(215)
Financing activities	(207)	(17)
Net increase (decrease) in cash and cash equivalents	3	(11)

19 DERIVATIVES AND HEDGING

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

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

	2017			2016		
	Positive fair value	Negative fair value	Notional amount	Positive fair value	Negative fair value	Notional amount
Derivatives held for trading						
Interest rate swaps	60	45	4,956	47	42	3,389
Currency swaps	4	13	583	21	27	623
Forward foreign exchange contracts	11	7	4,127	79	33	4,200
Options	118	113	3,576	279	256	5,842
Futures	3	2	4,086	9	11	2,491
Forward rate agreements	-	-	-	-	-	50
	196	180	17,328	435	369	16,595
Derivatives held as hedges						
Interest rate swaps	-	-	2,120	-	-	1,678
Forward foreign exchange contracts	1	5	612	-	25	878
	1	5	2,732	-	25	2,556
	197	185	20,060	435	394	19,151
Risk weighted equivalents (credit and market risk)			1,738			1,774

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

19 DERIVATIVES AND HEDGING (continued)

Derivatives held as hedges include:

- a) Fair value hedges which are predominantly used to hedge fair value changes arising from interest rate fluctuations in loans and advances, placements, deposits, available-for-sale debt securities and subordinated loan of a subsidiary.

For the year ended 31 December 2017, the Group recognised a net gain of US\$ 18 million (2016: net gain of US\$ 54 million) on hedging instruments. The total loss on hedged items attributable to the hedged risk amounted to US\$ 18 million (2016: loss of US\$ 54 million).

- b) The Group uses deposits which are accounted for as hedges of net investment in foreign operations. As at 31 December 2017, the Group had deposits amounting to US\$ 649 million (2016: US\$ 588 million) which were designated as net investment hedges.

Derivative product types

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

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

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

Derivative related credit risk

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

Derivatives held or issued for trading purposes

Most of the Group's derivative trading activities relate to sales, positioning and arbitrage. Sales activities involve offering products to customers. Positioning involves managing market risk positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying and profiting from price differentials between markets or products. Also included under this heading are any derivatives which do not meet IAS 39 hedging requirements.

19 DERIVATIVES AND HEDGING (continued)

Derivatives held or issued for hedging purposes

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

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

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

20 CREDIT COMMITMENTS AND CONTINGENT ITEMS

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

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

	2017	2016
Short-term self-liquidating trade and transaction-related contingent items	3,437	2,843
Direct credit substitutes and guarantees	3,979	3,581
Undrawn loans and other commitments	2,179	2,166
	<u>9,595</u>	<u>8,590</u>
Risk weighted equivalents	<u>3,282</u>	<u>2,890</u>

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

	2017	2016
On demand	1,635	999
1 - 6 months	2,818	2,844
6 - 12 months	1,784	2,481
1 - 5 years	3,285	2,151
Over 5 years	73	115
	<u>9,595</u>	<u>8,590</u>

20 CREDIT COMMITMENTS AND CONTINGENT ITEMS (continued)

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

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

21 SIGNIFICANT NET FOREIGN CURRENCY EXPOSURES

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

Long (short)	2017		2016	
	Currency	US\$ equivalent	Currency	US\$ equivalent
Brazilian Real	2,039	616	1,816	558
Pound Sterling	(5)	(7)	(6)	(7)
Egyptian Pound	1,763	99	1,718	94
Jordanian Dinar	185	261	159	224
Algerian Dinar	14,810	129	14,224	129
Tunisian Dinar	6	2	2	1
Euro	5	6	2	2
Bahrain Dinar	7	18	(1)	(1)

22 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

22.1 31 December 2017

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

Financial assets measured at fair value:

	Level 1	Level 2	Total
Trading securities	1,051	-	1,051
Non-trading securities - available-for-sale			
Quoted debt securities	4,921	-	4,921
Unquoted debt securities	-	436	436
Quoted equity shares	4	-	4
Derivatives held for trading			
Interest rate swaps	-	60	60
Currency swaps	-	4	4
Forward foreign exchange contracts	-	11	11
Options	54	64	118
Futures	3	-	3
Derivatives held as hedges			
Interest rate swaps	-	-	-
Forward foreign exchange contracts	-	1	1

22 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

22.1 31 December 2017 (continued)

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

Financial liabilities measured at fair value:

	Level 1	Level 2	Total
Derivatives held for trading			
Interest rate swaps	-	45	45
Currency swaps	-	13	13
Forward foreign exchange contracts	-	7	7
Options	47	66	113
Futures	2	-	2
Derivatives held as hedges			
Interest rate swaps	-	-	-
Forward foreign exchange contracts	-	5	5

Fair values of financial instruments not carried at fair value

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

	Carrying value	Level 1	Level 2	Fair value
Financial assets				
Other non-trading securities	223	201	48	249
Financial liabilities				
Term notes, bonds and other term financing	2,148	154	2,005	2,159

22.2 31 December 2016

Quantitative disclosure of fair value measurement hierarchy for assets as at 31 December 2016:

Financial assets measured at fair value:

	Level 1	Level 2	Total
Trading securities	708	3	711
Non-trading securities - available-for-sale			
Quoted debt securities	4,142	-	4,142
Unquoted debt securities	-	485	485
Quoted equity shares	4	-	4
Derivatives held for trading			
Interest rate swaps	-	47	47
Currency swaps	-	21	21
Forward foreign exchange contracts	-	79	79
Options	228	51	279
Futures	9	-	9
Derivatives held as hedges			
Interest rate swaps	-	-	-
Forward foreign exchange contracts	-	-	-

22 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

22.2 31 December 2016 (continued)

Quantitative disclosure of fair value measurement hierarchy for liabilities as at 31 December 2016:

Financial liabilities measured at fair value:

	Level 1	Level 2	Total
Derivatives held for trading			
Interest rate swaps	-	42	42
Currency swaps	-	27	27
Forward foreign exchange contracts	-	33	33
Options	204	52	256
Futures	11	-	11
Derivatives held as hedges			
Interest rate swaps	-	-	-
Forward foreign exchange contracts	-	25	25

Fair values of financial instruments not carried at fair value

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

	Carrying value	Level 1	Level 2	Fair value
Financial assets				
Other non-trading securities	989	1,012	-	1,012
Financial liabilities				
Term notes, bonds and other term financing	4,269	707	3,573	4,280

Financial instruments in level 1

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the group is the current bid price. These instruments are included in Level 1. Instruments included in Level 1 comprise primarily DAX, FTSE 100 and Dow Jones equity investments classified as trading securities or available for sale.

Financial instruments in level 2

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

Transfers between level 1 and level 2

There were no transfers between level 1 and level 2 during the year ended 31 December 2017 (31 December 2016: none).

23 RISK MANAGEMENT

Introduction

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

Over the last few years the Group has invested heavily into developing a comprehensive and robust risk management infrastructure. This includes risk identification processes under credit, market and operational risk spectrums, risk measurement models and rating systems as well as a strong business process to monitor and control these risks.

Risk management structure

Executive Management is responsible for implementing the Group's Risk Strategy/Appetite and Policy Guidelines set by the Board Risk Committee (BRC), including the identification and evaluation on a continuous basis of all significant risks to the business and the design and implementation of appropriate internal controls to minimise them. This is done through the following board committees, senior management committees and the Credit & Risk Group in Head Office.

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

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

The Group's Head Office Credit Committee (HOCC) is responsible for credit decisions at the higher levels of the Group's lending portfolio, setting country and other high level Group limits, dealing with impaired assets and general credit policy matters.

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

The Group Operational Risk Management Committee ("GORCO") is responsible for defining long-term strategic plans and short-term tactical initiatives for the timely identification, prudent management, control and measurement of the Group's exposure to actual and emerging operational and other non-financial risks. GORCO frames policy and oversees the operational risk function. Specialist risk committees, such as the Group Compliance Oversight Committee, the Group Business Continuity Committee and the Group IT Risk Committee are responsible for the proper management of certain categories of non-financial risk.

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

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

23 RISK MANAGEMENT (continued)

Risk measurement and reporting system

Risk mitigation

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

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

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

Excessive risk concentration

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

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

Credit risk

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

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

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23 RISK MANAGEMENT (continued)

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

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

	Gross maximum exposure	
	2017	2016
Liquid funds	1,355	1,794
Trading debt securities	1,051	708
Placements with banks and other financial institutions	3,170	4,130
Securities bought under repurchase agreements	1,521	1,556
Non-trading debt securities	5,574	5,610
Loans and advances	15,329	14,683
Other credit exposures	1,301	1,465
	29,301	29,946
Credit commitments and contingent items (note 20)	9,595	8,590
Total	38,896	38,536

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

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

Risk concentration of the maximum exposure to credit risk

The Group's assets (before taking into account any collateral held or other credit enhancements), liabilities and equity and commitments and contingencies can be analysed by the following geographical regions:

	Assets		Liabilities and equity		Credit commitments and contingent items	
	2017	2016	2017	2016	2017	2016
Western Europe	3,163	4,043	2,157	987	1,550	1,220
Arab World	11,614	11,763	18,778	21,252	3,803	3,373
Asia	2,189	1,144	359	550	281	463
North America	3,058	3,234	977	927	540	580
Latin America	8,125	8,049	6,601	5,842	3,380	2,923
Other	1,152	1,713	429	388	41	31
Total	29,301	29,946	29,301	29,946	9,595	8,590

23 RISK MANAGEMENT (continued)

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

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

	<u>Gross maximum exposure</u>		<u>Net maximum exposure</u>	
	2017	2016	2017	2016
Financial services	9,580	11,541	8,048	9,572
Other services	5,387	5,136	5,359	5,108
Manufacturing	2,203	3,699	2,162	3,663
Construction	1,256	1,136	1,166	1,037
Mining and quarrying	307	643	307	643
Transport	1,136	926	1,136	926
Personal /Consumer finance	573	635	572	634
Trade	1,242	879	1,236	870
Agriculture, fishing and forestry	1,426	408	1,426	408
Technology, media and telecommunications	539	357	539	356
Government	5,652	4,586	5,482	4,544
Total	29,301	29,946	27,433	27,761

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

	<u>Gross maximum exposure</u>		<u>Net maximum exposure</u>	
	2017	2016	2017	2016
Financial services	3,214	3,240	3,049	2,933
Other services	2,198	1,722	2,193	1,717
Manufacturing	1,065	1,462	1,056	1,455
Construction	663	590	660	588
Mining and quarrying	203	462	203	462
Transport	332	268	332	268
Trade	567	545	564	543
Agriculture, fishing and forestry	181	24	181	24
Technology, media and telecommunications	128	225	127	225
Government	1,044	52	1,037	50
Total	9,595	8,590	9,402	8,265

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23 RISK MANAGEMENT (continued)

Credit quality per class of financial assets

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

31 December 2017	Neither past due nor impaired		Past due but not impaired	Past due and individually impaired	Total
	High grade	Standard grade			
Liquid funds	1,355	-	-	-	1,355
Trading debt securities	229	822	-	-	1,051
Placements with banks and other financial institutions	1,872	1,298	-	-	3,170
Securities bought under repurchase agreements	100	1,421	-	-	1,521
Non-trading debt securities	4,052	1,520	-	2	5,574
Loans and advances	4,423	10,656	72	178	15,329
Other credit exposures	1,036	265	-	-	1,301
	13,067	15,982	72	180	29,301
31 December 2016	Neither past due nor impaired		Past due but not impaired	Past due and individually impaired	Total
	High grade	Standard grade			
Liquid funds	1,794	-	-	-	1,794
Trading debt securities	-	708	-	-	708
Placements with banks and other financial institutions	3,121	1,009	-	-	4,130
Securities bought under repurchase agreements	148	1,408	-	-	1,556
Non-trading debt securities	4,062	1,545	-	3	5,610
Loans and advances	5,268	9,090	73	252	14,683
Other credit exposures	1,240	225	-	-	1,465
	15,633	13,985	73	255	29,946

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

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

	2017	2016
Loans and advances	239	294

23 RISK MANAGEMENT (continued)

Collateral and other credit enhancements

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

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

Settlement risk

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

Market risk

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

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

Interest rate risk

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

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

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

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23 RISK MANAGEMENT (continued)

Interest rate risk (continued)

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

	2016			
	Increase in basis points	Sensitivity statement of profit or loss	Decrease in basis points	Sensitivity statement of profit or loss
US Dollar	25	(2)	25	2
Euro	25	1	25	(1)
Pound Sterling	25	-	25	-
Brazilian Real	25	3	25	(3)
Others	25	4	25	(4)

Currency risk

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

The table below indicates the currencies to which the Group had significant exposure at 31 December 2017 and 31 December 2016 on its monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the US\$, with all other variables held constant on the consolidated statement of profit or loss (due to the fair value of currency sensitive trading and non-trading monetary assets and liabilities) and equity (due to the change in fair value of currency swaps and forward foreign exchange contracts used as fair value hedges) and the effect of the impact of foreign currency movements on the structural positions of the Bank in its subsidiaries. A negative amount in the table reflects a potential net reduction in the consolidated statement of profit or loss or equity, while a positive amount reflects a potential net increase.

Currency	2017			2016		
	Change in currency rate in %	Effect on profit before tax	Effect on equity	Change in currency rate in %	Effect on profit before tax	Effect on equity
Brazilian Real	+/- 5%	-	+/-31	+/- 5%	-	+/-28
Pound Sterling	+/- 5%	-	-	+/- 5%	-	-
Egyptian Pound	+/- 5%	-	+/-4	+/- 5%	+/-1	+/-4
Jordanian Dinar	+/- 5%	+/-4	+/-9	+/- 5%	+/-2	+/-9
Algerian Dinar	+/- 5%	-	+/-6	+/- 5%	-	+/-6
Tunisian Dinar	+/- 5%	-	-	+/- 5%	-	-
Euro	+/- 5%	-	-	+/- 5%	-	-
Bahrain Dinar	+/- 5%	+/-1	-	+/- 5%	-	-

23 RISK MANAGEMENT (continued)

Equity price risk

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

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

	2017		2016	
	% Change in equity price	Effect on statement of profit or loss/ equity	% Change in equity price	Effect on statement of profit or loss/ equity
Trading equities	+/- 5%	-	+/- 5%	-
Available-for-sale equities	+/- 5%	+/-1	+/- 5%	+/-1

Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes or systems or from external events. Operational risk is inherent in all business activities and can never be eliminated entirely; however shareholder value can be preserved and enhanced by managing, mitigating and, in some cases, insuring against operational risk. To achieve this goal the Operational Risk Management Unit has developed an operational risk framework, which includes identification, measurement, management, and monitoring and risk control/mitigation elements. A variety of underlying processes are being deployed across the Group including risk and control self-assessments, Key Risk Indicators (KRI), group-wide Control Standards, control environment scans and new product review & approval processes.

The Group intends to make operational risk transparent throughout the enterprise, to which end processes are being developed to provide for regular reporting of relevant operational risk management information to business management, senior management, the GORCO, the BRC and the Board of Directors generally.

Group policy dictates that the operational functions of booking, recording and monitoring of transactions are carried out by staff that are independent of the individuals initiating the transactions. Each business line – including Operations, Information Technology, Human Resources, Legal & Compliance and Finance - is further responsible for employing the aforementioned framework processes and control programmes to manage its operational risk within the guidelines established by the Group's policy and procedures. To ensure that all operational risks to which the Group is exposed are adequately managed, support functions are also involved in the identification, measurement, management, monitoring and control/mitigation of operational risk, as appropriate.

23 RISK MANAGEMENT (continued)

Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Group maintains liquid assets at prudential levels to ensure that cash can quickly be made available to honour all its obligations, even under adverse conditions. The Group is generally in a position of excess liquidity, its principal sources of liquidity being its deposit base, liquidity derived from its operations and inter-bank borrowings. The Minimum Liquidity Guideline (MLG) is used to manage and monitor daily liquidity. The MLG represents the minimum number of days the Group can survive the combined outflow of all deposits and contractual drawdowns, under market value driven encashability scenarios.

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

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2017 based on contractual undiscounted repayment obligations. See the next table for the expected maturities of these liabilities. Repayments which are subjected to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

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

23 RISK MANAGEMENT (continued)

Liquidity risk (continued)

At 31 December 2016	Within 1 month	1 - 3 months	3 - 6 months	6 - 12 months	1 - 5 years	5-10 years	10- 20 years	Total
Financial liabilities								
Deposits from customers	5,738	2,231	1,074	1,573	3,930	48	81	14,675
Deposits from banks	2,603	639	1,033	1,253	276	192	1	5,997
Securities sold under repurchase agreements	155	-	12	-	2	-	-	169
Certificates of deposits	9	1	5	10	12	-	-	37
Interest payable and other liabilities	929	45	42	67	86	3	-	1,172
Term notes, bonds and other term financing	-	64	1,155	955	1,114	1,554	-	4,842
Total non-derivative undiscounted financial liabilities on statement of financial position	<u>9,434</u>	<u>2,980</u>	<u>3,321</u>	<u>3,858</u>	<u>5,420</u>	<u>1,797</u>	<u>82</u>	<u>26,892</u>
ITEMS OFF STATEMENT OF FINANCIAL POSITION								
Gross settled foreign currency derivatives	3,379	868	654	326	551	44	-	5,822
Guarantees	3,333	-	-	-	-	-	-	3,333

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2017

All figures in US\$ Million

23 RISK MANAGEMENT (continued)

Liquidity risk (continued)

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

At 31 December 2017	Within 1 month	1 - 3 months	3 - 6 months	6 - 12 months	Total within 12 months	1 - 5 years	5-10 years	10 - 20 years	Over 20 years	Undated	Total over 12 months	Total
ASSETS												
Liquid funds	1,100	60	68	30	1,258	130	-	-	-	-	130	1,388
Trading securities	-	24	-	693	717	334	-	-	-	-	334	1,051
Placements with banks and other financial institutions	2,360	541	176	93	3,170	-	-	-	-	-	-	3,170
Securities bought under repurchase agreements	1,421	100	-	-	1,521	-	-	-	-	-	-	1,521
Non-trading securities	41	287	227	675	1,230	3,042	1,076	170	56	25	4,369	5,599
Loans and advances	2,243	2,141	2,081	2,686	9,151	5,010	888	228	51	1	6,178	15,329
Others	11	25	10	127	173	149	15	2	-	1,102	1,268	1,441
Total assets	7,176	3,178	2,562	4,304	17,220	8,665	1,979	400	107	1,128	12,279	29,499
LIABILITIES, SHAREHOLDERS' EQUITY AND NON-CONTROLLING INTERESTS												
Deposits from customers	3,551	1,635	1,112	3,650	9,948	6,557	240	10	-	-	6,807	16,755
Deposits from banks	1,610	418	441	629	3,098	310	-	-	-	-	310	3,408
Certificates of deposit	1	3	6	6	16	11	-	-	-	-	11	27
Securities sold under repurchase agreements	1,466	117	-	3	1,586	25	17	-	-	-	42	1,628
Term notes, bonds and other term financing	-	-	-	150	150	1,998	-	-	-	-	1,998	2,148
Others	30	31	61	91	213	92	9	-	-	807	908	1,121
Shareholders' equity and non-controlling interests	-	-	-	-	-	-	-	-	-	4,412	4,412	4,412
Total liabilities, shareholders' equity and non-controlling interests	6,658	2,204	1,620	4,529	15,011	8,993	266	10	-	5,219	14,488	29,499
Net liquidity gap	518	974	942	(225)	2,209	(328)	1,713	390	107	(4,091)	(2,209)	-
Cumulative net liquidity gap	518	1,492	2,434	2,209		1,881	3,594	3,984	4,091	-		

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

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31 December 2017

All figures in US\$ Million

23 RISK MANAGEMENT (continued)

Liquidity risk (continued)

At 31 December 2016	Within 1 month	1 -3 months	3 - 6 months	6 - 12 months	Total within 12 months	1 - 5 years	5-10 years	10 - 20 years	Over 20 years	Undated	Total over 12 months	Total
ASSETS												
Liquid funds	1,480	50	111	55	1,696	135	-	-	-	-	135	1,831
Trading securities	-	11	30	6	47	643	16	2	-	3	664	711
Placements with banks and other financial institutions	3,810	229	61	30	4,130	-	-	-	-	-	-	4,130
Securities bought under repurchase agreements	1,507	-	49	-	1,556	-	-	-	-	-	-	1,556
Non-trading securities	2,509	409	975	542	4,435	1,015	158	2	-	25	1,200	5,635
Loans and advances	2,188	1,863	1,903	1,983	7,937	5,241	1,228	264	13	-	6,746	14,683
Others	58	10	17	24	109	197	16	1	-	1,272	1,486	1,595
Total assets	11,552	2,572	3,146	2,640	19,910	7,231	1,418	269	13	1,300	10,231	30,141
LIABILITIES, SHAREHOLDERS' EQUITY AND NON-CONTROLLING INTERESTS												
Deposits from customers	3,671	1,387	585	1,230	6,873	7,321	38	38	-	-	7,397	14,270
Deposits from banks	2,723	507	989	1,164	5,383	333	153	1	-	-	487	5,870
Certificates of deposit	9	1	5	10	25	12	-	-	-	-	12	37
Securities sold under repurchase agreements	155	-	12	-	167	2	-	-	-	-	2	169
Term notes, bonds and other term financing	-	53	1,125	925	2,103	836	1,330	-	-	-	2,166	4,269
Others	51	45	42	67	205	86	3	-	-	972	1,061	1,266
Shareholders' equity and non-controlling interests	-	-	-	-	-	-	-	-	-	4,260	4,260	4,260
Total liabilities, shareholders' equity and non-controlling interests	6,609	1,993	2,758	3,396	14,756	8,590	1,524	39	-	5,232	15,385	30,141
Net liquidity gap	4,943	579	388	(756)	5,154	(1,359)	(106)	230	13	(3,932)	(5,154)	-
Cumulative net liquidity gap	4,943	5,522	5,910	5,154		3,795	3,689	3,919	3,932	-		

24 OPERATING SEGMENTS

For management purposes, the Group is organised into five operating segments which are based on business units and their activities. The Group has accordingly been structured to place its activities under the distinct divisions which are as follows:

- **MENA subsidiaries** cover retail, corporate and treasury activities of subsidiaries in North Africa and Levant;
- **International wholesale banking** encompasses corporate and structured finance, trade finance, Islamic banking services and syndications;
- **Group treasury** comprises treasury activities of Bahrain Head Office, New York and London;
- **ABC Brasil** primarily reflects the commercial banking and treasury activities of the Brazilian subsidiary Banco ABC Brasil S.A., focusing on the corporate and middle market segments in Brazil; and
- **Other** includes activities of Arab Financial Services B.S.C. (c).

	2017					Total
	MENA subsidiaries	International wholesale banking	Group treasury	ABC Brasil	Other	
Net interest income	124	160	20	226	26	556
Other operating income	41	65	31	143	33	313
Total operating income	165	225	51	369	59	869
Profit before impairment provisions	75	137	27	237	33	509
Impairment provisions - net	(1)	(17)	-	(78)	-	(96)
Profit before taxation and unallocated operating expenses	74	120	27	159	33	413
Taxation on foreign operations	(23)	(3)	-	(32)	-	(58)
Unallocated operating expenses						(102)
Profit for the year						253
Operating assets	3,397	9,912	7,928	8,184	78	29,499
Operating liabilities	2,899	-	15,194	6,983	11	25,087
	2016					
	MENA subsidiaries	International wholesale banking	Group treasury	ABC Brasil	Other	Total
Net interest income	139	143	30	215	11	538
Other operating income	38	84	15	156	34	327
Total operating income	177	227	45	371	45	865
Profit before impairment provisions	79	141	30	258	18	526
Impairment provisions - net	(3)	(11)	-	(78)	-	(92)
Profit before taxation and unallocated operating expenses	76	130	30	180	18	434
Taxation on foreign operations	(22)	(7)	(1)	(73)	-	(103)
Unallocated operating expenses						(97)
Profit for the year						234
Operating assets	3,146	9,924	9,178	7,815	78	30,141
Operating liabilities	2,688	-	16,591	6,597	5	25,881

24 OPERATING SEGMENTS (continued)

Geographical information

The Group operates in six geographic markets: Middle East and North Africa, Western Europe, Asia, North America, Latin America and others. The following table show the external total operating income of the major units within the Group, based on the country of domicile of the entity for the years ended 31 December 2017 and 2016:

2017	Bahrain	Europe	Brasil	Other	Total
Total operating income	218	100	369	182	869
2016					
Total operating income	197	103	371	194	865

There were no revenues derived from transactions with a single external customer that amounted to 10% or more of the Group's revenue (2016: none).

25 REPURCHASE AND RESALE AGREEMENTS

Proceeds from assets sold under repurchase agreements at the year-end amounted to US\$ 1,628 million (2016: US\$ 169 million). The carrying value of securities sold under repurchase agreements at the year-end amounted to US\$ 1,628 million (2016: US\$ 169 million).

Amounts paid for assets purchased under resale agreements at the year-end amounted to US\$ 1,521 million (2016: US\$ 1,556 million) and relate to customer product and treasury activities. The market value of the securities purchased under resale agreements at the year-end amounted to US\$ 1,523 million (2016: US\$ 1,569 million).

26 TRANSACTIONS WITH RELATED PARTIES

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

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

	Ultimate parent	Major shareholder	Directors	2017	2016
Deposits from customers	3,081	695	6	3,782	3,229
Term notes, bonds and other term financing*	1,505	-	-	1,505	2,175
Short-term self-liquidating trade and transaction-related contingent items	331	-	-	331	377

* Loan from a major shareholder was renewed at the time of maturity as a deposit for two years maturing in June 2019.

26 TRANSACTIONS WITH RELATED PARTIES (continued)

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

	2017	2016
Commission income	7	13
Interest expense	107	77

Compensation of the key management personnel is as follows:

	2017	2016
Short term employee benefits	19	17
Post employment benefits	5	3
	24	20

27 FIDUCIARY ASSETS

Funds under management at the year-end amounted to US\$ 15,917 million (2016: US\$ 14,715 million). These assets are held in a fiduciary capacity and are not included in the consolidated statement of financial position.

28 ISLAMIC DEPOSITS AND ASSETS

Deposits from customers, banks and term notes, bonds and other financing include Islamic deposits of US\$ 772 million (2016: US\$ 388 million). Loans and advances, non-trading securities and placements include Islamic assets of US\$ 1,657 million (2016: US\$ 1,473 million), US\$ 599 million (2016: US\$ 697 million) and US\$ 286 million (2016: US\$ 149 million).

29 ASSETS PLEDGED AS SECURITY

At the consolidated statement of financial position date, in addition to the items mentioned in note 25, assets amounting to US\$ 499 million (2016: US\$ 642 million) have been pledged as security for borrowings and other banking operations.

30 BASIC AND DILUTED EARNINGS PER SHARE AND PROPOSED DIVIDENDS AND TRANSFERS**30.1 Basic and diluted earnings per share**

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

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

	2017	2016
Profit attributable to the shareholders of the parent	193	183
Weighted average number of shares outstanding during the year (millions)	3,110	3,110
Basic and diluted earnings per share (US\$)	0.06	0.06

30.2 Proposed dividends and transfers

	2017	2016
Proposed cash dividend for 2017 of US\$ 0.03 per share (2016: US\$ 0.03 per share)	93	93

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

31 CAPITAL ADEQUACY

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

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

The risk asset ratio calculations as at 31 December 2017 are based on standardised measurement methodology and in accordance with the CBB Basel III guidelines.

CAPITAL BASE		2017	2016
CET 1		4,196	4,101
AT 1		55	53
Total Tier 1 capital		4,251	4,154
Tier 2		253	384
Total capital base	[a]	4,504	4,538
RISK WEIGHTED EXPOSURES			
		2017	2016
Credit risk weighted assets and off balance sheet items		20,849	20,757
Market risk weighted assets and off balance sheet items		1,624	1,412
Operational risk weighted assets		1,572	1,568
Total risk weighted assets	[b]	24,045	23,737
Risk asset ratio	[a/b*100]	18.7%	19.1%
Minimum requirement		12.5%	12.5%

The Group's capital base primarily comprises:

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

(b) Tier 2 capital: eligible subordinated term debt and collective impairment provisions.

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

32 CHANGES IN LIABILITIES ARISING FROM FINANCING ACTIVITIES

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

	1 January 2016	Cash flow, net	Foreign exchange movement	Other	31 December 2016
Certificates of deposit	41	(3)	(1)	-	37
Term notes, bonds and other term financing	3,943	331	(5)	-	4,269
Total liabilities from financing activities	3,984	328	(6)	-	4,306

* Other relates to a loan from a major shareholder that was renewed at the time of maturity as a deposit for two years maturing in June 2019. Refer note 26.

33 COMPARATIVE FIGURES

The Group has revised the presentation of its consolidated statement of financial position for 'deposits from banks' and 'deposits from customers' to better represent the category of deposits. Accordingly, deposits from non-banking financial institutions which were previously presented as 'deposits from banks and other financial institutions' in the consolidated statement of financial position have been reclassified into 'deposits from customers', which the management considers to be more relevant. Therefore, prior year comparatives amounting to US\$ 1,036 million as at 31 December 2016 have been reclassified from 'deposits from banks and other financial institutions' to 'deposits from customers'. As at 1 January 2016, US\$ 729 million has also been reclassified from 'deposits from banks and other financial institutions' to 'deposits from customers'.