

**BBK B.S.C.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**31 DECEMBER 2016**

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

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

#### *Opinion*

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

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

#### *Basis for opinion*

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

#### *Key audit matters*

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

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



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

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

#### Key audit matters (continued)

| 1. Impairment of carrying value of loans and advances   |  |
|---|--|
| Key audit matter  | How the key audit matter was addressed in the audit  |
| <p>The Group exercises significant judgement using subjective assumptions over both when and how much to record as loan impairment, and estimation of the amount of the impairment provision for loans and advances. Because loans and advances form a major portion of the Group's assets, and due to the significance of the judgments used in classifying loans and advances into various stages stipulated in IFRS 9 and determining related provision requirements, this audit area is considered a key audit risk.</p> <p>As at 31 December 2016, the Group's gross loans and advances amounted to BD 1,894 million and the related impairment provisions amounted to BD 126.9 million, comprising BD 49.3 million of provision against Stage 1 and 2 exposures and BD 77.6 million against exposures classified under Stage 3. The impairment provision policy is presented in the accounting policies in note 3 to the consolidated financial statements.</p> | <ul style="list-style-type: none"> <li>• We gained understanding of the Group's key credit processes comprising granting, booking, monitoring and provisioning and tested the operating effectiveness of key controls over these processes;</li> <li>• For exposures determined to be individually impaired, we tested a sample of loans and advances and examined management's estimate of future cash flows, assessed their reasonableness and checked the resultant provision calculations; and</li> <li>• For provision against exposures classified as Stage 1 and Stage 2 on early adoption of IFRS 9, we obtained an understanding of the Group's provisioning methodology, assessed the reasonableness of the underlying assumptions and the sufficiency of the data used by the management. Our procedures in this regard are discussed in further detail below under the key audit matter "Early adoption of IFRS 9".</li> </ul> |

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

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

*Key audit matters (continued)*

| <b>2. Early adoption of IFRS 9</b>  |  |
|---|--|
| <b>Key audit matter</b>   | <b>How the key audit matter was addressed in the audit</b>   |
| <p>The International Accounting Standards Board (IASB) issued <i>IFRS 9 – “Financial Instruments”</i> which replaces “<i>IAS 39 – Financial Instruments</i>” in three phases as follows:</p> <p><b>Phase 1</b> – classification and measurement of financial assets and financial liabilities;</p> <p><b>Phase 2</b> – Impairment methodology; and</p> <p><b>Phase 3</b> – Hedge accounting.</p> <p>Effective 1 January 2016, the Group has early adopted IFRS 9 ahead of its mandatory effective date of 1 January 2018. As permitted by IFRS 9, the requirements have been applied retrospectively without restating comparatives.</p> <p>Differences between previously reported carrying amounts and new carrying amounts of financial instruments as of 31 December 2015 and 1 January 2016 amounting to BD 11.9 million has been recognized in the opening retained earnings.</p> | <p>With respect to classification and measurement of financial assets and financial liabilities, our audit procedures comprised the following;</p> <ul style="list-style-type: none"> <li>• We read the Group's IFRS 9 based classification and measurement of financial assets and financial liabilities policy and compared it with the requirements of IFRS 9;</li> <li>• We obtained an understanding and checked the Group's business model assessment and the test on the contractual cash flows, which give rise to cash flows that are 'solely payments of principal and interest' [SPPI test] performed by the Group's consultant; and</li> <li>• We checked the appropriateness of the opening balance adjustments.</li> </ul> <p>With respect to impairment methodology, our audit procedures comprised the following;</p> <ul style="list-style-type: none"> <li>• We read the Group's IFRS 9 based impairment provisioning policy and compared it with the requirements of IFRS 9;</li> </ul> |

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

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

*Key audit matters (continued)*

| <b>2. Early adoption of IFRS 9 (continued)</b>  |   |
|---|---|
| <b>Key audit matter</b>   | <b>How the key audit matter was addressed in the audit</b>  |
| <p>The key changes arising from early adoption of IFRS 9 are that the Group's credit losses are now based on expected losses rather than an incurred loss model, and the change in the classification and measurement of the Group's financial assets and liabilities, which are detailed in note 3 to the consolidated financial statements. There were no significant changes arising from the early adoption of the hedge accounting requirements of IFRS 9.</p> | <ul style="list-style-type: none"> <li>• We obtained an understanding of the Group's internal rating models for loans and advances and read the rating validation report prepared by the Group's consultant to gain comfort that the discrimination and calibration of the rating model is appropriate. Further, we performed procedures to ensure the competence, objectivity and independence of the Group's consultant;</li> <li>• We checked the appropriateness of the Group's determination of significant increase in credit risk and the resultant basis for classification of exposures into various stages;</li> <li>• For a sample of exposures, we checked the appropriateness of the Group's staging;</li> <li>• We checked and understood the key data sources and assumptions for data used in the Expected Credit Loss (ECL) models (the Models) used by the Group to determine impairment provisions;</li> <li>• For forward looking assumptions used by the Group's management in its ECL calculations, we held discussions with management and corroborated the assumptions using publicly available information;</li> </ul> |



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

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

*Key audit matters (continued)*

| <b>2. Early adoption of IFRS 9 (continued)</b> |   |
|--|---|
| <b>Key audit matter</b>                        | <b>How the key audit matter was addressed in the audit</b>  |
|  | <ul style="list-style-type: none"> <li>• For a sample of exposures, we checked the appropriateness of determining Exposure at Default, including the consideration of prepayments and repayments in the cash flows and the resultant arithmetical calculations;</li> <li>• For Probability of Default (PD) used in the ECL calculations we checked the Through the Cycle (TTC) PDs calculation and checked the appropriateness of conversion of the TTC PDs to point in time (PIT) PDs;</li> <li>• We checked the calculation of the Loss Given Default (LGD) used by the Group in the ECL calculations, including the appropriateness of the use of collateral and the resultant arithmetical calculations;</li> <li>• We checked the completeness of loans and advances, off balance sheet items, investment securities, placements and other financial assets included in the ECL calculations as of 31 December 2016; We understood the theoretical soundness and tested the mathematical integrity of the Models;</li> <li>• For data from external sources, we understood the process of choosing such data, its relevance for the Group, and the controls and governance over such data;</li> <li>• Where relevant, we used Information System specialists to gain comfort on data integrity;</li> </ul> |

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

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

*Key audit matters (continued)*

| <b>2. Early adoption of IFRS 9 (continued)</b> |   |
|--|---|
| <b>Key audit matter</b>                        | <b>How the key audit matter was addressed in the audit</b>  |
|  | <ul style="list-style-type: none"> <li>• We checked consistency of various inputs and assumptions used by the Group's management to determine impairment provisions; and</li> <li>• We checked the appropriateness of the opening balance adjustments.</li> </ul> <p>With respect to hedge accounting, We read the Group's IFRS 9 based policy and compared it with the requirements of IFRS 9, further we have checked the appropriateness of the policy implementation.</p> <p>We assessed the financial statement disclosures arising on early adoption of IFRS 9 to determine if they were in accordance with the requirements of the Standard. Refer to the accounting policies, critical accounting estimates and judgements, disclosures of loans and advances and credit risk management in notes 3, 7 and 32 to the consolidated financial statements.</p> |

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

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

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

Other information consists of the information included in the Group's 2016 Annual Report, other than the consolidated financial statements and our auditor's report thereon. The Board of Directors is responsible for the other information. Prior to the date of this auditor's report, we obtained the Board of Directors' report, which will form part of the annual report, and the remaining sections of the annual report are expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon. In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information obtained prior to the date of the auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

### **Report on Other Legal and Regulatory Requirements**

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

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the Board of Directors' report 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 2016 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position; and
- d) satisfactory explanations and information have been provided to us by Management in response to all our requests.

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



Partner's registration no.117  
27 February 2017  
Manama, Kingdom of Bahrain



**BBK B.S.C.**
**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

As at 31 December 2016

|  | Notes | 2016 <sup>(1)</sup><br>BD '000 | 2015<br>BD '000  |
|--|-------|--------------------------------|------------------|
| <b>ASSETS</b>  |       |                                |                  |
| Cash and balances with central banks                                 | 4     | 314,368                        | 286,750          |
| Treasury bills   | 5     | 401,635                        | 394,090          |
| Deposits and amounts due from banks and other financial institutions | 6     | 318,407                        | 325,096          |
| Loans and advances to customers                                      | 7     | 1,767,138                      | 1,764,799        |
| Investment securities  | 8     | 768,134                        | 758,107          |
| Investments in associated companies and joint ventures               | 9     | 43,923                         | 35,823           |
| Interest receivable and other assets                                 | 10    | 64,769                         | 56,970           |
| Premises and equipment   | 11    | 24,183                         | 24,806           |
| <b>TOTAL ASSETS</b>  |       | <b>3,702,557</b>               | <b>3,646,441</b> |
| <b>LIABILITIES AND EQUITY</b>  |       |                                |                  |
| <b>Liabilities</b>   |       |                                |                  |
| Deposits and amounts due to banks and other financial institutions   |       | 259,911                        | 179,404          |
| Borrowings under repurchase agreement                                |       | 184,016                        | 174,508          |
| Term borrowings  | 12    | 206,109                        | 204,677          |
| Customers' current, savings and other deposits                       | 13    | 2,493,715                      | 2,642,892        |
| Interest payable and other liabilities                               | 14    | 84,591                         | 84,226           |
| <b>Total liabilities</b>   |       | <b>3,228,342</b>               | <b>3,285,707</b> |
| <b>Equity</b>  |       |                                |                  |
| Share capital  | 15    | 108,165                        | 108,165          |
| Treasury stock   | 15    | (1,206)                        | (4,728)          |
| Perpetual tier 1 convertible capital securities                      | 15    | 86,098                         | -                |
| Share premium  | 15    | 39,919                         | 39,919           |
| Statutory reserve  | 16    | 54,082                         | 54,082           |
| General reserve  | 16    | 54,082                         | 51,507           |
| Cumulative changes in fair values                                    | 17    | (13,669)                       | (12,304)         |
| Foreign currency translation adjustments                             |       | (11,558)                       | (10,635)         |
| Retained earnings  |       | 122,830                        | 102,580          |
| Proposed Appropriations  | 18    | 33,666                         | 30,586           |
| <b>ATTRIBUTABLE TO THE OWNERS OF THE BANK</b>                        |       | <b>472,409</b>                 | <b>359,172</b>   |
| Non-controlling interest   |       | 1,806                          | 1,562            |
| <b>Total equity</b>  |       | <b>474,215</b>                 | <b>360,734</b>   |
| <b>TOTAL LIABILITIES AND EQUITY</b>                                  |       | <b>3,702,557</b>               | <b>3,646,441</b> |

<sup>(1)</sup> 31 December 2016 results reflect the adoption of IFRS 9. Prior periods balances have not been restated. Refer to Note 3.3 - Accounting policies for further information.

  
Murad Ali Murad  
Chairman

  
Aref Saleh Khamis  
Deputy Chairman

  
Reyadh Yousif Sater  
Chief Executive

The attached notes 1 to 44 form part of these consolidated financial statements

## CONSOLIDATED STATEMENT OF PROFIT OR LOSS

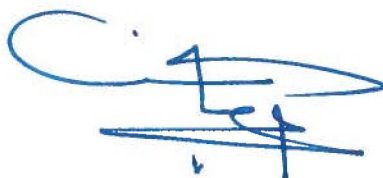
Year ended 31 December 2016

|   | Notes | 2016 <sup>(1)</sup><br>BD '000 | 2015<br>BD '000 |
|---|-------|--------------------------------|-----------------|
| Interest and similar income                                     | 19    | 128,556                        | 114,613         |
| Interest and similar expense                                    |       | (42,708)                       | (41,907)        |
| <b>Net interest income</b>                                      |       | <b>85,848</b>                  | <b>72,706</b>   |
| Share of profit of associated companies and joint ventures      | 9     | 5,467                          | 4,215           |
| Other income  | 20    | 42,212                         | 44,219          |
| <b>Total operating income</b>                                   |       | <b>133,527</b>                 | <b>121,140</b>  |
| Staff costs   |       | 33,453                         | 31,343          |
| Other expenses  |       | 16,263                         | 15,267          |
| Depreciation  | 11    | 3,430                          | 3,226           |
| Net provision for impairment on loans and advances to customers | 7     | 23,753                         | 18,975          |
| Net (write back)/ provision for impairment on investments       | 8     | (1,115)                        | 538             |
| <b>Total operating expenses</b>                                 |       | <b>75,784</b>                  | <b>69,349</b>   |
| <b>PROFIT BEFORE TAXATION</b>                                   |       | <b>57,743</b>                  | <b>51,791</b>   |
| Net tax (provision)/ benefit                                    |       | (996)                          | 1,598           |
| <b>PROFIT FOR THE YEAR</b>                                      |       | <b>56,747</b>                  | <b>53,389</b>   |
| <b>Attributable to:</b>   |       |                                |                 |
| Owners of the Bank  |       | 56,410                         | 53,212          |
| Non-controlling interest  |       | 337                            | 177             |
|   |       | <b>56,747</b>                  | <b>53,389</b>   |
| Basic earnings per share (BD)                                   | 21    | 0.049                          | 0.050           |
| Diluted earnings per share (BD)                                 | 21    | 0.044                          | 0.050           |

<sup>(1)</sup> December 2016 results reflect the adoption of IFRS 9. Prior periods balances have not been restated. Refer to Note 3.3 - Accounting policies for further information.



Murad Ali Murad  
Chairman



Aref Saleh Khamis  
Deputy Chairman



Reyadh Yousif Sater  
Chief Executive

## CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME

Year ended 31 December 2016

|   | Note | 2016 <sup>(1)</sup><br>BD '000 | 2015<br>BD '000 |
|---|------|--------------------------------|-----------------|
| <b>Profit for the year</b>  |      | <b>56,747</b>                  | 53,389          |
| <b>Other comprehensive income</b>   |      |                                |                 |
| <i>Items that will not be reclassified to profit or loss</i>                          |      |                                |                 |
| Fair value through other comprehensive income reserve (equity instruments)            | 17   | <b>4,113</b>                   | -               |
| <b>Items that are or may be reclassified subsequently to profit or loss</b>           |      |                                |                 |
| <i>Movement in translation reserve:</i>   |      |                                |                 |
| Foreign currency translation adjustments  |      | <b>(923)</b>                   | (3,376)         |
| <i>Movement in hedging reserve:</i>   |      |                                |                 |
| Effective portion of changes in fair value  | 17   | <b>174</b>                     | (304)           |
| Net amount transferred to profit or loss  |      |                                |                 |
| <i>Movement in fair value reserve (debt instruments - IFRS 9):</i>                    |      |                                |                 |
| Net change in fair value  |      | <b>8,377</b>                   | -               |
| Net amount transferred to profit or loss  |      | <b>(887)</b>                   | -               |
| <i>Movement in fair value reserve (available-for-sale financial assets - IAS 39):</i> |      |                                |                 |
| Net change in fair value  |      | -                              | (29,420)        |
| <b>Other comprehensive income (loss) for the year</b>                                 |      | <b>10,854</b>                  | (33,100)        |
| <b>Total comprehensive income for the year</b>  |      | <b>67,601</b>                  | 20,289          |
| <b>Attributable to:</b>   |      |                                |                 |
| Owners of the Bank  |      | <b>67,264</b>                  | 20,112          |
| Non-controlling interest  |      | <b>337</b>                     | 177             |
|   |      | <b>67,601</b>                  | 20,289          |

<sup>(1)</sup> 31 December 2016 results reflect the adoption of IFRS 9. Prior periods have not been restated. Refer to Note 3.3 - Accounting policies for further information.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2016

| Attributable to the owners of the Bank and capital securities' holders       |   |                        |                            |                       |                           |                         |  |  |          |  |                                 |                              |                                  |                                     |
|--|---|------------------------|----------------------------|-----------------------|---------------------------|-------------------------|--|--|----------|--|---------------------------------|------------------------------|----------------------------------|-------------------------------------|
| Note   | Perpetual tier 1 convertible securities |                        |                            | Share premium BD '000 | Statutory reserve BD '000 | General reserve BD '000 | Cumulative changes in fair values <sup>(1)</sup> BD '000 | Foreign currency translation adjustments |          | Retained earnings <sup>(1)</sup> BD '000 | Proposed appropriations BD '000 | Total <sup>(1)</sup> BD '000 | Non-controlling interest BD '000 | Total equity <sup>(1)</sup> BD '000 |
|  | Share capital BD '000                   | Treasury stock BD '000 | capital securities BD '000 |                       |                           |                         |  | BD '000                                  | BD '000  |  |                                 |                              |                                  |                                     |
| Balance at 1 January 2015  | 103,014                                 | (6,951)                | -                          | 39,919                | 51,507                    | 46,825                  | 17,420   | (7,259)                                  | 82,017   | 31,402                                   | 357,894                         | 1,458                        | 359,352                          |                                     |
| Profit for the year  | -                                       | -                      | -                          | -                     | -                         | -                       | -  | -  | 53,212   | -  | 53,212                          | 177                          | 53,389                           |                                     |
| Other comprehensive loss   | -                                       | -                      | -                          | -                     | -                         | -                       | (29,724)   | (3,376)                                  | -        | -  | (33,100)                        | -                            | (33,100)                         |                                     |
| Total comprehensive income   | -                                       | -                      | -                          | -                     | -                         | -                       | (29,724)   | (3,376)                                  | 53,212   | -  | 20,112                          | 177                          | 20,289                           |                                     |
| Share - based payments   | 40                                      | -                      | -                          | -                     | -                         | -                       | -  | -  | 269      | -  | 269                             | -                            | 269                              |                                     |
| Dividends paid   | 18                                      | -                      | -                          | -                     | -                         | -                       | -  | -  | -        | (20,179)                                 | (20,179)                        | -                            | (20,179)                         |                                     |
| Stock dividends  | 18                                      | 5,151                  | -                          | -                     | -                         | -                       | -  | -  | -        | (5,151)                                  | -                               | -                            | -                                |                                     |
| Donations  | -                                       | -                      | -                          | -                     | -                         | -                       | -  | -  | -        | (1,390)                                  | (1,390)                         | -                            | (1,390)                          |                                     |
| Movement in treasury stock   | 15                                      | -                      | 2,223                      | -                     | -                         | -                       | -  | -  | -        | -  | 2,223                           | -                            | 2,223                            |                                     |
| Unclaimed dividends  | 15                                      | -                      | -                          | -                     | -                         | -                       | -  | -  | 243      | -  | 243                             | -                            | 243                              |                                     |
| Movement in non-controlling interest   | -                                       | -                      | -                          | -                     | -                         | -                       | -  | -  | -        | -  | -                               | (73)                         | (73)                             |                                     |
| Transfer to statutory reserve  | 16                                      | -                      | -                          | -                     | 2,575                     | -                       | -  | -  | (2,575)  | -  | -                               | -                            | -                                |                                     |
| Proposed appropriations  | 18                                      | -                      | -                          | -                     | -                         | -                       | -  | -  | (30,586) | 30,586                                   | -                               | -                            | -                                |                                     |
| Transfer to general reserve 2014   | -                                       | -                      | -                          | -                     | -                         | 4,682                   | -  | -  | -        | (4,682)                                  | -                               | -                            | -                                |                                     |
| Balance at 31 December 2015  | 108,165                                 | (4,728)                | -                          | 39,919                | 54,082                    | 51,507                  | (12,304)   | (10,635)                                 | 102,580  | 30,586                                   | 359,172                         | 1,562                        | 360,734                          |                                     |
| Transition adjustment on adoption of IFRS 9 at 1 January 2016 (note 3.3)     | -                                       | -                      | -                          | -                     | -                         | -                       | (16,880)   | -  | 4,980    | -  | (11,900)                        | -                            | (11,900)                         |                                     |
| Restated balance at 1 January 2016   | 108,165                                 | (4,728)                | -                          | 39,919                | 54,082                    | 51,507                  | (29,184)   | (10,635)                                 | 107,560  | 30,586                                   | 347,272                         | 1,562                        | 348,834                          |                                     |
| Profit for the year  | -                                       | -                      | -                          | -                     | -                         | -                       | -  | -  | 56,410   | -  | 56,410                          | 337                          | 56,747                           |                                     |
| Other comprehensive income   | -                                       | -                      | -                          | -                     | -                         | -                       | 15,515   | (923)                                    | (3,738)  | -  | 10,854                          | -                            | 10,854                           |                                     |
| Total comprehensive income   | -                                       | -                      | -                          | -                     | -                         | -                       | 15,515   | (923)                                    | 52,672   | -  | 67,264                          | 337                          | 67,601                           |                                     |
| Share - based payments   | 40                                      | -                      | -                          | -                     | -                         | -                       | -  | -  | (31)     | -  | (31)                            | -                            | (31)                             |                                     |
| Perpetual tier 1 convertible capital securities issued                       | -                                       | -                      | 86,098                     | -                     | -                         | -                       | -  | -  | -        | -  | 86,098                          | -                            | 86,098                           |                                     |
| Expenses related to perpetual - tier 1 convertible capital securities issued | -                                       | -                      | -                          | -                     | -                         | -                       | -  | -  | (180)    | -  | (180)                           | -                            | (180)                            |                                     |
| Distribution on Perpetual tier 1 convertible capital securities              | -                                       | -                      | -                          | -                     | -                         | -                       | -  | -  | (3,552)  | -  | (3,552)                         | -                            | (3,552)                          |                                     |
| Dividends paid   | 18                                      | -                      | -                          | -                     | -                         | -                       | -  | -  | -        | (26,611)                                 | (26,611)                        | (93)                         | (26,704)                         |                                     |
| Donations  | -                                       | -                      | -                          | -                     | -                         | -                       | -  | -  | -        | (1,400)                                  | (1,400)                         | -                            | (1,400)                          |                                     |
| Movement in treasury stock   | 15                                      | -                      | 3,522                      | -                     | -                         | -                       | -  | -  | -        | -  | 3,522                           | -                            | 3,522                            |                                     |
| Unclaimed dividends  | 15                                      | -                      | -                          | -                     | -                         | -                       | -  | -  | 27       | -  | 27                              | -                            | 27                               |                                     |
| Proposed appropriations  | 18                                      | -                      | -                          | -                     | -                         | -                       | -  | -  | (33,666) | 33,666                                   | -                               | -                            | -                                |                                     |
| Transfer to general reserve 2015   | -                                       | -                      | -                          | -                     | -                         | 2,575                   | -  | -  | -        | (2,575)                                  | -                               | -                            | -                                |                                     |
| Balance at 31 December 2016  | 108,165                                 | (1,206)                | 86,098                     | 39,919                | 54,082                    | 54,082                  | (13,669)   | (11,558)                                 | 122,830  | 33,666                                   | 472,409                         | 1,806                        | 474,215                          |                                     |

(1) 31 December 2016 results reflect the adoption of IFRS 9. Prior periods have not been restated. Refer to Note 3.3 - Accounting policies for further information.

**CONSOLIDATED STATEMENT OF CASH FLOWS**

Year ended 31 December 2016

|  | Notes | 2016 (1)<br>BD '000 | 2015<br>BD '000 |
|--|-------|---------------------|-----------------|
| <b>OPERATING ACTIVITIES</b>  |       |                     |                 |
| Profit for the year before taxation  |       | 57,743              | 51,791          |
| Adjustments for non-cash items:  |       |                     |                 |
| Net provisions (write back) relating to:   |       |                     |                 |
| Loans and advances to customers  | 7     | 23,753              | 18,975          |
| Investment securities  | 8     | (1,115)             | 538             |
| Share of profit of associated companies and joint ventures                                 | 9     | (5,467)             | (4,215)         |
| Depreciation   | 11    | 3,430               | 3,226           |
| Realised gains on sale of investment securities  | 20    | (2,707)             | (4,408)         |
| Accrual on term borrowings   |       | 1,432               | 1,439           |
|  |       | <b>77,069</b>       | <b>67,346</b>   |
| <b>(Increase) decrease in operating assets</b>   |       |                     |                 |
| Mandatory reserve deposits with central banks  |       | 5,049               | (6,277)         |
| Treasury bills maturing after 90 days  |       | (13,212)            | (100,790)       |
| Deposits and amounts due from banks and other financial institutions                       |       | (15,824)            | 28,378          |
| Loans and advances to customers  |       | (26,092)            | 62,688          |
| Interest receivable and other assets   |       | (7,625)             | 1,725           |
| <b>Increase (decrease) in operating liabilities</b>  |       |                     |                 |
| Deposits and amounts due to banks and other financial institutions                         |       | 80,507              | (133,620)       |
| Borrowings under repurchase agreements   |       | 9,508               | 136,804         |
| Customers' current, savings and other deposits   |       | (149,177)           | 171,815         |
| Interest payable and other liabilities   |       | 365                 | 5,384           |
| Income tax paid  |       | (935)               | (444)           |
| Net cash (used in)/ from operating activities  |       | <b>(40,367)</b>     | <b>233,009</b>  |
| <b>INVESTING ACTIVITIES</b>  |       |                     |                 |
| Purchase of investment securities  |       | (247,605)           | (246,015)       |
| Sale of investment securities  |       | 240,940             | 252,152         |
| Sale / partial repayment of capital of investment in associated companies                  | 9     | (4,492)             | 3,000           |
| Dividends received from associated companies   | 9     | 2,103               | 1,835           |
| Other movements in investment in associated companies                                      |       | (238)               | 9               |
| Movement in non-controlling interest   |       | -                   | (73)            |
| Purchase of premises and equipment   |       | (2,807)             | (3,018)         |
| Net cash (used in)/ from investing activities  |       | <b>(12,099)</b>     | <b>7,890</b>    |
| <b>FINANCING ACTIVITIES</b>  |       |                     |                 |
| Payment of dividend and donations  | 18    | (28,011)            | (21,569)        |
| Term borrowings  |       | -                   | (37,700)        |
| Issuance of perpetual tier 1 convertible capital securities                                |       | 86,098              | -               |
| Payment of expenses related to issuance of perpetual tier 1 convertible capital securities |       | -                   | -               |
|  |       | (180)               | -               |
| Distribution of perpetual tier 1 convertible capital securities Interest                   |       | (3,552)             | -               |
| Movement in treasury stock   |       | 3,522               | 2,223           |
| Net cash from financing activities   |       | <b>57,877</b>       | <b>(57,046)</b> |
| Foreign currency translation adjustments   |       | (923)               | (3,376)         |
| <b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>   |       | <b>4,488</b>        | <b>180,477</b>  |
| Cash and cash equivalents at beginning of the year   |       | 533,116             | 352,639         |
| <b>CASH AND CASH EQUIVALENTS AT END OF THE YEAR</b>  | 23    | <b>537,604</b>      | <b>533,116</b>  |

The attached notes 1 to 44 form part of these consolidated financial statements

**1 ACTIVITIES**

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

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

The consolidated financial statements were authorised for issue in accordance with a resolution of the Bank's Board of Directors on 27 February 2017.

**2 BASIS OF PREPARATION****Statement of compliance**

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and in conformity with the Bahrain Commercial Companies Law and the CBB and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association. As explained in Note 3.3 the Group has early adopted IFRS 9 Financial Instruments issued in July 2014 with a date of initial application of 1 January 2016.

**Accounting convention**

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

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

**Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries (the "Group"), all of which have 31 December as their year end. The Bank has the following principal subsidiaries:

| <i>Name</i>               | <i>Ownership</i> | <i>Country of incorporation</i> | <i>Activity</i>        |
|---------------------------|------------------|---------------------------------|------------------------|
| CrediMax B.S.C. (c)       | 100%             | Kingdom of Bahrain              | Credit card operations |
| Invita Company B.S.C. (c) | 100%             | Kingdom of Bahrain              | Business process       |

CrediMax B.S.C. (c) owns 55% (2015: 55%) of the share capital of Global Payment Services W.L.L., which is established in the Kingdom of Bahrain and engaged in processing and backup services relating to credit, debit and charge cards.

Invita Company B.S.C. (c) owns 60% (2015: 60%) of the share capital of Invita Kuwait K.S.C.C., which is established in the State of Kuwait and engaged in business processing and outsourcing services.



**2 BASIS OF PREPARATION (continued)****Basis of consolidation (continued)**

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

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

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

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

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

Profit or loss and each component of other comprehensive income (OCI) are attributed to the equity holders of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into 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.

**3.1 New Standards and Interpretations issued but not yet effective**

The following new Standards and amendments have been issued by the International Accounting Standards Board (IASB) but are not yet mandatory as of 31 December 2016:

- IFRS 15 - Revenue from Contracts with customers (effective 1 January 2018).
- IFRS 16 Leases (effective 1 January 2019).

The Group does not expect any significant impact on the Groups' financial position and results.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**3 ACCOUNTING POLICIES (continued)****3.2 New Standards and Interpretations issued and effective**

(i) The Group has adopted the following new and amended International Accounting Standards/International Financial Reporting Standards as of 1 January 2016:

- Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisitions of Interests;
- Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation; and
- Amendments to IAS 27: Equity Method in Separate Financial Statements.

The above amendments to IFRSs which are effective for annual accounting periods starting from 1 January 2016 did not have any material impact on the accounting policies, financial position or performance of the Group.

**3.3 Early Adoption of IFRS 9**

The Group has early adopted IFRS 9 Financial Instruments issued in July 2014 with a date of initial application of 1 January 2016. The requirements of IFRS 9 represent a significant change from IAS 39 Financial Instruments: Recognition and Measurement. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

The key changes to the Group's accounting policies resulting from its adoption of IFRS 9 are summarised below.

**Classification of financial assets and financial liabilities**

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale.

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. For an explanation of how the Group classifies financial assets under IFRS 9, Refer to Note 3.4 Summary of significant accounting policies - Financial assets and financial liabilities ii) classification.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

Financial liabilities previously measured at amortised cost under IAS 39 have been classified and measured under IFRS 9 at amortised cost using the effective interest rate method. There have been no changes in the classification and measurement of financial liabilities on the adoption of IFRS 9.

- The amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- The remaining amount of change in the fair value is presented in profit or loss.

For an explanation of how the Group classifies financial liabilities under IFRS 9. Refer to Note 3.4 Summary of significant accounting policies - Financial assets and financial liabilities ii) classification.



**3 ACCOUNTING POLICIES (continued)****3.3 Early Adoption of IFRS 9 (continued)****Impairment of financial assets**

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments. Under IFRS 9, credit losses are recognised earlier than under IAS 39.

*Key changes in the Group's accounting policy for impairment of financial assets are listed below:*

The Group applies three-stage approach to measuring expected credit losses (ECL) on financial assets carried at amortised cost and debt instruments classified as FVOCI. Assets migrate through the following three stages based on the change in credit quality since initial recognition.

**Stage 1: 12 months ECL**

For exposures where there has not been a significant increase in credit risk since initial recognition, the portion of the lifetime ECL associated with the probability of default events occurring within next 12 months is recognised.

**Stage 2: Lifetime ECL - not credit impaired**

For credit exposures where there has been a significant increase in credit risk since initial recognition but that are not credit impaired, a lifetime ECL is recognised.

**Stage 3: Lifetime ECL - credit impaired**

Financial assets are assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred. As this uses the same criteria as under IAS 39, the groups methodology for specific provisions remains largely unchanged.

For an explanation of how the Group applies the impairment requirements of IFRS 9. Refer to note 3.4 summary of significant accounting policies - Financial assets and financial liabilities - vii) Impairment.

**Hedge accounting**

The general hedge accounting requirements of IFRS 9 retain the three types of hedge accounting mechanisms in IAS 39. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify as hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is no longer required.

**Transition**

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.

(a) Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2016. Accordingly, the information presented for 2015 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2015 under IFRS 9.

(b) The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

- The determination of the business model within which a financial asset is held.
- The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.
- The designation of certain investments in equity instruments not held for trading as at FVOCI.
- If a debt security had low credit risk at the date of initial application of IFRS 9, then the Group has assumed that credit risk on the asset had not increased significantly since its initial recognition.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

As at 31 December 2016

**3 ACCOUNTING POLICIES (continued)****3.3 Early Adoption of IFRS 9 (continued)****Impact of Adopting IFRS 9**

The impact of this change in accounting policy as at 1st January 2016 has been to increase retained earnings by BD 4,980 thousand, and to decrease the fair value reserve by BD 16,880 thousand as follows:

|  | Retained<br>earnings<br>BD '000 | Fair value<br>reserve<br>BD '000 |
|--|---------------------------------|----------------------------------|
| Closing balance under IAS 39 (31 December 2015)  | 102,580                         | (12,304)                         |
| <u>Impact on reclassification and remeasurements:</u>  |                                 |                                  |
| Investment securities (debt) from available-for-sale to amortised cost   | -                               | 4,988                            |
| Investment securities (debt and equity) from available-for-sale to FVTPL   | 4,853                           | (4,853)                          |
| Investment securities (equity) from available-for-sale to FVOCI  | 17,381                          | (17,015)                         |
|  | 124,814                         | (29,184)                         |
| <u>Impact on recognition of Expected Credit Losses:</u>  |                                 |                                  |
| Expected credit losses under IFRS 9 for debt financial assets at FVOCI   | (366)                           | -                                |
| Expected credit losses under IFRS 9 for financial assets at amortised cost<br>(including loan commitments and financial guarantee contracts) | (16,888)                        | -                                |
|  | (17,254)                        | -                                |
|  | 107,560                         | (29,184)                         |

**Opening balance under IFRS 9 on date of initial application of 1 January 2016**

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

## 3 ACCOUNTING POLICIES (continued)

### 3.3 Early Adoption of IFRS 9 (continued)

#### Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

The following table is reconciliation of original measurement categories and carrying value in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Group's financial assets and financial liabilities as at 1 January 2016.

|  | Original<br>classification<br>under IAS 39 | New<br>classification<br>under IFRS 9 | Original<br>carrying<br>amount under<br>IAS 39<br>BD '000 | New carrying<br>amount under<br>IFRS 9<br>BD '000 |
|--|--|---------------------------------------|---|---|
| <b>Financial assets</b>  |  |                                       |   |   |
| Cash and balances with central banks                                 |  |                                       | 286,750   | 286,750   |
| Loans and advances to customers                                      | Loans and receivables                      | Amortised cost                        | 1,764,799   | 1,747,926   |
| Investment securities – debt   | Loans and receivables                      | Amortised cost                        | 475,498   | 475,493   |
| Investment securities – debt   | Held-to-maturity investments               | Amortised cost                        | 9,223   | 9,223   |
| Investment securities – debt   | Held-to-maturity investments               | FVOCI                                 | 31,376  | 36,364  |
| Investment securities – debt   | Available-for-sale                         | Amortised cost                        | 537,293   | 537,293   |
| Investment securities – debt   | Available-for-sale                         | FVOCI                                 | 3,710   | 3,710   |
| Investment securities – debt   | Available-for-sale                         | FVTPL                                 | 23,268  | 23,268  |
| Investment securities – equity                                       | Available-for-sale                         | FVTPL                                 | 71,829  | 71,829  |
| Investment securities – equity                                       | Available-for-sale                         | FVOCI                                 |   |   |
| Deposits and amounts due from banks and other financial institutions | Loans and receivables                      | Amortised cost                        | 325,096   | 325,086   |
| Interest receivable and other assets                                 | Loans and receivables                      | Amortised cost                        | 56,970  | 56,970  |
|  |  |                                       | 3,585,812   | 3,573,912   |
| <b>Financial liabilities</b>   |  |                                       |   |   |
| Deposits and amounts due to banks and other financial institutions   | Amortised cost                             | Amortised cost                        | 179,404   | 179,404   |
| Borrowings under repurchase agreement                                | Amortised cost                             | Amortised cost                        | 174,508   | 174,508   |
| Term borrowings  | Amortised cost                             | Amortised cost                        | 204,677   | 204,677   |
| Customers' current, savings and other deposits                       | Amortised cost                             | Amortised cost                        | 2,642,892   | 2,642,892   |
| Interest payable and other liabilities                               | Amortised cost                             | Amortised cost                        | 84,226  | 84,226  |
|  |  |                                       | 3,285,707   | 3,285,707   |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**3 ACCOUNTING POLICIES (continued)****3.3 Early Adoption of IFRS 9 (continued)**

The Group's accounting policies on the classification of financial instruments under IFRS 9 are set out in Note 3.4. The application of these policies resulted in the reclassifications set out in the table above and explained below:

- a Before the adoption of IFRS 9, certain Debt securities were reclassified out of the available-for-sale categories to Held-to-maturity. On the adoption of IFRS 9, the carrying amount of those assets was adjusted so that their amortised cost under IFRS 9 was as if those assets were accounted for at amortised cost from their inception.
- b Under IFRS 9, certain managed funds which do not meet the FVOCI criteria and debt securities where the contractual cash flows of these securities are not solely payments of principal and interest on the principal outstanding have been re-classified to FVTPL. Further, certain equity investment securities which are not strategic in nature has been re-classified from Available -for-sale (AFS) to FVTPL on adoption of IFRS 9.
- c Certain debt securities are held by the Bank Treasury in a separate portfolio for long-term yield and for liquidity purposes. These securities may be sold, but such sales are not expected to be more than infrequent. The Bank considers that these securities are held within a business model whose objective is both to held to collect the contractual cash flows and sale. These assets are classified as measured at Fair value through other comprehensive income under IFRS 9.

The following table shows the effects of the reclassification of financial assets from IAS 39 categories into the amortised cost category under IFRS 9.

|  | 2016<br>BD '000 |
|--|-----------------|
| <i>From available-for-sale financial assets under IAS 39</i>   |                 |
| Fair value at 31 December 2016   | 32,640          |
| Fair value movement that would have been recognised during 2016 in OCI if the financial assets had not been reclassified | (2,136)         |

**Impairment allowances:**

The following table reconciles the closing impairment allowance for financial assets in accordance with IAS 39 as at 31 December 2015 to the opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2016.

|  | 31 December<br>2015<br>BD '000 | Remeasure-<br>ment<br>BD '000 | 1 January<br>2016<br>BD '000 |
|--|--------------------------------|-------------------------------|------------------------------|
| Loans and receivables and held to maturity securities under IAS 39/ financial assets at amortised cost under IFRS 9<br>(includes cash and cash equivalents, loans and advances to banks and loans and advances to customers) | 98,840                         | 16,883                        | 115,723                      |
| Available-for-sale debt investment securities under IAS 39 reclassified to amortised cost under IFRS 9   | -                              | 5                             | 5                            |
| Available-for-sale debt investment securities under IAS 39/debt financial assets at FVOCI under IFRS 9   | 22,982                         | 366                           | 23,348                       |
| <b>Total</b>   | 121,822                        | 17,254                        | 139,076                      |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**3 ACCOUNTING POLICIES (continued)****3.3 Early Adoption of IFRS 9 (continued)****Classification of assets and liabilities**

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

| <b>31 December 2016</b>   | <i>Designated<br/>as at<br/>FVTPL<br/>BD '000</i> | <i>FVOCI –<br/>debt<br/>instrument<br/>BD '000</i> | <i>FVOCI<br/>– equity<br/>instruments<br/>BD '000</i> | <i>Amortised<br/>cost/others<br/>BD '000</i> | <i>Total<br/>BD '000</i> |
|---|---|--|---|--|--------------------------|
| Cash and balances with central banks                                    | -   | -  | -   | 314,368                                      | 314,368                  |
| Treasury Bills  | -   | 7,381  | -   | 394,254                                      | 401,635                  |
| Deposits and amounts due from banks<br>and other financial institutions | -   | -  | -   | 318,407                                      | 318,407                  |
| Loans and advances to customers   | -   | -  | -   | 1,767,138                                    | 1,767,138                |
| Investment securities   | 10,486  | 561,875  | 72,700  | 123,073                                      | 768,134                  |
| Investments in associated companies<br>and joint ventures               | -   | -  | -   | 43,923                                       | 43,923                   |
| Interest receivable and other assets                                    | -   | -  | -   | 64,769                                       | 64,769                   |
| Premises and equipment  | -   | -  | -   | 24,183                                       | 24,183                   |
| <b>Total assets</b>   | <b>10,486</b>                                     | <b>569,256</b>                                     | <b>72,700</b>   | <b>3,050,115</b>                             | <b>3,702,557</b>         |
| Deposits and amounts due to banks<br>and other financial institutions   | -   | -  | -   | 259,911                                      | 259,911                  |
| Borrowings under repurchase agreement                                   | -   | -  | -   | 184,016                                      | 184,016                  |
| Term borrowings   | -   | -  | -   | 206,109                                      | 206,109                  |
| Customers' current, savings and<br>other deposits                       | -   | -  | -   | 2,493,715                                    | 2,493,715                |
| Interest payable and other liabilities                                  | -   | -  | -   | 84,591                                       | 84,591                   |
| <b>Total liabilities</b>  | <b>-</b>  | <b>-</b>   | <b>-</b>  | <b>3,228,342</b>                             | <b>3,228,342</b>         |
| <b>31 December 2015</b>   | <i>Held-to-<br/>maturity<br/>BD '000</i>          | <i>Loans and<br/>receivables<br/>BD '000</i>       | <i>Available for-<br/>sale<br/>BD '000</i>            | <i>Amortised<br/>cost/others<br/>BD '000</i> | <i>Total<br/>BD '000</i> |
| Cash and balances with central banks                                    | -   | 286,750  | -   | -  | 286,750                  |
| Treasury Bills  | 394,090   | -  | -   | -  | 394,090                  |
| Deposits and amounts due from banks<br>and other financial institutions | -   | 325,096  | -   | -  | 325,096                  |
| Loans and advances to customers   | -   | 1,764,799  | -   | -  | 1,764,799                |
| Investment securities   | 90,633  | -  | 667,474   | -  | 758,107                  |
| Investments in associated companies<br>and joint ventures               | -   | -  | -   | 35,823                                       | 35,823                   |
| Interest receivable and other assets                                    | -   | -  | -   | 56,970                                       | 56,970                   |
| Premises and equipment  | -   | -  | -   | 24,806                                       | 24,806                   |
| <b>Total assets</b>   | <b>484,723</b>                                    | <b>2,376,645</b>                                   | <b>667,474</b>  | <b>117,599</b>                               | <b>3,646,441</b>         |
| Deposits and amounts due to banks<br>and other financial institutions   | -   | -  | -   | 179,404                                      | 179,404                  |
| Borrowings under repurchase agreement                                   | -   | -  | -   | 174,508                                      | 174,508                  |
| Term borrowings   | -   | -  | -   | 204,677                                      | 204,677                  |
| Customers' current, savings and<br>other deposits                       | -   | -  | -   | 2,642,892                                    | 2,642,892                |
| Interest payable and other liabilities                                  | -   | -  | -   | 84,226                                       | 84,226                   |
| <b>Total liabilities</b>  | <b>-</b>  | <b>-</b>   | <b>-</b>  | <b>3,285,707</b>                             | <b>3,285,707</b>         |

### 3 ACCOUNTING POLICIES (continued)

#### 3.4 Summary of significant accounting policies

##### Financial assets and financial liabilities

##### i. Recognition and initial measurement

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

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

##### ii. Classification

##### Financial assets – Policy applicable from 1 January 2016

On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL. A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

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

- The asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

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

All other financial assets are classified as measured at FVTPL.

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

##### Business model assessment

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

- The stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, realising cash flows through the sale of the assets and holding it for liquidity purposes;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed; and

### **3 ACCOUNTING POLICIES (continued)**

#### **3.4 Summary of significant accounting policies (continued)**

##### **ii. Classification (continued)**

###### **Business model assessment (continued)**

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

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

###### **Assessment whether contractual cash flows are solely payments of principal and interest**

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

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

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

###### **Reclassifications**

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

###### **Financial assets – applicable up to 31 December 2015**

All financial assets are initially recognised at the fair value of consideration given, including acquisition costs associated with the investment, except in case of trading investments, where the acquisition costs are expensed in the consolidated statement of profit or loss.

For purposes of subsequent measurement financial assets are classified in four categories:

- Financial assets at fair value through profit or loss
- Loans and receivables
- Held-to-maturity investments
- Available-for-sale financial investments

The Group classifies investments as trading if they are acquired primarily for the purpose of making a short term profit.

The Group classifies debt instruments as carried at amortised cost if the debt instruments are not quoted in an active market.

The Group classifies investments which it intends and has the ability to hold to maturity as held-to-maturity.



**3 ACCOUNTING POLICIES (continued)****3.4 Summary of significant accounting policies (continued)****ii. Classification (continued)****Financial assets – applicable up to 31 December 2015 (continued)**

The Group classifies financial instruments which contain embedded derivatives which cannot be separated from the host instrument as carried at fair value through statement of profit or loss.

All other investments are classified as available-for-sale.

Judgements are made in the classification of available-for-sale, held for- 'trading and held-to-maturity investments based on management's 'intention at acquisition of the financial asset.

**Financial liabilities**

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

**iii. Derecognition***Financial assets*

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

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

From 1 January 2016 any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability.

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

A financial asset (in whole or in part) is derecognised where:

- the rights to receive cash flows from the asset have expired;

the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of ownership or (b) when it has neither transferred or retained substantially all the risks and rewards and when it no longer has control over the financial asset, but has transferred control of the asset.

**Financial liabilities**

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

**Trading investments - applicable up to 31 December 2015**

Trading investments are measured at fair value with any gain or loss arising from a change in fair value being included in the consolidated statement of profit or loss in the period in which it arises. Interest earned or dividends received are included in net trading income.



### 3 ACCOUNTING POLICIES (continued)

#### 3.4 Summary of significant accounting policies (continued)

##### iii. Derecognition (continued)

##### **Financial assets designation at fair value through profit or loss - Applicable from 1 January 2016**

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

##### **Financial assets designated at fair value through statement of profit or loss -applicable up to 31 December 2015**

Financial assets classified in this category are designated by management on initial recognition when the following criteria are met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis; or
- the assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows, that would not be separately recorded.

Financial assets at fair value through statement of profit or loss are recorded in the consolidated statement of financial position at fair value. Changes in fair value are recorded in 'net gain or loss on financial assets designated at fair value through statement of profit or loss. Interest earned is accrued in interest income, while dividend income is recorded in other income. The Group has not designated any financial assets at fair value through profit or loss.

##### **Deposits and due from banks and other financial institutions**

These are stated at cost, adjusted for effective fair value hedges, less any amounts written off and provision for impairment.

##### **Loans and Advances**

Loans and advances measured at amortised cost, they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method, and adjusted for effective fair value hedges and net of interest suspended, provision for impairment and any amounts written off.

##### **Investment securities - Applicable from 1 January 2016**

The 'investment securities' includes:

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

### 3 ACCOUNTING POLICIES (continued)

#### 3.4 Summary of significant accounting policies (continued)

##### iii. Derecognition (continued)

##### **Investment securities - Applicable from 1 January 2016 (continued)**

For debt securities measured at FVOCI, gains and losses are recognised in OCI, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- Interest revenue using the effective interest method;
- Expected Credit Loss and reversals; and
- Foreign exchange gains and losses.

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

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

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

##### **Investment securities - Applicable upto 31 December 2015**

These include bonds, equities, managed funds and other investments. Investments in managed funds comprise investments in mutual funds, private equity, real estate and credit structured products.

These are classified as follows:

- Investments carried at amortised cost
- Available-for-sale

##### *Investments carried at amortised cost*

Debt instruments which could be classified as loans and advances and which have fixed or determinable payments but are not quoted in an active market are treated as investments and carried at amortised cost, adjusted for effective fair value hedges, less provision for impairment. Premiums and discounts on non-trading investments with fixed or determinable repayments are amortised, using the effective interest rate method, and taken to interest income.

##### *Available-for-sale*

All other investments are classified as "available-for-sale". After initial recognition, available-for-sale investments are subsequently measured at fair value, unless fair value cannot be reliably measured in which case they are measured at cost less impairment. Fair value changes which are not part of an effective hedging relationship, are reported as a separate component of equity as cumulative changes in fair value 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 value" within equity, is included in the consolidated statement of profit or loss for the year.

That portion of any fair value changes relating from an effective hedging relationship is recognised directly in the consolidated statement of profit or loss.

##### **Fair value measurement**

The Group measures financial instruments, such as, derivatives at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortised cost are disclosed in Note 39.

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:

### 3 ACCOUNTING POLICIES (continued)

#### 3.4 Summary of significant accounting policies (continued)

##### Fair value measurement (continued)

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

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

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

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

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

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

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

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

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

The Group's Risk Management determines the policies and procedures for fair value measurement. For the purpose of fair value disclosures, the Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

##### Impairment

##### Policy applicable from 1 January 2016

The Group recognises loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- Financial assets that are debt instruments;
- Financial guarantee contracts issued; and
- Loan commitments issued.

No impairment loss is recognised on equity investments.

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

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

### 3 ACCOUNTING POLICIES (continued)

#### 3.4 Summary of significant accounting policies (continued)

##### Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

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

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

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

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

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

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

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

##### Credit-impaired financial assets

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

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

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

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

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

The exposure to the home country sovereign i.e. Bahrain is considered to be low risk and fully recoverable and hence no ECL is measured.

### 3 ACCOUNTING POLICIES (continued)

#### 3.4 Summary of significant accounting policies (continued)

##### **Presentation of allowance for ECL in the statement of financial position**

Loss allowances for ECL are presented in the statement of financial position as follows:

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

##### **Write-off**

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

##### **Impairment and uncollectability of financial assets - applicable up to 31 December 2015**

The Group assesses at each statement of financial position date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of the financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, the probability that they will enter bankruptcy or other financial reorganisation, default or delinquency in interest or principal payments 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.

##### *(i) Financial assets carried at amortised cost*

For financial assets carried at amortised cost (such as amounts due from banks, loans and advances to customers), 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 characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the consolidated statement of profit or loss. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of 'interest 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.



### 3 ACCOUNTING POLICIES (continued)

#### 3.4 Summary of significant accounting policies (continued)

##### Impairment and uncollectability of financial assets (continued)

###### *(i) Financial assets carried at amortised cost (continued)*

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 future write-off is later recovered, the recovery is credited to provision for impairment.

The present value of estimated future cash flows is discounted at the financial asset's original effective interest rate. 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 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. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

###### *(ii) Available-for-sale financial assets*

For available-for-sale investments, 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 on the investment 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. If in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to a credit event occurring after the impairment loss was recognised in the consolidated statement of profit or loss, the impairment loss is reversed through the consolidated statement of profit or loss.

In the case of equity investments classified as available-for-sale, objective evidence would also include a 'significant' or 'prolonged' decline in the fair value of the investment below its cost. Where there is evidence of impairment the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated statement of income 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 fair value after impairment are recognised directly in equity.

### 3 ACCOUNTING POLICIES (continued)

#### 3.4 Summary of significant accounting policies (continued)

##### Impairment and uncollectability of financial assets (continued)

###### *(iii) Renegotiated loans*

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

##### Term borrowings

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

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

##### Derecognition of financial assets and financial liabilities

###### *Financial assets*

A financial asset (in whole or in part) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of ownership or (b) when it has neither transferred or retained substantially all the risks and rewards and when it no longer has control over the financial asset, but has transferred control of the asset.

###### *Financial liabilities*

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

##### Investment in associated companies and joint ventures

The Group's investments in its associate and joint venture are accounted for using the equity method. Under the equity method, the investment in an associate or a joint venture is initially recognised at cost.

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

An associate is an entity over which the Group has significant influence. 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.

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

### **3 ACCOUNTING POLICIES (continued)**

#### **3.4 Summary of significant accounting policies (continued)**

##### **Investment in associated companies and joint ventures (continued)**

The considerations made in determining significant influence or joint control are similar to those necessary to determine control over subsidiaries.

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

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

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

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

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

##### **Premises and equipment**

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

##### **Collateral pending sale**

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

##### **Deposits**

All money market and customer deposits are carried at the fair value of consideration received, adjusted for effective hedges, less amounts repaid.

##### **Repurchase and resale agreements**

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



### 3 ACCOUNTING POLICIES (continued)

#### 3.4 Summary of significant accounting policies (continued)

##### Repurchase and resale agreements (continued)

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

##### Taxation

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

##### Employees' end of service benefits

Costs relating to employees' end of service benefits are accrued in accordance with actuarial and other valuations as required by regulations applicable in each location.

##### Share-based payment transactions

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

##### Provisions

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

##### Treasury stock

Treasury stock is deducted from equity and is stated at cost. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of own equity instruments.

##### Proposed dividends

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

##### Financial guarantees

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

##### Derivatives

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

### 3 ACCOUNTING POLICIES (continued)

#### 3.4 Summary of significant accounting policies (continued)

##### Derivatives (continued)

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.

##### Hedge accounting

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

##### Hedge accounting - Policy applicable on 1 January 2016

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

A hedging relationship qualifies for hedge accounting if it meets all of the following effectiveness requirements:

- there is 'an economic relationship' between the hedged item and the hedging instrument;
- the effect of credit risk does not 'dominate the value changes' that result from that economic relationship; and
- the hedge ratio of the hedging relationship is the same as that resulting from the quantity of hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item.

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

##### Hedge accounting - Policy applicable up to 31 December 2015

At inception of the hedge relationship, the Group formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship.

A formal assessment is also undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%. Hedges are formally assessed each quarter to reconfirm their effectiveness.

##### Classification of Hedge accounting

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

##### *Fair value hedges*

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

### **3 ACCOUNTING POLICIES (continued)**

#### **3.4 Summary of significant accounting policies (continued)**

##### **Classification of Hedge accounting (continued)**

###### *Cash flow value hedges*

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

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

###### ***Discontinuation of hedges - Policy applicable from 1 January 2016***

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

###### ***Discontinuation of hedges - Policy applicable upto 31 December 2015***

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. For effective fair value hedges of financial instruments with fixed maturities any adjustment arising from hedge accounting is amortised over the remaining term to maturity. For effective cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of profit or loss.

##### **Fiduciary assets**

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

##### **Offsetting**

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

##### **Recognition of income and expenses**

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

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

Interest expense is recognised using the effective yield method.

### **3 ACCOUNTING POLICIES (continued)**

#### **3.4 Summary of significant accounting policies (continued)**

##### **Recognition of income and expenses (continued)**

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

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

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

##### **Foreign currencies**

###### *(i) Transactions and balances*

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

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

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

###### *(ii) Group companies*

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

##### **Cash and cash equivalents**

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

##### **Trade date accounting 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. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

### 3 ACCOUNTING POLICIES (continued)

#### 3.5 Significant accounting judgments and estimates

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

##### *Going concern*

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

##### *Fair value of financial instruments*

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, 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 where observable market data is not available, judgment is required to establish fair values. The judgments include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities.

##### *Classification of financial assets - Policy applicable from 1 January 2016*

Assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding.

##### *Impairment of financial instruments - Policy applicable from 1 January 2016*

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

##### *Impairment losses on loans and advances and investments*

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. In estimating these cash flows, the Group makes judgments about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**4 CASH AND BALANCES WITH CENTRAL BANKS**

|  | <b>2016</b>    | <b>2015</b>    |
|--|----------------|----------------|
|  | <b>BD '000</b> | <b>BD '000</b> |
| Cash   | <b>20,853</b>  | 17,636         |
| Current accounts and placements with central banks | <b>216,167</b> | 186,716        |
| Mandatory reserve deposits with central banks      | <b>77,348</b>  | 82,398         |
|  | <b>314,368</b> | 286,750        |

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

**5 TREASURY BILLS**

These are short term treasury bills issued by the Government of the Kingdom of Bahrain which are carried at amortized cost, and Republic of India which are carried at FVOCI. The impairment allowance on the same is BD 0.228 thousand (1 January 2016 BD 0.148 thousand).

At 31 December 2016, treasury bills issued by Government of the Kingdom of Bahrain includes short term Islamic Sukuk amounting BD 48,527 thousand (2015: BD 28,138 thousand).

**6 DEPOSITS AND AMOUNTS DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS**

|  | <b>2016</b>    | <b>2015</b>    |
|--|----------------|----------------|
|  | <b>BD '000</b> | <b>BD '000</b> |
| Deposits with banks and other financial institutions | <b>278,817</b> | 264,359        |
| Other amounts due from banks                         | <b>39,597</b>  | 60,737         |
| Less: Allowance for impairment                       | <b>(7)</b>     | -              |
|  | <b>318,407</b> | 325,096        |

Allowance for impairment is on deposits with banks and other financial institutions in accordance with IFRS 9.

**7 LOANS AND ADVANCES TO CUSTOMERS**

|  | <b>2016</b>      | <b>2015</b>    |
|--|------------------|----------------|
|  | <b>BD '000</b>   | <b>BD '000</b> |
| Loans and advances to customers at amortised cost: |                  |                |
| Commercial loans and overdrafts                    | <b>1,429,210</b> | 1,491,342      |
| Consumer loans                                     | <b>464,830</b>   | 372,297        |
|  | <b>1,894,040</b> | 1,863,639      |
| Less: Allowance for impairment                     | <b>(126,902)</b> | (98,840)       |
|  | <b>1,767,138</b> | 1,764,799      |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**7 LOANS AND ADVANCES TO CUSTOMERS (continued)**

Movements in allowance for impairment are as follows:

## i) Commercial loans and overdrafts

|   | 2016                                   |  |  | 2015                 |                  |
|---|--|--|--|----------------------|------------------|
|   | Stage 1:<br>12-month<br>ECL<br>BD '000 | Stage 2:<br>Lifetime ECL<br>not credit-<br>impaired<br>BD '000 | Stage 3:<br>Lifetime<br>ECL credit-<br>impaired<br>BD '000 | Total ECL<br>BD '000 | Total<br>BD '000 |
| Balance at 1 January - on adoption of IFRS 9                                | 2,437                                  | 42,661   | 51,357   | 96,455               | 73,770           |
| Changes due to financial assets recognised<br>in opening balance that have: |  |  |  | -                    | -                |
| Transfer to 12 month ECL  | 2,181                                  | (2,181)  | -  | -                    | -                |
| Transfer to lifetime ECL not credit- impaired                               | (245)                                  | 249  | (4)  | -                    | -                |
| Transfer to lifetime ECL credit- impaired                                   |  | (10,407)   | 10,407   | -                    | -                |
| Net remeasurement of loss allowance   | (1,750)                                | 8,275  | 21,892   | 28,417               | 20,144           |
| Recoveries / write-backs  | -                                      | -  | (5,499)  | (5,499)              | (3,034)          |
| Amounts written off during the year   | -                                      | -  | (9,414)  | (9,414)              | (2,835)          |
| Foreign exchange and other movements  | -                                      | -  | (1,408)  | (1,408)              | (3,100)          |
| <b>Balance at end of year</b>   | <b>2,623</b>                           | <b>38,597</b>  | <b>67,331</b>  | <b>108,551</b>       | <b>84,945</b>    |

## ii) Consumer loans

|   | 2016                                   |  |  | 2015                 |                  |
|---|--|--|--|----------------------|------------------|
|   | Stage 1:<br>12-month<br>ECL<br>BD '000 | Stage 2:<br>Lifetime ECL<br>not credit-<br>impaired<br>BD '000 | Stage 3:<br>Lifetime<br>ECL credit-<br>impaired<br>BD '000 | Total ECL<br>BD '000 | Total<br>BD '000 |
| Balance at 1 January - on adoption of IFRS 9                                | 2,813                                  | 5,669  | 10,275   | 18,757               | 12,983           |
| Changes due to financial assets recognised<br>in opening balance that have: |  |  |  | -                    | -                |
| Transfer to 12 month ECL  | 565                                    | (565)  | -  | -                    | -                |
| Transfer to lifetime ECL not credit- impaired                               | (90)                                   | 90   | -  | -                    | -                |
| Transfer to lifetime ECL credit- impaired                                   | -                                      | -  | -  | -                    | -                |
| Net remeasurement of loss allowance   | (337)                                  | (109)  | 2,413  | 1,967                | 2,605            |
| Recoveries / write-backs  | -                                      | -  | (1,132)  | (1,132)              | (740)            |
| Amounts written off during the year   | -                                      | -  | (1,222)  | (1,222)              | (902)            |
| Foreign exchange and other movements  | -                                      | -  | (19)   | (19)                 | (51)             |
| <b>Balance at end of year</b>   | <b>2,951</b>                           | <b>5,085</b>   | <b>10,315</b>  | <b>18,351</b>        | <b>13,895</b>    |

At 31 December 2016, interest in suspense on past due loans that are fully impaired amounts to BD 21,572 thousand (31 December 2015: BD 17,680 thousand), effective 31 January 2014 the Bank has treated this as a memorandum account.

The fair value of the collateral consisting of cash, securities and real estate that the Group holds relating to loans individually determined to be impaired at 31 December 2016 amounts to BD 54,229 thousand (2015: BD 62,447 thousand).

At 31 December 2016, loans and advances includes Islamic financing facilities provided by the Group to corporates amounting BD 109,466 thousand (2015: BD 122,879 thousand). These mainly consists of Murabaha and Ijarah financing facilities.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

## 8 INVESTMENT SECURITIES

|   | <i>FVTPL</i><br><i>BD '000</i> | <i>FVOCI</i><br><i>BD '000</i>                         | <i>Amortised</i><br><i>cost</i><br><i>BD '000</i>                      | <i>2016</i><br><i>Total</i><br><i>BD '000</i> |
|---|--------------------------------|--|--|---|
| <b>Quoted investments</b>                   |                                |  |  |   |
| Government bonds                            | -                              | 349,331  | 13,271   | 362,602                                       |
| Other bonds                                 | 3,780                          | 213,148  | -  | 216,928                                       |
| Equities                                    | 5,263                          | 38,480   | -  | 43,743  |
|   | <b>9,043</b>                   | <b>600,959</b>   | <b>13,271</b>  | <b>623,273</b>                                |
| <b>Unquoted investments</b>                 |                                |  |  |   |
| Government bonds                            | -                              | -  | 109,807  | 109,807                                       |
| Other bonds                                 | -                              | -  | -  | -   |
| Equities                                    | -                              | 34,220   | -  | 34,220  |
| Managed funds                               | 1,443                          | -  | -  | 1,443   |
|   | <b>1,443</b>                   | <b>34,220</b>  | <b>109,807</b>   | <b>145,470</b>                                |
|   | <b>10,486</b>                  | <b>635,179</b>   | <b>123,078</b>   | <b>768,743</b>                                |
| Allowance for impairment on debt investment | -                              | (604)  | (5)  | (609)   |
| <b>Balance at 31 December 2016</b>          | <b>10,486</b>                  | <b>634,575</b>   | <b>123,073</b>   | <b>768,134</b>                                |
|   |                                | <i>Available-</i><br><i>for-sale</i><br><i>BD '000</i> | <i>Carried at</i><br><i>amortised</i><br><i>cost</i><br><i>BD '000</i> | <i>Total</i><br><i>2015</i><br><i>BD '000</i> |
| <b>Quoted investments</b>                   |                                |  |  |   |
| Government bonds                            |                                | 355,829  | 1,976  | 357,805                                       |
| Other bonds                                 |                                | 216,447  | -  | 216,447                                       |
| Equities                                    |                                | 71,249   | -  | 71,249  |
|   |                                | <b>643,525</b>   | <b>1,976</b>   | <b>645,501</b>                                |
| <b>Unquoted investments</b>                 |                                |  |  |   |
| Government bonds                            |                                | -  | 81,133   | 81,133  |
| Other bonds                                 |                                | 23,206   | 7,524  | 30,730  |
| Equities                                    |                                | 41,210   | -  | 41,210  |
| Managed funds                               |                                | 2,598  | -  | 2,598   |
|   |                                | <b>67,014</b>  | <b>88,657</b>  | <b>155,671</b>                                |
|   |                                | <b>710,539</b>   | <b>90,633</b>  | <b>801,172</b>                                |
| Allowance for impairment                    |                                | (43,065)   | -  | (43,065)                                      |
| <b>Balance at 31 December 2015</b>          |                                | <b>667,474</b>   | <b>90,633</b>  | <b>758,107</b>                                |

At 31 December 2016, investment securities includes long term Islamic Sukuk amounting to BD 76,659 thousand (2015: BD 60,792 thousand).

**Equity investment securities designated as FVOCI**

At 1 January 2016, the Group designated certain investments securities amounting to BD 71,829 thousand as at FVOCI. In 2015, these investments were classified as available-for-sale. Total dividends income recognized during the year of 2016 on these investments is BD 3,161 thousand.

**Allowance for impairment**

The movements in allowance for impairment of investment securities are as follows:

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

## 8 INVESTMENT SECURITIES (continued)

|  | 2016             |  |                                     | 2015       |               |
|--|------------------|--|-------------------------------------|------------|---------------|
|  | 12-month<br>ECL* | Lifetime<br>ECL not<br>credit-<br>impaired | Lifetime<br>ECL credit-<br>impaired | Total      | Total         |
|  | BD '000          | BD '000                                    | BD '000                             | BD '000    | BD '000       |
| <b>Government and other bonds at FVOCI and Amortized Cost</b>            |                  |  |                                     |            |               |
| Balance at 1 January - on adoption of IFRS 9                             | 162              | 209  | 22,982                              | 23,353     | 48,783        |
| Changes due to financial assets recognised in opening balance that have: |                  |  |                                     |            |               |
| Transfer to 12-month ECL   | 46               | (46)                                       | -                                   | -          | -             |
| Transfer to lifetime ECL not credit-impaired                             | (13)             | 13   | -                                   | -          | -             |
| Transfer to lifetime ECL credit-impaired                                 | -                | -  | -                                   | -          | -             |
| Net remeasurement of loss allowance                                      | (1)              | 292  | -                                   | 291        | 2,822         |
| Financial assets that have been derecognised                             | (30)             | (23)                                       | -                                   | (53)       | -             |
| Write-offs   | -                | -  | (21,576)                            | (21,576)   | (1,211)       |
| Recoveries of amounts previously written off                             | -                | -  | (1,406)                             | (1,406)    | (2,284)       |
| Changes in models/risk parameters  | -                | -  | -                                   | -          | -             |
| Foreign exchange and other movements                                     | -                | -  | -                                   | -          | (45)          |
| <b>Balance at 31 December</b>  | <b>164</b>       | <b>445</b>                                 | <b>-</b>                            | <b>609</b> | <b>48,065</b> |

The loss allowance of the FVOCI is not recognised in the statement of financial position because the carrying amount of debt investment securities at FVOCI (2015: available-for-sale) is at their fair value.

\* The above table includes ECL of government and other bonds measured at amortized cost of BD 5 thousand.

## 9 INVESTMENTS IN ASSOCIATED COMPANIES AND JOINT VENTURES

The Group has a 23.03% (2015: 23.03%) shareholding in Bahrain Commercial Facilities Company B.S.C. ("BCFC"), incorporated in the Kingdom of Bahrain, which is engaged in consumer financing, insurance, dealing in real estate and automobiles.

The Group has a 50% (2015: 50%) stake in Sakana Holistic Housing Solutions B.S.C. (c) ("Sakana"), a jointly controlled company incorporated in the Kingdom of Bahrain which is engaged in Islamic real estate financing, which is under liquidation.

The Group has a 22% (2015: 22%) shareholding in The Benefit Company B.S.C. (c) incorporated in the Kingdom of Bahrain which is engaged in ancillary services to provide payment systems and other related financial services for the benefit of commercial banks and their customers in the Kingdom of Bahrain.

The Group has a 35% (2015: 35%) equity stake in Diyar Al Haremeen Al Ola Limited ("Diyar"), a company incorporated in the Cayman Islands. Diyar holds 100% beneficial interest in a hotel in Makkah, Kingdom of Saudi Arabia. However, due to lack of significant influence in 2016 the Group reclassified this investment to FVOCI.

The Group has a 40% (2015: 40%) stake in BBK Geojit securities K.S.C., a jointly controlled company incorporated in the State of Kuwait.

The Group has a 24.27% (2015: nil) stake in Bahrain Liquidity Fund, an investment vehicle established in Kingdom of Bahrain to enhance liquidity in the market and to close the valuation gap between securities listed on Bahrain Bourse and their regional peers.

The Group has a 50% (2015: nil) stake in Aegila Capital Management Limited, a jointed venture company incorporated in the United Kingdom which is engaged in capital market advisory services for alternative investments with particular focus in the real estate.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**9 INVESTMENTS IN ASSOCIATED COMPANIES AND JOINT VENTURES (continued)**

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

|  | <b>2016</b>     | <b>2015</b>    |
|--|-----------------|----------------|
|  | <b>BD '000</b>  | <b>BD '000</b> |
| <i>Carrying amount of investment in associated companies and joint ventures</i>          |                 |                |
| At 1 January   | <b>35,823</b>   | 36,537         |
| Acquisitions during the year   | <b>10,694</b>   | -              |
| Share of profit  | <b>5,467</b>    | 4,215          |
| Dividends received from associated companies   | <b>(2,103)</b>  | (1,835)        |
| Change in unrealised fair values - associated companies (note 17)                        | <b>6</b>        | (85)           |
| Change in Foreign exchange translation adjustments                                       | <b>(2)</b>      | (9)            |
| Reclassification to FVOCI  | <b>(4,962)</b>  | -              |
| Capital distribution   | <b>(1,000)</b>  | (3,000)        |
| At 31 December   | <b>43,923</b>   | 35,823         |
|  | <b>2016</b>     | <b>2015</b>    |
|  | <b>BD '000</b>  | <b>BD '000</b> |
| <i>Share of associated companies and joint ventures statements of financial position</i> |                 |                |
| Current and non-current assets   | <b>94,874</b>   | 76,577         |
| Current and non-current liabilities  | <b>(50,951)</b> | (40,754)       |
| Net assets   | <b>43,923</b>   | 35,823         |
| <i>Share of associated companies and joint ventures revenues</i>                         |                 |                |
| Revenue  | <b>10,987</b>   | 10,124         |

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

|                                      | <b>2016</b>     | <b>2015</b>    |
|--------------------------------------|-----------------|----------------|
|                                      | <b>BD '000</b>  | <b>BD '000</b> |
| Net interest income                  | <b>21,504</b>   | 17,421         |
| Gross profit on automotive sales     | <b>6,671</b>    | 10,715         |
| Other operating income               | <b>12,866</b>   | 7,238          |
| Total operating income               | <b>41,041</b>   | 35,374         |
| Operating expense                    | <b>(17,847)</b> | (18,317)       |
| Other expense                        | <b>(2,625)</b>  | (1,551)        |
| Profit for the year                  | <b>20,569</b>   | 15,506         |
| Group's share of profit for the year | <b>4,737</b>    | 3,571          |



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**9 INVESTMENTS IN ASSOCIATED COMPANIES AND JOINT VENTURES (continued)**

|                                     | <b>2016</b>    | <b>2015</b>    |
|-------------------------------------|----------------|----------------|
|                                     | <b>BD '000</b> | <b>BD '000</b> |
| <b>Assets</b>                       |                |                |
| Cash and balances with banks        | <b>5,311</b>   | 2,206          |
| Loans and advances to customers     | <b>265,318</b> | 222,762        |
| Inventories                         | <b>26,752</b>  | 24,274         |
| Other assets                        | <b>47,618</b>  | 38,278         |
| <b>Total assets</b>                 | <b>344,999</b> | 287,520        |
| <b>Liabilities</b>                  |                |                |
| Bank overdrafts                     | <b>1,959</b>   | 1,328          |
| Trade and other payables            | <b>18,851</b>  | 19,469         |
| Bank term loans                     | <b>161,628</b> | 117,503        |
| Bonds issued                        | <b>39,816</b>  | 39,753         |
| <b>Total liabilities</b>            | <b>222,254</b> | 178,053        |
| <b>Donation reserve</b>             | <b>(872)</b>   | (838)          |
| <b>Equity</b>                       | <b>121,873</b> | 108,629        |
| Proportion of the Group's ownership | <b>23.03%</b>  | 23.03%         |
|                                     | <b>28,067</b>  | 25,017         |

The figures reported above for BCFC are based on 30 September 2016 reviewed financial statements adjusted for expected performance in the last quarter.

The market value of the Group's investment in BCFC is BD 25,205 thousand (2015: BD 28,778 thousand) compared to the carrying value of BD 28,067 thousand (2015: BD 25,017 thousand) as at 31 December 2016.

**10 INTEREST RECEIVABLE AND OTHER ASSETS**

|  | <b>2016</b>    | <b>2015</b>    |
|--|----------------|----------------|
|  | <b>BD '000</b> | <b>BD '000</b> |
| Interest receivable                          | <b>14,783</b>  | 17,350         |
| Accounts receivable                          | <b>23,002</b>  | 18,664         |
| Positive fair value of derivatives (note 26) | <b>6,938</b>   | 2,336          |
| Prepaid expenses                             | <b>1,777</b>   | 2,185          |
| Deferred tax                                 | <b>2,216</b>   | 2,991          |
| Collateral pending sale                      | <b>4,671</b>   | 4,784          |
| Other  | <b>11,382</b>  | 8,660          |
|  | <b>64,769</b>  | 56,970         |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

## 11 PREMISES AND EQUIPMENT

|                                       | <i>Freehold<br/>land<br/>BD '000</i> | <i>Properties<br/>and<br/>buildings<br/>BD '000</i> | <i>Furniture<br/>and<br/>equipment<br/>BD '000</i> | <i>Capital<br/>work in<br/>progress<br/>BD '000</i> | <i>Total<br/>BD '000</i> |
|---------------------------------------|--------------------------------------|---|--|---|--------------------------|
| Net book value at<br>31 December 2016 | 8,241                                | 10,603  | 5,123  | 216   | 24,183                   |
|                                       | <i>Freehold<br/>land<br/>BD '000</i> | <i>Properties<br/>and<br/>buildings<br/>BD '000</i> | <i>Furniture<br/>and<br/>equipment<br/>BD '000</i> | <i>Capital<br/>work in<br/>progress<br/>BD '000</i> | <i>Total<br/>BD '000</i> |
| Net book value at<br>31 December 2015 | 8,260                                | 11,370  | 5,051  | 125   | 24,806                   |

The depreciation charge for the year amounted to BD 3,430 thousand (2015: BD 3,226 thousand).

## 12 TERM BORROWINGS

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

| <i>Amount of facility<br/>US\$ '000</i> | <i>Rate of interest</i> | <i>Maturity<br/>Year</i> | <i>2016<br/>BD '000</i> | <i>2015<br/>BD '000</i> |
|---|-------------------------|--------------------------|-------------------------|-------------------------|
| 145,140                                 | Libor + 1.25%           | 2017                     | 8,509                   | 8,509                   |
| 129,860                                 | Libor + 1.75%           | 2018                     | 46,800                  | 45,368                  |
| 400,000                                 | 3.50%                   | 2020                     | 150,800                 | 150,800                 |
|   |                         |                          | <b>206,109</b>          | <b>204,677</b>          |

## 13 CUSTOMERS' CURRENT, SAVINGS AND OTHER DEPOSITS

|                  | <i>2016<br/>BD '000</i> | <i>2015<br/>BD '000</i> |
|------------------|-------------------------|-------------------------|
| Term deposits    | 1,362,104               | 1,497,279               |
| Current accounts | 571,324                 | 608,957                 |
| Savings accounts | 483,129                 | 440,189                 |
| Other accounts   | 77,158                  | 96,467                  |
|                  | <b>2,493,715</b>        | <b>2,642,892</b>        |

## 14 INTEREST PAYABLE AND OTHER LIABILITIES

|  | <i>2016<br/>BD '000</i> | <i>2015<br/>BD '000</i> |
|--|-------------------------|-------------------------|
| Accrued expenses                             | 36,585                  | 33,996                  |
| Interest payable                             | 13,405                  | 16,728                  |
| Accounts payable                             | 16,750                  | 14,634                  |
| Negative fair value of derivatives (note 26) | 9,775                   | 12,490                  |
| Other  | 7,212                   | 6,378                   |
| Allowance for impairment*                    | 864                     | -                       |
|  | <b>84,591</b>           | <b>84,226</b>           |

\* This represents allowance for impairment on financial contracts issued as of 31 December 2016, the sum of ECL provisions of BD 864 thousand and the amounts recognised at issuance less cumulative amortisation.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**15 EQUITY**

| <i>Share capital</i>   | <b>2016</b>    | <b>2015</b>    |
|--|----------------|----------------|
|  | <b>BD '000</b> | <b>BD '000</b> |
| <i>Authorised</i>  |                |                |
| 1,500,000,000 shares of BD 0.100 each                              | <b>150,000</b> | 150,000        |
| <i>Issued and fully paid</i>                                       |                |                |
| 1,081,647,952 shares (2015: 1,081,647,952 shares) of BD 0.100 each | <b>108,165</b> | 108,165        |
| <i>Treasury stock*</i>   | <b>(1,206)</b> | (4,728)        |

\* Treasury stock represents the purchase by the Bank of its own shares. At the end of the year, the Bank held 6,098,267 (2015: 17,195,500) of its own shares, inclusive of bonus shares issued during 2016.

*Share premium*

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

*Employee Performance Share Plan*

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

*Unclaimed dividends*

During the year, the Group transferred BD 27 thousand (2015: BD 243 thousand) to equity as unclaimed dividends by the shareholders. As per the Group policy and procedures, any unclaimed dividends in excess of 10 years are transferred to equity, however will be available to the respective shareholder for any future claims.

*Perpetual tier 1 convertible capital securities*

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

**16 RESERVES***Statutory reserve*

The statutory reserve has been created in accordance with the Bahrain Commercial Companies Law. The Bank transfers 10% of its annual profits to its statutory reserve till such time as the reserve equals 50% of the issued share capital of the Bank. During the year, the Bank had not transferred to statutory reserve (2015: BD 2,575 thousand) as the statutory reserve reached 50% of the issued share capital. The reserve is not available for distribution, except in circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

*General reserve*

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

## 17 CUMULATIVE CHANGES IN FAIR VALUES

|  | 2016<br>BD '000 | 2015<br>BD '000 |
|--|-----------------|-----------------|
| <b><i>Fair value through other comprehensive income</i></b>          |                 |                 |
| At 1 January   | (12,070)        | 17,350          |
| Changes due to adoption of IFRS 9:                                   |                 |                 |
| Transfer to retained earning on classification to FVTPL              | (4,853)         | -               |
| Transfer on classification to amortised cost                         | 4,988           | -               |
| Transfer from retained earnings on classification as FVOCI           | (17,015)        | -               |
| Restated balance as at 1 January                                     | (28,950)        | 17,350          |
| Transfer to retained earnings on sale/write off of equity securities | 3,738           | -               |
| Transfer to P&L on sale of investment securities                     | (2,095)         | (3,813)         |
| Transferred to P&L on impairment                                     | 238             | 1,094           |
| Fair value changes on investment securities at FVOCI during the year | 13,460          | (26,701)        |
| At 31 December   | (13,609)        | (12,070)        |
| <b><i>Cash flow hedges</i></b>                                       |                 |                 |
| At 1 January   | (234)           | 70              |
| Change in unrealised fair values                                     | 168             | (219)           |
| Change in unrealised fair values - associated companies (note 9)     | 6               | (85)            |
| At 31 December   | (60)            | (234)           |
|  | (13,669)        | (12,304)        |

## 18 PROPOSED APPROPRIATIONS

|                             | 2016<br>BD '000 | 2015<br>BD '000 |
|-----------------------------|-----------------|-----------------|
| Cash dividend               | 32,266          | 26,611          |
| Stock dividend              | -               | -               |
| Transfer to general reserve | -               | 2,575           |
| Donations                   | 1,400           | 1,400           |
|                             | 33,666          | 30,586          |

The Board of Directors has proposed cash dividend of BD 0.030 per share (2015: BD 0.025 per share), net of treasury stock as of 31 December 2016. The Bank paid dividend of BD 0.025 per share (2015: BD 0.025 per share).

The above appropriations will be submitted for approval at the Annual General Assembly of the Shareholders to be held on 29 March 2017. The payment of dividend is also subject to the approval of the Central Bank of Bahrain.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**19 INTEREST AND SIMILAR INCOME**

|  | 2016<br>BD '000 | 2015<br>BD '000 |
|--|-----------------|-----------------|
| Loans and advances to customers                                      | 91,714          | 87,094          |
| Investment securities  | 22,871          | 20,075          |
| Deposits and amounts due from banks and other financial institutions | 4,806           | 2,562           |
| Treasury bills   | 9,165           | 4,882           |
|  | <b>128,556</b>  | <b>114,613</b>  |

**20 OTHER INCOME**

|   | 2016<br>BD '000 | 2015<br>BD '000 |
|---|-----------------|-----------------|
| Fee and commission income               | 44,061          | 40,919          |
| Dividend income                         | 3,540           | 3,806           |
| Realised gains on investment securities | 2,707           | 4,408           |
| Gain on foreign exchange                | 5,149           | 5,260           |
| Others                                  | 1,539           | 2,350           |
|   | <b>56,996</b>   | <b>56,743</b>   |
| Fee and commission expense              | <b>(14,784)</b> | <b>(12,524)</b> |
|   | <b>42,212</b>   | <b>44,219</b>   |

Included in fee and commission income is BD 67 thousand (2015: BD 132 thousand) relating to trust and other fiduciary activities.

**21 BASIC AND DILUTED EARNINGS PER SHARE***Basic earnings per share*

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

*Diluted earnings per share*

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

|   | 2016                 | 2015                 |
|---|----------------------|----------------------|
| Profit for the year attributable to the owners of the Bank (BD '000)                  | 56,410               | 53,212               |
| (Less): Distribution on perpetual tier 1 convertible capital securities (BD '000)     | (3,552)              | -                    |
| Adjusted net profit for the year attributable to the owners of the Bank               | <b>52,858</b>        | <b>53,212</b>        |
| Weighted average number of shares, net of treasury stock, outstanding during the year | <b>1,070,557,685</b> | <b>1,060,391,006</b> |
| Basic earnings per share (BD)   | <b>0.049</b>         | <b>0.050</b>         |
| Weighted average number of ordinary shares adjusted for the effect of dilution        | <b>1,285,801,465</b> | <b>1,060,391,006</b> |
| Diluted earnings per share (BD)   | <b>0.044</b>         | <b>0.050</b>         |



**22 OPERATING SEGMENTS****Segment information**

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

- |  |   |
|--|---|
| <b>Retail banking</b>                            | - Principally handling individual customers' deposits and providing consumer finance type loans, overdrafts, credit facilities and funds transfer facilities, credit cards and foreign exchange.  |
| <b>Corporate banking</b>                         | - Principally handling loans and other credit facilities, deposit and current accounts for corporate and institutional customers in Bahrain.  |
| <b>International banking</b>                     | - Principally handling loans and other credit facilities, deposit and current accounts for international corporate and institutional customers. This also covers the operations of the overseas units.  |
| <b>Investment, treasury and other activities</b> | - Principally providing money market, trading and treasury services as well as the management of the Group's funding operations. Investment activities involve handling investments in local and international markets, investment advisory services and funds management. Other activities also include business process outsourcing services. |

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**22 OPERATING SEGMENTS (continued)**

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

|   | <i>Retail<br/>banking<br/>BD '000</i> | <i>Corporate<br/>banking<br/>BD '000</i> | <i>International<br/>banking<br/>BD '000</i> | <i>Investment,<br/>treasury<br/>and other<br/>activities<br/>BD '000</i> | <i>Total<br/>BD '000</i> |
|---|---------------------------------------|--|--|--|--------------------------|
| Interest income   | 27,160                                | 36,519                                   | 32,702                                       | 32,175   | 128,556                  |
| Interest expense  | (2,576)                               | (7,937)                                  | (10,531)                                     | (21,664)   | (42,708)                 |
| Internal fund transfer price  | (4,387)                               | (4,176)                                  | (3,995)                                      | 12,558   | -                        |
| Net Interest Income   | 20,197                                | 24,406                                   | 18,176                                       | 23,069   | 85,848                   |
| Other Operating Income  | 21,699                                | 3,993                                    | 5,776  | 10,744   | 42,212                   |
| Operating income before share of profit of<br>associated companies and joint ventures | 41,896                                | 28,399                                   | 23,952                                       | 33,813   | 128,060                  |
| Net provision for impairment<br>on loans and advances to customers                    | (1,663)                               | (11,688)                                 | (10,402)                                     | -  | (23,753)                 |
| Net provision of impairment<br>of non-trading investment securities                   | -                                     | -  | -  | 1,115  | 1,115                    |
| Segment result  | 15,050                                | 2,754                                    | 120  | 33,356   | 51,280                   |
| Share of profit of associated companies<br>and joint ventures                         | 5,562                                 | -  | -  | (95)   | 5,467                    |
| Profit for the year   |                                       |  |  |  | 56,747                   |
| Profit attributable to non-controlling interest                                       |                                       |  |  |  | (337)                    |
| Profit for the year attributable to the owners of the Bank                            |                                       |  |  |  | 56,410                   |
| Segment assets  | 537,433                               | 700,692                                  | 1,297,251                                    | 1,089,227  | 3,624,603                |
| Investment in associated companies<br>and joint ventures                              | 31,982                                | -  | -  | 11,941   | 43,923                   |
| Common assets   |                                       |  |  |  | 34,031                   |
| Total assets  |                                       |  |  |  | 3,702,557                |
| Segment liabilities   | 734,539                               | 792,531                                  | 885,892                                      | 765,143  | 3,178,105                |
| Common liabilities  |                                       |  |  |  | 50,237                   |
| Total liabilities   |                                       |  |  |  | 3,228,342                |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**22 OPERATING SEGMENTS (continued)**

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

|   | <i>Retail<br/>banking<br/>BD '000</i> | <i>Corporate<br/>banking<br/>BD '000</i> | <i>International<br/>banking<br/>BD '000</i> | <i>Investment,<br/>treasury<br/>and other<br/>activities<br/>BD '000</i> | <i>Total<br/>BD '000</i> |
|---|---------------------------------------|--|--|--|--------------------------|
| Interest income   | 24,681                                | 34,681                                   | 32,004                                       | 23,247   | 114,613                  |
| Interest expense  | (2,672)                               | (8,600)                                  | (8,598)                                      | (22,037)   | (41,907)                 |
| Internal fund transfer price  | (6,157)                               | (1,971)                                  | (3,545)                                      | 11,673   | -                        |
| Net Interest Income   | 15,852                                | 24,110                                   | 19,861                                       | 12,883   | 72,706                   |
| Other Operating Income  | 20,486                                | 4,061                                    | 5,944  | 13,728   | 44,219                   |
| Operating income before share of profit of<br>associated companies and joint ventures | 36,338                                | 28,171                                   | 25,805                                       | 26,611   | 116,925                  |
| Net provision for impairment<br>on loans and advances to customers                    | (1,293)                               | (6,298)                                  | (11,384)                                     | -  | (18,975)                 |
| Net write back of impairment<br>of non-trading investment securities                  | -                                     | -  | -  | (538)  | (538)                    |
| Segment result  | 12,875                                | 9,370                                    | 3,734  | 23,195   | 49,174                   |
| Share of profit of associated companies<br>and joint ventures                         | 4,215                                 | -  | -  | -  | 4,215                    |
| Profit for the year   |                                       |  |  |  | 53,389                   |
| Loss attributable to non-controlling interest   |                                       |  |  |  | (177)                    |
| Profit for the year attributable to the owners of the Bank                            |                                       |  |  |  | 53,212                   |
| Segment assets  | 486,914                               | 696,969                                  | 1,334,785                                    | 1,063,820  | 3,582,488                |
| Investment in associated companies<br>and joint ventures                              | 27,950                                | -  | -  | 7,873  | 35,823                   |
| Common assets   |                                       |  |  |  | 28,130                   |
| Total assets  |                                       |  |  |  | 3,646,441                |
| Segment liabilities   | 679,825                               | 975,041                                  | 853,257                                      | 729,570  | 3,237,693                |
| Common liabilities  |                                       |  |  |  | 48,014                   |
| Total liabilities   |                                       |  |  |  | 3,285,707                |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**22 OPERATING SEGMENTS (continued)****Geographic information**

The Group operates in two geographic markets: Domestic (Bahrain), Others (Middle East/Africa, Europe, North America and Asia). The following tables show the distribution of the Group's revenue and non-current assets by geographical segment, allocated based on the location in which the assets and liabilities are located, for the years ended 31 December 2016 and 31 December 2015:

|  | <i>Domestic<br/>BD '000</i> | <i>Others<br/>BD '000</i> | <i>Total<br/>BD '000</i> |
|--|-----------------------------|---------------------------|--------------------------|
| <b>31 December 2016</b>                                    |                             |                           |                          |
| Net interest income  | 75,413                      | 10,435                    | 85,848                   |
| Share of profit in associated companies and joint ventures | 5,467                       | -                         | 5,467                    |
| Other income   | 38,331                      | 3,881                     | 42,212                   |
|  | <b>119,211</b>              | <b>14,316</b>             | <b>133,527</b>           |
| Non-current assets   | <b>20,132</b>               | <b>4,051</b>              | <b>24,183</b>            |
|  | <i>Domestic<br/>BD '000</i> | <i>Others<br/>BD '000</i> | <i>Total<br/>BD '000</i> |
| <b>31 December 2015</b>                                    |                             |                           |                          |
| Net interest income  | 61,777                      | 10,929                    | 72,706                   |
| Share of profit in associated companies and joint ventures | 4,215                       | -                         | 4,215                    |
| Other income   | 40,553                      | 3,666                     | 44,219                   |
|  | <b>106,545</b>              | <b>14,595</b>             | <b>121,140</b>           |
| Non-current assets   | <b>20,659</b>               | <b>4,147</b>              | <b>24,806</b>            |

Non-current assets represents premises and equipment.

**23 CASH AND CASH EQUIVALENTS**

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

|   | <i>2016<br/>BD '000</i> | <i>2015<br/>BD '000</i> |
|---|-------------------------|-------------------------|
| Cash (note 4)   | 20,853                  | 17,636                  |
| Current accounts and placements with central banks (note 4)   | 216,167                 | 186,716                 |
| Treasury bills  | -                       | 5,667                   |
| Deposits and amounts due from banks and other financial institutions<br>with original maturities of ninety days or less | 300,584                 | 323,097                 |
|   | <b>537,604</b>          | <b>533,116</b>          |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**24 RELATED PARTY TRANSACTIONS**

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

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

|  | <i>Major<br/>shareholders<br/>BD '000</i> | <i>Associated<br/>companies<br/>and joint<br/>ventures<br/>BD '000</i> | <i>Directors<br/>and key<br/>management<br/>personnel<br/>BD '000</i> | <i>Total<br/>BD '000</i> |
|--|---|--|---|--------------------------|
| <b>2016</b>                                    |   |  |   |                          |
| Loans and advances to customers                | -   | 15,521   | 3,325   | 18,846                   |
| Customers' current, savings and other deposits | 208,871                                   | 3,286  | 8,885   | 221,042                  |
| <b>2015</b>                                    |   |  |   |                          |
| Loans and advances to customers                | -   | 4,207  | 1,224   | 5,431                    |
| Customers' current, savings and other deposits | 290,287                                   | 6,180  | 8,895   | 305,362                  |

For the years ended 31 December 2016 and 31 December 2015 the Group has not recorded any impairment provision on the amounts due from related parties.

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

|                  | <i>Major<br/>shareholders<br/>BD '000</i> | <i>Associated<br/>companies<br/>and joint<br/>ventures<br/>BD '000</i> | <i>Directors<br/>and key<br/>management<br/>personnel<br/>BD '000</i> | <i>Total<br/>BD '000</i> |
|------------------|---|--|---|--------------------------|
| <b>2016</b>      |   |  |   |                          |
| Interest income  | -   | 567  | 120   | 687                      |
| Interest expense | 3,127                                     | 106  | 115   | 3,348                    |
| <b>2015</b>      |   |  |   |                          |
| Interest income  | -   | 320  | 18  | 338                      |
| Interest expense | 3,328                                     | 100  | 126   | 3,554                    |

Compensation of the key management personnel is as follows:

|                              | <b>2016<br/>BD '000</b> | <b>2015<br/>BD '000</b> |
|------------------------------|-------------------------|-------------------------|
| Short term employee benefits | 10,279                  | 7,507                   |
| Others                       | (31)                    | 269                     |
|                              | <b>10,248</b>           | <b>7,776</b>            |

**Key management interest in an employee share incentive scheme**

The Bank has introduced effective 2010, a new share-based payment scheme (refer to note 40 for details).



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

## 25 MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The maturity profile of the assets and liabilities at 31 December 2016 and as at 31 December 2015 given below have been determined on the basis of the remaining period at the statement of financial position date to the contractual maturity date, except in the case of customer deposits. The liquidity profile of customer deposits has been determined on the basis of the effective maturities indicated by the Group's deposit retention history.

|  | 31 December 2016 |                |                |                |                  |                  |                  | BD '000          |                    |                  |  |
|--|------------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|--------------------|------------------|--|
|  | Within 1 month   | 1 to 3 months  | 3 to 6 months  | 6 to 12 months | Subtotal         | 1 to 5 years     | 5 to 10 years    | 10 to 20 years   | More than 20 years | Total            |  |
| <b>Assets</b>  |                  |                |                |                |                  |                  |                  |                  |                    |                  |  |
| Cash and balances with central banks                                 | 237,020          | -              | -              | -              | 237,020          | -                | -                | -                | 77,348             | 314,368          |  |
| Treasury bills   | 35,780           | 233,931        | 43,887         | 88,037         | 401,635          | -                | -                | -                | -                  | 401,635          |  |
| Deposits and amounts due from banks and other financial institutions | 295,207          | 10,455         | 12,318         | 427            | 318,407          | -                | -                | -                | -                  | 318,407          |  |
| Loans and advances to customers                                      | 104,292          | 136,801        | 154,280        | 96,613         | 491,986          | 779,317          | 270,083          | 52,013           | 173,739            | 1,767,138        |  |
| Investment securities  | 9,360            | 17,353         | 23,955         | 41,029         | 91,697           | 286,899          | 254,736          | 9,368            | 125,434            | 768,134          |  |
| Investments in associated companies and joint venture                | -                | -              | -              | -              | -                | -                | -                | -                | 43,923             | 43,923           |  |
| Interest receivable and other assets                                 | 56,088           | 96             | 49             | 52             | 56,285           | 8,484            | -                | -                | -                  | 64,769           |  |
| Premises and equipment   | -                | -              | -              | -              | -                | 19,879           | 914              | 1,619            | 1,771              | 24,183           |  |
| <b>Total assets</b>  | <b>737,747</b>   | <b>398,636</b> | <b>234,489</b> | <b>226,158</b> | <b>1,597,030</b> | <b>1,094,579</b> | <b>525,733</b>   | <b>63,000</b>    | <b>422,215</b>     | <b>3,702,557</b> |  |
| <b>Liabilities</b>   |                  |                |                |                |                  |                  |                  |                  |                    |                  |  |
| Deposits and amounts due to banks and other financial institutions   | 187,518          | 72,311         | -              | 82             | 259,911          | -                | -                | -                | -                  | 259,911          |  |
| Borrowings under repurchase agreement                                | 645              | -              | -              | 22,058         | 22,703           | 161,313          | -                | -                | -                  | 184,016          |  |
| Term borrowings  | -                | -              | 8,509          | -              | 8,509            | 197,600          | -                | -                | -                  | 206,109          |  |
| Customers' current, savings and other deposits                       | 406,410          | 241,403        | 61,263         | 28,447         | 737,523          | 66,128           | -                | -                | 1,690,064          | 2,493,715        |  |
| Interest payable and other liabilities                               | 57,703           | 3,331          | 1,591          | 1,291          | 63,916           | 20,675           | -                | -                | -                  | 84,591           |  |
| <b>Total liabilities</b>   | <b>652,276</b>   | <b>317,045</b> | <b>71,363</b>  | <b>51,878</b>  | <b>1,092,562</b> | <b>445,716</b>   | <b>-</b>         | <b>-</b>         | <b>1,690,064</b>   | <b>3,228,342</b> |  |
| <b>Net</b>   | <b>85,471</b>    | <b>81,591</b>  | <b>163,126</b> | <b>174,280</b> | <b>504,468</b>   | <b>648,863</b>   | <b>525,733</b>   | <b>63,000</b>    | <b>(1,267,849)</b> | <b>474,215</b>   |  |
| <b>Cumulative</b>  | <b>85,471</b>    | <b>167,062</b> | <b>330,188</b> | <b>504,468</b> |                  | <b>1,153,331</b> | <b>1,679,064</b> | <b>1,742,064</b> | <b>474,215</b>     |                  |  |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

25 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

31 December 2015

| 31 December 2015   |                |                |                |                |                  |                  |                  |                    |                    |                  |
|--|----------------|----------------|----------------|----------------|------------------|------------------|------------------|--------------------|--------------------|------------------|
| BD '000  |                |                |                |                |                  |                  |                  |                    |                    | Total            |
| Within 1 month   | 1 to 3 months  | 3 to 6 months  | 6 to 12 months | Subtotal       | 1 to 5 years     | 5 to 10 years    | 10 to 20 years   | More than 20 years |                    |                  |
| <b>Assets</b>  |                |                |                |                |                  |                  |                  |                    |                    |                  |
| Cash and balances with central banks                                 | 204,352        | -              | -              | -              | 204,352          | -                | -                | -                  | 82,398             | 286,750          |
| Treasury bills   | 77,647         | 146,069        | 72,057         | 98,317         | 394,090          | -                | -                | -                  | -                  | 394,090          |
| Deposits and amounts due from banks and other financial institutions | 288,375        | 36,721         | -              | -              | 325,096          | -                | -                | -                  | -                  | 325,096          |
| Loans and advances to customers                                      | 101,348        | 145,071        | 121,488        | 139,823        | 507,730          | 769,419          | 243,185          | 54,137             | 190,328            | 1,764,799        |
| Investment securities  | 24,602         | 9,641          | 19,872         | 50,883         | 104,998          | 261,825          | 239,942          | 14,016             | 137,326            | 758,107          |
| Investments in associated companies and joint venture                | -              | -              | -              | -              | -                | -                | -                | -                  | 35,823             | 35,823           |
| Interest receivable and other assets                                 | 47,884         | 63             | 90             | 54             | 48,091           | 8,879            | -                | -                  | -                  | 56,970           |
| Premises and equipment   | -              | -              | -              | -              | -                | 20,022           | 1,216            | 1,728              | 1,840              | 24,806           |
| <b>Total assets</b>  | <b>744,208</b> | <b>337,565</b> | <b>213,507</b> | <b>289,077</b> | <b>1,584,357</b> | <b>1,060,145</b> | <b>484,343</b>   | <b>69,881</b>      | <b>447,715</b>     | <b>3,646,441</b> |
| <b>Liabilities</b>   |                |                |                |                |                  |                  |                  |                    |                    |                  |
| Deposits and amounts due to banks and other financial institutions   | 137,683        | 28,893         | 9,440          | 3,388          | 179,404          | -                | -                | -                  | -                  | 179,404          |
| Borrowings under repurchase agreement                                | -              | -              | -              | -              | -                | 174,508          | -                | -                  | -                  | 174,508          |
| Term borrowings  | -              | -              | -              | -              | -                | 204,677          | -                | -                  | -                  | 204,677          |
| Customers' current, savings and other deposits                       | 334,779        | 228,438        | 95,990         | 112,213        | 771,420          | 28,391           | 9                | -                  | 1,843,072          | 2,642,892        |
| Interest payable and other liabilities                               | 66,400         | 3,000          | 1,438          | 3,647          | 74,485           | 9,432            | -                | -                  | 309                | 84,226           |
| <b>Total liabilities</b>   | <b>538,862</b> | <b>260,331</b> | <b>106,868</b> | <b>119,248</b> | <b>1,025,309</b> | <b>417,008</b>   | <b>9</b>         | <b>-</b>           | <b>1,843,381</b>   | <b>3,285,707</b> |
| <b>Net</b>   | <b>205,346</b> | <b>77,234</b>  | <b>106,639</b> | <b>169,829</b> | <b>559,048</b>   | <b>643,137</b>   | <b>484,334</b>   | <b>69,881</b>      | <b>(1,395,666)</b> | <b>360,734</b>   |
| <b>Cumulative</b>  | <b>205,346</b> | <b>282,580</b> | <b>389,219</b> | <b>559,048</b> |                  | <b>1,202,185</b> | <b>1,686,519</b> | <b>1,756,400</b>   | <b>360,734</b>     |                  |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**26 DERIVATIVES**

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

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

|   | <i>Positive<br/>fair<br/>value<br/>BD '000</i> | <i>Negative<br/>fair<br/>value<br/>BD '000</i> | <i>Notional<br/>amount<br/>BD '000</i> |
|---|--|--|--|
| <b>31 December 2016</b>                             |  |  |  |
| <b><i>Derivatives held for trading</i></b>          |  |  |  |
| Forward foreign exchange contracts                  | 108  | 137  | 105,635                                |
| <b><i>Derivatives held as fair value hedges</i></b> |  |  |  |
| Interest rate swaps                                 | 6,672  | 9,638  | 549,716                                |
| <b><i>Derivatives held as cash flow</i></b>         |  |  |  |
| Interest rate swaps                                 | 158  | -  | 57,519                                 |
|   | <b>6,938</b>                                   | <b>9,775</b>                                   | <b>712,870</b>                         |
|   |  |  |  |
|   | <i>Positive<br/>fair<br/>value<br/>BD '000</i> | <i>Negative<br/>fair<br/>value<br/>BD '000</i> | <i>Notional<br/>amount<br/>BD '000</i> |
| <b>31 December 2015</b>                             |  |  |  |
| <b><i>Derivatives held for trading</i></b>          |  |  |  |
| Forward foreign exchange contracts                  | 302  | 360  | 162,509                                |
| <b><i>Derivatives held as fair value hedges</i></b> |  |  |  |
| Interest rate swaps                                 | 1,991  | 12,078   | 505,932                                |
| <b><i>Derivatives held as cash flow hedges</i></b>  |  |  |  |
| Interest rate swaps                                 | 43   | 52   | 57,519                                 |
|   | <b>2,336</b>                                   | <b>12,490</b>                                  | <b>725,960</b>                         |

***Derivative product types***

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

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

**26 DERIVATIVES (continued)*****Derivative product types (continued)***

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

***Derivatives held or issued for trading purposes***

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

***Derivatives held or issued for hedging purposes***

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

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

***Fair value hedges***

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

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

At 31 December 2016, the Group held the following interest rate swaps as hedging instruments in fair value hedges of interest risk.

**Risk category**

|                                       | <i>Less than<br/>1 month</i> | <i>1–3 months</i> | <i>3 months –<br/>1 year</i> | <i>1–5 years</i> | <i>More than<br/>5 years</i> |
|---------------------------------------|------------------------------|-------------------|------------------------------|------------------|------------------------------|
| <b>Interest rate risk</b>             |                              |                   |                              |                  |                              |
| <b>Hedge of Investment Securities</b> |                              |                   |                              |                  |                              |
| <b>31 December 2016</b>               |                              |                   |                              |                  |                              |
| Nominal amount (BD '000)              | 1,847                        | 5,820             | 13,761                       | 226,150          | 302,138                      |
| Average fixed interest rate           | 4%                           | 5.8%              | 4.3%                         | 4.7%             | 5%                           |
| <b>31 December 2015</b>               |                              |                   |                              |                  |                              |
| Nominal amount (BD '000)              | 1,885                        | 3,770             | 19,604                       | 194,267          | 286,406                      |
| Average fixed interest rate           | 5%                           | 5%                | 5%                           | 5%               | 5.4%                         |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

## 26 DERIVATIVES (continued)

**Fair value hedges (continued)**

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

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

|                               | 2016                          |  | 2015                          |   |
|-------------------------------|-------------------------------|--|-------------------------------|---|
|                               | Carrying<br>amount<br>BD '000 | Accumulated fair<br>value<br>hedge<br>adjustments<br>on the<br>hedged<br>item<br>included in<br>the<br>carrying<br>amount<br>BD '000 | Carrying<br>amount<br>BD '000 | Accumulated fair<br>value<br>hedge<br>adjustments<br>on the<br>hedged<br>item<br>included in<br>the carrying<br>amount<br>BD '000 |
| Bonds [Investment securities] | 549,057                       | 2,230  | 514,980                       | 9,580   |

For the year ended 31 December 2016, the Group recognised a net gain of BD 1 thousand (2015: net gain of BD 31 thousand), representing the gain on the hedging instruments. The total loss on hedged items attributable to the hedged risk amounted to BD 21 thousand (2015: loss of BD 286 thousand).

**Cash Flow Hedges**

At 31 December 2016, the Group held the following instruments to hedge exposures to changes in interest rates and foreign currency.

|                             | 3 months–<br>1 year | 1–5 years |
|-----------------------------|---------------------|-----------|
| <b>Interest rate risk</b>   |                     |           |
| <b>Interest rate swaps</b>  |                     |           |
| <b>31 December 2016</b>     |                     |           |
| Nominal amount (BD '000)    | 8,509               | 49,010    |
| Average fixed interest rate | 2%                  | 3%        |
| <b>31 December 2015</b>     |                     |           |
| Nominal amount (BD '000)    | -                   | 57,519    |
| Average fixed interest rate | 0%                  | 3%        |

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

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

|                 | 2016                          |                         | 2015                          |                         |
|-----------------|-------------------------------|-------------------------|-------------------------------|-------------------------|
|                 | Carrying<br>amount<br>BD '000 | Cash<br>flow<br>BD '000 | Carrying<br>amount<br>BD '000 | Cash<br>flow<br>BD '000 |
| Term Borrowings | 57,519                        | 158                     | 57,519                        | (10)                    |



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**27 COMMITMENTS AND CONTINGENT LIABILITIES****Credit-related commitments**

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

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

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

The Group has the following credit related commitments:

| <b>31 December 2016</b>  | <b>On<br/>demand<br/>BD '000</b> | <b>than 3<br/>months<br/>BD '000</b>      | <b>3 to 12<br/>months<br/>BD '000</b> | <b>1 to 5<br/>years<br/>BD '000</b> | <b>Total<br/>BD '000</b> |
|--------------------------|----------------------------------|---|---------------------------------------|-------------------------------------|--------------------------|
| <b>Contingencies</b>     |                                  |   |                                       |                                     |                          |
| Letters of credit        | 3,336                            | 18,538                                    | 16,644                                | -                                   | 38,518                   |
| Guarantees               | 22,845                           | 70,744                                    | 110,179                               | 24,519                              | 228,287                  |
|                          |                                  |   |                                       |                                     | <u>266,805</u>           |
| <b>Commitments</b>       |                                  |   |                                       |                                     |                          |
| Undrawn loan commitments | 127,186                          | -   | -                                     | -                                   | 127,186                  |
|                          |                                  |   |                                       |                                     | <u>127,186</u>           |
|                          |                                  |   |                                       |                                     | <u>393,991</u>           |
| <b>31 December 2015</b>  | <b>On<br/>demand<br/>BD '000</b> | <b>Less than<br/>3 months<br/>BD '000</b> | <b>3 to 12<br/>months<br/>BD '000</b> | <b>1 to 5<br/>years<br/>BD '000</b> | <b>Total<br/>BD '000</b> |
| <b>Contingencies</b>     |                                  |   |                                       |                                     |                          |
| Letters of credit        | 3,946                            | 13,925                                    | 16,382                                | -                                   | 34,253                   |
| Guarantees               | 204,616                          | -   | -                                     | -                                   | 204,616                  |
|                          |                                  |   |                                       |                                     | <u>238,869</u>           |
| <b>Commitments</b>       |                                  |   |                                       |                                     |                          |
| Undrawn loan commitments | 143,943                          | -   | -                                     | -                                   | 143,943                  |
|                          |                                  |   |                                       |                                     | <u>143,943</u>           |
|                          |                                  |   |                                       |                                     | <u>382,812</u>           |

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

**Lease commitments**

**27 COMMITMENTS AND CONTINGENT LIABILITIES (continued)*****Operating lease commitments – Group as lessee***

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

|   | 2016<br>BD '000 | 2015<br>BD '000 |
|---|-----------------|-----------------|
| Within one year                             | 838             | 858             |
| After one year but not more than five years | 1,872           | 1,212           |
| More than five years                        | 4,406           | 2,418           |
|   | <u>7,116</u>    | <u>4,488</u>    |

**28 RISK MANAGEMENT**

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

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

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

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

The internal audit department assess whether the policies and procedures are complied with and, if necessary, suggest ways of further improving internal guidelines and procedures.

The various risks to which the Group is exposed to and how the Group manages them is discussed in the following paragraphs.

**29 CREDIT RISK AND CONCENTRATION OF CREDIT RISK**

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

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

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

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

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

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

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

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

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**30 MAXIMUM EXPOSURE TO CREDIT RISK WITHOUT TAKING INTO ACCOUNT ANY COLLATERAL AND OTHER CREDIT ENHANCEMENTS**

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

|  | <b>2016</b><br><b>BD '000</b> | <b>2015</b><br><b>BD '000</b> |
|--|-------------------------------|-------------------------------|
| Balances with central banks  | <b>293,515</b>                | 269,114                       |
| Treasury bills   | <b>401,635</b>                | 394,090                       |
| Deposits and amounts due from banks and other financial institutions | <b>318,407</b>                | 325,096                       |
| Loans and advances to customers                                      | <b>1,767,138</b>              | 1,764,799                     |
| Investment securities  | <b>688,730</b>                | 663,051                       |
| Interest receivable and other assets                                 | <b>56,105</b>                 | 47,010                        |
|  | <b>3,525,530</b>              | 3,463,160                     |
| Contingent liabilities   | <b>266,805</b>                | 238,869                       |
| Commitments  | <b>127,186</b>                | 143,943                       |
|  | <b>393,991</b>                | 382,812                       |
|  | <b>3,919,521</b>              | 3,845,972                     |

**31 CONCENTRATION OF ASSETS, LIABILITIES AND OFF STATEMENT OF FINANCIAL POSITION ITEMS**

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

|  | <b>2016</b>                     |                                      |   | <b>2015</b>                     |                                      |   |
|--|---------------------------------|--------------------------------------|---|---------------------------------|--------------------------------------|---|
|  | <b>Assets</b><br><b>BD '000</b> | <b>Liabilities</b><br><b>BD '000</b> | <b>Credit commitments and contingencies</b><br><b>BD '000</b> | <b>Assets</b><br><b>BD '000</b> | <b>Liabilities</b><br><b>BD '000</b> | <b>Credit commitments and contingencies</b><br><b>BD '000</b> |
| Gulf Co-operation Council countries    | 3,088,221                       | 2,682,640                            | 333,308   | 2,959,680                       | 2,809,005                            | 329,950   |
| North America                          | 61,650                          | 5,965                                | 615   | 90,196                          | 5,217                                | 436   |
| European Union countries               | 217,846                         | 394,225                              | 9,799   | 219,528                         | 314,990                              | 11,379  |
| Asia                                   | 243,086                         | 132,243                              | 42,588  | 315,379                         | 142,972                              | 29,640  |
| Others                                 | 91,754                          | 13,269                               | 7,681   | 61,658                          | 13,523                               | 11,407  |
|  | <b>3,702,557</b>                | <b>3,228,342</b>                     | <b>393,991</b>  | <b>3,646,441</b>                | <b>3,285,707</b>                     | <b>382,812</b>  |
| Trading and manufacturing              | 629,572                         | 94,469                               | 176,992   | 613,889                         | 151,087                              | 164,186   |
| Banks and other financial institutions | 774,348                         | 1,246,851                            | 33,953  | 827,713                         | 1,237,166                            | 38,185  |
| Construction and real estate           | 408,702                         | 62,205                               | 120,289   | 430,783                         | 75,601                               | 123,703   |
| Government and public sector           | 1,196,815                       | 698,443                              | 2,890   | 1,141,750                       | 756,818                              | 3,016   |
| Individuals                            | 388,086                         | 833,728                              | 322   | 352,781                         | 768,835                              | 1,050   |
| Others                                 | 305,034                         | 292,646                              | 59,545  | 279,525                         | 296,200                              | 52,672  |
|  | <b>3,702,557</b>                | <b>3,228,342</b>                     | <b>393,991</b>  | <b>3,646,441</b>                | <b>3,285,707</b>                     | <b>382,812</b>  |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS**

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

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

The Group utilises a scale ranging from 1 to 10 for credit relationships, with 1 to 8 denoting performing grades, 9 and 10 non-performing, in line with Basel III guidelines. Grades 1 to 3 represents high grade, 4 to 6 represents standard grade and 7 to 8 represents sub-standard grade.

All credits are assigned a rating in accordance with the defined criteria.

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

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

**/ Credit quality analysis**

The following table sets out information about the credit quality of financial assets measured at amortised cost, FVOCI debt investments (2016) and available-for-sale debt assets (2015). Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively.

Explanation of the terms: 12-month ECL, lifetime ECL and credit-impaired are included in Note 3.3 impairment of financial assets.

|   | 2016                                   |  |  | 2015             |                  |
|---|--|--|--|------------------|------------------|
|   | Stage 1:<br>12-month<br>ECL<br>BD '000 | Stage 2:<br>Lifetime ECL<br>not credit-<br>impaired<br>BD '000 | Stage 3:<br>Lifetime<br>ECL credit-<br>impaired<br>BD '000 | Total<br>BD '000 | Total<br>BD '000 |
| Loans and advances to customers -<br>Commercial loans and overdrafts<br>at amortised cost |  |  |  |                  |                  |
| High (Grade 1 to 3)   | 338,048                                | -  | -  | 338,048          | 300,306          |
| Standard (Grade 4 to 6)   | 634,153                                | 152,974  | -  | 787,127          | 909,513          |
| Substandard (Grade 7 to 8)  | 8,355                                  | 195,696  | -  | 204,051          | 214,597          |
| Non-performing (Grade 9 to 10)  | -                                      | -  | 99,984   | 99,984           | 66,926           |
|   | 980,556                                | 348,670  | 99,984   | 1,429,210        | 1,491,342        |
| Loss allowance  | (2,623)                                | (38,597)   | (67,331)   | (108,551)        | (84,945)         |
| Carrying amount   | 977,933                                | 310,073  | 32,653   | 1,320,659        | 1,406,397        |



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)

**i Credit quality analysis (continued)**

|  | 2016                                   |  |  | 2015             |                  |
|--|--|--|--|------------------|------------------|
|  | Stage 1:<br>12-month<br>ECL<br>BD '000 | Stage 2:<br>Lifetime ECL<br>not credit-<br>impaired<br>BD '000 | Stage 3:<br>Lifetime<br>ECL credit-<br>impaired<br>BD '000 | Total<br>BD '000 | Total<br>BD '000 |
| Loans and advances to customers -<br>Consumer                            |  |  |  |                  |                  |
| at amortised cost  |  |  |  |                  |                  |
| High (Grade 1 to 3)  | 432,854                                | -  | -  | 432,854          | 342,837          |
| Standard (Grade 4 to 6)  | -                                      | 8,468  | -  | 8,468            | 5,112            |
| Substandard (Grade 7 to 8)   | -                                      | 10,173   | -  | 10,173           | 8,587            |
| Non-performing (Grade 9 to 10)   | -                                      | -  | 13,335   | 13,335           | 15,761           |
|  | 432,854                                | 18,641   | 13,335   | 464,830          | 372,297          |
| Loss allowance   | (2,951)                                | (5,085)  | (10,315)   | (18,351)         | (13,895)         |
| Carrying amount  | 429,903                                | 13,556   | 3,020  | 446,479          | 358,402          |
|  |  |  |  |                  |                  |
|  | 2016                                   |  |  | 2015             |                  |
|  | Stage 1:<br>12-month<br>ECL<br>BD '000 | Stage 2:<br>Lifetime ECL<br>not credit-<br>impaired<br>BD '000 | Stage 3:<br>Lifetime<br>ECL credit-<br>impaired<br>BD '000 | Total<br>BD '000 | Total<br>BD '000 |
| Debt investment securities at FVOCI<br>(2015: available-for-sale)        |  |  |  |                  |                  |
| High (AAA to A-)   | 183,857                                | -  | -  | 183,857          | 268,927          |
| Standard (BBB+ to B-) *  | 291,586                                | 94,419   | -  | 386,005          | 382,578          |
| Past due or individually impaired  | -                                      | -  | -  | -                | 23,064           |
| Total  | 475,443                                | 94,419   | -  | 569,862          | 674,569          |
| Loss Allowance   | (159)                                  | (445)  | -  | (604)            | (23,064)         |
| Net Carrying amount  | 475,284                                | 93,974   | -  | 569,258          | 651,505          |
| Carrying amount – fair value   |  |  |  |                  |                  |
|  |  |  |  |                  |                  |
| Debt investment securities at<br>amortised cost (2015: held-to-maturity) |  |  |  |                  |                  |
| High (AAA to A-)   | 83,290                                 | -  | -  | 83,290           | -                |
| Standard (BBB+ to B-)  | 434,042                                | -  | -  | 434,042          | 405,636          |
| Total  | 517,332                                | -  | -  | 517,332          | 405,636          |
| Loss allowance   | (5)                                    | -  | -  | (5)              | -                |
| Carrying amount  | 517,327                                | -  | -  | 517,327          | 405,636          |
|  |  |  |  |                  |                  |
| Loan commitments & Financial guarantee                                   |  |  |  |                  |                  |
| High (Grades 1 to 3)   | 144,149                                | -  | -  | 144,149          | 124,097          |
| Standard (Grade 4 to 6)  | 77,099                                 | 144,651  | -  | 221,750          | 229,536          |
| Substandard (Grade 7 to 8)   | 828                                    | 27,168   | -  | 27,996           | 28,718           |
| Non-performing (Grade 9 to 10)   | -                                      | 8  | 88   | 96               | 461              |
| Total  | 222,076                                | 171,827  | 88   | 393,991          | 382,812          |
| Loss allowance   | (268)                                  | (596)  | -  | (864)            | (501)            |
| Carrying amount (provision)  | 221,808                                | 171,231  | 88   | 393,127          | 382,311          |

\* Standard grade includes unrated investments amounting to BD 1,549 thousand (2015: BD 7,058 thousand).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)****i Credit quality analysis (continued)**

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

|                                   | 2016<br>BD '000 | 2015<br>BD '000 |
|-----------------------------------|-----------------|-----------------|
| <b>Debt investment securities</b> |                 |                 |
| High (AAA to A-)                  | <b>3,781</b>    | -               |

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

**Type of credit exposure**

|  | 2016<br>BD '000 | 2015<br>BD '000 |
|--|-----------------|-----------------|
| Derivative assets held for risk management | 11,628          | 16,771          |
| Loans and advances:                        |                 |                 |
| Cash                                       | 60,952          | 71,586          |
| Mortgage lending                           | 1,096,412       | 1,097,499       |
| Financial Instruments                      | 55,466          | 85,426          |

**ii Collateral and other credit enhancements**

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

The main types of collateral obtained are as follows:

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

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

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

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

**Inputs, assumptions and techniques used for estimating impairment**

Refer to note 3.3 Financial assets and financial liabilities (vii) impairment.

**Significant increase in credit risk**

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

**32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)****Credit risk grades**

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

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

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

**Determining whether credit risk has increased significantly**

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

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

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

**Renegotiated financial assets**

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

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

**32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)****Definition of default**

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

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

In assessing whether a borrower is in default, the Group considers indicators that are:

- Quantitative – e.g. overdue status and non-payment on another obligation of the same issuer to the Group; and
- Based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

The definition of default largely aligns with that applied by the Group for regulatory capital purposes.

**Incorporation of forward-looking information**

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

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

**Measurement of ECL**

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

- Probability of default (PD);
- Loss given default (LGD); and
- Exposure at default (EAD).

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

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

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

**LGD estimation are estimation of:**

**1 Cure Rate:** Defined as the ratio of accounts which have fallen to default and have managed to move backward to the performing accounts.

**2 Recovery Rate:** Defined as the ratio of liquidation value to market value of the underlying collateral at the time of default would also account for expected recovery rate from a general claim on the individual's assets for the unsecured portion of the exposure.

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**32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS (continued)****Measurement of ECL (continued)**

**3 Discounting Rate:** Defined as the opportunity cost of the recovery value not being realized on the day of default adjusted for-time value .

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

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

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

- Credit risk gradings;
- Product type; and
- Geographic location of the borrower.

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

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

|  | <b>2016</b>      |
|--|------------------|
|  | <b>BD '000</b>   |
| Banks and financial institutions         | <b>560,101</b>   |
| Sovereign                                | <b>22,202</b>    |
| Investment securities (debt instruments) | <b>1,087,475</b> |



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**33 CARRYING AMOUNT OF FINANCIAL ASSETS WHOSE TERMS HAVE BEEN RENEGOTIATED**

The table below shows the carrying amount for financial assets by class, renegotiated during the year.

|  | 2016<br>BD '000 | 2015<br>BD '000 |
|--|-----------------|-----------------|
| <b>Loans and advances to customers</b> |                 |                 |
| Commercial loans                       | 32,486          | 105,062         |
| Consumer loans                         | 7,469           | 7,915           |
|  | <b>39,955</b>   | <b>112,977</b>  |

**34 MARKET RISK**

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

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

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

|                  | 2016<br>BD '000 | 2015<br>BD '000 |
|------------------|-----------------|-----------------|
| Foreign exchange | 172             | 94              |
| Interest Rate    | 5               | 1               |
|                  | <b>177</b>      | <b>95</b>       |

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

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

**35 INTEREST RATE RISK MANAGEMENT**

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

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

Based on the consolidated statement of financial position as at 31 December 2016 an increase of 200 basis point in interest rates, with all variables held constant, will result in an increase in the net interest income, for the following next 12 months, by approximately BD 19,088 thousand (2015: increase by BD 18,504 thousand). However, further downward movement of interest rates by 200 basis points might not be practical assumption in the current environment, given the current low levels of interest rates, and hence capping the downward movement of interest rates at 0%, the negative impact on the net interest income as at 31 December 2016 estimated at BD 11,528 thousands (2015: BD 7,167 thousands). On the other hand, the scope for interest rates increase from its current levels is most probable which the Bank shall benefit.

|              | <i>Rate Shock<br/>Forecasting<br/>(+200 bps)</i> |                 |              | <i>Rate Shock<br/>Forecasting<br/>(-200 bps)</i> |                 |
|--------------|--|-----------------|--------------|--|-----------------|
|              | 2016<br>BD '000                                  | 2015<br>BD '000 |              | 2016<br>BD '000                                  | 2015<br>BD '000 |
| BHD          | 11,331   | 7,023           | BHD          | 7,499  | 3,133           |
| USD          | 6,250  | 7,496           | USD          | 2,400  | 1,290           |
| KWD          | (260)  | 763             | KWD          | 167  | 669             |
| OTHERS       | 1,766  | 3,223           | OTHERS       | 1,462  | 2,076           |
| <b>TOTAL</b> | <b>19,088</b>                                    | <b>18,504</b>   | <b>TOTAL</b> | <b>11,528</b>                                    | <b>7,167</b>    |

An increase of 200 basis point in interest rates, with all other variables held constant, will result in a negative impact on equity of approximately 2.8% amounting to BD 14,126 thousand (2015: 3.8%, BD 14,591 thousand). Similarly, a decrease of 200 basis point in interest rates, with all other variables held constant, will result in a positive impact on equity of approximately 2.8% amounting to BD 14,126 thousand (2015: 3.8%, BD 14,591 thousand).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**36 CURRENCY RISK**

The functional currency of the Group is the Bahraini Dinar.

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

|  | <b>2016</b>         | <b>2015</b>         |
|--|---------------------|---------------------|
|  | <b>BD '000</b>      | <b>BD '000</b>      |
|  | <b>equivalent</b>   | <b>equivalent</b>   |
|  | <b>long (short)</b> | <b>long (short)</b> |
| US dollar                                | <b>83,141</b>       | 60,496              |
| Euro                                     | <b>488</b>          | 51                  |
| GCC currencies (excluding Kuwaiti dinar) | <b>2,582</b>        | 8,789               |
| Kuwaiti dinar                            | <b>504</b>          | 274                 |
| Others                                   | <b>1,592</b>        | 463                 |

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

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

**37 EQUITY PRICE RISK**

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

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

|                                     | % change | Effect on equity |                 |
|-------------------------------------|----------|------------------|-----------------|
|                                     |          | Total            | Total           |
|                                     | in Index | 2016<br>BD '000  | 2015<br>BD '000 |
| Bahrain Bourse                      | ± 15%    | 1,863            | 2,263           |
| Other GCC and other stock exchanges | ± 15%    | 4,597            | 6,815           |
|                                     |          | <b>6,460</b>     | <b>9,078</b>    |

**38 LIQUIDITY RISK**

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

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

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

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

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

## 38 LIQUIDITY RISK (continued)

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

31 December 2016

|  | On Demand | BD '000        |               |               |                |              |               |                |                    | Total     |
|--|-----------|----------------|---------------|---------------|----------------|--------------|---------------|----------------|--------------------|-----------|
|  |           | Within 1 month | 1 to 3 months | 3 to 6 months | 6 to 12 months | 1 to 5 years | 5 to 10 years | 10 to 20 years | More than 20 years |           |
| Deposits and due to banks and other financial institutions | -         | 187,522        | 72,471        | 16            | 92             | -            | -             | -              | -                  | 260,101   |
| Borrowings under repurchase agreement                      | -         | 650            | -             | -             | 22,784         | 182,524      | -             | -              | -                  | 205,958   |
| Term borrowings  | -         | -              | 313           | 8,891         | 3,309          | 211,457      | -             | -              | -                  | 223,970   |
| Customers' current, savings and other deposits             | 1,131,845 | 494,365        | 411,937       | 227,023       | 135,748        | 112,706      | 4,471         | 8,944          | -                  | 2,527,039 |
| Total undiscounted financial liabilities                   | 1,131,845 | 682,537        | 484,721       | 235,930       | 161,933        | 506,687      | 4,471         | 8,944          | -                  | 3,217,068 |
| Letter of Guarantees                                       | 228,286   | -              | -             | -             | -              | -            | -             | -              | -                  | 228,286   |
| Undrawn loan commitments                                   | 127,187   | -              | -             | -             | -              | -            | -             | -              | -                  | 127,187   |

## Derivative financial instruments

|                                |         |         |          |          |           |           |          |          |           |
|--------------------------------|---------|---------|----------|----------|-----------|-----------|----------|----------|-----------|
| Contractual amounts payable    | (2,705) | (8,047) | (18,717) | (26,404) | (374,200) | (276,953) | (42,226) | (76,881) | (826,133) |
| Contractual amounts receivable | 3,005   | 8,491   | 17,367   | 23,007   | 350,297   | 263,969   | 31,873   | 69,094   | 767,103   |
|                                | -       | 300     | 444      | (1,350)  | (3,397)   | (23,903)  | (12,984) | (10,353) | (59,030)  |

31 December 2015

|  | On Demand | BD '000        |               |               |                |              |               |                |                    | Total     |
|--|-----------|----------------|---------------|---------------|----------------|--------------|---------------|----------------|--------------------|-----------|
|  |           | Within 1 month | 1 to 3 months | 3 to 6 months | 6 to 12 months | 1 to 5 years | 5 to 10 years | 10 to 20 years | More than 20 years |           |
| Deposits and due to banks and other financial institutions | -         | 133,544        | 30,521        | 9,450         | 5,894          | -            | -             | -              | -                  | 179,409   |
| Borrowings under repurchase agreement                      | -         | -              | -             | -             | 5,185          | 189,127      | -             | -              | -                  | 194,312   |
| Term borrowings  | -         | -              | 619           | 308           | 3,255          | 224,838      | -             | -              | -                  | 229,020   |
| Customers' current, savings and other deposits             | 1,146,028 | 375,422        | 454,149       | 302,021       | 369,262        | 24,920       | 5,874         | 11,730         | -                  | 2,689,406 |
| Total undiscounted financial liabilities                   | 1,146,028 | 508,966        | 485,289       | 311,779       | 383,596        | 438,885      | 5,874         | 11,730         | -                  | 3,292,147 |
| Letter of Guarantees                                       | 204,617   | -              | -             | -             | -              | -            | -             | -              | -                  | 204,617   |
| Undrawn loan commitments                                   | 143,942   | -              | -             | -             | -              | -            | -             | -              | -                  | 143,942   |
| Derivative financial instruments                           | -         | (2,188)        | (5,614)       | (6,203)       | (33,733)       | (343,944)    | (266,099)     | (40,428)       | (70,685)           | (768,894) |
| Contractual amounts payable                                | -         | 2,931          | 6,109         | 4,625         | 28,897         | 311,508      | 248,987       | 28,921         | 61,504             | 693,482   |
| Contractual amounts receivable                             | -         | 743            | 495           | (1,578)       | (4,836)        | (32,436)     | (17,112)      | (11,507)       | (9,181)            | (75,412)  |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**39 FAIR VALUES OF FINANCIAL INSTRUMENTS**

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

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

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

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

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy at 31 December 2016 and 31 December 2015.

| <b>31 December 2016</b>               | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b>   |
|---------------------------------------|----------------|----------------|----------------|----------------|
|                                       | <b>BD'000</b>  | <b>BD'000</b>  | <b>BD'000</b>  | <b>BD'000</b>  |
| <b>Financial assets</b>               |                |                |                |                |
| Bonds                                 | 563,023        | 2,634          | -              | 565,657        |
| Equities                              | 43,742         | 6,066          | 28,153         | 77,961         |
| Managed funds                         | -              | 1,442          | -              | 1,442          |
| Derivatives held for trading          | -              | 108            | -              | 108            |
| Derivatives held as fair value hedges | -              | 6,672          | -              | 6,672          |
| Derivatives held as cash flow hedges  | -              | 158            | -              | 158            |
|                                       | <b>606,765</b> | <b>17,080</b>  | <b>28,153</b>  | <b>651,998</b> |
| <b>Financial liabilities</b>          |                |                |                |                |
| Derivatives held for trading          | -              | 137            | -              | 137            |
| Derivatives held as fair value hedges | -              | 9,638          | -              | 9,638          |
|                                       | <b>-</b>       | <b>9,775</b>   | <b>-</b>       | <b>9,775</b>   |
| <b>31 December 2015</b>               | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b>   |
|                                       | <b>BD'000</b>  | <b>BD'000</b>  | <b>BD'000</b>  | <b>BD'000</b>  |
| <b>Financial assets</b>               |                |                |                |                |
| Bonds                                 | 569,612        | 2,664          | -              | 572,276        |
| Equities                              | 60,518         | 7,387          | -              | 67,905         |
| Managed funds                         | -              | 1,870          | -              | 1,870          |
| Derivatives held for trading          | -              | 179            | -              | 179            |
| Derivatives held as fair value hedges | -              | 2,114          | -              | 2,114          |
| Derivatives held as cash flow hedges  | -              | 43             | -              | 43             |
|                                       | <b>630,130</b> | <b>14,257</b>  | <b>-</b>       | <b>644,387</b> |
| <b>Financial liabilities</b>          |                |                |                |                |
| Derivatives held for trading          | -              | 26             | -              | 26             |
| Derivatives held as fair value hedges | -              | 12,412         | -              | 12,412         |
| Derivatives held as cash flow hedges  | -              | 52             | -              | 52             |
|                                       | <b>-</b>       | <b>12,490</b>  | <b>-</b>       | <b>12,490</b>  |

During 2015, unquoted equity and managed funds investments amounting to BD 25,284 thousand recorded at cost less impairment, were included under available-for-sale investments.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**39 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)****Transfers between level 1, level 2 and level 3**

During the reporting year ended 31 December 2016, there were no transfers into and out of Level 3 fair value measurements.

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

|                                   | 2016                         |                          |                       | 2015                         |                          |                       |
|-----------------------------------|------------------------------|--------------------------|-----------------------|------------------------------|--------------------------|-----------------------|
|                                   | Carrying<br>value<br>BD '000 | Fair<br>value<br>BD '000 | Difference<br>BD '000 | Carrying<br>value<br>BD '000 | Fair<br>value<br>BD '000 | Difference<br>BD '000 |
| <b>Financial liabilities</b>      |                              |                          |                       |                              |                          |                       |
| Term borrowings                   | 206,109                      | 199,596                  | (6,513)               | 204,677                      | 194,859                  | (9,818)               |
| <b>Financial assets</b>           |                              |                          |                       |                              |                          |                       |
| Non-trading investment securities | 123,073                      | 120,937                  | (2,136)               | 90,774                       | 89,205                   | (1,569)               |

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

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

**40 SHARE - BASED PAYMENTS**

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

|  | 2016<br>BD '000 | 2015<br>BD '000 |
|--|-----------------|-----------------|
| Expense arising from equity-settled share-based payment transactions | 714             | 716             |
| Shares vested during the year  | (745)           | (447)           |

During 2010, the Nomination and Remuneration Committee of the Bank modified the employees stock option plans for the previously granted stock options. The existing plan was discontinued with effect from 31 March 2010. The Bank moved to a new long-term incentive plan, which is referred to as the Employee Performance Share Plan (EPSP), which will award shares (rather than options) to executives. The details of the modifications to stock option plan and EPSP are described below:

**Employee Performance Share Plan (EPSP)**

Shares are granted to Senior Managers and above, with more than 12 months service at the date of grant and meeting certain performance criteria. The shares granted are subject to the satisfaction of conditions relating to the Bank's net profit over a three year period and the employee being in employment at the end of the 3 year period (vesting period).

The Bank utilises its existing treasury shares for the EPSP and may also choose to issue new shares to settle the EPSP in the future. The price of the shares granted was equal to the market price of the Bank's shares on the grant date. As at 31 December 2016, there has been a transfer of 10,398,441 shares (2015: 9,498,441 shares) from treasury stock to BBK Shares Incentives S.P.C which is in line with the Employee Performance Share Plan.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2016

**40 SHARE - BASED PAYMENTS (continued)****Employee Performance Share Plan (EPSP) (continued)**

The following table illustrates the number and cost per share of the shares granted during the year under the new scheme.

|   | <i>Number of<br/>shares<br/>2016</i> | <i>Cost per<br/>share<br/>2016<br/>BD</i> | <i>Number of<br/>shares<br/>2015</i> | <i>Cost per<br/>share<br/>2015<br/>BD</i> |
|---|--------------------------------------|---|--------------------------------------|---|
| Opening balance of shares granted<br>but not vested | <b>5,914,981</b>                     | <b>0.424</b>                              | 5,155,397                            | 0.415                                     |
| Equity shares granted during the year               | <b>2,851,177</b>                     | <b>0.312</b>                              | 2,681,473                            | 0.432                                     |
| Equity shares transferred to trust                  | <b>900,000</b>                       | <b>0.312</b>                              | 1,877,014                            | 0.432                                     |
| Shares transferred to active employees              | <b>(1,798,302)</b>                   | <b>0.425</b>                              | (1,117,430)                          | 0.400                                     |

The market price of BBK B.S.C. shares at 31 December 2016 was BD 0.400 (2015: BD 0.436).

**41 CAPITAL ADEQUACY**

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

|                                    | <i>2016<br/>BD '000</i> | <i>2015<br/>BD '000</i> |
|------------------------------------|-------------------------|-------------------------|
| Capital base:                      |                         |                         |
| CET1 capital                       | <b>383,518</b>          | 355,631                 |
| Tier 1 capital                     | <b>86,098</b>           | -                       |
| Tier 2 capital                     | <b>30,817</b>           | 29,056                  |
| Total capital base (a)             | <b>500,433</b>          | 384,687                 |
| Credit risk weighted exposure      | <b>2,465,337</b>        | 2,367,734               |
| Operational risk weighted exposure | <b>211,854</b>          | 204,947                 |
| Market risk weighted exposure:     | <b>27,025</b>           | 14,762                  |
| Total risk weighted exposure (b)   | <b>2,704,216</b>        | 2,587,443               |
| Capital adequacy (a/b * 100)*      | <b>18.51%</b>           | 14.87%                  |
| Minimum requirement                | <b>12.50%</b>           | 12.50%                  |

**Capital management**

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

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

**Basel III and Capital management**

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

**41 CAPITAL ADEQUACY (continued)*****Basel III and Capital management (continued)***

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

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

**42 LEGAL AND OPERATIONAL RISK*****Legal risk***

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

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

As at 31 December 2016, there were legal cases pending against the Group aggregating BD 814 thousand (2015: BD 814 thousand). Based on the opinion of the Group's legal advisors, the management believes that no liability is likely to arise from these cases.

***Operational risk***

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

The operational risk department operates independently from other units of the Bank and reports directly to the Audit Committee, which consists of members of the Board. It conducts regular reviews of all business areas of the Bank and reports control deficiencies and exceptions to the Bank's policies and procedures. It also recommends measures to mitigate operational risk, which are implemented by management immediately.

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

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

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

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

As at 31 December 2016

**43 DEPOSIT PROTECTION SCHEME**

Deposits held with the Bahrain operations of the Bank are covered by the Deposit Protection Scheme (the Scheme) established by the Central Bank of Bahrain regulation concerning the establishment of the Deposit Protection Scheme and Deposit Protection Board.

**44 STAFF SAVING SCHEME**

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

As at 31 December 2016 the total contribution fund including the earned income stands at BD 15,338 thousand (2015: BD 14,823 thousand). Out of the total fund amount, payment of the principal amount equal to BD 13,496 thousand (2015: BD 13,007 thousand) consisting of the respective staff and Bank's contribution is guaranteed by the Bank to employees participating in the scheme within the applicable law. Out of the principal amount, BD 4,912 thousand (2015: BD 3,912 thousand) is invested in Bahraini Sovereign Bonds.