

ANNUAL REPORT 2017



**BAHRAIN  
MIDDLE EAST  
BANK**  
بنك البحرين والشرق الاوسط

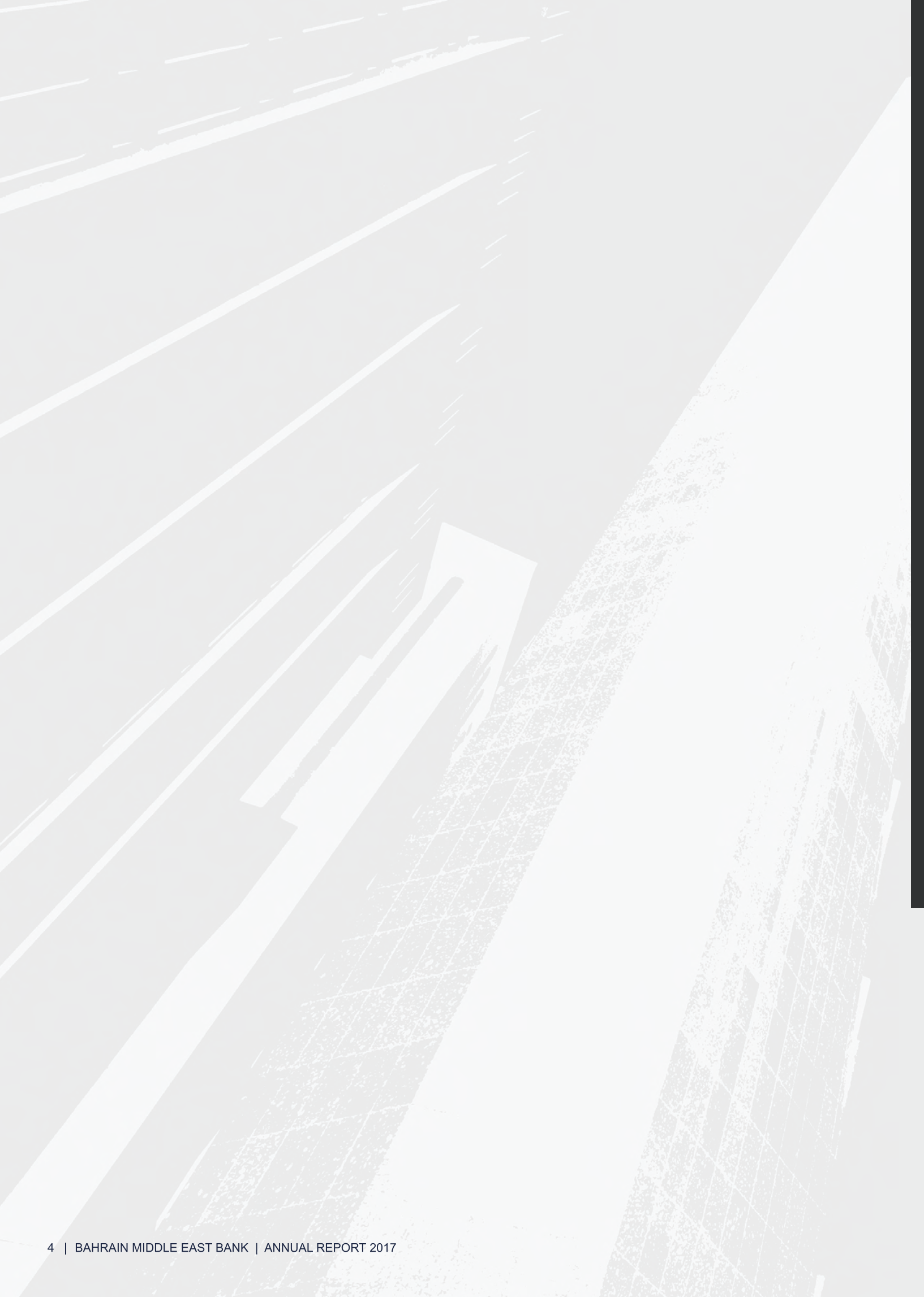
YOUR TRUSTED BANKING PARTNER



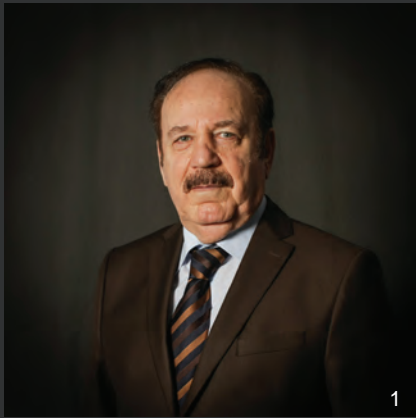
# ANNUAL REPORT 2017

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## BOARD OF DIRECTORS



1. Mr. Wilson S. Benjamin

Chairman

2. Mr. Murat Solak

Vice Chairman (*appointed to the Board on 26 April 2017*)

3. Mr. Ebrahim A. S. Bu Hendi

Director

4. Prof. Awadh Kh. Al-Enezi

Director

5. Mr. Karunaker Nampalli

Director

6. Mr. Jawad Naser Jawad Jaafar

Director

7. Mr. Yohannan Abraham

Director

8. Mr. Govindan Swaminathan

Director (*appointed to the Board on 22 October 2017*)



## SENIOR MANAGEMENT



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1. Mr. Korhan Alev
2. Mr. Gaurav Baid
3. Mr. Abdulla Dawood
4. Mr. Raza Shah Kakakhail
5. Mr. Hamad Al Hiddi
6. Mr. Philip Morley
7. Mr. Mohamed Alhusaini
8. Ms. Sulagna Ghosh
9. Mr. Mohammed Al Shaikh

Chief Executive Officer  
Chief Financial Officer  
AGM – Treasury & Financial Institutions  
Head of Operations  
Head of Risk Management  
Head of Information Technology  
Head of Compliance & MLRO  
Head of Internal Audit  
Head of Human Resources





**CHAIRMAN AND  
CHIEF EXECUTIVE  
OFFICER'S REPORT**

## **CHAIRMAN AND CHIEF EXECUTIVE OFFICER'S REPORT**

On behalf of the Board of Directors and management of Bahrain Middle East Bank B.S.C. ("BMB" or the "Bank") we are pleased to submit the Annual Report and accompanying financial statements for the year ended 31 December 2017.

### **BMB's Current Position and Business Outlook**

BMB set itself to obtain a sustainable platform for its business and growth in 2017. The primary step was to inject capital into the Bank to meet its license requirements, which would thereby provide the impetus for growth.

As a crucial step, the Bank successfully undertook to restructure its stakeholders, and it now has a committed major shareholder in Basaran Yatirim Holding, Turkey through their investment arm AN Investment.

Pursuant to their initial commitment to the Bank, their robust participation in the Rights Issue evolved their increase in stake, whilst it provided the requisite capital base for the Bank to meet regulatory requirements. The Bank's total share capital stood at US\$100 million as at 31 December 2017.

The increased capital base now provides the impetus to the Bank's business arm to garner reciprocal lines and build its operational base. The Board and the management of the Bank have set a prudent business plan for the near future.

The Bank's business was relatively north bound in 2017 and the Bank continued its sound financial position. Looking ahead, given geo-political stability, the Bank aims at good operational years in the near term.

### **2017 Financial Results**

Given the energies expended by the Bank to build up its capital base, BMB's primary emphasis in 2017 was on short-term low risk assets. BMB concentrated on serving its existing clients and gradually increasing its business base with new financial institutions.

As a result, interest income during 2017 was US\$ 11.95 million, an increase of 11.7% from US\$ 10.70 million in 2016. Due to our conservative approach on valuation of legacy private equity portfolio, the Bank had a loss of US\$ 1.09 million (2016: Income of US\$ 1.15 million), as reported under investment banking income (loss). These factors led to a 2.3% reduction in Total Operating Income for 2017 to US\$ 10.90 million (2016: US\$ 11.16 million). Total Operating Expenses during 2017 decreased by 20.8% to US\$ 4.49 million (2016: US\$ 5.67 million). Net Profit before Impairment provisions in 2017 increased by 16.7% to US\$ 6.40 million (2016: US\$ 5.49 million). Impairment provisions in 2017 were US\$ 1.18 million (2016: US\$ 0.41 million).

The above factors resulted in Net Profit for the year of US\$ 5.23 million (2016: US\$ 5.07 million). This represents earnings per share of US\$ 2.15 cents per share (2016: US\$ 2.10 cents per share).

Total Assets stood at US\$ 245.64 million (2016: US\$ 177.35 million) on 31 December 2017. Loans and Advances at year end 2017, totaled US\$ 138.71 million (2016: US\$ 123.96 million). Return on Assets for 2017 was 2.7% compared to 2.9% in 2016.

The Bank continues to focus on maintaining a sound liquidity position. As at 31 December 2017, Balances with Banks and Financial Institutions totaled US\$ 30.02 million (2016: US\$ 40.37 million), and Treasury bills and placements with financial institutions stood at US\$ 50.06 million (2016: US\$ 4.21 million). In addition, the Bank had US\$ 135.75 million of Loans and Advances which mature within 6 months (2016: US\$ 106.96 million) which also form part of BMB's total liquidity.

Due to Financial Institutions increased to US\$ 154.06 million at 31 December 2017 (2016: US\$ 126.57 million), while Due to Customers reduced to US\$ 3.12 million at 31 December 2017 (2016: US\$ 8.41 million).

The Bank's Basel III Capital Adequacy Ratio at 31 December 2017 stood at 36.3% compared with 23.8% at 31 December 2016, remaining well in excess of Central Bank of Bahrain minimum requirement of 12.5%.

During 2017, the Bank increased its paid-up share capital by US\$ 39.50 million by issuing rights shares. The paid-up capital of the Bank amounted to US\$ 100.00 million at 31 December 2017 (2016: US\$ 60.50 million). Total Equity at 31 December 2017 stood at US\$ 81.78 million, an increase of 104.8% over the US\$ 39.94 million reported at 31 December 2016. Return on Average Ordinary Shareholders Equity for 2017 was 10.1% compared with 13.5% in 2016, diluted due to increase in share capital in December 2017.

## **Compliance, Risk and Regulation**

BMB continues to focus on enhancing its compliance and risk management capability. During 2017, the Bank has early adopted International Financial Reporting Standard 9 (IFRS 9). The new standard sets out requirements for recognizing and measuring expected credit losses on various financial assets. During 2017, regulators have started to release information on forthcoming standards to be adopted such as IFRS 9 Financial Instruments, Common Reporting Standards and Value Added Tax. BMB has taken the initial steps required for a smooth adoption of these standards.

## **Conclusion**

BMB had a steady performance in 2017, despite the overhaul of its stakeholders, the political events within the region and changes in major market economies and consequently, the economic ramifications thereof. The primary objective of the Board of Directors and management during 2018 will be to enhance the Bank's presence in the Gulf region and provide the much requisite returns to all its stakeholders.



Wilson Benjamin  
Chairman of the Board of Directors



Korhan Alev  
Chief Executive Officer



## BOARD OF DIRECTORS AND COMMITTEES

### Board of Directors

Mr. Wilson S. Benjamin	Chairman
Mr. Murat Solak	Vice Chairman ( <i>appointed to the Board on 26 April 2017</i> )
Mr. Ebrahim A. S. Bu Hendi	Director
Prof. Awadh Kh. Al-Enezi	Director
Mr. Karunaker Nampalli	Director
Mr. Jawad Naser Jawad Jaafar	Director
Mr. Yohannan Abraham	Director
Mr. Govindan Swaminathan	Director ( <i>appointed to the Board on 22 October 2017</i> )
Sheikh Abdullah Ali K. Al Sabah	Vice Chairman ( <i>resigned from the Board on 26 April 2017</i> )
Mr. Salim Ali	Director ( <i>resigned from the Board on 9 October 2017</i> )

### Executive Committee

Mr. Murat Solak	Chairman ( <i>appointed on 26 April 2017</i> )
Mr. Yohannan Abraham	Vice Chairman ( <i>appointed on 26 July 2017</i> )
Sheikh Abdullah Ali K. Al Sabah	Chairman ( <i>resigned on 26 April 2017</i> )
Mr. Wilson S. Benjamin	Vice Chairman ( <i>resigned on 26 July 2017</i> )
Mr. Salim Ali	Member ( <i>resigned on 26 July 2017</i> )

### Audit Committee & Corporate Governance Committee

Mr. Ebrahim A. S. Bu Hendi	Chairman
Prof. Awadh Kh. Al-Enezi	Vice Chairman
Mr. Jawad Naser Jawad Jaafar	Member ( <i>appointed on 26 July 2017</i> )
Mr. Karunaker Nampalli	Member ( <i>resigned on 26 July 2017</i> )

### Nomination & Remuneration Committee

Prof. Awadh Kh. Al-Enezi	Chairman
Mr. Ebrahim A. S. Bu Hendi	Vice Chairman
Mr. Jawad Naser Jawad Jaafar	Member

## BOARD OF DIRECTORS

### Mr. Wilson S. Benjamin

Chairman, Board of Directors – Executive Director  
Appointed to the Board on 11 March 2000

Prior to his election as Chairman of the Board of the Bank in March 2006, Mr. Benjamin was the Vice Chairman of the Bank. Over the last 20 years, he has served as the Chief Executive Officer of a number of major multi-national companies and has managed investments in public and private companies in the United States, Europe and the Gulf Cooperation Council. Mr. Benjamin received a B.Sc. in Business Administration from Al-Hikma University in Baghdad, Iraq.

#### External Directorships

Position	Name of Entity	Location
Board Member	Al Fawares Holding Co KSCC	Kuwait
Board Member	IK Development Holding Co.	Iraq

### Mr. Murat Solak

Vice Chairman, Board of Directors – Non Executive Director  
Chairman, Executive Committee  
Appointed to the Board on 26 April 2017

Mr. Solak over the last 15 years, has served as Managing Director of a number of major multi-national companies and has managed marketing and public relations for these companies in the United States, Europe and the Gulf Cooperation Council. Mr. Solak has completed courses from the Istanbul Erkek Lisesi and has also received a B.Sc. in Business Administration from the Marmara University of Business Administration in Istanbul, Turkey.

#### External Directorships

Position	Name of Entity	Location
Board Member	AN Investment W.L.L.	Bahrain

### Mr. Ebrahim A. S. Bu Hendi

Director, Board of Directors – Independent Director  
Chairman, Audit Committee & Corporate Governance Committee  
Vice Chairman, Nomination & Remuneration Committee  
Appointed to the Board on 11 May 2005

Mr. Bu Hendi has over thirty years of Banking and treasury experience gained through working with CitiBank, Chase Manhattan, Banque BNP Paribas and National Commercial Bank, Saudi Arabia. He also spent 16 years at Bank of Bahrain & Kuwait as AGM – Treasury, Investment and overseas branches. He has been Board Member and Chairman of the Audit Committee of Bahrain Commercial Facilities Company since March 2007. Mr. Bu Hendi has an MBA from Sheffield Hallam University, U.K.

#### External Directorships

Position	Name of Entity	Location
Board Member	Bahrain Commercial Facilities Company B.S.C.	Bahrain

**Prof. Awadh Kh. Al-Enezi**

Director, Board of Directors – Independent Director  
 Vice Chairman, Audit Committee & Corporate Governance Committee  
 Chairman, Nomination & Remuneration Committee  
 Appointed to the Board on 23 October 1999

Prof. Al-Enezi is a PhD graduate of Bath University, U.K. in 1991 and the University of New York in 1993. He is presently a lecturer at the University of Kuwait. A recipient of numerous awards, he has published several papers dealing with the socio-economic culture in Kuwait. He is an active Board member of several committees in Kuwait University and as consultant in the public and private sectors.

**Mr. Karunaker Nampalli**

Director, Board of Directors – Executive Director  
 Appointed to the Board on 8 July 2006

Mr. Nampalli has over 43 years of banking and finance experience. He held senior banking positions in India and GCC specializing in Trade, Corporate and Project Finance. During his banking career, he also served as faculty member of a staff training college and conducted several banking workshops in major cities across India. Mr. Nampalli is a graduate of Osmania University, India and holds a Post Graduate Diploma in Export-Import Management. He is also a Certified Associate of the Indian Institute of Bankers.

## External Directorships

Position	Name of Entity	Location
Board Member*	Newport Maritime Inc.	Bahamas
Board Member*	American International Medical Services Co.	Kuwait
Vice President & Secretary*	AN Elmwood Investors Inc.	USA
Board Member*	North Bay Investment Inc.	Cayman Islands
Board Member*	North Bay Industrial Inc.	Cayman Islands
Board Member*	23 Sycamore Investment Inc.	USA
Board Member*	100 Adams Delaware Inc.	USA

\* All are nominee positions without any shareholdings in the companies

**Mr. Jawad Naser Jawad Jaafar**

Director, Board of Directors – Independent Director  
 Appointed to the Board on 26 November 2014

Mr. Jaafar is a veteran banker who has worked for 30 years in various banking institutions including Banque Indosuez, Ahli Commercial Bank, Eskan Bank and Seera Investment Bank. His spectrum of experience spans banks in Bahrain and abroad both in local and multinational institutions. He is a graduate of the University of Basra with a diploma in Chemistry in 1974, BIBF with a diploma in Intermediate Banking Studies in 1991 and the Arab University of Beirut with a diploma in General Law Studies in 2001.

**Mr. Yohannan Abraham**

Director, Board of Directors – Independent Director  
Appointed to the Board on 26 November 2014

Mr. Abraham has more than 36 years of experience spanning a number of multinational banks in leadership positions. He was the Chief Executive Officer of Société Générale Wealth Management in Bahrain and prior to that, was the Regional Head for Swiss Private Banking of BNP Paribas, Geneva. Earlier in his career, he was the Senior Vice President of Shearson Lehman Inc., and the Vice President of Merrill Lynch International. He is a licensed Financial Consultant recognized by the Financial Industry Regulatory Authority in the United States and a Masters Degree in Commerce.

## External Directorships

Position	Name of Entity	Location
Chairman & CEO	Global Market Partners W.L.L.	Bahrain
Chairman	Crescent Consultants W.L.L.	Bahrain

**Mr. Govindan Swaminathan**

Director, Board of Directors – Independent Director  
Appointed to the Board on 22 October 2017

Mr. Swaminathan has over 28 years of experience in various management roles in the Washington metropolitan areas in the United States. He has served as Financial Director and as a CFO in multi-million-dollar companies. He holds an MBA in Finance from the College of William & Mary, Virginia. He holds a CPA and is also a Chartered Accountant (India).

## SENIOR MANAGEMENT AND COMMITTEES

### Senior Management

Mr. Korhan Alev	Chief Executive Officer
Mr. Gaurav Baid	Chief Financial Officer
Mr. Abdulla Dawood	AGM – Treasury & Financial Institutions
Mr. Raza Shah Kakakhail	Head of Operations
Mr. Hamad Al Hiddi	Head of Risk Management
Mr. Philip Morley	Head of Information Technology
Mr. Mohamed Alhusaini	Head of Compliance & MLRO
Ms. Sulagna Ghosh	Head of Internal Audit
Mr. Mohammed Al Shaikh	Head of Human Resources

### Executive Management Committee

Mr. Korhan Alev	Chairman
Mr. Gaurav Baid	Vice Chairman
Mr. Abdulla Dawood	Member
Mr. Raza Shah Kakakhail	Member
Mr. Hamad Al Hiddi	Member
Mr. Mohamed Alhusaini	Member

## SENIOR MANAGEMENT

### Mr. Korhan Alev

Chief Executive Officer  
Chairman of the Executive Management Committee

Mr. Alev joined BMB in November 2017. He has over 25 years of experience in the banking sector, having worked in all critical areas of a bank including Treasury, Branch Managing, Finance Control, Credit: Credit Restructuring as well as Credit Marketing. He specializes in corporate banking and Credit. He began his career at Turk Ekonomi Bankasi A.S., Istanbul, Turkey (partners with BNP Paribas SA). He lately held positions at ING Bank A.S. Istanbul, Turkey as Director – Head of Lending, and at Oyak Anker Bank GmbH, Frankfurt Main, Germany as Director – Head of Corporate Banking.

Mr. Alev received his Bachelor's Degree in 1990 from University of Istanbul, Turkey majoring in Accounting and his MBA in 1992 from University of Denver, USA majoring in Finance. He holds a Trainer's Diploma from UK Academy, Turkey and has an Executive Coaching Diploma from Noble Manhattan, England.

**Mr. Gaurav Baid**

Chief Financial Officer

Vice Chairman of the Executive Management Committee

Mr. Baid joined BMB as Chief Financial Officer in October 2013. He has over 16 years of extensive diversified experience in financial, consulting and assurance services, within banking and financial sectors in the Kingdom of Bahrain, and services and manufacturing sectors in India. He previously served as a Senior Manager at Ernst & Young, Kingdom of Bahrain, with primary focus on audit of key investment and commercial banks.

Mr. Baid is a qualified Chartered Accountant and an Associate Member of the Institute of Chartered Accountants of India. He holds a Bachelor of Commerce degree in Financial Accounting and Auditing from University of Calcutta, India.

**Mr. Abdulla Dawood**

AGM – Head of Treasury & Financial Institutions

Member of the Executive Management Committee

Mr. Abdulla Dawood joined BMB in July 2017. His banking experience of more than 18 years is in Treasury, Capital Markets, Financial Institutions, Retail and Corporate Banking in both conventional and Islamic Banking.

Mr. Dawood holds an MBA degree in Business administration and a Bachelor degree in Banking & Finance. He is a member of ACI-The Financial Markets Association, Paris since 2005 and also Bahrain Representative for Arab Campiest Association.

Prior to joining BMB, he worked for Standard Chartered Bank, Bank of Bahrain & Kuwait and Khaleeji Commercial Bank.

**Mr. Raza Shah Kakakhail**

Senior Vice President - Head of Operations

Member of the Executive Management Committee

Mr. Shah joined BMB in June 2010 and has over 19 years of combined experience across both commercial and investment banking including banking operations, business expansion, treasury, trade finance, Islamic banking, corporate finance and client relationship management. Previously, Mr. Shah was employed at Bank Alfalah Limited as Country Head, Afghanistan and MCB Bank Ltd., Pakistan in various managerial level capacities.

Mr. Shah holds a Master's Degree in Public Administration (Major Finance) from University of Peshawar, Pakistan.

**Mr. Hamad AlHiddi**

Senior Vice President - Head of Risk Management

Member of the Executive Management Committee

Mr. Hamad AlHiddi joined Bahrain Middle East Bank in December 2017. He brings with him over 11 years of banking experience in the field of Risk Management, Compliance and Anti-Money Laundering. Besides his extensive formal education, he has undergone intensive training in banking and finance covering the various facets of risk.

His experience covers his service as Head of Risk Management, Compliance and MLRO at BOK International Bank, SICO Investment Bank, Gulf Finance House and he served in the Credit Department of Kuwait Finance House, Kingdom of Bahrain in the early part of his career. He holds an MBA specializing in finance and he is a holder of an Associate PRM Certificate, a risk management professional certificate issued by the Professional Risk Managers' International Association (PRMIA).

**Mr. Philip Morley**

Senior Vice President - Head of Information Technology

Mr. Morley joined BMB in 1998. He has over 19 years of experience in the IT Industry with in-depth knowledge of application systems, software development, project management and IT Infrastructure expertise. Prior to joining BMB, Mr. Philip Morley served as a consultant handling projects for various multinational organizations in India.

**Mr. Mohamed Alhusaini**

Vice President - Head of Compliance & MLRO  
Member of the Executive Management Committee

Mr. Alhusaini joined BMB in 2011. He has 9 years of experience initially starting in Risk Management and eventually taking up key Compliance and Corporate Governance roles. He is an ICA - International Diploma in Compliance - holder and a Member of the International Compliance Association (MICA). He is also an affiliate of The Professional Risk Managers International Association (PRMIA). He graduated with a Bachelor of Commerce degree majoring in Finance from McGill University in Montreal, Canada. Prior to joining BMB, Mr. Alhusaini worked with Eskan Bank, Kingdom of Bahrain.

**Ms. Sulagna Ghosh**

Head of Internal Audit

Ms. Ghosh joined BMB in June 2017. She has over 12 years of experience in audit and consulting in the financial services and private equity sector in India and in the Kingdom of Bahrain. Prior to joining BMB, she served as a Manager at Ernst & Young, Kingdom of Bahrain, with primary focus on audit of key investment, commercial banks and asset management companies. Her work in India covered assurance and fraud investigation services in manufacturing, trading and service industries.

Ms. Ghosh is a Member of The Institute of Internal Auditors and a qualified Chartered Accountant and an Associate Member of the Institute of Chartered Accountants of India.

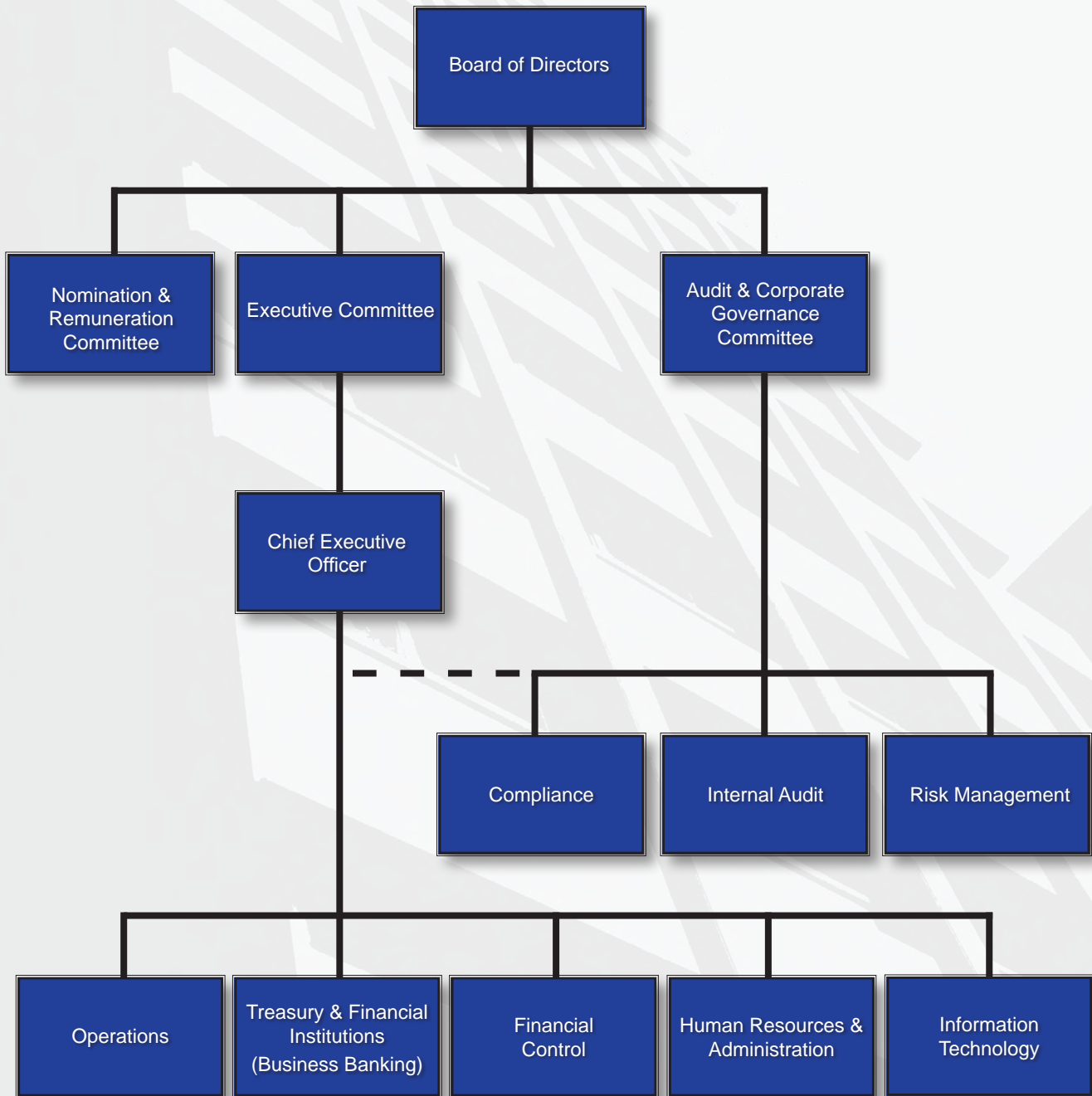
**Mr. Mohammed Al Shaikh**

Head of Human Resources

Mr. Al Shaikh joined BMB in 1983. He has over 39 years of experience in human resources, administration, training and development of staff. He has received extensive training in human resources and banking through courses in the U.K. and in the Kingdom of Bahrain. Prior to joining BMB, Mr. Al Shaikh worked with Aluminum Bahrain in the Human Resources Department.



# CORPORATE STRUCTURE







# **CORPORATE GOVERNANCE REPORT**

## 1. Introduction

BMB operates under a written corporate governance framework drawn from the Corporate Governance Code of the Kingdom of Bahrain. This framework explicitly states the goals, roles and responsibilities for its Board of Directors, management and staff, and includes well defined reporting lines and structures. At the department level, the Bank employs detailed policies and procedures, segregation of duties and dual controls to be in conformance with the Code.

## 2. Framework

The Corporate Governance Framework of the Bank includes:

- A Disclosure Policy;
- Code of Conduct policy;
- Code of Ethics;
- Whistle Blower Policy;
- Remuneration Policy;
- Key Persons Dealing Policy; and
- Corporate Governance Policy.

## 3. Shareholders

The shareholding structure of the Bank as at 31 December 2017 is as follows:

### 3.1. Top five shareholders

Name of the shareholder	Number of shares	% of shareholding
AN Investment W.L.L. (Bahrain)	323,088,497	80.77%
Al Fawares Holding Company K.S.C. (Kuwait)	57,906,308	14.48%
Securities Group K.S.C. (Kuwait)	11,760,000	2.94%
Shaikh Rashed Khalifa Hamad Al Khalifa (Bahrain)	2,160,000	0.54%
Various other shareholders	5,085,195	1.27%

### 3.2. Distribution of shareholders as percentage of total outstanding shares

Ordinary shares	Number of shares	Number of shareholders	% of shareholding
Less than 1%	7,245,195	13,120	1.81%
1% to less than 5%	11,760,000	1	2.94%
5% to less than 10%	-	-	-
10% to less than 20%	57,906,308	1	14.48%
20% to less than 50%	-	-	-
50% and above	323,088,497	1	80.77%
<b>Total</b>	<b>400,000,000</b>	<b>13,123</b>	<b>100.00%</b>

### 3.3. Distribution of shareholders by nationality

Country	% of shareholding
Kingdom of Bahrain	81.70%
State of Kuwait	18.09%
Kingdom of Saudi Arabia	0.20%
Others	0.01%
<b>Total</b>	<b>100.00%</b>

### 3.4. Changes in capital structure of the Bank during 2017

#### 3.4.1. Acquisition of 25.24% shares by AN Investment W.L.L. through voluntary unconditional offer

During the year, AN Investment W.L.L. submitted a Voluntary Unconditional Offer to acquire up to 80,097,018 shares (33.1% of the issued and paid-up capital) of BMB, from other shareholders, which represented all the outstanding shares of the issued and paid-up capital of BMB (other than those already owned by AN Investment W.L.L. and Al Fawares Holding Company K.S.C.).

The Offer closed on 2 April 2017 and a total of 61,091,823 of BMB's shares were surrendered by the shareholders, representing 25.24% of the total issued and paid-up ordinary shares of BMB. As a result of this acquisition, AN Investment W.L.L.'s shareholding in the Bank increased from 42.97% to 68.21%. AN Investment W.L.L.'s shareholding further increased to 80.77% as a result of rights issue as mentioned below in point 3.4.2.

#### 3.4.2. Rights issue

The shareholders in their extra-ordinary general meeting held on 22 October 2017 resolved to increase the Bank's authorised share capital from 242,003,326 shares of US\$ 0.25 each to 484,006,652 shares of US\$ 0.25 each by issuing right shares of 242,003,326.

Total shares subscribed by the shareholders were 157,996,674, amounting to US\$ 39,499 thousand. Registration of this increase in share capital with the Ministry of Industry, Commerce and Tourism, and other legal formalities in this regard, were in progress as of 31 December 2017.

### 3.5 Shares held by government, directors and senior management of the Bank

Neither the Government of the Kingdom of Bahrain nor the directors and senior management of the Bank hold any shares of the Bank.

During the year, Sh. Abdullah Al Sabah and Dr. Awadh K. Al Enezi, directors of the Bank, transferred their direct shareholding of 158,836 shares and 126,001 shares, respectively to AN Investment W.L.L., as part of the voluntary unconditional offer.

### 3.6 Insider Trading

No trading of the Bank's shares was undertaken by its Directors or senior management during the financial year 2017.

## **4. The Board of Directors**

### **4.1. Responsibilities of the Board**

The Board is ultimately responsible for the governance and performance of the Bank. The Board discharges that responsibility by:

- Setting the strategic direction of the Bank including the identification, acceptance, monitoring and management of risks;
- Establishing a robust corporate governance system, which includes risk limits, internal controls, policies and procedures and a system to foster compliance with applicable laws and as well as professional standards and ethics by itself and Bank staff and monitoring the same for implementation;
- Reviewing its own and the Bank management's performance; and
- Preparation and reporting of the Bank's financial results in a fair and transparent manner.

### **4.2. Structure and composition of the Board**

In accordance with the Bank's Articles of Association, the Board is elected by the Bank's shareholders. The current composition of the Board is eight Directors, with five being Independent Directors. Collectively, the Board possesses knowledge, experience and skills appropriate for the Bank.

The Board considers that there is an appropriate balance of Executive and Independent Directors on the Board and that the current Board composition is appropriate.

The roles and responsibilities of the Chairman and the CEO are separate from one another.

The Chairman's main responsibilities are:

- To lead the Board and ensure the effective engagement and contribution of all Directors, so that the Board may fully discharge its legal and regulatory responsibilities;
- To ensure effective communication with shareholders and ensure that the Board members understand the views of the major shareholders; and
- To develop a constructive relationship with the CEO and to manage his performance.

The day-to-day management of the Bank has been delegated by the Board to the CEO. The CEO is responsible for the control and monitoring of the Bank's business on a day-to-day basis, recommending strategy to the Board, leading senior management and implementing the Board's strategic and operational decisions.

Independent Directors have the flexibility to meet prior or post the Board meetings and to review issues without the presence of the other Board members.

### **4.3. Appointment / Re-election of the Board**

The Board of Directors are elected based on majority voting by the shareholders. The majority of the current Board of Directors were re-elected at the Annual General Meeting on 16 February 2017, for a three-year period. Resignation of two of the Directors in 2017 were duly covered with a by-election in the Extra-Ordinary General Meeting held on 22 October 2017. The Directors elected thereof, cover the same term of the full Board.

#### 4.4 Induction and professional development

Induction programs are tailored for all newly appointed Directors. The program comprises a comprehensive Directors' Handbook, meetings with other Directors and senior management, as well as comprehensive guidance on the duties and responsibilities of Directors, the Bank's policies and procedures and relevant legal and regulatory requirements.

#### 4.5 Assessment of the Board

The performance evaluation of the Board, its Committees and Directors was undertaken at the year end. The Evaluation Report will be placed before the shareholders at the Annual General Meeting on 21 March 2018.

#### 4.6 Meetings of the Board of Directors and Committees

The Board of Directors met as per the constitution of each Committee and in line with the Articles of the Bank and the Corporate Governance Code. They also received information between meetings in respect of activities of the management committee and developments in the Bank's business.

##### 4.6.1 Meetings of the Board of Directors

The Board of Directors met six times during the year ended 31 December 2017, on the dates listed below:

Name of Director	Board Meetings (Location: Kingdom of Bahrain)					
	31 January 2017	27 February 2017	23 March 2017	26 April 2017	26 July 2017	23 October 2017
Mr. Wilson S. Benjamin	✓	✓	✓	✓	✓	✓
Mr. Murat Solak	NA	NA	NA	✓	✓	✓
Mr. Ebrahim A. S. Bu Hendi	✓	✓	✓	✓	✓	✓
Prof. Awadh Kh. Al-Enezi	✓	✓	✓	✓	✓	✓
Mr. Karunaker Nampalli	✓	✓	✓	✓	✓	✓
Mr. Jawad Naser Jawad Jaafar	✓	✓	✓	✓	✓	✓
Mr. Yohannan Abraham	✓	✓	✓	✓	✓	✓
Mr. Govindan Swaminathan	NA	NA	NA	NA	NA	✓
Sheikh Abdullah Ali K. Al Sabah	✓	✓	✓	✓	NA	NA
Mr. Salim Ali	✓	X	✓	✓	✓	NA

✓ - Present, including attendance through conference calls

X - Absent

NA - Not applicable. The Board member joined/resigned during the year.

#### 4.6.2 Meetings of the Executive Committee

The Executive Committee met three times during the year ended 31 December 2017, on the dates listed below:

Name of Director	Executive Committee Meetings		
	19 January 2017	10 April 2017	23 October 2017
Mr. Murat Solak	NA	NA	✓
Mr. Yohannan Abraham	NA	NA	✓
Sheikh Abdullah Ali K. Al Sabah	✓	✓	NA
Mr. Wilson S. Benjamin	✓	✓	NA
Mr. Salim Ali	✓	✓	NA

#### 4.6.3 Meetings of the Audit and Corporate Governance Committee

The Audit and Corporate Governance Committee met four times during the year ended 31 December 2017, on the dates listed below:

Name of Director	Audit & Corporate Governance Committee Meetings			
	19 January 2017	26 April 2017	26 July 2017	23 October 2017
Mr. Ebrahim A. S. Bu Hendi	✓	✓	✓	✓
Prof. Awadh Kh. Al-Enezi	✓	✓	✓	✓
Mr. Jawad Naser Jawad Jaafar	NA	NA	NA	✓
Mr. Karunaker Nampalli	✓	✓	✓	NA

#### 4.6.4 Meetings of the Nomination & Remuneration Committee

During the year ended 31 December 2017, the Nomination & Remuneration Committee met on the dates listed below. The aggregate remuneration paid to its members during 2017 amounted to US\$ 10 thousand (2016: US\$ 10 thousand).

Name of Director	Nomination & Remuneration Committee Meetings	
	16 January 2017	6 April 2017
Prof. Awadh Kh. Al-Enezi	✓	✓
Mr. Ebrahim A. S. Bu Hendi	✓	✓
Mr. Jawad Naser Jawad Jaafar	✓	✓

## 4.7 Board Committees

The Board has established the following four committees to ensure that it carries out its functions and provides effective supervision and leadership:

- Executive Committee
- Audit Committee
- Corporate Governance Committee
- Nomination and Remuneration Committee

The functions of the Audit Committee and Corporate Governance Committee have been combined based on the activities of the Bank, with the prior approval of the Central Bank of Bahrain.

### 4.7.1 Executive Committee (“EXCO”)

The primary responsibilities and functions of EXCO are to:

- Act on behalf of the Board when practicality and expediency dictates;
- Act in limited circumstances, on emergency matters that require immediate approval or other actions of the Board;
- Ensure continuity in the management of the business and affairs of the Bank;
- Discuss at greater lengths various macro management aspects of the Bank, including investments, credit, risk and capital adequacy aspects of the Bank;
- Provide an avenue where specific issues may be explored in greater depth than may be possible during Board meetings; and
- Act as an advisor to the Board on various matters.

### 4.7.2 Audit Committee

The primary responsibilities and functions of the Audit Committee are to provide assistance to the Board to fulfill its duties to ensure and oversee:

- The integrity of the Bank’s financial statements;
- The suitability, independence and performance of the Bank’s auditors (internal and external), as well as remuneration of the Bank’s external auditors;
- Internal controls, including controls over financial reporting and disclosure; and
- Compliance with legal and regulatory requirements.

Generally, the role of the Audit Committee is advisory in nature, with recommendations reported to the Board for final approval. However, in certain limited circumstances decisions may be taken by the Audit Committee, which are binding on the Board (i.e. approving the terms of engagement of the external auditor). The Audit Committee holds a minimum of four meetings per year and provides regular reports to the Board.

### **4.7.3 Corporate Governance Committee**

The primary responsibilities and functions of the Corporate Governance Committee are:

- To oversee the annual performance evaluation of the Board and individual Directors;
- To ensure compliance with regulatory requirements relating to corporate governance; and
- Report on corporate governance matters to the Bank's constituents; in particular reference to the regulator and shareholders.

The role of this Committee is advisory in nature. Recommendations, if any, are made to the Board for final approval.

### **4.7.4 Nomination & Remuneration Committee**

The Nomination & Remuneration Committee responsibilities are to:

- Identify persons qualified to become members of the Board or senior managers of the Bank (with the exception of the appointment of the internal auditor which is the responsibility of the Audit Committee), and make recommendations accordingly;
- Review the Bank's remuneration policies for approved persons consistent with Central Bank of Bahrain ("CBB") guidelines, corporate values and strategy of the Bank;
- Make recommendations regarding remuneration policies and amounts for approved persons to the Board, taking account of total remuneration including salaries, fees, expenses and employee benefits;
- Recommend Board member remuneration based on their attendance and performance; and
- Oversee Directors' corporate governance educational activities.

In determining the composition of the Board, the Nomination and Remuneration Committee considers the knowledge, skills and experience required by the Board. No Director participates in any decisions regarding his own appointment or remuneration. The Nomination and Remuneration Committee is authorized to take certain appointment and remuneration decisions which may bind the Board. In all other cases, recommendations are made to the Board for its final approval.

## **5. Code of ethics, conflict of interest and whistle blower policy**

The Corporate Governance Committee reviews the Code of ethics and conflict of interest declarations by each Board member and employees of the Bank, and reports to the shareholders at each Annual General Meeting.

The Board maintains awareness of other commitments of its Directors and senior management. BMB implemented a Directors' Conflict of Interest Policy which is part of the Code of Conduct. As at 31 December 2017, the Board was satisfied that other commitments of the Directors and senior management do not conflict with their duties.

The Board confirms that it has not denied any employee access to the Audit Committee and that it has provided protection to whistle blowers from adverse personnel action.

## **6. External Auditors**

Ernst & Young were appointed as the external auditors of the Bank for the year 2017 by the shareholders in the Annual General Meeting held on 16 February 2017.

The Audit Committee and Articles of Association include measures to ensure ongoing independence of the Bank's external auditors. The details of audit and non-audit fees payable to the external auditors are available at the Bank's corporate office.

The Bank's external auditors, have unhindered access to the Audit Committee, Executive Committee, and the Board of Directors, with or without members of management being present to discuss their audit findings and any other matter which should be brought to the attention of the Board.

## **7. Internal Control**

The Board is committed to managing risk and ensuring that effective measures are in place to safeguard the Bank's assets, ensure proper accounting records and reliable financial information by procedures designed to avoid or reduce risks and ensure compliance with applicable laws and regulations.

The Bank's internal controls over financial reporting comprise processes designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles.

While the Audit Committee oversees and reviews the Bank's compliance policies and their implementation, the Bank's compliance officer, acts as the focal point and is responsible for implementing, monitoring and ensuring compliance with regulatory and statutory requirements. Compliance with anti-money laundering procedures and internal training in such procedures is also monitored and implemented by the Bank's compliance officer.

The Bank's compliance officer also serves as its Money Laundering Reporting Officer ("MLRO") for financial crimes regulatory purposes.

## **8. Related-party transactions**

Details of all transactions where a Director and/or other related parties might have potential interests are provided to the Board for its review and approval, and the interested Directors neither participate in the discussions nor vote on such matters. During the year, there were no abstentions by any board members from voting motivated by a conflict of interest.

For details of the Bank's related party transactions, please see Note 22 of the audited consolidated financial statements as of 31 December 2017.

## **9. Communication with shareholders**

In addition to the Bank's extensive disclosure through its annual report and website, the Chairman and the CEO are in regular dialogue with the controllers to ensure that the Board understands their views.

In compliance with CBB regulations under PD Module of the Volume 1 of CBB Rulebook, the Bank has an approved Public Disclosure policy that discloses material information about its activities to various stakeholders of the Bank.

## 10. Dividend policy

The Bank's dividend payout is dependent on the financial position of the Bank and the overall strategy as determined by the Board.

## 11. Remuneration

In 2014, the shareholders approved a Remuneration Policy and an Employee Shares Incentive Plan to comply with CBB's Guidelines on Sound Remuneration Practices. The Remuneration Policy formalizes the basis for remuneration in the Bank for the Directors and all staff, by effectively linking remuneration to performance. It also introduces new methods that ensure rewards are properly linked with the risks being taken and the timing and likelihood of future revenues. It introduces provisions for clawback and malus to protect the shareholders' interests in case of deterioration of the business due to past actions of individuals employed by the Bank. It also includes back testing and stress-testing methodologies to ensure that the policies adopted are suitable for the intended purpose.

The Nomination and Remuneration Committee ("NRC") is responsible for the effective implementation and maintenance of the Remuneration Policy. It approves the remuneration system in the Bank, which includes remuneration for each member of Executive Management and the total variable remuneration to be distributed. The remuneration pool is set to materially mirror the performance of the Bank. NRC is also responsible for administering the long term performance assurance measures such as deferral of remuneration or, when required, clawback and malus.

The foremost principle of the remuneration system is Risk Management, where remuneration must be effectively aligned with prudent risk taking practices and discipline at all levels of the Bank. The remuneration of all executive management must be adjusted for all types of risks. Any given bonus or variable remuneration may not be linked directly to a revenue amount or a net profit figure without taking into account risk factors for possible adjustment. As a minimum, the following risks are evaluated by the NRC annually and remuneration adjusted accordingly:

- Credit / Investment Risk;
- Market Risk;
- Liquidity Risk;
- Cost & quantity of Capital;
- Capital Adequacy;
- Reputational Risk;
- Regulatory Risk; and
- Timing of revenues, risks and cash flow.

In its review of those risks, NRC uses various quantitative and qualitative data to form its opinion. The experience and judgement of the Board members is relied on in particular for assessing risks that are subjective in nature.

The deferral of remuneration is an instrumental tool in ensuring that, where profits and losses are realised over different periods of time, the remuneration is aligned to the time horizon of the risks.

This would be applicable particularly where the time horizon of the future cash flows is either far into the future or uncertain. The NRC examines closely, pay-outs made out for income that cannot be realised or whose likelihood of realisation remains uncertain at the time of the pay-out.

The forms of remuneration approved are cash and equity, with the form and mix of remuneration in either of those instruments dependent on the proper alignment of risks.

The Remuneration system takes into account the overall performance of the Bank, however individuals employed at all levels are primarily remunerated based on their performance vis-à-vis achieving their set objectives. The system distinguishes between Executive Management engaged in risk taking and those in control functions, whose objectives are different and are measured accordingly.

Material Risk Takers are executives who through their activity and authority have a material impact on the risk exposure of the Bank and its ability to generate revenue and profits. Material Risk Takers are paid with both fixed and variable elements. The variable remuneration component constitutes a substantial portion of the potential total remuneration for such executives during each year and increases significantly along with the level of seniority and responsibility. Half of the variable remuneration paid to these officers is required to be in equity. On the other hand, executives and staff employed in control functions are remunerated independently of the business areas that they oversee. The performance measures of such persons must be based principally on the achievement of the objectives and targets of their functions rather than the performance of the business line they may be monitoring for the Bank. As such, the mix of fixed and variable remuneration for control function staff is weighted in favor of fixed remuneration.

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

Fixed & Variable Remuneration (US\$ '000)	2017		2016	
	Fixed	Variable	Fixed	Variable
Members of Board of Directors - Sitting Fees	119	-	99	-
Members of Board of Directors - Other Remuneration	-	-	12	-
Approved Persons in Business Lines	734	169	1,109	1,128
Approved Persons in Control Functions	671	373	665	542
Other Material Risk Takers	-	-	91	-
Other staff not included in above categories	984	152	1,114	133

Variable Remuneration (US\$ '000)	2017		2016	
	Cash	Equity	Cash	Equity
Members of Board of Directors	-	-	-	-
Approved Persons in Business Lines	64	105	564	564
Approved Persons in Control Functions	203	170	354	188
Other Material Risk Takers	-	-	-	-
Other staff not included in above categories	152	-	133	-

No guaranteed bonuses, sign-on rewards or severance payments were awarded during the year.

In 2015, the Group had initiated a share incentive plan under which eligible employees receive a portion of their annual performance-based incentive compensation in the form of shares vesting over a period of three years. These shares were granted to the employees at US\$ 15 cents per share. There are 3,856 thousand shares (2016:10,112 thousand) in the incentive plan. All these shares have commenced vesting, but have not fully vested as at 31 December 2017. An income statement charge of US\$ 126 thousand (2016: US\$ 64 thousand) was taken by the Group based on management's best estimate of the number of shares that are likely to vest.

For 2017, none of the variable remuneration to be paid in cash was deferred (2016: US\$ 114 thousand). Deferred cash incentive vests over a period of three years based on certain conditions.

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

The aggregate remuneration to the Board of Directors and senior management is disclosed above. Further details, including the specific amounts paid to Board Committee members, are available at the corporate office of the Bank.

## **12. Employment of relatives of approved persons**

As a matter of policy, the Bank avoids the employment of any close relative of any member of its existing staff. Employing relatives would be with consideration to the applicants' qualifications and merits and is subject to approval by the NRC, with the condition that any conflicts of interest (if any) be fully disclosed and accepted by the committee.

The Chief Executive Officer discloses to the Board annually the relatives of any approved persons occupying controlled functions within the Bank.

During the year, the Bank did not employ any close relatives of any staff of the Bank.

## **13. Corporate Governance Code and Status of Compliance**

The Bank's Board and management have endeavored to comply with the Corporate Governance requirements as prescribed in the High Level Controls Module and Public Disclosures Module of the CBB Rulebook Volume 1 and Volume 6. The Rulebook incorporates the Corporate Governance requirements issued by the Ministry of Industry and Commerce in 2010. The External Auditors of the Bank have also reviewed the adherence of the Bank to the Corporate Governance Code and the disclosure requirements of the CBB.

The Bank's Corporate Governance framework contains a full set of Charters, Policies, and a Corporate Governance Committee in line with the guidelines and industry best practices.

The Bank is in compliance to the requirements of the above, as at 31 December 2017 with the following exceptions, which are duly explained below.

Rule-book Reference	Regulation	Status and Explanation
HC-1.4.6 (Guideline only)	The chairman of the Board should be an independent director, so that there will be an appropriate balance of power and greater capacity of the Board for independent decision making.	Being a 'controlled company', Chairman is an Executive Director, being representative of a controller.
And		
HC-1.4.8	The Chairman must not be an Executive Director.	

#### 14. Key Performance Indicators

5 years key ratios	2017	2016	2015	2014	2013
Gross operating income (US\$ '000)	10,897	11,157	12,566	12,231	11,929
Net profit (loss) (US\$ '000)	5,228	5,073	5,079	4,524	(4,657)
Return on average assets (%)	2.7%	2.9%	2.9%	2.6%	-4.1%
Return on average shareholders' equity (%)	10.1%	13.5%	15.3%	15.2%	-15.7%
Cost-to-income (%)	41.2%	50.8%	43.7%	42.7%	52.7%



# CONSOLIDATED FINANCIAL STATEMENTS 2017



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

## Report on the Audit of the Consolidated Financial Statements

### *Opinion*

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

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

### *Basis for opinion*

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

### *Key audit matters*

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

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

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

## 1. Impairment of carrying value of loans and advances

Refer to note 4 and note 7 to the consolidated financial statements

Key audit matter / risk	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 impairment of loans and advances, 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 2017, the Group's gross loans and advances amounted to US\$ 144 million and the related impairment provisions amounted to US\$ 5.2 million, comprising US\$ 1.7 million of provision against Stage 1 and 2 exposures and US\$ 3.5 million against exposures classified under Stage 3. The impairment provision policy is presented in the accounting policies in note 4.4 and impairment provision is presented in note 7 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 the 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 management.</li> </ul> <p>Our procedures in this regard are discussed in further detail below under the key audit matter "Early adoption of IFRS 9".</p>

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

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

### Key audit matters (continued)

2. Early adoption of IFRS 9 Refer to note 4 and note 24 to the consolidated financial statements	
Key audit matter / risk	How the key audit matter was addressed in the audit
<p>The International Accounting Standards Board (IASB) issued IFRS 9 – “Financial Instruments” which replaces “IAS 39 – Financial Instruments” in three phases as follows:</p> <p>Phase 1 – classification and measurement of financial assets and financial liabilities;</p> <p>Phase 2 – Impairment methodology; and</p> <p>Phase 3 – Hedge accounting.</p> <p>Effective 1 January 2017, 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 2016 and 1 January 2017 amounting to US\$ 2.9 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 policy on classification and measurement of financial assets and financial liabilities 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];</li> </ul> <p>With respect to impairment methodology, our audit procedures comprised the following;</p> <ul style="list-style-type: none"> <li>• We obtained an understanding of the Group’s internal rating models for loans and advances;</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> <li>• For a sample of exposures, we checked the appropriateness of determining Exposure at Default;</li> </ul>

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

## 2. Early adoption of IFRS 9 (continued)

Refer to note 4 and note 24 to the consolidated financial statements

Key audit matter / risk	How the key audit matter was addressed in the audit
<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 4.3 and 4.4 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>• For Probability of Default ("PD") used in the ECL calculations we checked the Through the Cycle ("TTC") PDs with external published data and checked the appropriateness of conversion of the TTC PDs to Point in Time PDs;</li> <li>• We checked the completeness of loans and advances, investment securities, placements and other financial assets included in the ECL calculations as of 31 December 2017;</li> <li>• 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> <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>We assessed the disclosures to the consolidated financial statements 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 4.3, 4.4, 4.15 and 24 to the consolidated financial statements.</p>

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

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

### Key audit matters (continued)

<b>3. Maturity of deposits from financial institution</b> Refer to note 9 and note 24 to the consolidated financial statements	
<b>Key audit matter / risk</b>	<b>How the key audit matter was addressed in the audit</b>
The Group's due to financial institutions of US\$ 154.1 million includes deposits of US\$ 127.4 million from a single financial institution in the region since September 2010, with a monthly maturity and rollover. Because these deposits represent 77.8% of the total liabilities of the Group, this audit area is considered a key audit risk.	<p>We have circularised deposits confirmations to the financial institution to check the completeness of the balances.</p> <p>We have assessed the management's liquidity projections, challenged the assumptions and the input from their past experience used in the assumptions, further we have verified the deal tickets to check the maturities of the deposits to see if these are rolled over on maturities. We also checked the rollover of these deposits subsequent to 31 December 2017 and before 31 January 2018.</p> <p>We also assessed whether the consolidated financial statements disclosures appropriately reflect the requirements of IFRS. Refer to note 9 and 24 to the consolidated financial statements.</p>

#### *Other information included in the Group's 2017 Annual Report*

Other information consists of the information included in the Annual Report, other than the consolidated financial statements and our auditor's report thereon. The Board of Directors is responsible for the other information. Prior to the date of this auditor's report, we obtained the Chairman and Chief Executive Officer's 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.

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

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

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

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

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

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.

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

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

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

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

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

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


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

## Report on Other Legal and Regulatory Requirements

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

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the Chairman and Chief Executive Officer's 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 the CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2017 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position; and
- d) satisfactory explanations and information have been provided to us by Management in response to all our requests.

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

The logo for Ernst & Young, featuring the company name in a stylized, handwritten-style script.

Partner's registration no. 115

31 January 2018

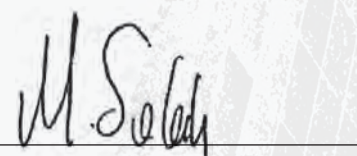
Manama, Kingdom of Bahrain

**Bahrain Middle East Bank B.S.C.**  
**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**  
**At 31 December 2017**

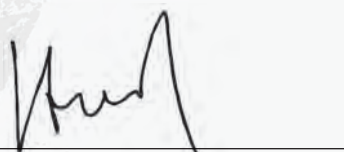
	Note	2017 US\$ '000	2016 US\$ '000
<b>ASSETS</b>			
Balances with banks and financial institutions	5	30,023	40,374
Treasury bills and placements with financial institutions	5	50,061	4,207
Investment securities	6	23,456	6,349
Loans and advances	7	138,714	123,958
Other assets	8	3,385	2,464
<b>TOTAL ASSETS</b>		<b>245,639</b>	<b>177,352</b>
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES</b>			
Due to financial institutions	9	154,064	126,567
Due to customers	10	3,124	8,405
Borrowings	11	4,810	-
Other liabilities	12	1,859	2,443
<b>Total liabilities</b>		<b>163,857</b>	<b>137,415</b>
<b>EQUITY</b>			
Share capital	13	100,000	60,501
Accumulated losses		(18,218)	(21,481)
Fair value reserve		-	917
<b>Total equity</b>		<b>81,782</b>	<b>39,937</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>245,639</b>	<b>177,352</b>



Wilson S. Benjamin  
Chairman



Murat Solak  
Vice Chairman



Korhan Alev  
Chief Executive Officer

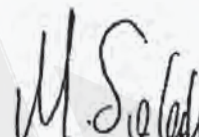
The attached notes 1 to 28 form part of these consolidated financial statements

**Bahrain Middle East Bank B.S.C.**  
**CONSOLIDATED STATEMENT OF INCOME**  
**For the year ended 31 December 2017**

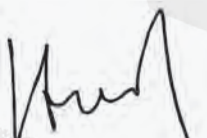
	Note	2017 US\$ '000	2016 US\$ '000
<b>OPERATING INCOME</b>			
Interest income	15	11,948	10,699
Interest expense	16	(334)	(965)
<b>Net interest income</b>		<b>11,614</b>	<b>9,734</b>
Investment banking (loss) income	17	(1,086)	1,149
Other income		221	368
<b>Foreign exchange gain (loss)</b>		<b>148</b>	<b>(94)</b>
<b>Total operating income</b>		<b>10,897</b>	<b>11,157</b>
<b>OPERATING EXPENSES</b>			
Staff expenses		3,053	4,127
Premises expenses		436	329
Other operating expenses	18	1,004	1,214
<b>Total operating expenses</b>		<b>4,493</b>	<b>5,670</b>
<b>NET PROFIT FOR THE YEAR BEFORE IMPAIRMENT PROVISIONS</b>			
		<b>6,404</b>	<b>5,487</b>
Impairment provision on cash and cash equivalents	5	(19)	-
Impairment provision on investment securities	6	(89)	(571)
Impairment (provision) / write back on loans and advances	7	(1,068)	157
<b>NET PROFIT FOR THE YEAR</b>		<b>5,228</b>	<b>5,073</b>
<b>BASIC AND DILUTED EARNINGS PER SHARE (IN US\$ CENTS)</b>			
	19	<b>2.15</b>	<b>2.10</b>



Wilson S. Benjamin  
Chairman



Murat Solak  
Vice Chairman



Korhan Alev  
Chief Executive Officer

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

**Bahrain Middle East Bank B.S.C.**  
**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**  
**For the year ended 31 December 2017**

	<i>2017</i> <i>US\$ '000</i>	<i>2016</i> <i>US\$ '000</i>
<b>NET PROFIT FOR THE YEAR</b>	<u><b>5,228</b></u>	<u><b>5,073</b></u>
Other comprehensive loss:		
Other comprehensive loss to be reclassified to profit or loss in subsequent periods:		
Fair value reserve:		
Net amount transferred to statement of income on sale/impairment	-	21
Net changes in fair value during the year	-	(419)
<b>Total other comprehensive loss for the year</b>	<u>-</u>	<u>(398)</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u><u><b>5,228</b></u></u>	<u><u><b>4,675</b></u></u>

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

**Bahrain Middle East Bank B.S.C.**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**For the year ended 31 December 2017**

	2017	2016
	Note US\$ '000	US\$ '000
<b>OPERATING ACTIVITIES</b>		
Net profit for the year	5,228	5,073
Adjustments for:		
Impairment provision on cash and cash equivalents	5      19	-
Impairment provision on investment securities	6      89	571
Impairment provision / (write back) on loans and advances	7      1,068	(157)
Depreciation and amortisation	90	43
Changes in operating assets and liabilities:		
Investment securities	(17,295)	2,589
Loans and advances	(18,559)	(13,096)
Other assets	(333)	382
Due to financial institutions	27,497	1,469
Due to customers	(5,281)	(321)
Borrowings	4,810	-
Other liabilities	(584)	(343)
Net cash used in operating activities	<u>(3,251)</u>	<u>(3,790)</u>
<b>INVESTING ACTIVITIES</b>		
Purchase of furniture and equipment	(280)	-
Purchase of intangible assets	(398)	-
Net cash used in investing activities	<u>(678)</u>	<u>-</u>
<b>FINANCING ACTIVITIES</b>		
Issuance of new shares	13      39,499	-
Expenses on issuance of new shares	(28)	-
Net cash from financing activities	<u>39,471</u>	<u>-</u>
Impairment allowance on cash and cash equivalents	5      (39)	-
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>35,503</b>	<b>(3,790)</b>
Cash and cash equivalents at 1 January	<u>44,581</u>	48,371
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>	<b>5      80,084</b>	<b>44,581</b>

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

**Bahrain Middle East Bank B.S.C.**  
**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
**For the year ended 31 December 2017**

	<i>Share capital</i>	<i>Accumulated losses</i>	<i>Fair value reserve</i>	<i>Total equity</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Balance at 1 January 2016	60,501	(26,554)	1,315	35,262
Total comprehensive income (loss) for the year	-	5,073	(398)	4,675
Balance at 31 December 2016	60,501	(21,481)	917	39,937
Transition adjustment on adoption of IFRS 9 at 1 January 2017 (note 4.3)	-	(1,937)	(917)	(2,854)
Restated balance at 1 January 2017	60,501	(23,418)	-	37,083
Issuance of new shares	39,499	-	-	39,499
Expenses on issuance of new shares	-	(28)	-	(28)
Total comprehensive income for the year	-	5,228	-	5,228
<b>Balance at 31 December 2017</b>	<b>100,000</b>	<b>(18,218)</b>	<b>-</b>	<b>81,782</b>

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

# **Bahrain Middle East Bank B.S.C.**

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

### **At 31 December 2017**

#### **1. ACTIVITIES**

Bahrain Middle East Bank B.S.C. (“the Bank”) is a Bahraini Shareholding Company incorporated in the Kingdom of Bahrain. On 9 April 2007, the Central Bank of Bahrain (“the CBB”) issued a Conventional Wholesale Banking license to the Bank. The commercial registration (“CR”) number of the Bank is 12266. The Bank is listed on the Bahrain Bourse under the ticker “BMB” AN Investment W.L.L., a limited liability company incorporated in the Kingdom of Bahrain, is the Parent company of the Bank. The principal activities of the Bank and its subsidiaries (together “the Group”) are trade finance, corporate advisory and asset management services.

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

These consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 31 January 2018.

#### **2. BASIS OF CONSOLIDATION**

These consolidated financial statements incorporate the financial statements of the Bank, its subsidiary and the investment holding companies of the Bank as at 31 December 2017.

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

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

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

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

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

# **Bahrain Middle East Bank B.S.C.**

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

### **At 31 December 2017**

#### **2. BASIS OF CONSOLIDATION (continued)**

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

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

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

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

#### **3. BASIS OF PREPARATION**

##### **3.1 Statement of compliance**

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and are in conformity with the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse and the terms of the Bank's memorandum and articles of association. As explained in Note 4.3 the Group has early adopted IFRS 9 Financial Instruments issued in July 2014, with a date of initial application of 1 January 2017.

**Bahrain Middle East Bank B.S.C.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**At 31 December 2017**

**3.2 Accounting convention**

The consolidated financial statements are prepared on a historical cost basis, except for investment securities at fair value through profit or loss (“FVTPL”) and derivative financial instruments, that have been measured at fair value.

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

**4. SIGNIFICANT ACCOUNTING POLICIES**

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

The accounting policies adopted are consistent with those of the previous financial year, except for the early adoption of IFRS 9 as explained in Note 4.3 and for the following relevant new standards and amendments to IFRS effective as of 1 January 2017. These new standards and amendments do not have a material impact on the consolidated financial statements of the Group:

- *Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative;*
- *Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses;* and
- *Amendments to IFRS 12 Disclosure of Interests in Other Entities: Clarification of the scope of disclosure requirements in IFRS 12.*

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

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

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

IFRS 15 was issued in May 2014, and amended in April 2016, and establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

**Bahrain Middle East Bank B.S.C.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**At 31 December 2017**

**4. SIGNIFICANT ACCOUNTING POLICIES (continued)**

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

The new revenue standard will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. Early adoption is permitted. The Group plans to adopt the new standard on the required effective date. The Group, based on a preliminary assessment of IFRS 15, determined that the application of IFRS 15 will not have a material impact on the financial position or financial performance of the Group.

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

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

**4.3 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 2017. 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.

**Bahrain Middle East Bank B.S.C.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**At 31 December 2017**

For an explanation of how the Group classifies financial assets under IFRS 9, refer to Note 4.4 Financial Instruments i) Financial assets - Policy applicable from 1 January 2017.

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

- 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 4.4 Financial Instruments iii) Financial liabilities - Policy applicable from 1 January 2017.

**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 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.

**Bahrain Middle East Bank B.S.C.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**At 31 December 2017**

**4. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.3 Early Adoption of IFRS 9 (continued)**

**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 4.4 Financial Instruments i) Financial assets - Policy applicable from 1 January 2017 - 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 as at 1 January 2017. The Bank has not restated comparative information for 2016 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2016 is reported under IAS 39 and is not comparable to the information presented for 2017.

(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.
- 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.

**Bahrain Middle East Bank B.S.C.  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
At 31 December 2017**

**Impact of Adopting IFRS 9**

The impact of this change in accounting policy as at 1st January 2017 has been to increase accumulated losses by US\$ 1,937 thousand, and to decrease the fair value reserve by US\$ 917 thousand as follows:

	<b>Accumulated losses</b>	<b>Fair value reserve</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Closing balance under IAS 39 (31 December 2016)	(21,481)	917
<u>Impact on reclassification and remeasurements:</u>		
Investment securities (equity) from available-for-sale to FVTPL	917	(917)
<u>Impact on recognition of Expected Credit Losses:</u>		
Cash and cash equivalents	(20,564)	-
Investment securities (debt) at amortised cost	(20)	-
Loans and advances	(99)	-
	(2,735)	-
	(2,854)	-
<b>Opening balance under IFRS 9 on date of initial application of 1 January 2017</b>	<b>(23,418)</b>	<b>-</b>

If IFRS 9 had not been adopted, the consolidated statement of income for the year ended 31st December 2017 would have been impacted by an increase in net profit of US\$ 152 thousand resulting from the use of the incurred loss methodology to calculate impairment losses on financial assets and the classification of investment securities to FVTPL.

Additional disclosures, as required by IFRS 7, reflecting the revised impairment model for financial assets of the Group as a result of adopting IFRS 9, are disclosed in relevant notes throughout the consolidated financial statements.

## Bahrain Middle East Bank B.S.C. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS At 31 December 2017

### 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 2017.

	Classification under IAS 39	Classification under IFRS 9	Carrying amount under IAS 39 US\$ '000	Remeasurement US\$ '000	Carrying amount under IFRS 9 US\$ '000
<b>Financial assets</b>					
Balances with banks and financial institutions	Loans and receivables	Amortised cost	40,374	(6)	40,368
Treasury bills and placements with financial institutions	Loans and receivables	Amortised cost	4,207	(14)	4,193
Investment securities – equity	FVTPL	FVTPL	849	-	849
Investment securities – managed funds	FVTPL	FVTPL	300	-	300
Investment securities – managed funds	Available-for-sale	FVTPL	5,021	-	5,021
Investment securities – debt	Held-to-maturity investments	Amortised cost	179	(99)	80
Loans and advances	Loans and receivables	Amortised cost	123,958	(2,735)	121,223
Other assets	Loans and receivables	Amortised cost	2,464	-	2,464
			177,352	(2,854)	174,498
<b>Financial liabilities</b>					
Due to financial institutions	Amortised cost	Amortised cost	126,567	-	126,567
Due to customers	Amortised cost	Amortised cost	8,405	-	8,405
Other liabilities	Amortised cost	Amortised cost	2,443	-	2,443
			137,415	-	137,415
<b>Impairment allowances:</b>					
The following table reconciles the closing impairment allowance for financial assets in accordance with IAS 39 as at 31 December 2016 to the opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2017.					
	31 December 2016 US\$ '000	Remeasurement US\$ '000	1 January 2017 US\$ '000		
Cash and cash equivalents	-	20	20		
Held-to-maturity investment (reclassified to amortised cost under IFRS 9)	-	99	99		
Loans and advances	1,436	2,735	4,171		
<b>Total</b>	1,436	2,854	4,290		

**Bahrain Middle East Bank B.S.C.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**At 31 December 2017**

**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 2017</b>	<i>Fair value through profit or loss US\$ '000</i>	<i>Fair value through other comprehensive income US\$ '000</i>	<i>Amortised cost US\$ '000</i>	<i>Total US\$ '000</i>
Balances with banks and financial institutions	-	-	30,023	30,023
Treasury bills and placements with financial institutions	-	-	50,061	50,061
Investment securities	12,460	-	10,996	23,456
Loans and advances	-	-	138,714	138,714
Other assets	-	-	2,554	2,554
<b>Total assets</b>	<b>12,460</b>	<b>-</b>	<b>232,348</b>	<b>244,808</b>
Due to financial institutions	-	-	154,064	154,064
Due to customers	-	-	3,124	3,124
Borrowings	-	-	4,810	4,810
Other liabilities	54	-	1,805	1,859
<b>Total liabilities</b>	<b>54</b>	<b>-</b>	<b>163,803</b>	<b>163,857</b>

<b>31 December 2016</b>	<i>Fair value through profit or loss US\$ '000</i>	<i>Held-to- maturity US\$ '000</i>	<i>Available- for-sale US\$ '000</i>	<i>Loans and receivables US\$ '000</i>	<i>Total US\$ '000</i>
Balances with banks and financial institutions	-	-	-	40,374	40,374
Treasury bills and placements with financial institutions	-	-	-	4,207	4,207
Investment securities	1,149	179	5,021	-	6,349
Loans and advances	-	-	-	123,958	123,958
Other assets	-	-	-	2,238	2,238
<b>Total assets</b>	<b>1,149</b>	<b>179</b>	<b>5,021</b>	<b>170,777</b>	<b>177,126</b>
Due to financial institutions	-	-	-	126,567	126,567
Due to customers	-	-	-	8,405	8,405
Other liabilities	-	-	-	2,043	2,043
<b>Total liabilities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>137,015</b>	<b>137,015</b>

**Bahrain Middle East Bank B.S.C.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**At 31 December 2017**

**4. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.4 Financial instruments**

**i) Financial assets - Policy applicable from 1 January 2017**

**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.

**Classification**

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.

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**Business model assessment**

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

- The stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, realising cash flows through the sale of the assets and holding it for liquidity purposes;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed; and
- The frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

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

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

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. '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:

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**4. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.4 Financial instruments (continued)**

**i) Financial assets - Policy applicable from 1 January 2017 (continued)**

- 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.

**Subsequent measurement**

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

**Amortised cost**

After initial measurement, financial assets are subsequently measured at amortised cost using the effective interest rate (EIR) method, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as 'interest income' in the consolidated statement of income.

**Investment securities - FVTPL**

These include financial assets held for trading and financial assets designated at FVTPL. Financial assets at FVTPL are carried in the consolidated statement of financial position at fair value with net changes in fair value presented in the consolidated statement of income.

**Investment securities - FVOCI**

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

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

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

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

**Derecognition**

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 the consolidated statement of income.

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, the original financial asset is derecognised and a new financial asset is recognised at either amortised cost or fair value. If the cash flows are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, the Group recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in the consolidated statement of income.

**Impairment**

The Group recognises 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.

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**4. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.4 Financial instruments (continued)**

**i) Financial assets - Policy applicable from 1 January 2017 (continued)**

**Impairment (continued)**

No impairment loss is recognised on equity investments.

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

- Financial assets (cash and cash equivalents and debt investment securities) that are determined to have low credit risk at the reporting date; and
- Financial instruments on which credit risk has not increased significantly since their initial recognition.

**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;

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

As step 1, the financial assets are 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 financial asset is credit impaired.

As step 2, the expected credit loss is calculated i.e., 12-month expected loss for all financial assets in stage 1 and lifetime expected credit loss for all financial assets in stage 2. The financial assets 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;

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- 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 calculated.

#### **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; and
- Loan commitments and financial guarantee contracts: generally, 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.

#### **ii) Financial assets - Policy applicable up to 31 December 2016**

##### **Initial recognition and measurement**

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

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

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**4. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.4 Financial instruments (continued)**

**ii) Financial assets - Policy applicable up to 31 December 2016 (continued)**

**Initial recognition and measurement (continued)**

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

**Subsequent measurement**

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

*Financial assets at fair value through profit or loss*

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

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

*Loans and receivables*

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

*Held-to-maturity investments*

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

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*Available-for-sale investments*

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

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

**Derecognition**

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

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

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

**Impairment**

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

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**4. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.4 Financial instruments (continued)**

**ii) Financial assets - Policy applicable up to 31 December 2016 (continued)**

**Impairment (continued)**

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

*Financial assets carried at amortised cost*

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

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

*Available-for-sale financial investments*

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

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

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**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.

**iii) Financial liabilities - Policy applicable from 1 January 2017**

**Initial recognition and measurement**

Financial liabilities are classified into one of the following two categories:

- financial liabilities at amortised cost; or
- financial liabilities at fair value through the profit or loss (FVTPL)

Financial liabilities are initially recognised at fair value, representing the proceeds received net of premiums, discounts and transaction costs that are directly attributable to the financial liability.

The Group's financial liabilities comprise due to financial institutions, due to customers, borrowings and other liabilities.

**Subsequent measurement**

Subsequent to initial measurement, financial assets and liabilities are measured at either amortised cost or fair value

*Financial liabilities at amortised cost*

All financial liabilities, other than those classified as financial liabilities at FVTPL, are classified as financial liabilities at amortised cost and are measured at amortised cost using the effective interest rate method.

*Financial liabilities at fair value through profit or loss*

Financial liabilities not otherwise classified above are classified as financial liabilities at FVTPL. This classification includes derivatives that are liabilities measured at fair value.

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**4. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.4 Financial instruments (continued)**

**iii) Financial liabilities - Policy applicable from 1 January 2017 (continued)**

**Derecognition**

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

The Group derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at either amortised cost or fair value. The difference between the carrying amount of the financial liability derecognised and the new financial liability with modified terms is recognised in the statement of income.

**iv) Financial liabilities - Policy applicable up to 31 December 2016**

**Initial recognition and measurement**

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

**Subsequent measurement**

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

*Financial liabilities at fair value through profit or loss*

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

*Borrowings*

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

*Financial guarantee contracts*

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

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**Derecognition**

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

**v) Offsetting of financial instruments**

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

**vi) Fair values**

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

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

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

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

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

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**4. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.5 Foreign currencies**

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

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

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

**4.6 Borrowings**

After initial recognition, interest-bearing borrowings are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the EIR amortisation process. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as interest expense in the consolidated statement of income.

**4.7 Payables, accruals and provisions**

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

Provisions are recognised when the Group has a present obligation as a result of a past event, when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

**4.8 Dividends and any other appropriations**

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

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

#### **4.9 Treasury shares**

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

#### **4.10 Derivatives**

The Group uses derivative financial instruments, such as forward currency contracts and currency swaps, to hedge its foreign currency risks. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative. Any gains or losses arising from changes in the fair value of derivatives are taken directly to profit or loss,

#### **4.11 Segment reporting**

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

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

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

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**4. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**4.13 Assets under management**

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

**4.14 Income and expenses**

Interest income is recognised using the effective yield method.

Fee and commission income is recognised when services are rendered.

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

Interest expenses is recognised using the EIR method.

**4.15 Significant accounting judgements and estimates**

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

*Fair value measurement*

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

*Classification of financial assets - Policy applicable from 1 January 2017*

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 2017*

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.

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*Impairment of loans and advances - Policy applicable upto 31 December 2016*

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.

*Impairment of available-for-sale investments - Policy applicable upto 31 December 2016*

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

*Going concern*

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

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**5. CASH AND CASH EQUIVALENTS**

	2017 US\$ '000	2016 US\$ '000
<i>With original maturities of three months or less</i>		
Balances with banks and financial institutions	30,025	40,374
Less: Allowance for impairment	(2)	-
	<u>30,023</u>	<u>40,374</u>
Treasury bills and placements with financial institutions	50,098	4,207
Less: Allowance for impairment	(37)	-
	<u>50,061</u>	<u>4,207</u>
Cash and cash equivalents	<u>80,084</u>	<u>44,581</u>

Movements in allowance for impairment for cash and cash equivalents are as follows:

	2017			2016
	Stage 1: 12-month ECL	Stage 1: 12-month ECL	Total ECL	Total impairment provision
	<i>Balances with banks and financial institutions US\$ '000</i>	<i>Treasury bills and placements with financial institutions US\$ '000</i>	<i>Cash and cash equivalents US\$ '000</i>	<i>Cash and cash equivalents US\$ '000</i>
Balance at 1 January - on adoption of IFRS 9	6	14	20	-
Net remeasurement of loss allowance	(4)	23	19	-
<b>Balance at 31 December</b>	<u>2</u>	<u>37</u>	<u>39</u>	<u>-</u>

Treasury bills and placements with financial institutions include US\$ 1,552 thousand (2016: US\$ 1,976 thousand) placed with a third party retail bank in the Kingdom of Bahrain; representing amounts held on account of sub-participants in private equity funds and for the purposes of honoring their capital calls to fund managers.

**6. INVESTMENT SECURITIES**

	2017			
	<i>Fair value through profit or loss US\$ '000</i>	<i>Fair value through other comprehensive income US\$ '000</i>	<i>Amortised cost US\$ '000</i>	<i>Total US\$ '000</i>
<b>Quoted investments</b>				
Sovereign bonds	5,988	-	-	5,988
Other bonds and debt securities	2,818	-	-	2,818
Equities	394	-	-	394
	<u>9,200</u>	<u>-</u>	<u>-</u>	<u>9,200</u>
<b>Unquoted investments</b>				
Other bonds and debt securities	-	-	11,000	11,000
Managed funds	3,260	-	-	3,260
	<u>3,260</u>	<u>-</u>	<u>11,000</u>	<u>14,260</u>
	<u>12,460</u>	<u>-</u>	<u>11,000</u>	<u>23,460</u>
Less: Allowance for impairment	-	-	(4)	(4)
	<u>12,460</u>	<u>-</u>	<u>10,996</u>	<u>23,456</u>

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	2016			
	<i>Fair value through profit or loss US\$ '000</i>	<i>Available-for-sale US\$ '000</i>	<i>Held-to-maturity US\$ '000</i>	<i>Total US\$ '000</i>
<i>Quoted investments</i>				
Equities	849	-	-	849
	<u>849</u>	<u>-</u>	<u>-</u>	<u>849</u>
<i>Unquoted investments</i>				
Other bonds and debt securities	-	-	179	179
Managed funds	300	8,021	-	8,321
	<u>300</u>	<u>8,021</u>	<u>179</u>	<u>8,500</u>
	1,149	8,021	179	9,349
Less: Allowance for impairment	-	(3,000)	-	(3,000)
Balance at 31 December 2016	<u>1,149</u>	<u>5,021</u>	<u>179</u>	<u>6,349</u>

The sovereign bonds held by the Group are pledge to a local financial institution (refer note 11).

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

	2017				2016
	<i>Stage 1: 12-month ECL US\$ '000</i>	<i>Stage 2: Lifetime ECL not credit- impaired US\$ '000</i>	<i>Stage 3: Lifetime ECL credit- impaired US\$ '000</i>	<i>Total ECL US\$ '000</i>	<i>Total US\$ '000</i>
<b>Sovereign and other bonds and debt securities at amortized cost</b>					
Balance at 1 January - on adoption of IFRS 9	-	99	-	99	-
Changes due to financial assets recognised in opening balance that have:					
Transfer to lifetime ECL credit-impaired	-	(99)	99	-	-
Net remeasurement of loss allowance	4	-	85	89	-
Write-offs	-	-	(184)	(184)	-
Balance at 31 December	<u>4</u>	<u>-</u>	<u>-</u>	<u>4</u>	<u>-</u>

The Group's unquoted investments in managed funds were classified as available-for-sale as of 31 December 2016. The movement in impairment provisions on these investments at 31 December 2016 was as follows:

	2016
	<i>Available-for-sale investments US\$ '000</i>
At 1 January 2016	10,813
Charge for the year	571
Write-offs	(8,367)
Foreign exchange movements	(17)
At 31 December 2016	<u>3,000</u>

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**7. LOANS AND ADVANCES**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Trade finance	<b>137,420</b>	118,861
Installment sale receivable	<b>3,533</b>	3,533
Corporate loan	<b>3,000</b>	3,000
	<b>143,953</b>	125,394
Less: Allowance for impairment	<b>(5,239)</b>	(1,436)
	<b>138,714</b>	123,958

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

Movements in allowance for impairment are as follows:

	<b>2017</b>			<b>2016</b>	
	<b>Stage 1:</b>	<b>Stage 2:</b>	<b>Stage 3:</b>	<b>Total ECL</b>	<b>Total</b>
	<b>12- month</b>	<b>Lifetime</b>	<b>Lifetime</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
	<b>ECL</b>	<b>ECL not credit-</b>	<b>ECL credit-</b>		
	<b>US\$ '000</b>	<b>impaired</b>	<b>impaired</b>		
	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
Balance at 1 January - on adoption of IFRS 9	1,018	3,153	-	4,171	2,936
Changes due to financial assets recognised in opening balance that have:					
Transfer to lifetime ECL credit- impaired	-	(1,928)	1,928	-	-
Net remeasurement of loss allowance	141	(678)	1,605	1,068	(157)
Amounts written off during the year	-	-	-	-	(1,343)
Balance at 31 December	<b>1,159</b>	<b>547</b>	<b>3,533</b>	<b>5,239</b>	<b>1,436</b>

Installment sale receivable relates to a sale agreement entered by the Bank to sell its investment in a piece of land in the State of Kuwait on an installment sale basis. The loan is secured by corporate guarantees from a shareholder and additional guarantee from two associates of the shareholder. This loan is non-performing and has been fully provided for.

**8. OTHER ASSETS**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Accrued interest receivable	<b>2,410</b>	2,080
Prepayments	<b>203</b>	186
Furniture and equipment	<b>230</b>	40
Intangible assets	<b>398</b>	-
Others	<b>144</b>	158
	<b>3,385</b>	2,464

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**9. DUE TO FINANCIAL INSTITUTIONS**

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

**10. DUE TO CUSTOMERS**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Customer participation in funds	1,552	1,976
Others	1,572	2,043
Cash collateral	-	4,386
	<u><b>3,124</b></u>	<u><b>8,405</b></u>

Customer participation in funds represents amounts received from customers to be invested in private equity funds administered by the Bank, placed with a third party retail bank in the Kingdom of Bahrain. These funds, although treated as part of customer deposits, are retained by the Bank until capital calls are made by private equity fund managers. Customer participation in funds includes US\$ 170 thousand (2016: US\$ 266 thousand) in deposits held on behalf of BMB Technology and Telecommunications Fund.

Others consist of deposit amounts from corporates and individual customers.

**11. BORROWINGS**

These represent short term borrowings from a local financial institution for general financing purposes. These carry annual interest rate of 2.55% per annum and mature in first quarter of 2018. These are secured against pledge of the Group's sovereign bonds of US\$ 5,988 thousand as of 31 December 2017 (refer note 6).

**12. OTHER LIABILITIES**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Accrued expenses	784	1,472
Employees' leaving indemnity	417	400
Provision against litigation	300	300
Accrued interest payable	59	18
Negative fair value of derivative	54	-
Others	245	253
	<u><b>1,859</b></u>	<u><b>2,443</b></u>

**13. SHARE CAPITAL**

	<b>2017</b>		<b>2016</b>	
	<b>Number</b>	<b>Amount</b>	<b>Number</b>	<b>Amount</b>
	<b>'000</b>	<b>US\$ '000</b>	<b>'000</b>	<b>US\$ '000</b>
<b>Authorized</b>				
Ordinary shares of US\$ 0.25 each	<u><b>2,000,000</b></u>	<u><b>500,000</b></u>	<u><b>2,000,000</b></u>	<u><b>500,000</b></u>
<b>Issued and fully paid</b>				
Ordinary shares of US\$ 0.25 each	<u><b>400,000</b></u>	<u><b>100,000</b></u>	<u><b>242,003</b></u>	<u><b>60,501</b></u>

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**13. SHARE CAPITAL (continued)**

The shareholders in their extra-ordinary general meeting held on 22 October 2017 resolved to increase the Bank's issued share capital from 242,003 thousand shares of US\$ 0.25 each to 484,006 thousand shares of US\$ 0.25 each by issuing right shares of 242,003 thousand. Total shares subscribed and fully paid by the shareholders were 157,997 thousand, amounting to US\$ 39,499 thousand. The shares allotment has been approved by the Central Bank of Bahrain and Bahrain Bourse; however registration of this increase in share capital with the Ministry of Industry, Commerce and Tourism, and other legal formalities in this regard, are in progress.

**Treasury shares**

At 31 December 2017, the Bank owned 6 of its own shares (31 December 2016: 6 shares). The value of these shares is deducted from the shareholders' equity.

**14. STATUTORY RESERVE**

The Bahrain Commercial Companies Law requires 10% of the net profit for the year to be transferred to a statutory reserve until such reserve equals 50% of the paid up capital. The reserve cannot be utilised for the purpose of distribution, except in such circumstances as stipulated in the Bahrain Commercial Companies Law. Transfer to statutory reserve has not been made during the year in view of the accumulated losses as of 31 December 2017.

**15. INTEREST INCOME**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Loans and advances	<b>11,471</b>	10,130
Treasury bills and placements with financial institutions	<b>263</b>	505
Investment securities	<b>214</b>	64
	<b>11,948</b>	10,699

**16. INTEREST EXPENSE**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Deposits from financial institutions	<b>325</b>	886
Borrowings	<b>8</b>	-
Deposits from customers	<b>1</b>	79
	<b>334</b>	965

**17. INVESTMENT BANKING (LOSS) INCOME**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Fee and commission income	<b>94</b>	850
Loss on investment securities - net	<b>(1,180)</b>	(285)
Gain on sale of written-off assets	<b>-</b>	584
	<b>(1,086)</b>	1,149

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**18. OTHER OPERATING EXPENSES**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Legal and professional expenses	<b>340</b>	312
Business development expenses	<b>227</b>	87
Insurance and regulatory charges	<b>185</b>	214
Communication expenses	<b>109</b>	126
Provision against litigation	<b>-</b>	300
Others	<b>143</b>	175
	<b><u>1,004</u></b>	<b><u>1,214</u></b>

**19. BASIC AND DILUTED EARNINGS PER SHARE**

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

	<b>2017</b>	<b>2016</b>
Net profit for the year attributable to the owners of the Bank (US\$ '000)	<b><u>5,228</u></b>	<u>5,073</u>
Weighted average number of shares outstanding during the year	<b><u>243,305</u></b>	<u>242,003</u>
Basic and diluted earnings per share (US\$ cents)	<b><u>2.15</u></b>	<u>2.10</u>

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

**20. OPERATING SEGMENTS**

**Segment information**

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

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

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

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

	<i>Financing</i> <i>US\$ '000</i>	<i>Investing</i> <i>US\$ '000</i>	<i>Others</i> <i>US\$ '000</i>	<i>Total</i> <i>US\$ '000</i>
Interest income	11,734	214	-	11,948
Interest expense	(334)	-	-	(334)
Investment banking (loss) income	-	(1,180)	94	(1,086)
Other income	-	-	221	221
Foreign exchange gain	-	-	148	148
	<hr/>	<hr/>	<hr/>	<hr/>
Results from operations	11,400	(966)	463	10,897
Impairment provisions - net	(1,087)	(89)	-	(1,176)
<b>Segment profit (loss)</b>	<b>10,313</b>	<b>(1,055)</b>	<b>463</b>	<b>9,721</b>
Unallocated corporate expenses				(4,493)
<b>Net profit for the year</b>				<b>5,228</b>
	<hr/>	<hr/>	<hr/>	<hr/>
<b>Segment assets</b>	<b>221,096</b>	<b>23,622</b>	<b>921</b>	<b>245,639</b>
	<hr/>	<hr/>	<hr/>	<hr/>
<b>Segment liabilities</b>	<b>162,111</b>	<b>-</b>	<b>1,746</b>	<b>163,857</b>
	<hr/>	<hr/>	<hr/>	<hr/>

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

	<i>Financing</i> <i>US\$ '000</i>	<i>Investing</i> <i>US\$ '000</i>	<i>Others</i> <i>US\$ '000</i>	<i>Total</i> <i>US\$ '000</i>
Interest income	10,635	64	-	10,699
Interest expense	(965)	-	-	(965)
Investment banking income	169	299	681	1,149
Other income	-	-	368	368
Foreign exchange loss	-	-	(94)	(94)
	<hr/>	<hr/>	<hr/>	<hr/>
Results from operations	9,839	363	955	11,157
Impairment provisions - net	157	(571)	-	(414)
Segment profit (loss)	9,996	(208)	955	10,743
	<hr/>	<hr/>	<hr/>	<hr/>
Unallocated corporate expenses				(5,670)
<b>Net profit for the year</b>				<b>5,073</b>
	<hr/>	<hr/>	<hr/>	<hr/>
Reportable segment assets	170,619	6,349	384	177,352
	<hr/>	<hr/>	<hr/>	<hr/>
Reportable segment liabilities	134,990	-	2,425	137,415
	<hr/>	<hr/>	<hr/>	<hr/>

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**Geographic information**

Although the Group's two main business segments are managed on a worldwide basis, they operate in three main geographical areas. The Group's exposure to credit risk is concentrated in these areas: Europe (Primarily Western Europe), North America (United States of America and Canada) and Gulf Cooperation Council ("GCC"). The following table shows the distribution of the Group's revenue and assets by geographical segment, allocated based on the location in which the assets and liabilities are located, for the years ended 31 December 2017 and 31 December 2016:

	2017		2016	
	Total income (loss) US\$ '000	Total assets US\$ '000	Total income US\$ '000	Total assets US\$ '000
Europe	11,200	158,933	9,989	123,331
North America	(541)	36,641	951	40,030
GCC	546	49,237	1,070	13,982
Rest of the world	26	828	112	9
<b>Total</b>	<b>11,231</b>	<b>245,639</b>	<b>12,122</b>	<b>177,352</b>

**21. REMUNERATION**

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

**Fixed and variable remuneration**

	2017		2016	
	Fixed US\$ '000	Variable US\$ '000	Fixed US\$ '000	Variable US\$ '000
Members of Board of Directors - Sitting fees	119	-	99	-
Members of Board of Directors - Other remuneration	-	-	12	-
Approved persons in business lines	734	169	1,109	1,128
Approved persons in control functions	671	373	665	542
Other material risk takers	-	-	91	-
Other staff not included in above categories	984	152	1,114	133

**Variable remuneration**

	2017		2016	
	Cash US\$ '000	Equity US\$ '000	Cash US\$ '000	Equity US\$ '000
Approved persons in business lines	64	105	564	564
Approved persons in control functions	203	170	354	188
Other staff not included in above categories	152	-	133	-

In 2015, the Group had initiated a share incentive plan under which eligible employees receive a portion of their annual performance-based incentive compensation in the form of shares vesting over a period of three years. These shares were granted to the employees at US\$ 15 cents per share. There are 3,856 thousand shares (2016:10,112 thousand) in the incentive plan. All these shares have commenced vesting, but have not fully vested as at 31 December 2017. An income statement charge of US\$ 126 thousand (2016: US\$ 64 thousand) was taken by the Group based on management's best estimate of the number of shares that are likely to vest.

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**21. REMUNERATION (continued)**

The movement in the number of shares is as follows:

<i>Number of shares '000</i>	<b>2017</b>	<b>2016</b>
Opening	<b>10,112</b>	5,094
Granted during the year	<b>1,833</b>	5,018
Vested during the year	-	-
Forfeited during the year	<b>(8,089)</b>	-
	<b><u>3,856</u></b>	<b><u>10,112</u></b>

Included in the variable remuneration to be paid in cash, is US\$ nil (2016: US\$ 114 thousand), which is deferred cash incentive and will vest over a period of three years based on certain conditions.

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

**22. RELATED PARTY TRANSACTIONS AND BALANCES**

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

Key management personnel of the Group are those persons having authority and responsibility for planning, directing and controlling the activities of the Group. Key management personnel comprise the Board of Directors, Chief Executive Officer, Chief Financial Officer and Heads of Departments. Transactions entered during the year and balances as at 31 December 2017 and 31 December 2016 are set out below:

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

	<i>Key management personnel</i>		<i>Shareholders and their related parties</i>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
<b>Statement of financial position</b>				
<b>Assets</b>				
Loans and advances	-	-	<b>3,000</b>	-
<b>Liabilities</b>				
Deposits	-	-	<b>267</b>	139
Other liabilities - employee leaving indemnity	<b>242</b>	225	-	-
<b>Statement of income</b>				
Interest income	-	-	<b>266</b>	267
Investment banking income	-	-	-	11

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**Key management compensation**

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

	<b>2017</b> <b>US\$ '000</b>	<b>2016</b> <b>US\$ '000</b>
Salaries and other short-term employee benefits	1,250	1,687
Employee leaving indemnity	32	30
	<u>1,282</u>	<u>1,717</u>
Directors' remuneration	<u>119</u>	<u>111</u>

**Guarantee**

The Bank has received a corporate guarantee from a shareholder with regard to the Bank's installment sale receivable (refer note 7), and an additional guarantee from two associates of the shareholder.

**23. CAPITAL MANAGEMENT**

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

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

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

The Capital Adequacy Ratio of the Bank as at 31 December 2017 and 31 December 2016 is as follows:

	<b>2017</b> <b>US\$ '000</b>	<b>2016</b> <b>US\$ '000</b>
<b>Regulatory capital</b>		
<b>Common Equity Tier 1 (CET1) and Total Tier 1 (T1)</b>		
Share capital	100,000	60,501
Accumulated losses	(18,314)	(21,656)
Fair value reserve on investments	-	917
<b>CET1 capital prior to regulatory adjustments</b>	<u>81,686</u>	<u>39,762</u>
<b>Regulatory adjustments</b>		
Intangibles other than mortgage servicing rights	(239)	-
<b>Total CET1 capital after the regulatory adjustments (a)</b>	<u>81,447</u>	<u>39,762</u>
<b>Tier 2 (T2)</b>		
Stage 1 and Stage 2 impairment allowances (Collective impairment provision)	1,749	1,436
<b>Tier 2 (T2) (b)</b>	<u>1,749</u>	<u>1,436</u>
<b>Total capital (c) = (a) + (b)</b>	<u>83,196</u>	<u>41,198</u>

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**23. CAPITAL MANAGEMENT (continued)**

	2017			2016		
	Principal amounts US\$ '000	Risk weighted equivalents US\$ '000	Capital requirement US\$ '000	Principal amounts US\$ '000	Risk weighted equivalents US\$ '000	Capital requirement US\$ '000
<b>Risk weighted exposures</b>						
Claims on sovereigns	6,041	-	-	53	-	-
Claims on banks	82,745	32,006	4,001	44,301	20,854	2,607
Claims on corporates*	151,419	164,378	20,547	119,751	113,068	14,134
Investments in securities	3,733	5,403	675	6,251	8,952	1,119
Other assets	3,285	3,285	411	2,362	2,362	295
Off-balance sheet items						
Commitments and contingent liabilities	2,267	2,267	283	5,811	5,811	726
Credit risk weighted exposures		207,339	25,917		151,047	18,881
Market risk weighted exposure		1,925	241		2,488	311
Operational risk weighted exposure		20,175	2,522		19,788	2,474
Total risk weighted exposures (d)		229,439	28,680		173,323	21,666
<b>Capital ratios</b>						
CET 1 and T1 capital (a) / (d)		35.5%			22.9%	
Total capital (c) / (d)		36.3%			23.8%	
Minimum required as per CBB regulatory guidelines under Basel III		12.5%			12.5%	

\*Substantially all claims on corporates are insured by a major international insurance company with long term credit rating of 'A3' (Moody's). As of 31 December 2017, the Bank has utilised insurance wrap of US\$ 12.5 million (2016: US\$ 6.2 million), which is reflected in the credit risk weighted exposures.

**24. FINANCIAL RISK MANAGEMENT**

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

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

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

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

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

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

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

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

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

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

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**24. FINANCIAL RISK MANAGEMENT (continued)**

As a further step in mitigating risks, the Group follows a policy of diversification in its activities and seeks to minimize the risk exposure to particular geographical regions, counterparties and types of business. In identifying and monitoring risk exposures, the Group uses a variety of quantitative tools as well as qualitative approaches to measure risks at the “macro” level. The Group seeks to judiciously balance the use of these two approaches rather than rely on a single approach.

The following sections review the principal risks to which the Group is exposed in the normal course of its business and how it manages those risks.

**a) Credit risk**

Credit risk is the risk of loss arising as a result of the inability or unwillingness of a counterparty to meet its obligations to the Group. Risk Management, under the oversight of EMC, has the responsibility for establishing credit risk standards and implementing the Group’s credit risk management process.

**Maximum exposure to credit risk**

	<b>2017</b>				
<b>ASSETS</b>	<i>Neither past due nor impaired US\$ '000</i>	<i>Past due or individually impaired US\$ '000</i>	<i>Impairment provisions US\$ '000</i>	<i>Maximum credit risk US\$ '000</i>	<i>Quarterly average balance US\$ '000</i>
Balances with banks and financial institutions	30,025	-	(2)	30,023	23,065
Treasury bills and placements with financial institutions	50,098	-	(37)	50,061	26,381
Investment securities	23,460	-	(4)	23,456	11,253
Loans and advances	140,420	3,533	(5,239)	138,714	132,053
Other assets	2,554	-	-	2,554	3,186
	<u>246,557</u>	<u>3,533</u>	<u>(5,282)</u>	<u>244,808</u>	<u>195,938</u>
<b>Off-balance sheet items</b>	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<b>2016</b>				
<b>ASSETS</b>	<i>Neither past due nor impaired US\$ '000</i>	<i>Past due or individually impaired US\$ '000</i>	<i>Impairment provisions US\$ '000</i>	<i>Maximum credit risk US\$ '000</i>	<i>Quarterly average balance US\$ '000</i>
Balances with banks and financial institutions	40,374	-	-	40,374	20,923
Treasury bills and placements with financial institutions	4,207	-	-	4,207	30,889
Investment securities	1,328	8,021	(3,000)	6,349	8,414
Loans and advances	125,394	-	(1,436)	123,958	119,051
Other assets	2,238	-	-	2,238	2,561
	<u>173,541</u>	<u>8,021</u>	<u>(4,436)</u>	<u>177,126</u>	<u>181,838</u>
<b>Off-balance sheet items</b>	7,101	-	-	7,101	7,970
	<u>7,101</u>	<u>-</u>	<u>-</u>	<u>7,101</u>	<u>7,970</u>

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**Credit quality by class of financial assets**

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

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

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

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

**Credit quality analysis**

The following table sets out information about the credit quality of financial assets measured at amortised cost and FVOCI. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

Explanation of the terms: 12-month ECL, lifetime ECL and credit-impaired are included in Note 4.4 Financial Instruments i) Financial assets - Policy applicable from 1 January 2017 - Impairment.

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**24. FINANCIAL RISK MANAGEMENT (continued)**

	2017			2016	
	Stage 1: 12-month ECL US\$ '000	Stage 2: Lifetime ECL not credit- impaired US\$ '000	Stage 3: Lifetime ECL credit- impaired US\$ '000	Total US\$ '000	Total US\$ '000
<b>Loans and advances</b>					
Standard (Grade 1 to 7)	137,420	-	-	137,420	118,169
Substandard (Grade 8)	-	3,000	-	3,000	7,225
Non-performing (Grade 10)	-	-	3,533	3,533	-
	<u>137,420</u>	<u>3,000</u>	<u>3,533</u>	<u>143,953</u>	<u>125,394</u>
Loss allowance	(1,159)	(547)	(3,533)	(5,239)	(1,436)
Carrying amount	<u>136,261</u>	<u>2,453</u>	<u>-</u>	<u>138,714</u>	<u>123,958</u>

	2017			2016		
	Stage 1: 12-month ECL			Impairment provision		
	Debt securities at amortised cost US\$ '000	Cash and cash equivalents US\$ '000	Total US\$ '000	Debt securities at amortised cost US\$ '000	Cash and cash equivalents US\$ '000	Total US\$ '000
Standard (Grade 1 to 7)	11,000	80,123	91,123	-	44,581	44,581
Substandard (Grade 8)	-	-	-	179	-	179
	<u>11,000</u>	<u>80,123</u>	<u>91,123</u>	<u>179</u>	<u>44,581</u>	<u>44,760</u>
Loss allowance	(4)	(39)	(43)	-	-	-
Carrying amount	<u>10,996</u>	<u>80,084</u>	<u>91,080</u>	<u>179</u>	<u>44,581</u>	<u>44,760</u>

**Inputs, assumptions and techniques used for estimating 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.

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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 considers all counterparties internally rated 8 and below to be significantly deteriorated, as they are below the minimum credit quality thresholds specified in the Group's credit policy. In addition, the Group also considers all counterparties internally rated 2 and above, 3, 4, 5, 6 and 7, to be significantly deteriorated where they have been downgraded by 6 notches, 5 notches, 4 notches, 3 notches, 2 notches and 1 notch respectively since initial recognition or since the date of the last annual review, and where the current pricing has not been adjusted to reflect the new risk profile of the counterparty.

Debt investment securities are considered to have low credit risk when their credit risk rating is equivalent to an investment grade rating or a debt investment security with similar credit risk characteristics.

The criteria for determining whether credit risk has increased significantly vary by portfolio and include quantitative changes in the probability of default (PDs) and qualitative factors, including whether the exposure has been watch-listed, whether the exposure is more than 30 days past due and as a backstop based on delinquency.

**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. 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 Group has taken exposures.

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**24. FINANCIAL RISK MANAGEMENT (continued)**

**a) Credit risk (continued)**

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

The Group has identified economic factors such as the International Monetary Fund (IMF) trends in fiscal balances, unemployment rates and GDP growth. Given the nature of the Group's exposures and availability of historical statistically reliable information, the Group derives the point-in-time (PIT) PD using the adjusted through-the-cycle (TTC) PD data published by Standard & Poor's (S&P) for each rating category. The Group uses the Vasicek model to link the TTC PDs with forward looking economic factors to drive PIT PD estimates for each rating category. The Vasicek model takes into consideration forward looking economic forecasts under three scenarios (base case, negative case, and positive case), historical economic data, the asset correlation of each rating category (as per the Basel IRB economic capital formula), and TTC PDs for deriving PIT PDs. The relationship between the economic factors and default and loss rates have been developed using internal historical data and relevant external market data.

**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 historical and market data. They are adjusted to reflect forward-looking information as described above.

PD estimates are estimates at a certain date, and are calculated using Standard & Poor's recovery studies data after consideration of the contractual maturities of exposures and estimated prepayment rates and are derived using the Vasicek model. The PIT PD estimates are converted to cumulative PIT PDs for exposures that have tenors in excess of one year and that are assessed on lifetime PDs. The lifetime PDs are calculated by compounding the 12 month PIT PDs.

LGD is the magnitude of the likely loss if there is a default. The LGD models consider the forecasted collateral value (including credit insurance) and recovery costs of any collateral that is integral to the financial asset.

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.

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Subject to a maximum of 12-month PD for financial assets for which credit risk has not significantly increased, the Group measures ECL considering the risk of default over the maximum contractual period over which it is exposed to credit risk.

The Group calculates PIT PD estimates under three scenarios, a base case, negative case and positive case. A probability weighted ECL is then calculated by assigning probabilities, based on current market conditions, to each scenario. At 1st January 2017 and 31st December 2017, the probabilities assigned to the base case, negative case and positive case scenarios were in the ratio of 60:20:20 respectively.

#### **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.

#### **Modified financial assets**

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

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

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**24. FINANCIAL RISK MANAGEMENT (continued)**

**a) Credit risk (continued)**

**Analysis of risk concentration**

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

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

**Geographical region**

	<b>31 December 2017</b>				
	<i>Europe US\$ '000</i>	<i>North America US\$ '000</i>	<i>GCC US\$ '000</i>	<i>Rest of the world US\$ '000</i>	<i>Total US\$ '000</i>
Balances with banks and financial institutions	590	25,561	3,865	7	30,023
Treasury bills and placements with financial institutions	15,006	-	35,055	-	50,061
Investment securities	10,996	3,260	9,200	-	23,456
Loans and advances	130,196	7,712	-	806	138,714
Other assets	2,145	108	286	15	2,554
<b>Total</b>	<b>158,933</b>	<b>36,641</b>	<b>48,406</b>	<b>828</b>	<b>244,808</b>
Off-balance sheet items	-	-	-	-	-

	<b>31 December 2016</b>				
	<i>Europe US\$ '000</i>	<i>North America US\$ '000</i>	<i>GCC US\$ '000</i>	<i>Rest of the world US\$ '000</i>	<i>Total US\$ '000</i>
Balances with banks and financial institutions	3,203	32,113	5,049	9	40,374
Treasury bills and placements with financial institutions	-	-	4,207	-	4,207
Investment securities	179	5,321	849	-	6,349
Loans and advances	117,883	2,582	3,493	-	123,958
Other assets	2,066	14	158	-	2,238
<b>Total</b>	<b>123,331</b>	<b>40,030</b>	<b>13,756</b>	<b>9</b>	<b>177,126</b>
Off-balance sheet items	1,739	2,783	2,579	-	7,101

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<i>Industry Sector</i>	<i>31 December 2017</i>				
	<i>Banking / Finance US\$ '000</i>	<i>Government US\$ '000</i>	<i>Consumer Goods US\$ '000</i>	<i>Others US\$ '000</i>	<i>Total US\$ '000</i>
Balances with banks and financial institutions	30,023	-	-	-	30,023
Treasury bills and placements with financial institutions	50,061	-	-	-	50,061
Investment securities	17,074	5,988	-	394	23,456
Loans and advances	2,964	-	119,654	16,096	138,714
Other assets	190	166	1,847	351	2,554
<b>Total</b>	<b>100,312</b>	<b>6,154</b>	<b>121,501</b>	<b>16,841</b>	<b>244,808</b>
<b>Off-balance sheet items</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

	<i>31 December 2016</i>				
	<i>Banking / Finance US\$ '000</i>	<i>Government US\$ '000</i>	<i>Consumer Goods US\$ '000</i>	<i>Others US\$ '000</i>	<i>Total US\$ '000</i>
Balances with banks and financial institutions	40,374	-	-	-	40,374
Treasury bills and placements with financial institutions	4,207	-	-	-	4,207
Investment securities	5,321	-	-	1,028	6,349
Loans and advances	2,966	-	105,358	15,634	123,958
Other assets	23	66	1,803	346	2,238
<b>Total</b>	<b>52,891</b>	<b>66</b>	<b>107,161</b>	<b>17,008</b>	<b>177,126</b>
<b>Off-balance sheet items</b>	<b>4,522</b>	<b>-</b>	<b>-</b>	<b>2,579</b>	<b>7,101</b>

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**24. FINANCIAL RISK MANAGEMENT (continued)**

**b) Market risk**

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

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

**i) Interest rate risk**

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

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

**ii) Currency risk**

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

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

<b>Currency</b>	<i>Sensitivity to net profit and equity</i>	
	<b>2017</b> <b>US\$ '000</b>	<b>2016</b> <b>US\$ '000</b>
Euro	<b>359</b>	27
Great Britain Pound	<b>1</b>	10
	<b>360</b>	<b>37</b>

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**iii) Equity price risk**

Equity price risk is the risk that the fair value of equities decreases as the result of changes in the level of equity indices or individual stocks. The Group is exposed to equity price risk on its FVTPL equity and managed funds investments.

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

	<i>Sensitivity to net profit and equity</i>	
	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Investment securities - Equities and managed funds	<b>183</b>	<b>57</b>

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

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

**Market risk capital charge**

The capital requirement for market risk using the Standardised Approach as at 31 December 2017 and 31 December 2016 was as follows:

	<b>Capital requirement</b>			
	<i>At 31 December 2017</i>	<i>Maximum value</i>	<i>Minimum value</i>	<i>Average value</i>
	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
Foreign exchange risk	<b>142</b>	<b>142</b>	<b>106</b>	<b>124</b>
Equity position risk	<b>98</b>	<b>119</b>	<b>105</b>	<b>112</b>

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

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**24. FINANCIAL RISK MANAGEMENT (continued)**

**c) Liquidity risk**

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

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

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

The Group has a contractual maturity of deposits to a single counterparty amounting to US\$ 127.4 million (2016: US\$ 126.5 million) in the first quarter of 2018. However, based on management's estimation, these deposits are expected to be rolled over for a longer period, as in the past. The Bank is confident to meet its obligations, as they fall due.

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

	<b>31 December 2017</b>					
	<i>Up to 3 months US\$ '000</i>	<i>&gt; 3 months up to 6 months US\$ '000</i>	<i>&gt; 6 months up to 12 months US\$ '000</i>	<i>&gt; 1 year up to 5 years US\$ '000</i>	<i>Over 5 years US\$ '000</i>	<i>Total US\$ '000</i>
<b>Assets</b>						
Balances with banks and financial institutions	30,023	-	-	-	-	30,023
Treasury bills and placements with financial institutions	50,061	-	-	-	-	50,061
Investment securities	20,363	773	2,320	-	-	23,456
Loans and advances	62,665	73,085	-	2,964	-	138,714
Other assets	1,826	758	104	631	66	3,385
<b>Total assets</b>	<b>164,938</b>	<b>74,616</b>	<b>2,424</b>	<b>3,595</b>	<b>66</b>	<b>245,639</b>
<b>Liabilities</b>						
Due to financial institutions	150,064	4,000	-	-	-	154,064
Due to customers	3,124	-	-	-	-	3,124
Borrowings	4,810	-	-	-	-	4,810
Other liabilities	866	31	899	63	-	1,859
<b>Total liabilities</b>	<b>158,864</b>	<b>4,031</b>	<b>899</b>	<b>63</b>	<b>-</b>	<b>163,857</b>
<b>Net liquidity gap</b>	<b>6,074</b>	<b>70,585</b>	<b>1,525</b>	<b>3,532</b>	<b>66</b>	<b>81,782</b>
<b>Cumulative liquidity gap</b>	<b>6,074</b>	<b>76,659</b>	<b>78,184</b>	<b>81,716</b>	<b>81,782</b>	<b>81,782</b>

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	31 December 2016					
	Up to 3 months US\$ '000	> 3 months up to 6 months US\$ '000	> 6 months up to 12 months US\$ '000	> 1 year up to 5 years US\$ '000	Over 5 years US\$ '000	Total US\$ '000
<b>Assets</b>						
Balances with banks and financial institutions	40,374	-	-	-	-	40,374
Treasury bills and placements with financial institutions	4,207	-	-	-	-	4,207
Investment securities	2,153	1,506	2,511	-	179	6,349
Loans and advances	71,081	35,874	14,037	2,966	-	123,958
Other assets	1,884	343	131	40	66	2,464
<b>Total assets</b>	<b>119,699</b>	<b>37,723</b>	<b>16,679</b>	<b>3,006</b>	<b>245</b>	<b>177,352</b>
<b>Liabilities</b>						
Deposits from financial institutions	126,567	-	-	-	-	126,567
Deposits from customers	8,405	-	-	-	-	8,405
Other liabilities	1,253	-	889	301	-	2,443
<b>Total liabilities</b>	<b>136,225</b>	<b>-</b>	<b>889</b>	<b>301</b>	<b>-</b>	<b>137,415</b>
<b>Net liquidity gap</b>	<b>(16,526)</b>	<b>37,723</b>	<b>15,790</b>	<b>2,705</b>	<b>245</b>	<b>39,937</b>
<b>Cumulative liquidity gap</b>	<b>(16,526)</b>	<b>21,197</b>	<b>36,987</b>	<b>39,692</b>	<b>39,937</b>	<b>39,937</b>

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

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

	31 December 2017					
	Up to 3 months US\$ '000	> 3 months up to 6 months US\$ '000	> 6 months up to 12 months US\$ '000	> 1 year up to 5 years US\$ '000	Over 5 years US\$ '000	Total US\$ '000
<b>Liabilities</b>						
Due to financial institutions	150,126	4,051	-	-	-	154,177
Due to customers	3,124	-	-	-	-	3,124
Borrowings	4,813	-	-	-	-	4,813
Other liabilities	866	31	899	63	-	1,859
<b>Total undiscounted financial liabilities</b>	<b>158,929</b>	<b>4,082</b>	<b>899</b>	<b>63</b>	<b>-</b>	<b>163,973</b>

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**24. FINANCIAL RISK MANAGEMENT (continued)**

**c) Liquidity risk (continued)**

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

**d) Operating and legal risk**

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

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

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

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

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

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

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**25. COMMITMENTS AND CONTINGENT LIABILITIES**

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

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

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Undrawn investment commitments in equity funds	<b>3,612</b>	4,522
Other commitments	<b>2,579</b>	2,579

At 31 December 2017, the Bank had undrawn investment commitments to private equity funds of US\$ 3,612 thousand (31 December 2016: US\$ 4,522 thousand). Of these, the Group's proprietary commitments amounted to US\$ 2,267 thousand (31 December 2016: US\$ 2,812 thousand) and the balance relates to co-investors of the Bank who have committed to sub-participate along with the Bank.

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

The Group is engaged in litigation cases involving claims made by and against the Group relating to its ex-employees and certain third parties. The Board, after reviewing the claims pending against the Group and based on the advice of the relevant professional legal advisors, are satisfied that the outcome of these claims will not have a material adverse effect on the financial position of the Group. The Group has recognised an income statement charge of US\$ Nil (2016: US\$ 300 thousand) against these legal claims.

**26. ASSETS UNDER MANAGEMENT**

The Group's clients participate in products offered under its two alternative investment asset classes. Total assets under management ("AUM") in each product category at the consolidated statement of financial position date are as follows:

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Trade finance	<b>9,500</b>	-
Private equity	<b>4,833</b>	7,227
	<b><u>14,333</u></b>	<b><u>7,227</u></b>

Assets under management, relating to trade finance, include sub-participations by various clients in trade finance deals administered by the Group.

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Assets under management, relating to private equity, include BMB Technology and Telecommunications Investment Company (under liquidation), a US focused venture capital fund of funds, customer sub-participations in private equity funds managed by the Group and other client funds managed on a discretionary basis.

**27. FAIR VALUE OF FINANCIAL INSTRUMENTS**

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

**Fair value hierarchy**

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

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

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

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

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

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

	<i>31 December 2017</i>				
	<i>Level 1</i>	<i>Level 2</i>	<i>Level 3</i>	<i>Total fair values</i>	<i>Total carrying amount</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
<b><i>Financial assets measured at fair value</i></b>					
Investment securities	9,200	-	3,260	12,460	12,460
<b><i>Financial liabilities measured at fair value</i></b>					
Derivatives held for trading	-	54	-	54	54

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	31 December 2016				Total carrying amount US\$ '000
	Level 1 US\$ '000	Level 2 US\$ '000	Level 3 US\$ '000	Total fair values US\$ '000	
<b>Financial assets measured at fair value</b>					
Investment securities	849	-	5,321	6,170	6,170
<b>Financial assets not measured at fair value</b>					
Investment securities	-	-	149	149	179

Management has assessed that the fair values of financial assets comprising of balances with banks and financial institutions, placements with financial institutions, investment securities measured at amortised cost, loans and advances and other assets, and financial liabilities comprising of due financial institutions, due to customers, borrowings and other liabilities approximate their carrying amounts.

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

	2017 US\$ '000	2016 US\$ '000
At 1 January	5,321	7,036
Additions	22	5
Exits (at cost)	(1,023)	(895)
Net fair value movement	(1,060)	(184)
Fair value transferred to statement of income on disposals / impairment	-	(641)
At 31 December	<u>3,260</u>	<u>5,321</u>

Level 3 investments represent fund investments where the underlying fund managers exercise judgements in valuation of investments.

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

## 28. DERIVATIVE FINANCIAL INSTRUMENTS

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments. The Group uses currency swaps to manage some of its foreign currency exposures. These currency swaps are not designated as cash flow, fair value or net investment in foreign operations hedges and are entered into for periods consistent with currency transaction exposures.

The table below shows the fair values of the derivative financial instruments together with the notional amounts:

	2017		2016	
	Notional amounts US\$ '000	Fair value US\$ '000	Notional amounts US\$ '000	Fair value US\$ '000
<i>Derivatives held for trading:</i>				
Currency swap	<u>6,189</u>	<u>(54)</u>	<u>-</u>	<u>-</u>





