

Bahrain Middle East Bank B.S.C.
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2017



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

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the accompanying consolidated financial statements of Bahrain Middle East Bank B.S.C. ("the Bank") and its 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. (continued)**

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

Key audit matters (continued)

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"> • 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; • 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 • 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. <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. (continued)**

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"> • 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; • 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]; <p>With respect to impairment methodology, our audit procedures comprised the following;</p> <ul style="list-style-type: none"> • We obtained an understanding of the Group's internal rating models for loans and advances; • 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; • For a sample of exposures, we checked the appropriateness of the Group's staging; • 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; • 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; • For a sample of exposures, we checked the appropriateness of determining Exposure at Default.

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

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 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"> • 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; • 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; • We understood the theoretical soundness and tested the mathematical integrity of the Models; • 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; • Where relevant, we used Information System specialists to gain comfort on data integrity; • We checked consistency of various inputs and assumptions used by the Group's management to determine impairment provisions; and • We checked the appropriateness of the opening balance adjustments. <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. (continued)**

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

Key Audit Matters (continued)

3 Maturity of deposits from financial institution Refer to note 9 and note 24 to the consolidated financial statements	
Key audit matter / risk	How the key audit matter was addressed in the audit
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. (continued)

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

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. (continued)

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. (continued)**

Report on Other Legal and Regulatory Requirements

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

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the 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.

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
ASSETS			
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
TOTAL ASSETS		245,639	177,352
LIABILITIES AND EQUITY			
LIABILITIES			
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
Total liabilities		163,857	137,415
EQUITY			
Share capital	13	100,000	60,501
Accumulated losses		(18,218)	(21,481)
Fair value reserve		-	917
Total equity		81,782	39,937
TOTAL LIABILITIES AND EQUITY		245,639	177,352



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
OPERATING INCOME			
Interest income	15	11,948	10,699
Interest expense	16	(334)	(965)
Net interest income		11,614	9,734
Investment banking (loss) income	17	(1,086)	1,149
Other income		221	368
Foreign exchange gain (loss)		148	(94)
Total operating income		10,897	11,157
OPERATING EXPENSES			
Staff expenses		3,053	4,127
Premises expenses		436	329
Other operating expenses	18	1,004	1,214
Total operating expenses		4,493	5,670
NET PROFIT FOR THE YEAR			
BEFORE IMPAIRMENT PROVISIONS		6,404	5,487
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
NET PROFIT FOR THE YEAR		5,228	5,073
BASIC AND DILUTED EARNINGS			
PER SHARE (IN US\$ CENTS)	19	2.15	2.10



Wilson S Benjamin
Chairman



Murat Solak
Vice Chairman



Korhan Alev
Chief Executive Officer

Bahrain Middle East Bank B.S.C.**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

For the year ended 31 December 2017

	2017	2016
	US\$ '000	US\$ '000
NET PROFIT FOR THE YEAR	5,228	5,073
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)
Total other comprehensive loss for the year	-	(398)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	5,228	4,675

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

	<i>Note</i>	2017 US\$ '000	2016 US\$ '000
OPERATING ACTIVITIES			
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>
INVESTING ACTIVITIES			
Purchase of furniture and equipment		(280)	-
Purchase of intangible assets		(398)	-
Net cash used in investing activities		<u>(678)</u>	<u>-</u>
FINANCING ACTIVITIES			
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)	-
NET CHANGE IN CASH AND CASH EQUIVALENTS		35,503	(3,790)
Cash and cash equivalents at 1 January		44,581	48,371
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	5	<u>80,084</u>	<u>44,581</u>

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>US\$ '000</i>	<i>Accumulated losses</i> <i>US\$ '000</i>	<i>Fair value reserve</i> <i>US\$ '000</i>	<i>Total equity</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 (<i>note 4.3</i>)	-	(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
Balance at 31 December 2017	100,000	(18,218)	-	81,782

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

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.

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

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

2 BASIS OF CONSOLIDATION (continued)

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

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

3 BASIS OF PREPARATION

3.1 Statement of compliance

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

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.

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

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

IFRS 15 Revenue from Contracts with Customers (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.

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.

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

4.3 Early Adoption of IFRS 9 (continued)

Impairment of financial assets (continued)

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.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

4 SIGNIFICANT ACCOUNTING POLICIES (continued)**4.3 Early Adoption of IFRS 9 (continued)****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:

	Accumulated losses	Fair value reserve
	US\$ '000	US\$ '000
	(21,481)	917
	917	(917)
	(20,564)	-
	(20)	-
	(99)	-
	(2,735)	-
	(2,854)	-
	(23,418)	-

Closing balance under IAS 39 (31 December 2016)

Impact on reclassification and remeasurements:

Investment securities (equity) from available-for-sale to FVTPL

Impact on recognition of Expected Credit Losses:

Cash and cash equivalents

Investment securities (debt) at amortised cost

Loans and advances

Opening balance under IFRS 9 on date of initial application of 1 January 2017

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

4.3 Early Adoption of IFRS 9 (continued)

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

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

Impairment allowances:

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
Total	1,436	2,854	4,290

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

4.3 Early Adoption of IFRS 9 (continued)

Classification of assets and liabilities

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

31 December 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>
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
Total assets	12,460	-	232,348	244,808
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
Total liabilities	54	-	163,803	163,857

31 December 2016	<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
Total assets	1,149	179	5,021	170,777	177,126
Due to financial institutions	-	-	-	126,567	126,567
Due to customers	-	-	-	8,405	8,405
Other liabilities	-	-	-	2,043	2,043
Total liabilities	-	-	-	137,015	137,015

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.

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.

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

4.4 Financial instruments (continued)

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

Classification (continued)

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

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

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

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

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

Reclassifications

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

Subsequent measurement

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

Amortised cost

After initial measurement, financial asset 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.

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

4.4 Financial instruments (continued)

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

Investment securities - FVOCI (continued)

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.

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;

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

4.4 Financial Instruments (continued)

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

Impairment (continued)

Measurement of ECL (continued)

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;
- 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.

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

4.4 Financial instruments (continued)

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.

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

Subsequent measurement

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

Financial assets at fair value through profit or loss

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

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

Loans and receivables

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

Held-to-maturity investments

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

Available-for-sale investments

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

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

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

4.4 Financial instruments (continued)

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

Derecognition

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

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

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

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.

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

Financial assets carried at amortised cost

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

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

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

4.4 Financial instruments (continued)

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

Impairment (continued)

Available-for-sale financial investments

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

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

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.

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.

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.

4 SIGNIFICANT ACCOUNTING POLICIES (continued)

4.4 Financial Instruments (continued)

vi) Fair values

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

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

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

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

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

4.5 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 SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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.

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 SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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.

Bahrain Middle East Bank B.S.C.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

6 INVESTMENT SECURITIES (continued)

	2016			
	<i>Fair value through profit or loss</i>	<i>Available-for- sale</i>	<i>Held-to-maturity</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Quoted investments				
Equities	849	-	-	849
	<u>849</u>	<u>-</u>	<u>-</u>	<u>849</u>
Unquoted investments				
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 pledged 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</i>	<i>Stage 2: Lifetime ECL not credit- impaired</i>	<i>Stage 3: Lifetime ECL credit- impaired</i>	<i>Total ECL</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Sovereign and other bonds and debt securities at amortized cost					
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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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

7 LOANS AND ADVANCES

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

	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 ECL US\$ '000	Total US\$ '000
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	1,159	547	3,533	5,239	1,436

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

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

9 DUE TO FINANCIAL INSTITUTIONS

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

10 DUE TO CUSTOMERS

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

Bahrain Middle East Bank B.S.C.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

10 DUE TO CUSTOMERS (continued)

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

The 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

	2017 US\$ '000	2016 US\$ '000
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>1,859</u>	<u>2,443</u>

13 SHARE CAPITAL

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

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.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

15 INTEREST INCOME

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

16 INTEREST EXPENSE

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

17 INVESTMENT BANKING (LOSS) INCOME

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

18 OTHER OPERATING EXPENSES

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

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:

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

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At 31 December 2017

20 OPERATING SEGMENTS

Segment information

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

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

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

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

	<i>Financing</i> US\$ '000	<i>Investing</i> US\$ '000	<i>Others</i> US\$ '000	<i>Total</i> US\$ '000
Interest income	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
Results from operations	11,400	(966)	463	10,897
Impairment provisions - net	(1,087)	(89)	-	(1,176)
Segment profit (loss)	10,313	(1,055)	463	9,721
Unallocated corporate expenses				(4,493)
Net profit for the year				5,228
Segment assets	221,096	23,622	921	245,639
Segment liabilities	162,111	-	1,746	163,857

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2016

20 OPERATING SEGMENTS (continued)**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	
	<i>Total income (loss) US\$ '000</i>	<i>Total assets US\$ '000</i>	<i>Total income US\$ '000</i>	<i>Total assets US\$ '000</i>
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
Total	11,231	245,639	12,122	177,352

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	
	<i>Fixed US\$ '000</i>	<i>Variable US\$ '000</i>	<i>Fixed US\$ '000</i>	<i>Variable US\$ '000</i>
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	
	<i>Cash US\$ '000</i>	<i>Equity US\$ '000</i>	<i>Cash US\$ '000</i>	<i>Equity US\$ '000</i>
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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2016

21 REMUNERATION (continued)

The movement in the number of shares is as follows:

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

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>	
	2017	2016	2017	2016
	US\$ '000	US\$ '000	US\$ '000	US\$ '000

Statement of financial position**Assets**

Loans and advances	-	-	3,000	-
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Liabilities

Deposits	-	-	267	139
Other liabilities - employee leaving indemnity	242	225	-	-

Statement of income

Interest income	-	-	266	267
Investment banking income	-	-	-	11

31 December 2016

22 RELATED PARTY TRANSACTIONS AND BALANCES (continued)**Key management compensation**

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

	2017 US\$ '000	2016 US\$ '000
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:

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

At 31 December 2017

23 CAPITAL MANAGEMENT (continued)

<u>Risk weighted exposures</u>	2017			2016		
	<i>Principal</i>	<i>Risk</i>	<i>Capital</i>	<i>Principal</i>	<i>Risk</i>	<i>Capital</i>
	<i>amounts</i>	<i>weighted</i>	<i>requirement</i>	<i>amounts</i>	<i>weighted</i>	<i>requirement</i>
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
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
<u>Off-balance sheet items</u>						
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
<u>Capital ratios</u>						
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.

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.

At 31 December 2017

24 FINANCIAL RISK MANAGEMENT (continued)

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.

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.

At 31 December 2017

24 FINANCIAL RISK MANAGEMENT (continued)**a) Credit risk (continued)****Maximum exposure to credit risk**

	2017				
	<i>Neither past due nor impaired</i> US\$ '000	<i>Past due or individually impaired</i> US\$ '000	<i>Impairment provisions</i> US\$ '000	<i>Maximum credit risk</i> US\$ '000	<i>Quarterly average balance</i> US\$ '000
ASSETS					
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
	246,557	3,533	(5,282)	244,808	195,938
Off-balance sheet items	-	-	-	-	-
	2016				
	<i>Neither past due nor impaired</i> US\$ '000	<i>Past due or individually impaired</i> US\$ '000	<i>Impairment provisions</i> US\$ '000	<i>Maximum credit risk</i> US\$ '000	<i>Quarterly average balance</i> US\$ '000
ASSETS					
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
	173,541	8,021	(4,436)	177,126	181,838
Off-balance sheet items	7,101	-	-	7,101	7,970

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

24 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Credit quality by class of financial assets (continued)

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

<i>Categories</i>	<i>Internal rating</i>	<i>ECAI equivalent</i>
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.

	2017			2016	
	<i>Stage 1: 12-month ECL</i>	<i>Stage 2: Lifetime ECL not credit-impaired</i>	<i>Stage 3: Lifetime ECL credit-impaired</i>	<i>Total</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Loans and advances					
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	-
	137,420	3,000	3,533	143,953	125,394
Loss allowance	(1,159)	(547)	(3,533)	(5,239)	(1,436)
Carrying amount	136,261	2,453	-	138,714	123,958

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

24 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

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.

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.

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).

At 31 December 2017

24 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Measurement of ECL (continued)

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.

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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At 31 December 2017

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

	31 December 2017				
	Europe US\$ '000	North America US\$ '000	GCC US\$ '000	Rest of the world US\$ '000	Total US\$ '000
Balances with banks and financial institutions	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
Total	158,933	36,641	48,406	828	244,808
Off-balance sheet items	-	-	-	-	-
	31 December 2016				
	Europe US\$ '000	North America US\$ '000	GCC US\$ '000	Rest of the world US\$ '000	Total US\$ '000
Balances with banks and financial institutions	3,203	32,113	5,049	9	40,374
Treasury bills and placements with financial institutions	-	-	4,207	-	4,207
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
Total	123,331	40,030	13,756	9	177,126
Off-balance sheet items	1,739	2,783	2,579	-	7,101

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

24 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Industry sector

	31 December 2017				
	<i>Banking</i>	<i>Government</i>	<i>Consumer</i>	<i>Others</i>	<i>Total</i>
	<i>/ Finance</i>		<i>Goods</i>		
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
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
Total	100,312	6,154	121,501	16,841	244,808
<i>Off-balance sheet items</i>	-	-	-	-	-
	31 December 2016				
	<i>Banking</i>	<i>Government</i>	<i>Consumer</i>	<i>Others</i>	<i>Total</i>
	<i>/ Finance</i>		<i>Goods</i>		
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
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
Total assets	52,891	66	107,161	17,008	177,126
<i>Off-balance sheet items</i>	4,522	-	-	2,579	7,101

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.

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

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

24 FINANCIAL RISK MANAGEMENT (continued)

b) Market risk (continued)

iii) Equity price risk (continued)

The following table depicts the sensitivity to the Group's net profit and equity for a movement of +5% in the equity prices or net asset values of 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>	
	2017	2016
	US\$ '000	US\$ '000
Investment securities - Equities and managed funds	183	57

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:

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

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

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At 31 December 2017

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:

	31 December 2017					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	
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
Total assets	164,938	74,616	2,424	3,595	66	245,639
Liabilities						
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
Total liabilities	158,864	4,031	899	63	-	163,857
Net liquidity gap	6,074	70,585	1,525	3,532	66	81,782
Cumulative liquidity gap	6,074	76,659	78,184	81,716	81,782	81,782

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

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	
Assets						
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
Total assets	119,699	37,723	16,679	3,006	245	177,352
Liabilities						
Deposits from financial institutions	126,567	-	-	-	-	126,567
Deposits from customers	8,405	-	-	-	-	8,405
Other liabilities	1,253	-	889	301	-	2,443
Total liabilities	136,225	-	889	301	-	137,415
Net liquidity gap	(16,526)	37,723	15,790	2,705	245	39,937
Cumulative liquidity gap	(16,526)	21,197	36,987	39,692	39,937	39,937

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					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	
Liabilities						
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
Total undiscounted financial liabilities	158,929	4,082	899	63	-	163,973

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2017

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:

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

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

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

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.

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At 31 December 2017

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

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

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

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

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

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

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

	31 December 2017				Total carrying amount US\$ '000
	Level 1 US\$ '000	Level 2 US\$ '000	Level 3 US\$ '000	Total fair values US\$ '000	
Financial assets measured at fair value					
Investment securities	9,200	-	3,260	12,460	12,460
Financial liabilities measured at fair value					
Derivatives held for trading	-	54	-	54	54
	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	
Financial assets measured at fair value					
Investment securities	849	-	5,321	6,170	6,170
Financial assets not measured at fair value					
Investment securities	-	-	149	149	179

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

Management has assessed that the fair values of financial assets comprising of balances with banks and financial institutions, placements with financial institutions, 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	2016
	US\$ '000	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	3,260	5,321

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