



# CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31<sup>st</sup> December 2018

**GiB**

**CONSOLIDATED FINANCIAL STATEMENTS**For the year ended 31<sup>st</sup> December 2018**Table of contents****Independent auditors' report to the shareholders**

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## **INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF GULF INTERNATIONAL BANK B.S.C.**

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

#### *Opinion*

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

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

#### *Basis for opinion*

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

#### *Key audit matters*

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the year ended 31 December 2018. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

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

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

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

*Key audit matters (continued)*

<b>1. Impairment of loans and advances under IFRS9</b>	
<b>Key audit matter</b>	<b>How the key audit matter was addressed in the audit</b>
<p>The Group exercises significant judgment using subjective assumptions over both when and how much to record as loan impairment, and estimation of the amount of the impairment provision for loans and advances.</p> <p>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 2018, the Group's gross loans and advances amounted to US\$ 10,581.7 million and the related impairment provisions amounted to US\$ 763.9 million, comprising US\$ 140.6 million of provision against Stage 1 and 2 exposures and US\$ 623.3million against exposures classified under Stage 3. The impairment provision policy is presented in the accounting policies, and in Note 27 to the consolidated financial statements.</p>	<ul style="list-style-type: none"> <li>• We gained an understanding of the Group's key credit processes comprising granting, booking, monitoring and provisioning and tested the operating effectiveness of key controls over these processes;</li> <li>• We read the Group's IFRS 9 based impairment provisioning policy and compared it with the requirements of IFRS 9 as well as relevant regulatory guidelines and pronouncements; and</li> <li>• We assessed the soundness of the Group's loan grading processes.</li> </ul> <p><b>Stage 1 and Stage 2 Provisions:</b></p> <ul style="list-style-type: none"> <li>• For the provision against exposures classified as Stage 1 and Stage 2, we obtained an understanding of the Group's provisioning methodology, the underlying assumptions and the sufficiency of the data used by management;</li> <li>• We obtained an understanding of the Group's internal rating model for loans and advances. We have read the annual external validation report on the internal rating model to assess the appropriateness of the rating model;</li> <li>• We checked the appropriateness of the Group's determination of significant increase in credit risk and the resultant basis for classification of exposures into various stages;</li> <li>• For forward looking assumptions used by the Group in its Expected Credit Loss ("ECL") calculations, we held discussions with management and corroborated the assumptions using publicly available information;</li> <li>• For a sample of exposures, we checked the appropriateness of the Group's staging;</li> </ul>

**INDEPENDENT AUDITOR’S REPORT TO THE SHAREHOLDERS OF  
GULF INTERNATIONAL BANK B.S.C. (continued)**

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

*Key audit matters (continued)*

<b>1. Impairment of loans and advances under IFRS9 (continued)</b>	
<b>Key audit matter</b>	<b>How the key audit matter was addressed in the audit</b>
	<ul style="list-style-type: none"> <li>• For Probability of Default (“PD”) used in the ECL calculations we checked the Through the Cycle (“TTC”) PDs with external published data and checked the appropriateness of conversion of the TTC PDs to Point in Time PDs;</li> <li>• We checked that the Loss Given Default used by the Group’s management in the ECL calculations are those approved by the Group Risk Committee;</li> <li>• For a sample of exposures, we checked the appropriateness of determining Exposure at Default, including the consideration of prepayments and repayments in the cash flows and the resultant arithmetical calculations;</li> <li>• We checked the completeness of loans and advances and credit related contingent items included in the ECL calculations as of 31 December 2018;</li> <li>• We involved Risk and Information System specialists to verify the appropriateness of the model and data integrity; and</li> <li>• We assessed the financial statement disclosures to ensure compliance with IFRS 9. Refer to the accounting policies, critical accounting estimates and judgments, disclosures of loans and advances and credit risk management in notes 2, 3, 10 and 27 respectively to the consolidated financial statements.</li> </ul>

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

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

*Key audit matters (continued)*

<b>1. Impairment of loans and advances under IFRS9 (continued)</b>	
<b>Key audit matter</b>	<b>How the key audit matter was addressed in the audit</b>
	<p><b>Stage 3 (Specific) Provisions:</b></p> <ul style="list-style-type: none"> <li>For a sample of exposures determined to be individually impaired, we obtained an understanding of the latest developments in the counterparty's situation and examined management's estimate of future cash flows and checked the resultant provision calculations.</li> </ul> <p>For each exposure in the sample selected, we re-performed the provision calculation by considering the appropriateness of the management assumptions used and where possible benchmarked the provision held to that across industry.</p>

*Other information included in the Group's 2018 Annual Report*

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

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

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

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

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

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

## **INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF GULF INTERNATIONAL 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*

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 ISA, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

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

## **INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF GULF INTERNATIONAL 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)*

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

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


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

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

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

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

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





## Consolidated statement of financial position

	<i>Note</i>	<u>31.12.18</u> US\$ millions	<u>31.12.17</u> US\$ millions
<b>ASSETS</b>			
Cash and other liquid assets	5	5,114.2	3,768.5
Securities purchased under agreements to resell	6	1,015.9	855.0
Placements	7	6,770.8	6,033.2
Trading securities	8	177.7	191.8
Investment securities	9	3,897.2	3,993.8
Loans and advances	10	9,817.8	10,043.1
Other assets	11	752.5	585.9
<b>Total assets</b>		<u>27,546.1</u>	<u>25,471.3</u>
<b>LIABILITIES</b>			
Deposits from banks	13	2,372.2	2,129.1
Deposits from customers	13	18,322.4	15,989.8
Securities sold under agreements to repurchase	14	735.4	1,130.5
Other liabilities	15	581.9	547.4
Senior term financing	16	3,338.0	3,263.6
<b>Total liabilities</b>		<u>25,349.9</u>	<u>23,060.4</u>
<b>EQUITY</b>			
Share capital	17	2,500.0	2,500.0
Reserves	18	361.4	352.5
Retained earnings		(665.2)	(441.6)
<b>Total equity</b>		<u>2,196.2</u>	<u>2,410.9</u>
<b>Total liabilities &amp; equity</b>		<u>27,546.1</u>	<u>25,471.3</u>

The consolidated financial statements were approved by the Board of Directors on 15<sup>th</sup> February 2019 and signed on its behalf by:-

**Abdullah bin Hassan Alabdulgader**  
Chairman

**Sultan bin Abdul Malek Al-Sheikh**  
Chairman of the Board Audit Committee

**Abdulaziz A. Al-Helaissi**  
Group Chief Executive Officer

The notes on pages 6 to 52 form part of these consolidated financial statements.

## Consolidated statement of income

	<i>Note</i>	Year ended 31.12.18 US\$ millions	Year ended 31.12.17 US\$ millions
Interest income	20	764.8	595.2
Interest expense	20	491.1	342.1
Net interest income		<u>273.7</u>	253.1
Fee and commission income	21	61.2	72.6
Foreign exchange income	22	18.6	14.1
Trading income	23	9.5	13.0
Other income	24	35.5	7.5
<b>Total income</b>		<u>398.5</u>	360.3
Staff expenses		156.8	142.6
Premises expenses		23.0	19.6
Other operating expenses		85.6	77.8
<b>Total operating expenses</b>	25	<u>265.4</u>	240.0
<b>Net income before provisions and tax</b>		133.1	120.3
Provision charge for loans and advances	10	(353.1)	(43.7)
Provision charge for other assets		(0.2)	-
<b>Net (loss) / income before tax</b>		<u>(220.2)</u>	76.6
Taxation charge		(6.8)	(6.6)
<b>Net (loss) / income</b>		<u>(227.0)</u>	70.0

Abdullah bin Hassan Alabdulgader  
Chairman

Sultan bin Abdul Malek Al-Sheikh  
Chairman of the Board Audit Committee

Abdulaziz A. Al-Helaissi  
Group Chief Executive Officer

The notes on pages 6 to 52 form part of these consolidated financial statements.

## Consolidated statement of comprehensive income

	Year ended <u>31.12.18</u> US\$ millions	Year ended <u>31.12.17</u> US\$ millions
Net (loss) / income	(227.0)	70.0
Other comprehensive income:-		
Items that may subsequently be reclassified to consolidated statement of income:-		
Cash flow hedges:-		
- net changes in fair value	(1.4)	(0.5)
	<u>(1.4)</u>	<u>(0.5)</u>
Items that will not be reclassified to consolidated statement of income:-		
Net changes in fair value of equity investments classified as fair value through other comprehensive income (FVTOCI)	11.5	(17.9)
Remeasurement of defined benefit pension fund	2.2	1.9
	<u>13.7</u>	<u>(16.0)</u>
Total other comprehensive income / (loss)	<u>12.3</u>	<u>(16.5)</u>
Total comprehensive (loss) / income	<u>(214.7)</u>	<u>53.5</u>

The notes on pages 6 to 52 form part of these consolidated financial statements.

## Consolidated statement of changes in equity

	Share capital	Reserves	Retained earnings	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 1<sup>st</sup> January 2018</b>	<b>2,500.0</b>	<b>352.5</b>	<b>(441.6)</b>	<b>2,410.9</b>
Net loss for the year	-	-	(227.0)	(227.0)
Other comprehensive income for the year	-	10.1	2.2	12.3
Total comprehensive income / (loss) for the year	-	10.1	(224.8)	(214.7)
Transfer to retained earnings	-	(1.2)	1.2	-
<b>At 31<sup>st</sup> December 2018</b>	<b>2,500.0</b>	<b>361.4</b>	<b>(665.2)</b>	<b>2,196.2</b>
<b>At 1<sup>st</sup> January 2017</b>	<b>2,500.0</b>	<b>364.7</b>	<b>(507.3)</b>	<b>2,357.4</b>
Net income for the year	-	-	70.0	70.0
Other comprehensive (loss) / income for the year	-	(18.4)	1.9	(16.5)
Total comprehensive (loss) / income for the year	-	(18.4)	71.9	53.5
Transfer from retained earnings	-	7.6	(7.6)	-
Transfer to retained earnings	-	(1.4)	1.4	-
<b>At 31<sup>st</sup> December 2017</b>	<b>2,500.0</b>	<b>352.5</b>	<b>(441.6)</b>	<b>2,410.9</b>

The notes on pages 6 to 52 form part of these consolidated financial statements.

## Consolidated statement of cash flows

	<b>Note</b>	<b>Year ended 31.12.18 US\$ millions</b>	<b>Year ended 31.12.17 US\$ millions</b>
<b>OPERATING ACTIVITIES</b>			
Net (loss) / income before tax		(220.2)	76.6
Adjustments to reconcile net income to net cash flow from operating activities:-			
Provision charge for other assets		0.2	-
Provision charge for loans and advances		353.1	43.7
Tax paid		(6.3)	(3.0)
Realised losses on debt investment securities		-	0.4
Amortisation of investment securities		8.1	9.8
Amortisation of senior term financing		0.5	0.5
Net increase in statutory deposits with central banks		(15.1)	(44.5)
Net increase in securities purchased under agreements to resell		(160.9)	(220.0)
Net increase in placements		(737.6)	(1,317.9)
Net decrease / (increase) in trading securities		14.1	(99.9)
Net increase in loans and advances		(127.8)	(341.7)
Increase in accrued interest receivable		(51.1)	(47.6)
Increase in accrued interest payable		60.6	58.0
Net decrease / (increase) in other net assets		29.6	(162.3)
Net increase / (decrease) in deposits from banks		243.1	(425.1)
Net increase in deposits from customers		2,332.6	2,542.3
Net decrease in securities sold under agreement to repurchase		(395.1)	(191.0)
<b>Net cash inflow / (outflow) from operating activities</b>		<b>1,327.8</b>	<b>(121.7)</b>
<b>INVESTING ACTIVITIES</b>			
Purchase of investment securities		(610.0)	(1,370.0)
Maturity of investment securities		682.2	1,392.5
<b>Net cash inflow from investing activities</b>		<b>72.2</b>	<b>22.5</b>
<b>FINANCING ACTIVITIES</b>			
Issuance of senior term financing		1,016.0	983.6
Maturity of senior term financing		(942.1)	(482.1)
<b>Net cash inflow from financing activities</b>		<b>73.9</b>	<b>501.5</b>
<b>Increase in cash and cash equivalents</b>		<b>1,473.9</b>	<b>402.3</b>
<b>Net foreign exchange difference</b>		<b>(143.3)</b>	<b>226.7</b>
<b>Cash and cash equivalents at 1<sup>st</sup> January</b>		<b>3,552.6</b>	<b>2,923.6</b>
<b>Cash and cash equivalents at 31<sup>st</sup> December</b>	<b>5</b>	<b>4,883.2</b>	<b>3,552.6</b>

The notes on pages 6 to 52 form part of these consolidated financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2018

#### 1. Incorporation and registration

The parent company of the Group, Gulf International Bank B.S.C. (the Bank), is a Bahraini Shareholding Company incorporated in the Kingdom of Bahrain by Amiri Decree Law No. 30 dated 24<sup>th</sup> November 1975 and is registered as a conventional wholesale bank and a conventional retail bank with the Central Bank of Bahrain. The registered office of the Bank is located at Al-Dowali Building, 3 Palace Avenue, Manama, Kingdom of Bahrain.

The Bank and its subsidiaries (the Group), is principally engaged in the provision of wholesale commercial, asset management and investment banking services, and recently entered a niche segment within retail consumer banking. The Group operates through subsidiaries, branch offices and representative offices located in five countries worldwide. The total number of staff at the end of the financial year was 1,012.

#### 2. Accounting policies

The principal accounting policies adopted in the preparation of the consolidated financial statements are set out below:-

##### 2.1 Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law. The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of trading securities, equity investment securities, derivative financial instruments and pension liabilities as explained in more detail in the following accounting policies. Recognised assets and liabilities that are hedged by derivative financial instruments are also stated at fair value in respect of the risk that is being hedged. The accounting policies have been consistently applied by the Group and are consistent with those of the previous year, except for the adoption of IFRS 15 - Revenue from contracts with customers with effect from 1<sup>st</sup> January 2018 as referred to below.

##### **IFRS 15 - Revenue from contracts with customers**

IFRS 15 introduces a new five-step model framework for determining whether, how much and when revenue is recognised. IFRS 15 has been applied retrospectively and has had no material impact on the Group's consolidated financial statements. Contracts with customers impacted by the new standards are summarised below:-

##### *Interest income and management fees*

Interest income and management fees are recognised using the effective interest rate method over the contractual life of the facility. Fees, including loan origination fees and early redemption fees, are included in the calculation of the effective interest rate to the extent that they are considered to be an integral part of the effective interest rate, and are amortised on a straight-line basis. As part of the Group's internal policies, interest income and the amortisation of management fees are suspended when either interest or principal is overdue. There is no material impact on the recognition of interest income or management fees resulting from the application of this standard.

##### *Commissions on letters of credit and guarantee and related advising fees*

Revenue earned from the arrangement of letters of credit or guarantee is recognised as the services are performed or received. Commissions on letters of credit and related fees are recognised after the transfer of services, whilst commissions on letters of guarantee are amortised over the life of the guarantee. There is no material impact on the recognition of letters of credit or guarantee or related fees from the application of this standard.

##### *Investment banking fees*

Investment banking fees comprise fees relating to the provision of financial services, underwriting activities, and services relating to structured financing, privatisations, initial public offerings, and mergers and acquisitions. For contracts involving multiple phases, monthly non-refundable retainer fees are charged and reflected in income as per the conditions stipulated in the contract. The Group is also entitled to advisory fees upon the completion of the transactions, which are only recognised at the end of the contract. There is no material impact on the recognition of investment banking fees resulting from the application of this standard.

##### 2.2 Consolidation principles

The consolidated financial statements include the accounts of Gulf International Bank B.S.C. and its subsidiaries. Subsidiaries are companies and other entities, including special purpose entities, which the Bank controls. The Bank controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The subsidiary's accounts are derecognised from the consolidated financial statements from the point when the control ceases. All intercompany balances and transactions, including unrealised gains and losses on transactions between Group companies, have been eliminated.

##### 2.3 Foreign currencies

The consolidated financial statements are presented in US Dollars, representing the Group's functional and presentation currency. Transactions in foreign currencies are converted to US Dollars at the spot rate of exchange prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into US Dollars at market rates of exchange prevailing at the balance sheet date.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended 31<sup>st</sup> December 2018**

**2. Accounting policies** (continued)

**2.4 Financial assets and liabilities**

Financial assets and liabilities comprise all assets and liabilities reflected in the consolidated statement of financial position, although excluding employee benefit plans and property and equipment.

**a) Recognition and measurement**

The Group recognises financial assets and liabilities in the consolidated statement of financial position when, and only when, the Group becomes party to the contractual provisions of the instrument.

Financial instruments are classified at inception into one of the following categories, which then determine the subsequent measurement methodology:-

Financial assets are classified into one of the following three categories:-

- financial assets at amortised cost;
- financial assets at fair value through other comprehensive income (FVTOCI); or
- financial assets at fair value through the profit or loss (FVTPL).

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 assets are initially recognised at fair value including transaction costs attributable to the financial asset, with the exception of trade receivables which are recognised at fair value. 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.

All regular way purchases and sales of financial assets and liabilities classified as FVTPL are recognised on the trade date, i.e. the date on which the Group commits to purchase or sell the financial asset or liability. All regular way purchases and sales of other financial assets and liabilities are recognised on the settlement date, i.e. the date on which the asset or liability is received from or delivered to the counterparty. Regular way purchases or sales are purchases or sales of financial assets that require delivery within the time frame generally established by regulation or convention in the market place.

Subsequent to initial measurement, financial assets and liabilities are measured at either amortised cost or fair value. The classification and the basis for measurement are subject to the Group's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets, as detailed below:-

*Financial assets at amortised cost*

Financial assets are measured at amortised cost using the effective interest rate method if:-

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

If the first criteria is not met, the financial assets are classified and measured at fair value through other comprehensive income (FVTOCI). If both criteria are not met, the financial assets are classified and measured at fair value through the profit or loss (FVTPL).

Additionally, even if a financial asset meets the amortised cost criteria, the Group may choose to designate the financial asset at FVTPL. Such an election is irrevocable and applicable only if the FVTPL classification significantly reduces a measurement or recognition inconsistency.

*Financial assets at fair value through other comprehensive income (FVTOCI)*

At initial recognition, the Group can make an irrevocable election to classify an equity investment that is not held for trading as FVTOCI.

For this purpose, a financial asset is deemed to be held for trading if the equity investment meets any of the following conditions:-

- it has been acquired principally for the purpose of selling in the near term;
- on initial recognition, it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profitability; or
- it is a derivative and not designated and effective as a hedging instrument or a financial guarantee.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended 31<sup>st</sup> December 2018**

**2. Accounting policies** (continued)

**2.4 Financial assets and liabilities** (continued)

**a) Recognition and measurement** (continued)

The irrevocable election is on an instrument-by-instrument basis. If an equity investment is designated as FVTOCI, all gains and losses, except for dividend income, are recognised in other comprehensive income and are not subsequently included in the consolidated statement of income.

*Financial assets at fair value through the profit or loss (FVTPL)*

Financial assets not otherwise classified above are classified and measured as FVTPL.

*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 as described in note 2.7(a).

*Financial liabilities at fair value through the 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.

**b) Modification of assets and liabilities**

*Financial assets*

If the terms of a financial asset are modified, the Group evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, 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 statement of income.

*Financial liabilities*

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.

**2.5 Impairment of financial assets**

Impairment allowances for expected credit losses (ECL) are recognised for financial instruments that are not measured at FVTPL. No impairment loss is recognised on equity investments.

An ECL provision is made at an amount equal to the lifetime ECL, except for the following, for which they are measured as a 12-month ECL:-

- debt investment securities that are determined to have a low credit risk (equivalent to investment grade rating) at the reporting date; and
- other financial instruments for which the credit risk has not increased significantly since their initial recognition.

The Group classifies its financial instruments into stage 1, stage 2 and stage 3, based on the applied impairment methodology, as described below:-

- Stage 1: for financial instruments where there has not been a significant increase in credit risk since initial recognition and that are not credit-impaired on origination, the Group recognises an allowance based on the 12-month ECL.
- Stage 2: for financial instruments where there has been a significant increase in credit risk since initial recognition but that are not credit-impaired, the Group recognises an allowance for the lifetime ECL.
- Stage 3: for credit-impaired financial instruments, the Group recognises the lifetime ECL.

12-month ECL (stage 1) is the portion of ECL that results from probable default events on a financial instrument within 12 months after the reporting date.

Lifetime ECL (stage 2) is a probability-weighted estimate of credit losses and is determined based on the difference between the present value of all cash shortfalls. The cash shortfall is the difference between all contractual cash flows that are due to the Group and the present value of the recoverable amount, for financial assets that are not credit-impaired at the reporting date.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2018

#### 2. Accounting policies (continued)

##### 2.5 Impairment of financial assets (continued)

For stage 3 financial instruments, the provisions for credit-impairment are determined based on the difference between the net carrying amount and the recoverable amount of the financial asset. The recoverable amount is measured as the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted based on the interest rate at the inception of the credit facility or, for debt instruments, at the current market rate of interest for a similar financial asset.

Provisions for credit-impairment are recognised in the consolidated statement of income and are reflected in an allowance account against loans and advances, investment securities, and placements.

Financial assets are written off after all restructuring and collection activities have taken place and there is no realistic prospect of recovery. Subsequent recoveries are included in other income.

Financial assets that are measured at amortised cost are tested as to whether they are credit-impaired. Objective evidence that a financial asset is credit-impaired may include a breach of contract, such as default or delinquency in interest or principal payments, the granting of a concession that, for economic or legal reasons relating to the borrower's financial difficulties, would not otherwise be considered, indications that it is probable that the borrower will enter bankruptcy or other financial reorganisation, the disappearance of an active market, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

Financial assets which have been renegotiated or modified are no longer considered to be past due and are replaced on performing status when all principal and interest payments are up to date and future payments are reasonably assured. Financial assets subject to individual impairment assessment and whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or should be considered past due. All renegotiated or modified facilities are classified as stage 2 or stage 3 for a minimum period of 12 months from the date of renegotiation. The ECL on renegotiated financial instruments is measured based on whether the terms of renegotiation resulted in the derecognition of an existing asset.

##### 2.6 Offsetting financial assets and liabilities

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

##### 2.7 Revenue recognition

###### a) Interest income and interest expense

Interest income and interest expense for all interest-bearing financial assets and liabilities except those classified as FVTPL are recognised using the effective interest rate method. The effective interest rate method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial asset or liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or liability. The application of the effective interest rate method has the effect of recognising interest income and interest expense evenly in proportion to the amount outstanding over the period to maturity or repayment.

In calculating the effective interest rate, cash flows are estimated taking into consideration all contractual terms of the financial asset or liability but excluding future credit losses. Fees, including loan origination fees and early redemption fees, are included in the calculation of the effective interest rate to the extent that they are considered to be an integral part of the effective interest rate.

Interest income is suspended when either interest or principal on a credit facility is overdue by more than 90 days whereupon all unpaid and accrued interest is reversed from income. Interest on non-accrual facilities is included in income only when received. Credit facilities are restored to accrual status only after all delinquent interest and principal payments have been brought current and future payments are reasonably assured.

###### b) Fees and commissions

Fees and commissions that are integral to the effective interest rate of a financial asset or liability are included in the calculation of the effective interest rate.

Other fees and commissions are recognised as the related services are performed or received, and are included in fee and commission income.

###### c) Trading and foreign exchange income

Trading and foreign exchange income arise from earnings generated from customer business and market making, and from changes in fair value resulting from movements in interest and exchange rates, equity prices and other market variables. Changes in fair value and gains and losses arising on the purchase and sale of trading instruments are included in trading income, together with the related interest income, interest expense and dividend income.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended 31<sup>st</sup> December 2018**

**2. Accounting policies** (continued)

**2.7 Revenue recognition** (continued)

**d) Dividend income**

Dividend income is recognised as follows:-

- dividends from equity instruments classified as FVTPL are recognised when the right to receive the dividend is established and are included in trading income.
- dividends from equity instruments classified as FVTOCI are recognised when the right to receive the dividend is established and are included in other income.

**2.8 Securities financing arrangements**

Securities purchased under agreements to resell (reverse repurchase agreements) and securities sold under agreements to repurchase (repurchase agreements) are treated as collateralised lending and borrowing transactions and are recorded in the consolidated statement of financial position at the amounts the securities were initially acquired or sold. Interest earned on reverse repurchase agreements and interest incurred on repurchase agreements are included in interest income and interest expense respectively.

**2.9 Premises and equipment**

Land is stated at cost. Other premises and equipment are stated at cost less accumulated depreciation. The residual values and useful lives of premises and equipment are reviewed at each balance sheet date, and adjusted where appropriate. Depreciation is calculated using the straight-line method over various periods. Where the carrying amount of premises or equipment is greater than the estimated recoverable amount, the carrying amount is reduced to the recoverable amount.

Generally, costs associated with the maintenance of existing computer software are recognised as an expense when incurred. However, expenditure that enhances and extends the benefits of computer software programs beyond their original specifications and lives is recognised as a capital improvement and capitalised as part of the original cost of the software.

**2.10 Other provisions**

Other provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event, 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.

**2.11 Derivative financial instruments and hedge accounting**

Derivative financial instruments are contracts, the value of which is derived from one or more underlying financial instruments or indices, and include futures, forwards, swaps and options in the interest rate, foreign exchange, equity and credit markets.

Derivative financial instruments are recognised in the consolidated statement of financial position at fair value. Fair values are derived from prevailing market prices, discounted cash flow models or option pricing models as appropriate.

In the consolidated statement of financial position, derivative financial instruments with positive fair values (unrealised gains) are included in other assets and derivative financial instruments with negative fair values (unrealised losses) are included in other liabilities.

The changes in the fair values of derivative financial instruments entered into for trading purposes or to hedge other trading positions are included in trading income.

The recognition of changes in the fair values of derivative financial instruments entered into for hedging purposes is determined by the nature of the hedging relationship. For the purposes of hedge accounting, derivative financial instruments are designated as a hedge of either: (i) the fair value of a recognised asset or liability (fair value hedge), or (ii) the future cash flows attributable to a recognised asset or liability or a firm commitment (cash flow hedge).

The Group's criteria for a derivative financial instrument to be accounted for as a hedge include:-

- the hedging instrument, the related hedged item, the nature of the risk being hedged, and the risk management objective and strategy must be formally documented at the inception of the hedge,
- it must be clearly demonstrated that the hedge is expected to be highly effective in offsetting the changes in fair values or cash flows attributable to the hedged risk in the hedged item, including how the Group will address the hedge ratio,
- the effectiveness of the hedge must be capable of being reliably measured, and
- there is an economic relationship between the hedging instrument and the hedged item and the effect of credit risk does not dominate the fair value changes of that relationship.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2018

#### 2. Accounting policies (continued)

##### 2.11 Derivative financial instruments and hedge accounting (continued)

Changes in the fair values of derivative financial instruments that are designated, and qualify, as fair value hedges and that prove to be highly effective in relation to the hedged risk, are included in trading income together with the corresponding change in the fair value of the hedged asset or liability that is attributable to the risk that is being hedged. Unrealised gains and losses arising on hedged assets or liabilities which are attributable to the hedged risk are adjusted against the carrying amounts of the hedged assets or liabilities in the consolidated statement of financial position. If the hedge no longer meets the criteria for hedge accounting, any adjustment to the carrying amount of a hedged interest-bearing financial instrument is amortised to income over the remaining period to maturity.

Changes in the fair values of derivative financial instruments that are designated, and qualify, as cash flow hedges and that prove to be highly effective in relation to the hedged risk, are recognised in other comprehensive income. Unrealised gains or losses recognised in other comprehensive income are transferred to the consolidated statement of income at the same time that the income or expense of the corresponding hedged item is recognised in the consolidated statement of income and are included in the same income or expense category as the hedged item. Unrealised gains or losses on any ineffective portion of cash flow hedging transactions are included in trading income.

The interest component of derivatives that are designated, and qualify, as fair value or cash flow hedges is included in interest income or interest expense relating to the hedged item over the life of the derivative instrument.

Hedge accounting is discontinued when the derivative hedging instrument either expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. Gains and losses arising on the termination of derivatives designated as cash flow hedges are recognised in interest income or interest expense over the original tenor of the terminated hedge transaction.

Some hybrid instruments contain both a derivative and non-derivative component. In such cases, the derivative is categorised as an embedded derivative. Embedded derivatives are separated from the host contract and accounted for separately if certain criteria are met. Where it is not practically possible to separate the embedded derivative, the entire hybrid instrument is categorised as a financial asset at FVTPL and measured at fair value. Changes in fair value are included in trading income.

##### 2.12 Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specific debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantees are issued to financial institutions and other counterparties on behalf of customers to secure loans, overdrafts and other banking facilities, and to other parties in relation to the performance of customers under obligations related to contracts, advance payments made by other parties, tenders and retentions.

Financial guarantees are initially recognised at fair value on the date the guarantee is issued. The guarantee liability is subsequently measured at the higher of the initial measurement, less amortisation to recognise the fee income earned over the period, or the present value of any expected payments to settle the liability when a payment under the contract has become probable. The expected loss on financial guarantees is measured at the expected payment to reimburse the holder less any amounts that the Group expects to recover. Any increase in a liability relating to guarantees is recognised in the consolidated statement of income. In the consolidated statement of financial position, financial guarantees are included in other liabilities.

##### 2.13 Post retirement benefits

The majority of the Group's employees are eligible for post retirement benefits under either defined benefit or defined contribution pension plans which are provided through separate trustee-administered funds, insurance plans or are directly funded by the Group. The Group also pays contributions to government managed pension plans in accordance with the legal requirements in each location.

The Group's contributions to defined contribution pension plans are expensed in the year to which they relate.

The calculation of obligations in respect of the defined benefit pension plans are performed by qualified actuaries using the projected unit credit method. The Group's net obligation is calculated by estimating the amount of future benefit that employees have earned in the current and prior periods, discounting that amount and deducting the fair value of the plan assets. When the calculation results in a potential asset for the Group, the recognised asset is limited to a ceiling so that it does not exceed the economic benefits available in the form of refunds from the plans or reductions in future contributions.

Remeasurements of the net defined benefit liability or asset, which comprise actuarial gains and losses, the return of plan assets (excluding interest) and the effect of the asset ceiling, are recognised immediately in the consolidated statement of other comprehensive income. The Group determines the net interest expense or income on the net defined benefit liability or asset for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the year to the opening net defined benefit liability or asset. Net interest expense and other expenses related to the defined benefit plans are recognised in the consolidated statement of income.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognised immediately in the consolidated statement of income. The Group recognises gains and losses on the settlement of defined benefit plans when the settlement occurs.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2018

#### 2. Accounting policies (continued)

##### 2.14 Taxation

###### a) **Current tax**

Current taxation is the expected tax payable on the taxable income for the year, using tax rates enacted at the reporting date, and includes any adjustments to tax payable in respect of previous years.

###### b) **Deferred tax**

Deferred tax is provided, using the liability method, for temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. A deferred tax asset is recognised only to the extent that it is probable that future taxable income will be available against which the unutilised tax losses and credits can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Deferred tax assets and liabilities are offset only if certain criteria are met. Currently enacted tax rates are used to determine deferred taxes.

##### 2.15 Cash and cash equivalents

In the consolidated statement of cash flows, cash and cash equivalents comprise cash and other liquid assets, excluding statutory deposits with central banks.

##### 2.16 Segment reporting

An operating segment is a distinguishable component of the Group that is engaged in business activities from which revenues are earned and expenses are incurred, including revenues and expenses that relate to transactions with any of the Group's other operating segments. All segments have discrete financial information which is regularly reviewed by the Group's Management Committee, being the Group's chief operating decision maker, to make decisions about resources allocated to the segment and to assess its performance. The Group's Management Committee assesses the segments based on net interest income which accounts for the majority of the Group's revenues.

##### 2.17 Fiduciary activities

The Group administers and manages assets owned by clients which are not reflected in the consolidated financial statements. Asset management fees are earned for providing investment management services and for managing mutual fund products. Asset administration fees are earned for providing custodial services. Fees are recognised as the services are provided and are included in fee and commission income.

##### 2.18 Dividends

Dividends on issued shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders.

##### 2.19 Shariah-compliant banking

The Group offers various Shariah-compliant products to its customers. The Shariah-compliant activities are conducted in accordance with Shariah principles and are subject to the supervision and approval of the Group's Shariah Supervisory Board. The disclosures set out in the consolidated financial statements in relation to these activities are prepared in accordance with Financial Accounting Standard 18 issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

##### 2.20 Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

##### 2.21 Future accounting developments

The International Accounting Standards Board (IASB) have issued a number of new standards, amendments to standards, and interpretations that are not yet effective and have not been applied in the preparation of the consolidated financial statements for the year ended 31<sup>st</sup> December 2018. The relevant new standards, amendments to standards, and interpretations, are as follows:-

###### - IFRS 16 - Leases:-

IFRS 16 requires lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right of use assets. IFRS 16 is effective for annual periods beginning on or after 1<sup>st</sup> January 2019. Lessees must adopt IFRS 16 using either a full retrospective or a modified retrospective approach. There is no material impact on the Group's consolidated financial statements resulting from the application of this standard.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended 31<sup>st</sup> December 2018****2. Accounting policies** (continued)**2.22 Capital management**

The Group uses regulatory capital ratios and its economic capital framework to monitor its capital base. The Group manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans.

**3. Accounting estimates and assumptions**

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of certain financial assets, liabilities, income and expenses.

The use of estimates and assumptions is principally limited to the determination of provisions for impairment, the valuation of financial instruments, the valuation of the Group's defined benefit pension plans, and in determining control relationships over investees, as explained in more detail below:-

**3.1 Provisions for impairment**

Financial assets are evaluated for impairment on the basis set out in note 2.5.

In determining impairment of financial assets, judgement is required in the estimation of the amount and timing of future cash flows as well as an assessment of whether the credit risk on the financial asset has increased significantly since initial recognition and incorporation of forward-looking information in the measurement of ECL. The information about the judgements made are set out in note 27.1.

**3.2 Fair value of financial assets and liabilities**

Where the fair value of financial assets and liabilities cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is derived from observable markets where available, but where this is not feasible, a degree of judgement is required in determining assumptions used in the models. Changes in assumptions used in the models could affect the reported fair value of financial assets and liabilities.

**3.3 Retirement benefit obligations**

Management, in coordination with independent qualified actuaries, are required to make assumptions regarding the defined benefit pension plans. The principal actuarial assumptions for the defined benefit pension plans are set out in note 12 and include assumptions on the discount rate, return on pension plan assets, mortality, future salary increases, and inflation. Changes in the assumptions could affect the reported asset, service cost and return on pension plan assets.

**3.4 Determination of control over investees**

The Group acts as fund manager to a number of investment funds. The determination of whether the Group controls an investment fund is based on an assessment of the aggregate economic interests of the Group in the fund and includes an assessment of any carried interests, expected management fees, and the investors' rights to remove the Group as fund manager.

Management are required to conclude whether the Group acts as an agent for the investors in the fund, or if the underlying fund is controlled by the Group.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2018

**4. Classification of assets and liabilities**

The classification of assets and liabilities by accounting categorisation was as follows:-

	Financial assets at amortised cost	Financial assets & liabilities at FVTPL	Financial assets at FVTOCI	Financial liabilities at amortised cost	Non- financial assets & liabilities	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 31<sup>st</sup> December 2018</b>						
Cash and other liquid assets	5,114.2	-	-	-	-	5,114.2
Securities purchased under agreements to resell	1,015.9	-	-	-	-	1,015.9
Placements	6,770.8	-	-	-	-	6,770.8
Trading securities	-	177.7	-	-	-	177.7
Investment securities	3,728.7	-	168.5	-	-	3,897.2
Loans and advances	9,817.8	-	-	-	-	9,817.8
Other assets	345.3	219.1	-	-	188.1	752.5
<b>Total assets</b>	<b>26,792.7</b>	<b>396.8</b>	<b>168.5</b>	<b>-</b>	<b>188.1</b>	<b>27,546.1</b>
Deposits from banks	-	-	-	2,372.2	-	2,372.2
Deposits from customers	-	-	-	18,322.4	-	18,322.4
Securities sold under agreements to repurchase	-	-	-	735.4	-	735.4
Other liabilities	-	144.3	-	371.0	66.6	581.9
Senior term financing	-	-	-	3,338.0	-	3,338.0
Equity	-	-	-	-	2,196.2	2,196.2
<b>Total liabilities &amp; equity</b>	<b>-</b>	<b>144.3</b>	<b>-</b>	<b>25,139.0</b>	<b>2,262.8</b>	<b>27,546.1</b>
<b>At 31<sup>st</sup> December 2017</b>						
Cash and other liquid assets	3,768.5	-	-	-	-	3,768.5
Securities purchased under agreements to resell	855.0	-	-	-	-	855.0
Placements	6,033.2	-	-	-	-	6,033.2
Trading securities	-	191.8	-	-	-	191.8
Investment securities	3,823.1	-	170.7	-	-	3,993.8
Loans and advances	10,043.1	-	-	-	-	10,043.1
Other assets	244.7	182.2	-	-	159.0	585.9
<b>Total assets</b>	<b>24,767.6</b>	<b>374.0</b>	<b>170.7</b>	<b>-</b>	<b>159.0</b>	<b>25,471.3</b>
Deposits from banks	-	-	-	2,129.1	-	2,129.1
Deposits from customers	-	-	-	15,989.8	-	15,989.8
Securities sold under agreements to repurchase	-	-	-	1,130.5	-	1,130.5
Other liabilities	-	131.5	-	333.0	82.9	547.4
Senior term financing	-	-	-	3,263.6	-	3,263.6
Equity	-	-	-	-	2,410.9	2,410.9
<b>Total liabilities &amp; equity</b>	<b>-</b>	<b>131.5</b>	<b>-</b>	<b>22,846.0</b>	<b>2,493.8</b>	<b>25,471.3</b>

The other assets and other liabilities classified as financial assets and liabilities at FVTPL comprise the fair values of derivatives designated as fair value and cash flow hedges.

The fair value analysis of derivative financial instruments is set out in note 31.4.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2018

**5. Cash and other liquid assets**

	<b>31.12.18</b>	31.12.17
	<b>US\$ millions</b>	US\$ millions
Cash and balances with central banks	<b>4,262.0</b>	2,862.7
Cash and balances with banks	<b>523.7</b>	587.5
Government bills	<b>97.5</b>	102.4
<b>Cash and cash equivalents</b>	<b>4,883.2</b>	3,552.6
Statutory deposits with central banks	<b>231.0</b>	215.9
<b>Cash and other liquid assets</b>	<b>5,114.2</b>	3,768.5

Statutory deposits with central banks are subject to local regulations which provide for restrictions on the deployment of these funds.

**6. Securities purchased under agreements to resell**

The Group enters into collateralised lending transactions (reverse repurchase agreements) in the ordinary course of its operating activities. The collateral is in the form of highly rated debt securities. The collateralised lending transactions are conducted under standardised terms that are usual and customary for such transactions.

**7. Placements**

Placements at 31<sup>st</sup> December 2018 included placements with central banks amounting to US\$2,886.4 million (2017: US\$1,749.1 million). The placements with central banks represented the placement of surplus liquid funds.

**8. Trading securities**

	<b>31.12.18</b>	31.12.17
	<b>US\$ millions</b>	US\$ millions
Managed funds	<b>106.4</b>	138.0
Equity securities	<b>58.3</b>	40.8
Debt securities	<b>13.0</b>	13.0
	<b>177.7</b>	191.8

Managed funds comprised funds placed for investment with specialist managers.

Debt and equity securities comprised securities acquired in relation to investment banking activities undertaken by the Group. The securities were held with the intention of selling in the near term.

**9. Investment securities**

**9.1 Composition**

The credit rating profile of investment securities, based on the lowest rating assigned by the major international rating agencies, was as follows:-

	<b>31.12.18</b>		31.12.17	
	<b>US\$ millions</b>	<b>%</b>	US\$ millions	%
AAA to A- / Aaa to A3	<b>3,207.8</b>	<b>86.0</b>	3,326.7	87.0
BBB+ to BBB- / Baa1 to Baa3	<b>273.6</b>	<b>7.4</b>	267.1	7.0
BB+ to B- / Ba1 to B3	<b>247.3</b>	<b>6.6</b>	229.3	6.0
Total debt securities	<b>3,728.7</b>	<b>100.0</b>	3,823.1	100.0
Equity investments	<b>168.5</b>		170.7	
	<b>3,897.2</b>		3,993.8	

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended 31<sup>st</sup> December 2018**

**9. Investment securities** (continued)

**9.1 Composition** (continued)

Investment securities principally comprised investment-grade rated debt securities issued by major international financial institutions and government-related entities.

Investment securities rated BB+ to B- / Ba1 to B3 at 31<sup>st</sup> December 2018 and 31<sup>st</sup> December 2017 principally comprised GCC sovereign debt securities.

Debt securities are classified as investment securities at amortised cost and equity investments are classified as FVTOCI.

**9.2 Provisions for impairment**

The movements in the provisions for credit impairment of investment securities were as follows:-

	Collective provisions			Specific provisions			<u>2018</u>		Collective provisions			Specific provisions		<u>2017</u>	
	Stage 1		Stage 2	Stage 3		Total	Stage 1		Stage 2	Stage 3		Total			
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	
At 1 <sup>st</sup> January and															
31 <sup>st</sup> December	4.5	-	-	4.5	4.5	-	-	4.5							

Stage 1 provisions under IFRS 9 reflect the probability-weighted estimate of expected credit losses, and comprise both quantitative and qualitative information and analysis, based on the Group's historical experience and taking into consideration both internal and external indicators and including forward-looking information.

**10. Loans and advances**

**10.1 Composition**

	<u>31.12.18</u>	<u>31.12.17</u>
	US\$ millions	US\$ millions
Gross loans and advances	10,581.7	10,456.7
Provisions for impairment	(763.9)	(413.6)
<b>Net loans and advances</b>	<b>9,817.8</b>	<b>10,043.1</b>



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2018

**10. Loans and advances** (continued)

**10.2 Industrial classification**

	<b>31.12.18</b>	31.12.17
	<b>US\$ millions</b>	US\$ millions
Trading and services	<b>2,038.1</b>	2,188.8
Energy, oil and petrochemical	<b>1,872.4</b>	1,971.8
Financial	<b>1,630.4</b>	1,743.6
Transportation	<b>1,507.7</b>	1,432.1
Manufacturing	<b>1,232.4</b>	1,186.7
Construction	<b>869.3</b>	803.2
Real estate	<b>707.7</b>	523.1
Communication	<b>228.7</b>	231.0
Agriculture and mining	<b>173.5</b>	183.1
Government	<b>121.8</b>	113.0
Other	<b>199.7</b>	80.3
	<b>10,581.7</b>	10,456.7
Provisions for impairment	<b>(763.9)</b>	(413.6)
	<b>9,817.8</b>	10,043.1

Gross loans at 31<sup>st</sup> December 2018 included Shariah-compliant transactions amounting to US\$3,829.3 million (2017: US\$3,658.7 million).

**10.3 Provisions for impairment**

	<b>Collective</b>		<b>Specific</b>	<b>2018</b>	<b>Collective</b>		<b>Specific</b>	<b>2017</b>
	<b>provisions</b>		<b>provisions</b>		<b>provisions</b>		<b>provisions</b>	
	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>
<b>At 1<sup>st</sup> January</b>	<b>46.3</b>	<b>106.3</b>	<b>261.0</b>	<b>413.6</b>	82.5	83.0	255.5	421.0
Transfer to stage 1	<b>0.5</b>	<b>(0.5)</b>	-	-	2.7	(2.7)	-	-
Transfer to stage 2	<b>(7.4)</b>	<b>7.4</b>	-	-	(13.9)	13.9	-	-
Transfer to stage 3	-	<b>(25.9)</b>	<b>25.9</b>	-	(1.1)	(2.9)	4.0	-
Amounts utilised	-	-	<b>(2.2)</b>	<b>(2.2)</b>	-	-	(51.2)	(51.2)
Exchange rate movements	-	-	<b>(0.6)</b>	<b>(0.6)</b>	-	-	0.1	0.1
Net remeasurement of loss allowance	<b>(8.9)</b>	<b>22.8</b>	<b>339.2</b>	<b>353.1</b>	(23.9)	15.0	52.6	43.7
<b>At 31<sup>st</sup> December</b>	<b>30.5</b>	<b>110.1</b>	<b>623.3</b>	<b>763.9</b>	46.3	106.3	261.0	413.6

The stage 1 and stage 2 provisions reflect the probability-weighted estimate of expected credit losses under IFRS 9. The provisions comprise both quantitative and qualitative information and analysis, based on the Group's historical experience and taking into consideration both internal and external indicators and includes forward-looking information.

Stage 3 provisions reflect credit-impaired provisions based on the difference between the net carrying amount and the recoverable amount of the loan.

The US\$339.2 million stage 3 provision for the year ended 31<sup>st</sup> December 2018 principally related to a number of borrowers that experienced stressed financial circumstances resulting from challenging micro-economic conditions which impacted the business environment in which the Group operates. This contributed to an increase in past due loans during the year as set out in note 10.4.

The gross amount of stage 3 loans against which a stage 3 provision had been made at 31<sup>st</sup> December 2018 was US\$649.2 million (2017: US\$379.8 million). Total stage 3 provisions at 31<sup>st</sup> December 2018, excluding provisions in relation to credit-related contingent exposures, represented 83.6 per cent of stage 3 loans (2017: 67.1 per cent).

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**For the year ended 31<sup>st</sup> December 2018**

**10. Loans and advances** (continued)

**10.3 Provisions for impairment** (continued)

Amounts utilised during the year ended 31<sup>st</sup> December 2017 mainly represented provisions utilised on the transfer of the related loans to the memorandum records. Recovery efforts on these loans are still ongoing with the intention to maximise potential recoveries.

Total provisions at 31<sup>st</sup> December 2018 included US\$88.2 million of provisions in relation to credit-related contingent exposures (2017: US\$19.1 million).

**10.4 Past due loans**

The gross and carrying amounts of loans for which either principal or interest was over 90 days past due were as follows:-

	<u>31.12.18</u>		<u>31.12.17</u>	
	<u>Gross</u>	<u>Carrying</u>	<u>Gross</u>	<u>Carrying</u>
	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>
Corporates	719.1	107.9	454.2	198.6
Financial sector	22.2	10.1	25.2	20.2
	<u>741.3</u>	<u>118.0</u>	<u>479.4</u>	<u>218.8</u>

Corporates include loans extended for investment purposes.

Gross past due loans at 31<sup>st</sup> December 2018 included US\$649.4 million of loans that were classified as stage 3 for provisioning purposes (2017: US\$378.1 million).

At 31<sup>st</sup> December 2018, total specific provisions against past due loans represented 84.1 per cent of gross past due loans (2017: 54.4 per cent).

**10.5 Restructured and modified loans**

During the years ended 31<sup>st</sup> December 2018 and 31<sup>st</sup> December 2017, the Group modified the contractual terms of a number of facilities for commercial purposes. Such modifications did not result in the derecognition of any assets, and the resulting modification gains were immaterial to the Group's consolidated statement of income. The nature of modifications is set out in note 27.1.

During the year ended 31<sup>st</sup> December 2018, the Group did not restructure any loans or make any concessions that would ordinarily have been accepted due to a deterioration in customer's financial position (2017: \$143.5 million).

**10.6 Collateral**

The Group did not take possession of any collateral during the years ended 31<sup>st</sup> December 2018 and 31<sup>st</sup> December 2017.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended 31<sup>st</sup> December 2018**

**11. Other assets**

	<b>31.12.18</b>	31.12.17
	<b>US\$ millions</b>	US\$ millions
Accrued interest, fees and commissions	<b>265.8</b>	214.7
Derivative financial instruments	<b>219.1</b>	182.2
Premises and equipment	<b>102.2</b>	111.6
Prepayments	<b>48.1</b>	27.3
Deferred items	<b>37.8</b>	20.1
Other, including accounts receivable	<b>79.5</b>	30.0
	<b>752.5</b>	585.9

Derivative financial instruments represent the positive fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in note 31.4.

The increase in accrued interest, fees and commissions at 31<sup>st</sup> December 2018 was principally due to an increase in market benchmark rates.

**12. Post retirement benefits**

The Group contributes to defined benefit and defined contribution pension plans which cover substantially all of its employees.

The Bank maintains pension plans for the majority of its employees. Contributions are based on a percentage of salary. The amounts to be paid as retirement benefits are determined by reference to the amounts of the contributions and investment earnings thereon. The total cost of contributions to defined benefit and defined contribution pension plans for the year ended 31<sup>st</sup> December 2018 amounted to US\$17.8 million (2017: US\$13.8 million).

The Bank's subsidiary, Gulf International Bank (UK) Limited (GIBUK), maintains a funded defined benefit scheme, whilst the Saudi Arabian subsidiary, GIB Capital C.J.S.C. (GIB Capital) and branch, maintain an unfunded defined benefit scheme. Both pension schemes are covered in more detail in this note.

**12.1 Gulf International Bank (UK) Limited (GIBUK)**

The Bank's principal subsidiary, Gulf International Bank (UK) Limited (GIBUK), maintains a funded defined benefit final salary pension plan for a number of its employees. The assets of the plan are held independently of the subsidiary's assets in a separate trustee administered fund. The fund is subject to the UK regulatory framework for pensions.

The fund exposes the Group to the risk of paying unanticipated contributions in times of adverse experience. Such events could be members living for longer than expected, higher than expected inflation or salary growth, and the risk that increases in the fund's obligations are not met by a corresponding improvement in the value of the fund's assets.

**a) The amount recognised in the consolidated statement of financial position is analysed as follows:-**

	<b>31.12.18</b>	31.12.17
	<b>US\$ millions</b>	US\$ millions
Fair value of plan assets	<b>195.2</b>	181.8
Present value of fund obligations	<b>207.4</b>	193.6
<b>Net liability in the consolidated statement of financial position</b>	<b>12.2</b>	11.8

The net liability or asset is a valuation measure derived using an actuarial mathematical model. The modelling is performed by an independent actuary based upon the measurement criteria stipulated by the accounting standard IAS19 - Employee Benefits. A pension asset does not indicate a realisable receivable from the pension plan and a liability does not indicate a funding requirement to the pension plan in the short term.

The valuation measure indicates a point in time view of the fair value of the plan's assets less a discounted measure of the plan's future obligations over a duration of 19 years.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended 31<sup>st</sup> December 2018**

**12. Post retirement benefits** (continued)

**12.1 Gulf International Bank (UK) Limited (GIBUK)** (continued)

**b) The movements in the fair value of plan assets were as follows:-**

	<u>2018</u>	<u>2017</u>
	US\$ millions	US\$ millions
At 1 <sup>st</sup> January	181.8	190.1
Included in the consolidated statement of income:-		
- Interest income on the plan assets	5.1	4.8
Included in the consolidated statement of other comprehensive income:-		
- Remeasurements:-		
- Return on plan assets excluding interest income	(12.1)	6.7
Other movements:-		
- Exchange rate movements	28.6	(10.0)
- Contributions paid by the participant	0.5	-
- Contributions paid by the Group	0.5	0.5
- Benefits paid by the plan	(9.2)	(10.3)
At 31 <sup>st</sup> December	<u>195.2</u>	<u>181.8</u>

The plan assets at 31<sup>st</sup> December 2018 comprised a 35 per cent (2017: 33 per cent) exposure to equities and a 33 per cent (2017: 37 per cent) exposure to multi-asset funds, with the balance of the exposure to hedging funds and debt. The plan assets have a quoted price in an active market and the hedging funds are designed to hedge the majority of inflation and interest rate risk.

**c) The movements in the present value of fund obligations were as follows:-**

	<u>2018</u>	<u>2017</u>
	US\$ millions	US\$ millions
At 1 <sup>st</sup> January	193.6	203.9
Included in the consolidated statement of income:-		
- Current service cost	0.7	0.6
- Past service cost	0.2	-
- Interest cost on the fund obligations	5.5	5.2
Included in the consolidated statement of other comprehensive income:-		
- Remeasurements due to changed actuarial assumptions:-		
- Financial assumptions	(14.1)	6.5
- Demographic assumptions	(1.1)	(3.6)
- Experience	0.9	1.9
Other movements:-		
- Exchange rate movements	30.4	(10.6)
- Contributions paid by the participant	0.5	-
- Benefits paid by the plan	(9.2)	(10.3)
At 31 <sup>st</sup> December	<u>207.4</u>	<u>193.6</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2018

**12. Post retirement benefits** (continued)

**12.1 Gulf International Bank (UK) Limited (GIBUK)** (continued)

d) **The movements in the net liability recognised in the consolidated statement of financial position were as follows:-**

	<u>2018</u>	<u>2017</u>
	US\$ millions	US\$ millions
At 1 <sup>st</sup> January	(11.8)	(13.8)
Net expense included in consolidated statement of income	(1.3)	(1.0)
Remeasurement included in consolidated statement of comprehensive income	2.2	1.9
Contributions paid by the Group	0.5	0.5
Exchange rate movements	(1.8)	0.6
At 31 <sup>st</sup> December	<u>(12.2)</u>	<u>(11.8)</u>

The Group paid US\$0.5 million in contributions to the plan during 2018 and expects to pay US\$0.4 million during 2019.

e) **The principal actuarial assumptions used for accounting purposes were as follows:-**

	<u>2018</u>	<u>2017</u>
Discount rate (per cent)	2.9	2.5
Retail price inflation (per cent)	3.2	3.2
Consumer price inflation (per cent)	2.2	2.2
Pension increase rate (per cent)	3.1	3.1
Salary growth rate (per cent)	3.0	3.0
Average life expectancy (years)	89	89

f) **Sensitivity information**

The present value of the fund's obligations, which has a weighted average duration of 19 years, was calculated based on certain actuarial assumptions. Should any one of the key assumptions change by an amount that is probable whilst holding the other assumptions constant, the present value of the fund's obligations would increase as follows:-

	<u>2018</u>	<u>2017</u>
	US\$ millions	US\$ millions
Life expectancy increased by 1 year	0.2	0.2
Discount rate decreased by 0.5 per cent	0.2	0.2
Inflation increased by 0.5 per cent	0.2	0.2

**12.2 GIB Capital C.J.S.C. (GIB Capital) and Saudi Arabian branch**

GIB Capital C.J.S.C. (GIB Capital) and the Bank's Saudi Arabian branch maintain an unfunded defined benefit scheme based on the prevailing Saudi Labour Laws.

The scheme exposes the Group to the risk of paying unanticipated contributions in times of adverse experience. Such events include members living for longer than expected, higher than expected inflation or salary growth, and the risk that withdrawals may be higher than assumed.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2018

**12. Post retirement benefits** (continued)

**12.2 GIB Capital C.J.S.C. (GIB Capital) and Saudi Arabian branch** (continued)

**a) The amount recognised in the consolidated statement of financial position is analysed as follows:-**

	<u>31.12.18</u>	<u>31.12.17</u>
	US\$ millions	US\$ millions
Fair value of plan assets	-	-
Present value of fund obligations	12.9	7.9
<b>Net liability in the consolidated statement of financial position</b>	<b>12.9</b>	<b>7.9</b>

The net liability or asset is a valuation measure derived using an actuarial mathematical model. The modelling is performed by an independent actuary based upon the measurement criteria stipulated by the accounting standard IAS19 - Employee Benefits. A pension liability does not indicate a funding requirement to the pension plan in the short term.

The valuation measure indicates a point in time view of the fair value of the plan's assets less a discounted measure of the plan's future obligations over a duration of 10 years.

**b) The movements in the present value of fund obligations were as follows:-**

	<u>2018</u>	<u>2017</u>
	US\$ millions	US\$ millions
At 1 <sup>st</sup> January	7.9	6.7
Included in the consolidated statement of income:-		
- Current service cost	5.6	2.3
- Interest cost on the fund obligations	0.1	-
Included in the consolidated statement of other comprehensive income:-		
- Remeasurements due to changed actuarial assumptions:-		
- Financial assumptions	0.6	-
- Demographic assumptions	(0.7)	-
- Experience	0.1	-
Other movements:-		
- Benefits paid by the plan	(0.7)	(1.1)
At 31 <sup>st</sup> December	12.9	7.9

**c) The principal actuarial assumptions used for accounting purposes were as follows:-**

	<u>2018</u>	
	Saudi Arabian Branch	GIB Capital
Discount rate (per cent)	4.6	4.6
Mortality rate (per cent)	75.0	75.0
Salary growth rate (per cent)	4.2	4.6

**d) Sensitivity information**

The present value of the fund's obligations, which has a weighted average duration of 10 years, was calculated based on certain actuarial assumptions. Should any one of the key assumptions change by an amount that is probable whilst holding the other assumptions constant, the present value of the fund's obligations would increase / (decrease) as follows:-

	<u>2018</u>
	US\$ millions
Discount rate increased by 0.5 per cent	(0.7)
Discount rate decreased by 0.5 per cent	0.7
Long term salary increased by 0.5 per cent	0.6
Long term salary decreased by 0.5 per cent	(0.6)

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For the year ended 31<sup>st</sup> December 2018

**13. Deposits**

The geographical composition of total deposits was as follows:-

	<u>31.12.18</u>	<u>31.12.17</u>
	US\$ millions	US\$ millions
GCC countries	13,574.0	12,600.2
Other Middle East and North Africa countries	466.9	779.3
Other countries	6,653.7	4,739.4
	<u>20,694.6</u>	<u>18,118.9</u>

GCC deposits comprise deposits from the Gulf Cooperation Council (GCC) country governments and central banks and other institutions headquartered in the GCC states.

At 31<sup>st</sup> December 2018, GCC deposits represented 65.6 per cent of total deposits (2017: 69.5 per cent).

Total deposits at 31<sup>st</sup> December 2018 included Shariah-compliant transactions amounting to US\$3,507.3 million (2017: US\$4,244.5 million). Shariah-compliant transactions comprise murabaha contracts.

**14. Securities sold under agreements to repurchase**

The Group enters into collateralised borrowing transactions (repurchase agreements) in the ordinary course of its financing activities. Collateral is provided in the form of securities held within the investment securities portfolio. At 31<sup>st</sup> December 2018, the fair value of investment securities that had been pledged as collateral under repurchase agreements was US\$784.8 million (2017: US\$1,183.8 million). The collateralised borrowing transactions are conducted under standardised terms that are usual and customary for such transactions.

**15. Other liabilities**

	<u>31.12.18</u>	<u>31.12.17</u>
	US\$ millions	US\$ millions
Accrued interest	256.7	196.1
Derivative financial instruments	144.3	131.5
Deferred items	66.6	82.9
Pension liabilities	25.1	11.8
Other, including accounts payable and accrued expenses	89.2	125.1
	<u>581.9</u>	<u>547.4</u>

Derivative financial instruments represent the negative fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in note 31.4.

Deferred items represent amounts received, e.g. loan origination fees, that are being amortised to income over the period of the related financial asset.

An analysis of the pension liabilities is set out in note 12.

**16. Senior term financing**

	<u>Maturity</u>	<u>31.12.18</u>	<u>31.12.17</u>
		US\$ millions	US\$ millions
Floating rate note	2019	533.1	533.3
Floating rate loans	2019	390.1	390.1
Floating rate loans	2020 - 2023	1,065.0	409.9
Floating rate repurchase agreements	2020 - 2028	318.5	207.6
Floating rate note	2021	533.1	533.3
Floating rate note	2022	498.2	497.7
Floating rate loans	2018	-	691.7
		<u>3,338.0</u>	<u>3,263.6</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**17. Share capital**

The authorised share capital at 31<sup>st</sup> December 2018 comprised 3.0 billion shares of US\$1 each (2017: 3.0 billion shares of US\$1 each). The issued share capital at 31<sup>st</sup> December 2018 comprised 2.5 billion shares of US\$1 each (2017: 2.5 billion shares of US\$1 each). All issued shares are fully paid.

**18. Reserves**

	Share premium	Compulsory reserve	Voluntary reserve	Cash flow hedge reserve	Investment securities revaluation reserve	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 1<sup>st</sup> January 2018</b>	7.6	225.8	163.3	(0.5)	(43.7)	352.5
Net fair value losses on cash flow hedges	-	-	-	(1.4)	-	(1.4)
Net fair value gains on equity investments classified as FVTOCI	-	-	-	-	11.5	11.5
Transfers to retained earnings	-	-	-	-	(1.2)	(1.2)
Net (decrease) / increase	-	-	-	(1.4)	10.3	8.9
<b>At 31<sup>st</sup> December 2018</b>	<b>7.6</b>	<b>225.8</b>	<b>163.3</b>	<b>(1.9)</b>	<b>(33.4)</b>	<b>361.4</b>
<b>At 1<sup>st</sup> January 2017</b>	7.6	222.0	159.5	-	(24.4)	364.7
Net fair value losses on cash flow hedges	-	-	-	(0.5)	-	(0.5)
Net fair value losses on equity investments classified as FVTOCI	-	-	-	-	(17.9)	(17.9)
Transfers to retained earnings	-	-	-	-	(1.4)	(1.4)
Net decrease	-	-	-	(0.5)	(19.3)	(19.4)
Transfers from retained earnings	-	3.8	3.8	-	-	7.6
<b>At 31<sup>st</sup> December 2017</b>	<b>7.6</b>	<b>225.8</b>	<b>163.3</b>	<b>(0.5)</b>	<b>(43.7)</b>	<b>352.5</b>

In accordance with the Bank's articles of association, 10 per cent of the Bank's net profit for the year is required to be transferred to each of the compulsory and voluntary reserves. Transfers to the compulsory reserve are required until such time as this reserve represents 50 per cent of the issued share capital of the Bank. The voluntary reserve may be utilised at the discretion of the Board of Directors. The compulsory reserve may be utilised as per the terms of the Bank's articles of association.

**19. Dividends**

No dividend is proposed in respect of the financial years ended 31<sup>st</sup> December 2018 and 31<sup>st</sup> December 2017.



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the year ended 31<sup>st</sup> December 2018

**20. Net interest income**

	<u>Year ended</u> <u>31.12.18</u> US\$ millions	<u>Year ended</u> <u>31.12.17</u> US\$ millions
<b>Interest income</b>		
Placements and other liquid assets	187.1	113.6
Investment securities	125.5	86.3
Loans and advances	452.2	395.3
Total interest income	<u>764.8</u>	<u>595.2</u>
<b>Interest expense</b>		
Deposits from banks and customers	368.4	235.3
Securities sold under agreements to repurchase	20.3	10.9
Term financing	102.4	95.9
Total interest expense	<u>491.1</u>	<u>342.1</u>
<b>Net interest income</b>	<u>273.7</u>	<u>253.1</u>

Interest income on loans and advances includes loan origination fees that form an integral part of the effective interest rate of the loan.

The increases in interest income on placements and other liquid assets, and interest expense on deposits from banks and customers was principally due to an increase in deposits from customers during the year ended 31<sup>st</sup> December 2018 reflecting a higher level of deposit activity by the Group's London-based subsidiary, Gulf International Bank (UK) Limited. This also accounted for an increase in cash and other liquid assets. The increases in the average volume of cash and other liquid assets, and deposits from customers is set out in note 40.

Accrued interest on impaired and past due loans included in interest income for the year ended 31<sup>st</sup> December 2018 amounted to nil (2017: nil). There was no accrued but uncollected interest included in interest income on past due loans or past due investment securities for either the year ended 31<sup>st</sup> December 2018 or 31<sup>st</sup> December 2017.

**21. Fee and commission income**

	<u>Year ended</u> <u>31.12.18</u> US\$ millions	<u>Year ended</u> <u>31.12.17</u> US\$ millions
<b>Fee and commission income</b>		
Commissions on letters of credit and guarantee	31.2	33.6
Investment banking and management fees	24.4	34.4
Loan commitment fees	3.9	3.2
Loan agency fees	1.2	1.3
Retail fees	0.8	0.2
Other fee and commission income	1.7	1.6
Total fee and commission income	<u>63.2</u>	<u>74.3</u>
<b>Fee and commission expense</b>	<u>(2.0)</u>	<u>(1.7)</u>
<b>Net fee and commission income</b>	<u>61.2</u>	<u>72.6</u>

Investment banking and management fees comprise fees relating to the provision of investment management and financial services, including asset and fund management, underwriting activities, and services relating to structured financing, privatisations, initial public offerings, and mergers and acquisitions.

Investment banking and management fees for the year ended 31<sup>st</sup> December 2018 included fee income relating to the Group's fiduciary activities amounting to US\$19.3 million (2017: US\$26.8 million). The decrease in investment banking and management fees was principally due to a lower level of investment in funds managed by the Group, and lower performance-related fees reflecting the challenging market environment prevailing during the year ended 31<sup>st</sup> December 2018.

Fee and commission expense principally comprises security custody fees and bank charges and commissions.

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**22. Foreign exchange income**

Foreign exchange income principally comprises customer-initiated foreign exchange contracts which have been offset in the market with matching contracts. There is no remaining market risk associated with these offset customer-related foreign exchange contracts.

Foreign exchange includes spot and forward foreign exchange contracts, and currency futures and options.

**23. Trading income**

	<b>Year ended</b> <b>31.12.18</b>	Year ended 31.12.17
	<b>US\$ millions</b>	US\$ millions
Interest rate derivatives	<b>6.0</b>	6.6
Equity securities	<b>3.4</b>	3.0
Debt securities	<b>0.2</b>	0.3
Managed funds	<b>(0.2)</b>	3.0
Commodity options	<b>0.1</b>	0.1
	<b>9.5</b>	13.0

Trading income comprises gains and losses arising both on the purchase and sale, and from changes in the fair value, of trading instruments, together with the related interest income, interest expense and dividend income. Trading income accordingly incorporates all income and expenses related to the Group's trading activities.

Interest rate derivative income principally comprises customer-initiated contracts which have been offset in the market with matching contracts. There is no remaining market risk associated with these contracts.

**24. Other income**

	<b>Year ended</b> <b>31.12.18</b>	Year ended 31.12.17
	<b>US\$ millions</b>	US\$ millions
Recoveries on previously written off assets	<b>26.7</b>	1.8
Dividends on equity investments classified as FVTOCI	<b>8.6</b>	6.9
Net realised losses on investment debt securities	-	(0.4)
Realised loss on written off asset	-	(1.0)
Sundry income	<b>0.2</b>	0.2
	<b>35.5</b>	7.5

Recoveries on previously written off assets comprise recoveries on assets that had previously been either written off or transferred to the memorandum records.

Net realised losses on investment debt securities for the year ended 31<sup>st</sup> December 2017 principally related to the sale of securities due to credit concerns.

The realised loss on written off asset for the year ended 31<sup>st</sup> December 2017 related to a contractual conditional partial write-off on a loan for which the conditions were met by the customer during the year.

**25. Operating expenses**

Operating expenses included US\$7.4 million of exceptional expenses which are one-off in nature.

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**26. Segmental information**

Segmental information is presented in respect of the Group's business and geographical segments. The primary reporting format, business segments, reflects the manner in which financial information is evaluated by the Board of Directors and the Group Management Committee.

**26.1 Business segments**

For financial reporting purposes, the Group is organised into four main operating segments:-

- Wholesale banking: the provision of wholesale commercial financing and other credit facilities for corporate and institutional customers.
- Treasury: the provision of a broad range of treasury and capital market products and services to corporate and financial institution clients, money market, proprietary investment and trading activities and the management of the Group's balance sheet, including funding.
- Asset management and investment banking: the provision of asset and fund management services, and of financial advisory services relating to structured financing, privatisations, initial public offerings, and mergers and acquisitions.
- Head office and support units: income arising on the investment of the Group's net free capital funds and expenses incurred by support units, including the investment in the retail banking strategy prior to the launch of all planned retail banking products and services.

The results reported for the business segments are based on the Group's internal financial reporting systems, which report interest revenue and interest expense on a net basis. The accounting policies of the segments are the same as those applied in the preparation of these consolidated financial statements and are set out in note 2. Transactions between business segments are conducted on normal commercial terms and conditions. Transfer pricing between the business units is based on the market cost of funds.

Segment results, assets and liabilities comprise items directly attributable to the business segments. Liabilities reported for head office and support units comprise retail-related deposits and senior term finance facilities and related accrued interest, the cost of which is recharged to the relevant operating business segments.

The business segment analysis is as follows:-

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**26. Segmental information** (continued)

**26.1 Business segments** (continued)

	Wholesale banking	Treasury	Asset management and investment banking	Head office and support units	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>2018</b>					
Net interest income	152.1	89.1	-	32.5	273.7
Total income	215.5	116.7	24.0	42.3	398.5
Segment result	(177.6)	106.2	3.9	(152.7)	(220.2)
Taxation charge					(6.8)
Net loss after tax					(227.0)
Segment assets	9,935.1	17,117.4	75.2	418.4	27,546.1
Segment liabilities	2,234.1	18,272.5	-	4,843.3	25,349.9
Total equity					2,196.2
Total liabilities and equity					27,546.1
<b>2017</b>					
Net interest income	147.1	79.7	0.1	26.2	253.1
Total income	186.6	100.5	37.5	35.7	360.3
Segment result	106.0	90.9	20.1	(140.4)	76.6
Taxation charge					(6.6)
Net income after tax					70.0
Segment assets	10,150.3	14,802.3	68.5	450.2	25,471.3
Segment liabilities	1,148.8	17,423.5	-	4,488.1	23,060.4
Total equity					2,410.9
Total liabilities and equity					25,471.3

**26.2 Geographical segments**

Although the Group's four main business segments are managed on a worldwide basis, they are considered to operate in two geographical markets: the GCC and the rest of the world.

The geographical composition of total income and total assets based on the location in which transactions are booked and income is recorded was as follows:-

	Total income	2018 Total assets	Total income	2017 Total assets
	US\$ millions	US\$ millions	US\$ millions	US\$ millions
GCC	325.2	18,729.5	275.8	18,493.2
Other countries	73.3	8,816.6	84.5	6,978.1
	398.5	27,546.1	360.3	25,471.3

The geographical analyses of deposits and risk assets are set out in notes 13 and 28 respectively.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2018

#### 27. Risk management

The principal risks associated with the Group's businesses are credit risk, market risk, liquidity risk and operational risk. The Group has a comprehensive risk management framework in place for managing these risks which is constantly evolving as the business activities change in response to credit, market, product and other developments. The risk management framework is guided by a number of overriding principles including the formal definition of risk management governance, an evaluation of risk appetite expressed in terms of formal risk limits, risk oversight independent of business units, disciplined risk assessment and measurement including Value-at-Risk (VaR) methodologies and portfolio stress testing, and risk diversification. The Board of Directors set the Group's overall risk parameters and risk tolerances, and the significant risk management policies. A Board Risk Policy Committee reviews and reports to the Board of Directors on the Group's risk profile and risk taking activities, including approving obligor limits by rating, industry and geography, and the review of rating back-testing exercises. A Management Committee, chaired by the Group Chief Executive Officer, has the primary responsibility for sanctioning risk taking activities and risk management policies within the overall risk parameters and tolerances defined by the Board of Directors. A Group Risk Committee, under the chairmanship of the Chief Risk Officer and comprising the Group's most senior risk professionals, provides a forum for the review and approval of risk measurement methodologies, risk control processes and the approval of new products, including approval of LGDs and eligible collateral for ECL calculations. The Group Risk Committee also reviews all risk policies and limits that require the formal approval of the Management Committee. The risk management control process is based on a detailed structure of policies, procedures and limits, and comprehensive risk measurement and management information systems for the control, monitoring and reporting of risks. The Provisioning Committee approves the categorisation of an exposure as stage 1, stage 2 or stage 3. Periodic reviews by internal auditors and regulatory authorities subject the risk management processes to additional scrutiny which help to further strengthen the risk management environment.

The principal risks associated with the Group's businesses and the related risk management processes are described in detail in the Basel 3 Pillar 3 disclosure report in the Annual Report, and are summarised below together with additional quantitative analyses:-

##### 27.1 Credit risk

Credit risk is the risk that counterparties will be unable to meet their obligations to the Group. Credit risk arises principally from the Group's lending and investment activities in addition to other transactions involving both on- and off-balance sheet financial instruments, including the specific risk for equity instruments. Disciplined processes are in place at both the business unit and corporate level that are intended to ensure that risks are accurately assessed and properly approved and monitored. Formal credit limits are applied at the individual transaction, counterparty, country and portfolio levels. Overall exposures are also evaluated to ensure a broad diversification of credit risk. The credit management process involves the monitoring of concentrations by product, industry, single obligor, risk grade and geography, and the regular appraisal of counterparty credit quality through the analysis of qualitative and quantitative information.

Credit risk is actively managed and rigorously monitored in accordance with well-defined credit policies and procedures. Prior to the approval of a credit proposal, a detailed credit risk assessment is carried out which includes an analysis of the obligor financial condition, market position, business environment and quality of management. The risk assessment generates an internal credit risk rating for each exposure, which affects the credit approval decision and the terms and conditions of the transaction. For cross border transactions an analysis of country risk is also conducted. The Group bases its credit decision for an individual counterparty on the aggregate Group exposure to that counterparty and all its related entities. Groupwide credit limit setting and approval authorisation requirements are conducted within Board approved guidelines, and the measurement, monitoring and control of credit exposures are done on a Groupwide basis in a consistent manner.

The Group also mitigates its credit exposures on foreign exchange and derivative financial instruments through the use of master netting agreements and collateral arrangements.

##### *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 taking into consideration both internal and external indicators and expert credit assessment and inclusion of forward-looking information.

The Group considers all counterparties internally rated 6+ 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, between 2- and 3+, between 3 and 4+, and 4 and below, to be significantly deteriorated where they have been downgraded 6 notches, 5 notches, 4 notches and 3 notches respectively since initial recognition, 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2018

#### 27. Risk management (continued)

##### 27.1 Credit risk (continued)

###### *Definition of default*

The Group considers a financial asset to be in default when the borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as liquidating collateral; or the borrower is past due more than 90 days on any credit obligation to the Group. In assessing whether a borrower is in default, the Group considers both qualitative factors such as breaches of covenants and quantitative factors such as overdue status and non-payment on another obligation of the same issuer to the Group.

###### *Incorporation of forward-looking information*

The Group incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. Based on advice from the Chief Economist and consideration of a variety of external actual and forecast information, the Group formulates a fundamental view of the future direction of relevant economic variables as well as a reasonable range of possible scenarios.

The Group has identified economic factors such as the International Monetary Fund (IMF) trends in fiscal balances and GDP growth in key markets of the Kingdom of Saudi Arabia, United Arab Emirates and United States of America as well as the views of the Chief Economist. Given the nature of the Group's exposures and availability of historical statistically reliable information, the Group derives the point-in-time (PIT) probability of default (PD) using the through-the-cycle (TTC) PD data published by Standard & Poors (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 input parameters into the measurement of ECL are the probability of default (PD), loss given default (LGD) and exposure at default (EAD). These parameters are derived from internally developed statistical models, other historical data using both internal and external factors, and incorporates forward-looking information.

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 Group estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties, based on historical data using both internal and external factors.

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 amounts allowed under the contract including amortisation. The EAD of a financial asset is its gross carrying amount. For lending commitments and financial guarantees, the EAD is converted to balance sheet equivalents.

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.

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics including instrument type, credit risk ratings and geographic location of the borrower.

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 31<sup>st</sup> December 2018, the probabilities assigned to the base case, negative case and positive case scenarios were in the ratio of 50:35:15 respectively (2017: 50:35:15).

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**27. Risk management** (continued)

**27.1 Credit risk** (continued)

*Modified financial assets*

The contractual terms of a loan may be modified for a number of reasons including changing market conditions, and other factors not related to the current or potential credit deterioration of a customer. When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects a comparison of its remaining lifetime PD at the reporting date based on modified terms, with the remaining lifetime PD estimated based on data at initial recognition and the original contractual terms.

The Group renegotiates loans to customers in financial difficulties to maximise collection opportunities and minimise the risk of default. The Group grants forbearance on a selective basis if there is evidence that the customer has made all reasonable efforts to honour the original contractual terms and the customer is expected to be able to meet the revised terms. Forbearance is a qualitative indicator of a significant increase in credit risk, and a customer would need to demonstrate consistently good payment behaviour over a period of time before the exposure is no longer considered to be credit-impaired, or in default, or the PD has decreased such that the provision for credit-impairment reverts to being measured at an amount equal to the 12-month ECL.

**a) Maximum exposure to credit risk**

The gross maximum exposure to credit risk before applying collateral, guarantees and other credit enhancements was as follows:-

	<u>31.12.18</u>	<u>31.12.17</u>
	US\$ millions	US\$ millions
<b>Balance sheet items:</b>		
Cash and other liquid assets	5,114.2	3,768.5
Securities purchased under agreements to resell	1,015.9	855.0
Placements	6,770.8	6,033.2
Trading securities	177.7	191.8
Investment securities	3,897.2	3,993.8
Loans and advances	9,817.8	10,043.1
Accrued interest receivable	265.8	214.7
<b>Total on-balance sheet credit exposure</b>	<u>27,059.4</u>	<u>25,100.1</u>
<b>Off-balance sheet items:</b>		
Credit-related contingent items	4,536.4	5,027.9
Foreign exchange-related items	192.4	59.2
Derivative-related items	429.4	278.4
Equity and commodity contracts	1.8	1.8
<b>Total off-balance sheet credit exposure</b>	<u>5,160.0</u>	<u>5,367.3</u>
<b>Total gross credit exposure</b>	<u>32,219.4</u>	<u>30,467.4</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**27. Risk management** (continued)

**27.1 Credit risk** (continued)

**b) Credit risk profile**

The Group monitors, manages and controls credit risk exposures based on an internal credit rating system that rates individual obligors based on a rating scale from 1 to 10, subject to positive (+) and negative (-) modifiers for rating grades 2 to 6. The internal credit rating is a measure of the credit-worthiness of a single obligor, based on an assessment of the credit risk relating to senior unsecured, medium-term, foreign currency credit exposure. The primary objectives of the internal credit rating system are the maintenance of a single uniform standard for credit quality measurement, and to serve as the primary basis for Board-approved risk parameters and delegated credit authority limits.

The internal credit rating system also serves as a key input into the Group's risk-adjusted return on capital (RAROC) performance measurement system.

The internal ratings map directly to the external rating grades used by the international credit rating agencies as follows:-

<b>Internal rating grade</b>	<b>Internal classification</b>	<b>Fitch and Standard &amp; Poor's</b>	<b>Moody's</b>
<b>Investment grade</b>			
Rating grade 1	Standard	AAA	Aaa
Rating grade 2	Standard	AA	Aa
Rating grade 3	Standard	A	A
Rating grade 4	Standard	BBB	Baa
<b>Sub-investment grade</b>			
Rating grade 5	Standard	BB	Ba
Rating grade 6	Standard	B	B
Rating grade 7	Standard	CCC	Caa
<b>Classified</b>			
Rating grade 8	Substandard	CC	Ca
Rating grade 9	Doubtful	C	C
Rating grade 10	Loss	D	-



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27. **Risk management** (continued)

27.1 **Credit risk** (continued)

b) **Credit risk profile** (continued)

The credit risk profile, based on internal credit ratings, was as follows:-

	Placements, reverse repos & other liquid assets	Securities	Loans and advances	31.12.18 Credit- related contingent items
	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>Stage 1 (12-month ECL)</b>				
Rating grades 1 to 4-	12,636.6	3,481.4	6,165.4	2,612.3
Rating grades 5+ to 5-	252.0	247.3	2,809.8	714.8
Rating grades 6+ to 6-	12.3	-	84.2	38.7
<b>Carrying amount (net)</b>	<b>12,900.9</b>	<b>3,728.7</b>	<b>9,059.4</b>	<b>3,365.8</b>
<b>Stage 2 (Lifetime ECL but not credit-impaired)</b>				
Rating grades 4 to 4-	-	-	24.3	0.3
Rating grades 5+ to 5-	-	-	262.2	45.9
Rating grades 6+ to 6-	-	-	342.5	113.5
Rating grade 7	-	-	103.3	0.5
<b>Carrying amount (net)</b>	<b>-</b>	<b>-</b>	<b>732.3</b>	<b>160.2</b>
<b>Stage 3 (Lifetime ECL and credit-impaired)</b>				
Rating grade 8	-	-	12.8	64.0
Rating grade 9	-	-	13.3	31.8
Rating grade 10	-	-	-	20.6
<b>Carrying amount (net)</b>	<b>-</b>	<b>-</b>	<b>26.1</b>	<b>116.4</b>
<b>Other credit risk exposures</b>				
Equity investments	-	168.5	-	-
Performance bonds	-	-	-	894.0
<b>Carrying amount</b>	<b>-</b>	<b>168.5</b>	<b>-</b>	<b>894.0</b>
	<b>12,900.9</b>	<b>3,897.2</b>	<b>9,817.8</b>	<b>4,536.4</b>

The above analysis is reported net of the following provisions for impairment:-

Stage 1	-	(4.5)	(30.5)	-
Stage 2	-	-	(110.1)	-
Stage 3	-	-	(623.3)	-
<b>Total</b>	<b>-</b>	<b>(4.5)</b>	<b>(763.9)</b>	<b>-</b>

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**27. Risk management** (continued)

**27.1 Credit risk** (continued)

**b) Credit risk profile** (continued)

	Placements, reverse repos & other liquid assets	Securities	Loans and advances	31.12.17 Credit- related contingent items
	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>Stage 1 (12-month ECL)</b>				
Rating grades 1 to 4-	10,533.0	3,593.8	5,945.7	3,212.5
Rating grades 5+ to 5-	99.1	229.3	3,064.2	535.2
Rating grades 6+ to 6-	24.6	-	114.4	62.4
Rating grade 7	-	-	0.2	-
<b>Carrying amount (net)</b>	<b>10,656.7</b>	<b>3,823.1</b>	<b>9,124.5</b>	<b>3,810.1</b>
<b>Stage 2 (Lifetime ECL but not credit-impaired)</b>				
Rating grade 4-	-	-	10.7	0.3
Rating grades 5+ to 5-	-	-	363.9	47.5
Rating grades 6+ to 6-	-	-	321.4	170.4
Rating grade 7	-	-	103.8	-
<b>Carrying amount (net)</b>	<b>-</b>	<b>-</b>	<b>799.8</b>	<b>218.2</b>
<b>Stage 3 (Lifetime ECL and credit-impaired)</b>				
Rating grade 8	-	-	90.0	52.9
Rating grade 9	-	-	28.8	12.3
Rating grade 10	-	-	-	0.4
<b>Carrying amount (net)</b>	<b>-</b>	<b>-</b>	<b>118.8</b>	<b>65.6</b>
<b>Other credit risk exposures</b>				
Equity investments	-	170.7	-	3.2
Performance bonds	-	-	-	930.8
<b>Carrying amount</b>	<b>-</b>	<b>170.7</b>	<b>-</b>	<b>934.0</b>
	<b>10,656.7</b>	<b>3,993.8</b>	<b>10,043.1</b>	<b>5,027.9</b>

The above analysis is reported net of the following provisions for impairment:-

Stage 1	-	(4.5)	(46.3)	-
Stage 2	-	-	(106.3)	-
Stage 3	-	-	(261.0)	-
<b>Total</b>	<b>-</b>	<b>(4.5)</b>	<b>(413.6)</b>	<b>-</b>

The 7-rated stage 1 exposure at 31<sup>st</sup> December 2017 largely related to a past due but not impaired loan exposure guaranteed by a government export credit agency.

Stage 3 financial assets represent assets for which there is objective evidence that the Group will not collect all amounts due, including both principal and interest, in accordance with the contractual terms of the obligation.

The Group holds collateral against loans and advances in the form of physical assets, cash deposits, securities and guarantees. The amount and type of collateral is dependent upon the assessment of the credit risk of the counterparty. The market / fair value of the collateral is actively monitored on a regular basis and requests are made for additional collateral in accordance with the terms of the underlying agreements. Collateral is not usually held against securities or placements and no such collateral was held at either 31<sup>st</sup> December 2018 or 31<sup>st</sup> December 2017.

The Group held collateral amounting to US\$40.5 million that was considered as a credit enhancement and hence reduced the ECL of stage 3 financial assets at 31<sup>st</sup> December 2018 (2017: US\$36.9 million).

An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 31 while the notional and risk-weighted exposures for off-balance sheet credit-related financial instruments are set out in note 32.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended 31<sup>st</sup> December 2018**

**27. Risk management** (continued)

**27.1 Credit risk** (continued)

**c) Credit risk concentration**

The Group monitors concentrations of credit risk by sector and by geographic location. The industrial classification of loans and advances is set out in note 10.2. The geographical distribution of risk assets is set out in note 28. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 31.

**d) Settlement risk**

Settlement risk is the risk of loss due to the failure of a counterparty to honour its obligations to deliver cash, securities, or other assets as contractually agreed.

For certain types of transactions, the Group mitigates this risk by conducting settlements through a settlement or clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval and limit monitoring process.

**27.2 Market risk**

Market risk is the risk of loss due to adverse changes in interest rates, foreign exchange rates, equity prices and market conditions, such as liquidity. The principal market risks to which the Group is exposed are interest rate risk, foreign exchange risk and equity price risk associated with its trading, investment and asset and liability management activities. The portfolio effects of holding a diversified range of instruments across a variety of businesses and geographic areas contribute to a reduction in the potential negative impact on earnings from market risk factors.

**a) Trading market risk**

The Group's trading activities principally comprise trading in debt and equity securities, foreign exchange and derivative financial instruments. Derivative financial instruments include futures, forwards, swaps and options in the interest rate, foreign exchange, equity, credit and commodity markets. The Group manages and controls the market risk within its trading portfolios through limit structures of both a VaR and non-VaR nature. Non-VaR based constraints relate, inter alia, to positions, volumes, concentrations, allowable losses and maturities. VaR is a risk measurement concept which uses statistical models to estimate, within a given level of confidence, the maximum potential negative change in the market value of a portfolio over a specified time horizon resulting from an adverse movement in rates and prices. It is recognised that there are limitations to the VaR methodology. These limitations include the fact that the historical data may not be the best proxy for future price movements. The Group performs regular back testing exercises to compare actual profits and losses with the VaR estimates to monitor the statistical validity of the VaR model. VaR is calculated based on the Group's market risk exposures at the close of the business each day. Intra-day risk levels may vary from those reported at the end of the day. In addition, losses beyond the specified confidence level are not captured by the VaR methodology. VaR is not a measure of the absolute limit of market risk and losses in excess of the VaR amounts will, on occasion, arise. To manage the risk associated with extreme market movements, the Group conducts stress testing which measures the impact of simulated abnormal changes in market rates and prices on the market values of the portfolios. The composition of the debt and equity trading securities is set out in note 8. An analysis of derivative financial instruments, including the VaR of foreign exchange and derivative trading contracts, is set out in note 31.

The VaR for the Group's trading positions, as calculated in accordance with the basis set out in note 34, was as follows:-

	<u>2018</u>				<u>2017</u>			
	<u>31.12.18</u>	<u>Average</u>	<u>High</u>	<u>Low</u>	<u>31.12.17</u>	<u>Average</u>	<u>High</u>	<u>Low</u>
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
Total VaR	3.5	2.4	3.7	1.8	1.8	1.8	2.5	0.1
Total undiversified stressed VaR	9.8	7.2	10.5	5.1	5.1	4.1	5.3	0.3

**b) Non-trading market risk**

Structural interest rate risk arises in the Group's core balance sheet as a result of mismatches in the repricing of interest rate sensitive financial assets and liabilities. The associated interest rate risk is managed within VaR limits and through the use of models to evaluate the sensitivity of earnings to movements in interest rates. The repricing profile and related interest rate sensitivity of the Group's financial assets and liabilities are set out in note 30. Movements in the fair value of equity investment securities are accounted for in other comprehensive income. The Group does not maintain material foreign currency exposures. In general, the Group's policy is to match financial assets and liabilities in the same currency or to mitigate currency risk through the use of currency swaps. Details of significant foreign currency net open positions are set out in note 31.5.

The more significant market risk-related activities of a non-trading nature undertaken by the Group, the related risks associated with those activities, and the types of derivative financial instruments used to manage and mitigate such risks are summarised as follows:-

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**27. Risk management** (continued)

**27.2 Market risk** (continued)

**b) Non-trading market risk** (continued)

<b>Activity</b>	<b>Risk</b>	<b>Risk mitigant</b>
Management of the return on variable rate assets funded by shareholders' funds	Reduced profitability due to a fall in short-term interest rates	Receive fixed interest rate swaps
Fixed rate assets funded by floating rate liabilities	Sensitivity to increases in short-term interest rates	Pay fixed interest rate swaps
Investment in foreign currency assets	Sensitivity to strengthening of US\$ against other currencies	Currency swaps
Profits generated in foreign currencies	Sensitivity to strengthening of US\$ against other currencies	Forward foreign exchange contracts and purchased currency options

**27.3 Liquidity risk**

Liquidity risk is the risk that sufficient funds are not available to meet the Group's financial obligations on a punctual basis as they fall due.

Liquidity management policies are designed to ensure that funds are available at all times to meet the funding requirements of the Group, even in adverse conditions. In normal conditions the objective is to ensure that there are sufficient funds available not only to meet current financial commitments but also to facilitate business expansion. These objectives are met through the application of prudent liquidity controls. These controls provide security of access to funds without undue exposure to increased costs from the liquidation of assets or the aggressive bidding for deposits. The Group's liquidity controls ensure that, over the short-term, the future profile of cash flows from maturing assets is adequately matched to the maturity of liabilities. Liquidity controls also provide for the maintenance of a stock of liquid and readily realisable assets and a diversified deposit base in terms of both maturities and range of depositors.

The management of liquidity and funding is primarily conducted in the Group's individual geographic entities within limits set and approved by the Board of Directors. The limits take account of the depth and liquidity of the market in which the entity operates. It is the Group's general policy that each geographic entity should be self-sufficient in relation to funding its own operations.

The Group's liquidity management policies include the following:-

- the monitoring of (i) future contractual cash flows against approved limits, and (ii) the level of liquid resources available in a stress event;
- the monitoring of balance sheet liquidity ratios;
- the monitoring of the sources of funding in order to ensure that funding is derived from a diversified range of sources;
- the monitoring of depositor concentrations in order to avoid undue reliance on individual depositors;
- the maintenance of a satisfactory level of term financing;
- the maintenance of appropriate standby funding arrangements; and
- the maintenance of liquidity and funding contingency plans. These plans identify early indicators of stress conditions and prescribe the actions to be taken in the event of systemic or other crisis, while minimising adverse long-term implications for the Group's business activities.

The Group has established approved limits which restrict the volume of liabilities maturing in the short-term. An independent risk management function monitors the future cash flow maturity profile against approved limits on a daily basis. The cash flows are monitored against limits applying to both daily and cumulative cash flows occurring over a 30 day period. The liquidity limits ensure that the net cash outflows over a 30 day period do not exceed the eligible stock of available liquid resources. The cash flow analysis is also monitored on a weekly basis by the Assets and Liabilities Committee (ALCO).

Customer deposits form a significant part of the Group's funding. The Group places considerable importance on maintaining the stability of both its customer and interbank deposits. The stability of deposits depends on maintaining confidence in the Group's financial strength and financial transparency.

The maturity profile of assets and liabilities is set out in note 29. An analysis of debt investment securities by rating classification is set out in note 27.1.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### For the year ended 31<sup>st</sup> December 2018

#### 27. Risk management (continued)

##### 27.4 Operational risk

Operational risk is the risk of unexpected losses resulting from inadequate or failed internal controls or procedures, systems failures, fraud, business interruption, compliance breaches, human error, management failure or inadequate staffing.

A framework and methodology has been developed to identify and control the various operational risks. While operational risk cannot be entirely eliminated, it is managed and mitigated by ensuring that the appropriate infrastructure, controls, systems, procedures, and trained and competent people are in place throughout the Group. A strong internal audit function makes regular, independent appraisals of the control environment in all identified risk areas. Adequately tested contingency arrangements are also in place to support operations in the event of a range of possible disaster scenarios.

##### 27.5 Capital management

The Group's lead regulator, the Central Bank of Bahrain (CBB), sets and monitors capital requirements for the Group as a whole. The parent company and individual banking operations are directly supervised by their local regulators.

As referred to in more detail in note 34, the Group adopted Basel 3 capital adequacy framework with effect from 1<sup>st</sup> January 2015 as required by the CBB.

In applying current capital requirements, the CBB requires the Group to maintain a prescribed minimum ratio of total regulatory capital to total risk-weighted assets. The CBB's minimum risk asset ratio is 12.5 per cent compared to a minimum ratio of 8 per cent prescribed by the Basel Committee on Banking Supervision. The Group calculates regulatory capital requirements for general market risk in its trading portfolios using a Value-at-Risk model and uses the CBB's prescribed risk-weightings under the standardised approach to determine the risk-weighted amounts for credit risk and specific market risk. Operational risk is calculated in accordance with the standardised approach. The regulatory capital requirement is calculated by applying the CBB's prescribed range of beta coefficients, ranging from 12 to 18 per cent, to the average gross income for the preceding three financial years for each of eight predefined business lines.

The Group's regulatory capital is analysed into two tiers:-

- Tier 1 capital, comprising issued share capital, share premium, retained earnings and reserves, adjusted to exclude revaluation gains and losses arising on the remeasurement to fair value of derivative cash flow hedging transactions.
- Tier 2 capital, comprising qualifying subordinated term finance and stage 1 and stage 2 impairment provisions for loans and advances, after applicable haircuts and ceiling limitations.

The CBB applies various limits to elements of the regulatory capital base. The amount of innovative tier 1 securities cannot exceed 15 per cent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying subordinated term finance cannot exceed 50 per cent of tier 1 capital. There are also restrictions on the amount of stage 1 and stage 2 impairment provisions that may be included as part of tier 2 capital.

The Group's risk exposures are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business. The impact of the level of capital on shareholders' return is also recognised as well as the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. The Group manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans. The capital structure may be adjusted through the dividend payout and the issue of new shares.

The Group complied with all externally imposed capital requirements throughout the years ended 31<sup>st</sup> December 2018 and 31<sup>st</sup> December 2017.

There have been no material changes in the Group's management of capital during the years ended 31<sup>st</sup> December 2018 and 31<sup>st</sup> December 2017.

The capital adequacy ratio calculation is set out in note 34.

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For the year ended 31<sup>st</sup> December 2018

28. Geographical distribution of risk assets

					<u>31.12.18</u>	<u>31.12.17</u>
	Placements, reverse repos & other liquid assets	Securities	Loans and advances	Credit- related contingent items	Total	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
GCC	4,301.2	2,778.0	9,603.6	4,104.6	20,787.4	20,095.7
Other Middle East & North Africa	-	3.5	2.0	1.2	6.7	29.9
Europe	7,028.5	385.4	137.7	156.0	7,707.6	6,787.4
North America	1,238.7	430.6	28.3	267.5	1,965.1	2,017.7
Asia	332.5	465.2	46.2	7.1	851.0	962.9
Latin America	-	12.2	-	-	12.2	19.7
	<u>12,900.9</u>	<u>4,074.9</u>	<u>9,817.8</u>	<u>4,536.4</u>	<u>31,330.0</u>	<u>29,913.3</u>

At 31<sup>st</sup> December 2018, risk exposures to customers and counterparties in the GCC represented 66.3 per cent (2017: 67.2 per cent) of total risk assets. The risk asset profile reflects the Group's strategic focus on wholesale banking activities in the GCC states.

Placements, reverse repos and other liquid assets exposure to Europe principally comprised exposure to financial institutions located in the United Kingdom, Netherlands, Switzerland and France.

An analysis of derivative and foreign exchange instruments is set out in note 31.

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**For the year ended 31<sup>st</sup> December 2018**

**29. Maturities of assets and liabilities**

The maturity profile of the carrying amount of assets, liabilities and equity, based on the contractual maturity dates, was as follows:-

	Within 3 months US\$ millions	4 months to 1 year US\$ millions	Years 2 and 3 US\$ millions	Years 4 and 5 US\$ millions	Over 5 years and other US\$ millions	Total US\$ millions
<b>At 31<sup>st</sup> December 2018</b>						
Cash and other liquid assets	5,017.6	96.6	-	-	-	5,114.2
Securities purchased under agreements to resell	595.9	420.0	-	-	-	1,015.9
Placements	5,627.1	1,143.7	-	-	-	6,770.8
Trading securities	-	-	13.0	-	164.7	177.7
Investment securities	149.5	380.0	568.1	575.5	2,224.1	3,897.2
Loans and advances	4,056.0	1,902.9	1,897.6	919.2	1,042.1	9,817.8
Other assets	411.8	50.1	11.9	13.7	265.0	752.5
<b>Total assets</b>	<b>15,857.9</b>	<b>3,993.3</b>	<b>2,490.6</b>	<b>1,508.4</b>	<b>3,695.9</b>	<b>27,546.1</b>
Deposits	16,623.3	3,948.0	119.8	3.5	-	20,694.6
Securities sold under agreements to repurchase	359.3	376.1	-	-	-	735.4
Other liabilities	333.5	44.3	8.4	9.8	185.9	581.9
Term financing	-	923.2	1,612.0	557.2	245.6	3,338.0
Equity	-	-	-	-	2,196.2	2,196.2
<b>Total liabilities &amp; equity</b>	<b>17,316.1</b>	<b>5,291.6</b>	<b>1,740.2</b>	<b>570.5</b>	<b>2,627.7</b>	<b>27,546.1</b>
<b>At 31<sup>st</sup> December 2017</b>						
Total assets	13,372.0	3,878.0	3,279.2	1,796.2	3,145.9	25,471.3
Total liabilities & equity	16,435.0	3,757.8	1,384.0	1,081.8	2,812.7	25,471.3

The asset and liability maturities presented in the table above are based on contractual repayment arrangements and as such do not take account of the effective maturities of deposits as indicated by the Group's deposit retention records. Formal liquidity controls are nevertheless based on contractual asset and liability maturities.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended 31<sup>st</sup> December 2018**

**29. Maturities of assets and liabilities** (continued)

The gross cash flows payable by the Group under financial liabilities, based on contractual maturity dates, was as follows:-

	Within 3 months US\$ millions	4 months to 1 year US\$ millions	Years 2 and 3 US\$ millions	Years 4 and 5 US\$ millions	Over 5 years and other US\$ millions
<b>At 31<sup>st</sup> December 2018</b>					
Deposits	16,975.6	4,151.6	120.0	3.7	-
Securities sold under agreements to repurchase	365.1	384.8	-	-	-
Term financing	-	976.5	1,705.1	589.4	259.8
Derivative financial instruments					
- contractual amounts payable	128.8	217.0	429.4	302.5	324.6
- contractual amounts receivable	(166.6)	(215.5)	(397.7)	(257.4)	(252.2)
<b>Total undiscounted financial liabilities</b>	<b>17,302.9</b>	<b>5,514.4</b>	<b>1,856.8</b>	<b>638.2</b>	<b>332.2</b>
<b>At 31<sup>st</sup> December 2017</b>					
Deposits	15,602.6	2,755.9	47.3	3.9	-
Securities sold under agreements to repurchase	733.0	406.1	-	-	-
Term financing	26.8	705.8	1,402.2	1,132.8	189.1
Derivative financial instruments					
- contractual amounts payable	100.3	157.1	261.3	173.1	192.8
- contractual amounts receivable	(70.5)	(125.5)	(207.5)	(124.6)	(133.1)
<b>Total undiscounted financial liabilities</b>	<b>16,392.2</b>	<b>3,899.4</b>	<b>1,503.3</b>	<b>1,185.2</b>	<b>248.8</b>

Information on the contractual terms for the drawdown of gross loan commitments is set out in note 32.

The figures in the table above do not agree directly to the carrying amounts in the consolidated statement of financial position as they incorporate all cash flows, on an undiscounted basis, related to both principal as well as those associated with future coupon and interest payments. Coupons and interest payments for periods for which the interest rate has not yet been determined have been calculated based on the relevant forward rates of interest prevailing at the balance sheet date.

A maturity analysis of derivative and foreign exchange instruments based on notional amounts is set out in note 31.3.



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**30. Interest rate risk**

The repricing profile of assets and liabilities categories and equity were as follows:-

	Within 3 months	Months 4 to 6	Months 7 to 12	Over 1 year	Non-interest bearing items	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 31<sup>st</sup> December 2018</b>						
Cash and other liquid assets	5,001.4	96.6	-	-	16.2	5,114.2
Securities purchased under agreements to resell	595.9	320.0	100.0	-	-	1,015.9
Placements	5,627.1	589.3	554.4	-	-	6,770.8
Trading securities	13.0	-	-	-	164.7	177.7
Investment securities						
- Fixed rate	75.0	50.1	143.1	573.0	-	841.2
- Floating rate	2,861.3	30.7	-	-	(4.5)	2,887.5
- Equities	-	-	-	-	168.5	168.5
Loans and advances	8,762.5	1,177.4	18.5	-	(140.6)	9,817.8
Other assets	-	-	-	-	752.5	752.5
<b>Total assets</b>	<b>22,936.2</b>	<b>2,264.1</b>	<b>816.0</b>	<b>573.0</b>	<b>956.8</b>	<b>27,546.1</b>
Deposits	18,159.7	2,013.3	401.8	119.8	-	20,694.6
Securities sold under agreements to repurchase	735.4	-	-	-	-	735.4
Other liabilities	-	-	-	-	581.9	581.9
Term financing	3,338.0	-	-	-	-	3,338.0
Equity	-	-	-	-	2,196.2	2,196.2
<b>Total liabilities &amp; equity</b>	<b>22,233.1</b>	<b>2,013.3</b>	<b>401.8</b>	<b>119.8</b>	<b>2,778.1</b>	<b>27,546.1</b>
<b>Interest rate sensitivity gap</b>	<b>703.1</b>	<b>250.8</b>	<b>414.2</b>	<b>453.2</b>	<b>(1,821.3)</b>	<b>-</b>
<b>Cumulative interest rate sensitivity gap</b>	<b>703.1</b>	<b>953.9</b>	<b>1,368.1</b>	<b>1,821.3</b>	<b>-</b>	<b>-</b>
<b>At 31<sup>st</sup> December 2017</b>						
Cumulative interest rate sensitivity gap	348.0	1,118.7	1,477.5	2,166.6	-	-

The repricing profile is based on the remaining period to the next interest repricing date. Derivative financial instruments that have been used for asset and liability management purposes to hedge exposure to interest rate risk are incorporated in the repricing profiles of the related hedged assets and liabilities. The stage 1 and stage 2 investment security and loan provisions are classified in non-interest bearing items.

The substantial majority of assets and liabilities reprice within one year. Accordingly, there is limited exposure to interest rate risk. The principal interest rate risk beyond one year, as set out in the asset and liability repricing profile, represents the investment of the Group's net free capital in fixed rate government securities. At 31<sup>st</sup> December 2018, the modified duration of these fixed rate securities was 3.25. Modified duration represents the approximate percentage change in the portfolio value resulting from a 100 basis point change in yield. More precisely in dollar terms, the price value of a basis point of the fixed rate securities was US\$258,292.

Based on the repricing profile at 31<sup>st</sup> December 2018, and assuming that the financial assets and liabilities were to remain until maturity or settlement with no action taken by the Group to alter the interest rate risk exposure, an immediate and sustained one per cent increase in interest rates across all maturities would result in an increase in net income before tax for the following year by approximately US\$18.5 million and an increase in the Group's equity by US\$17.6 million. The impact on the Group's equity represents the cumulative effect of the increase in interest rates over the entire duration of the mismatches in the repricing profile of the interest rate sensitive financial assets and liabilities.

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**30. Interest rate risk** (continued)

The Value-at-Risk by risk class for the Group's trading positions is set out in note 27. The market risk relating to derivative and foreign exchange instruments classified as FVTPL is set out in note 31.

**31. Derivatives and foreign exchange instruments**

The Group utilises derivative and foreign exchange instruments to meet the needs of its customers, to generate trading revenues and as part of its asset and liability management (ALM) activity to hedge its own exposure to market risk. Derivative instruments are contracts whose value is derived from one or more financial instruments or indices. They include futures, forwards, swaps and options in the interest rate, foreign exchange, equity, credit and commodity markets. Derivatives and foreign exchange are subject to the same types of credit and market risk as other financial instruments. The Group has appropriate and comprehensive Board-approved policies and procedures for the control of exposure to both market and credit risk from its derivative and foreign exchange activities.

In the case of derivative transactions, the notional principal typically does not change hands. It is simply a quantity which is used to calculate payments. While notional principal is a volume measure used in the derivative and foreign exchange markets, it is neither a measure of market nor credit risk. The Group's measure of credit exposure is the cost of replacing contracts at current market rates should the counterparty default prior to the settlement date. Credit risk amounts represent the gross unrealised gains on non-margined transactions before taking account of any collateral held or any master netting agreements in place.

The Group participates in both exchange traded and over-the-counter (OTC) derivative markets. Exchange traded instruments are executed through a recognised exchange as standardised contracts and primarily comprise futures and options. OTC contracts are executed between two counterparties who negotiate specific agreement terms, including the underlying instrument, notional amount, maturity and, where appropriate, exercise price. In general, the terms and conditions of these transactions are tailored to the requirements of the Group's customers although conform to normal market practice. Industry standard documentation is used, most commonly in the form of a master agreement. The existence of a master netting agreement is intended to provide protection to the Group in the event of a counterparty default.

The Group's principal foreign exchange transactions are forward foreign exchange contracts, currency swaps and currency options. Forward foreign exchange contracts are agreements to buy or sell a specified quantity of foreign exchange on a specific future date at an agreed rate. A currency swap involves the exchange, or notional exchange, of equivalent amounts of two currencies and a commitment to exchange interest periodically until the principal amounts are re-exchanged on a specified future date. Currency options provide the buyer with the right, but not the obligation, either to purchase or sell a fixed amount of a currency at a specified exchange rate on or before a specified future date. As compensation for assuming the option risk, the option seller (or writer) receives a premium at the start of the option period.

The Group's principal interest rate-related derivative transactions are interest rate swaps, forward rate agreements, futures and options. An interest rate swap is an agreement between two parties to exchange fixed rate and floating rate interest by means of periodic payments based upon a notional principal amount and the interest rates defined in the contract. Certain agreements combine interest rate and foreign currency swap transactions, which may or may not include the exchange of principal amounts. In a forward rate agreement, two parties agree a future settlement of the difference between an agreed rate and a future interest rate, applied to a notional principal amount for an agreed period. The settlement, which generally occurs at the start of the contract period, is the discounted present value of the payment that would otherwise be made at the end of that period. An interest rate future is an exchange traded contract for the delivery of a standardised amount of a fixed income security or time deposit at a future specified date. Interest rate options, including caps, floors and collars, provide the buyer with the right, but not the obligation, either to purchase or sell an interest rate financial instrument at a specified price or rate on or before a specified future date.

The Group's principal equity-related derivative transactions are equity and stock index options. An equity option provides the buyer with the right, but not the obligation, either to purchase or sell a specified stock or index at a specified price or level on or before a specified future date.

The Group buys and sells credit protection through credit default swaps. Credit default swaps provide protection against the decline in value of a referenced asset as a result of credit events such as default or bankruptcy. It is similar in structure to an option whereby the purchaser pays a premium to the seller of the credit default swap in return for payment related to the deterioration in value of the referenced asset. Credit default swaps purchased and sold by the Group are classified as derivative financial instruments.

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**31. Derivative and foreign exchange instruments** (continued)

**31.1 Product analysis**

The table below summarises the aggregate notional and credit risk amounts of foreign exchange, interest rate and commodity contracts.

	Notional amounts			Credit risk amounts
	Trading	Hedging	Total	
	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 31<sup>st</sup> December 2018</b>				
Foreign exchange contracts:-				
Unmatured spot, forward and futures contracts	14,025.6	-	14,025.6	191.6
Options purchased	67.6	-	67.6	0.8
Options written	67.6	-	67.6	-
	<b>14,160.8</b>	<b>-</b>	<b>14,160.8</b>	<b>192.4</b>
Interest rate contracts:-				
Interest rate swaps	5,570.3	13,618.9	19,189.2	256.5
Cross currency swaps	424.3	-	424.3	-
Options, caps and floors purchased	1,573.2	-	1,573.2	172.9
Options, caps and floors written	1,573.2	-	1,573.2	-
	<b>9,141.0</b>	<b>13,618.9</b>	<b>22,759.9</b>	<b>429.4</b>
Equity and commodity contracts:-				
Options and swaps purchased	72.8	-	72.8	1.8
Options and swaps written	72.8	-	72.8	-
	<b>145.6</b>	<b>-</b>	<b>145.6</b>	<b>1.8</b>
	<b>23,447.4</b>	<b>13,618.9</b>	<b>37,066.3</b>	<b>623.6</b>
	<b>16,729.0</b>	<b>12,629.1</b>	<b>29,358.1</b>	<b>339.4</b>

There is no credit risk in respect of options written as they represent obligations of the Group.

At 31<sup>st</sup> December 2018, the Value-at-Risk of the foreign exchange, interest rate and equity and commodity trading contracts analysed in the table above was US\$0.1 million, US\$0.1 million and nil respectively (2017: US\$0.1 million, nil and nil respectively). Value-at-Risk is a measure of market risk exposure and represents an estimate, with a 99 per cent level of confidence, of the potential loss that might arise if the positions were to be held unchanged for ten consecutive business days. The estimate is based on a twelve month historical observation period of unweighted data from the DataMetrics data set.

**31.2 Counterparty analysis**

	Financial sector	Corporates	31.12.18 Total	31.12.17 Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions
OECD countries	457.9	11.6	469.5	227.1
GCC countries	18.8	135.2	154.0	112.3
Other countries	-	0.1	0.1	-
	<b>476.7</b>	<b>146.9</b>	<b>623.6</b>	<b>339.4</b>

Credit risk is concentrated on major OECD-based financial institutions.

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**31. Derivative and foreign exchange instruments** (continued)

**31.3 Maturity analysis**

	Year 1	Years 2 & 3	Years 4 & 5	Over 5 years	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>At 31<sup>st</sup> December 2018</b>					
Foreign exchange contracts	14,156.4	4.4	-	-	14,160.8
Interest rate contracts	9,859.1	3,184.5	3,561.8	6,154.5	22,759.9
Equity and commodity contracts	77.2	68.4	-	-	145.6
	<u>24,092.7</u>	<u>3,257.3</u>	<u>3,561.8</u>	<u>6,154.5</u>	<u>37,066.3</u>
<b>At 31<sup>st</sup> December 2017</b>					
	18,363.6	3,540.7	2,617.0	4,836.8	29,358.1

The Group's derivative and foreign exchange activities are predominantly short-term in nature. Transactions with maturities over one year principally represent either fully offset trading transactions or transactions that are designated, and qualify, as fair value or cash flow hedges.

**31.4 Fair value analysis**

	Positive fair value	<u>31.12.18</u> Negative fair value	Positive fair value	<u>31.12.17</u> Negative fair value
	US\$ millions	US\$ millions	US\$ millions	US\$ millions
Derivatives classified as FVTPL:-				
Foreign exchange contracts	4.7	(4.1)	13.1	(12.7)
Interest rate contracts	144.3	(136.6)	125.7	(115.5)
Equity and commodity contracts	3.7	(3.6)	3.3	(3.3)
	<u>152.7</u>	<u>(144.3)</u>	142.1	(131.5)
Derivatives held as fair value hedges:-				
Interest rate contracts	66.4	-	40.1	-
<b>Amount included in other assets / (other liabilities)</b>	<u>219.1</u>	<u>(144.3)</u>	182.2	(131.5)

**31.5 Significant net open positions**

There were no significant derivative trading or foreign currency net open positions at either 31<sup>st</sup> December 2018 or at 31<sup>st</sup> December 2017.

**31.6 Hedge accounting**

The Group offers fixed rate liability and asset products to clients in the normal course of business. The interest rate received or paid is fixed for the term of the transaction, exposing the Group to interest rate risk during the life of the transaction.

In order to mitigate this interest rate market risk exposure, the Group uses interest rate swaps in one-to-one, one-to-many and many-to-many relationships. The derivative products effectively tie a floating interest rate to the fixed rate client transaction. The hedging item is executed at the same time that the client-related transaction, the hedged item, is booked.

Generally, the hedging item executed exactly matches the critical terms of the hedged item, that being the nominal value, currency, trade date and maturity date and hence the hedge ratio is expected to remain close to 100 per cent. The hedging relationship is generally highly effective because the critical terms of the instruments match at inception and will remain effective throughout the contractual term of the derivative until maturity. The critical terms are reviewed every reporting date to ensure that the match persists.

The Group's derivative instruments are also subject to credit risk. Credit risk can arise on both the hedging instrument and the hedged item in the form of counterparty credit risk or the Group's own credit risk. The Group mitigates its credit exposure through the use of master netting arrangements and collateral arrangements as set out in note 27.1 and credit risk is therefore, unlikely to dominate the change in fair value of such hedging instruments.

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**31. Derivative and foreign exchange instruments** (continued)

**31.6 Hedge accounting** (continued)

The hedging relationship is tested at each reporting date by comparing the fair value of the hedging instrument with that of the hedged instrument. If, as a result of the testing, there is a deviation to the hedge ratio then ineffectiveness is recognised in the consolidated statement of income. The hedging relationship is subsequently either rebalanced or discontinued in accordance with the Group's Board-approved policies and procedures.

The hedging instruments comprise hedges of fixed rate asset and fixed rate liability products with the following maturity profile: -

	Year 1	Years 2 and 3	Years 4 and 5	Over 5 years	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
<b>Notional amounts</b>					
<b>At 31<sup>st</sup> December 2018</b>					
Fixed rate asset products	3,762.0	733.1	378.0	2,123.8	6,996.9
Fixed rate liability products	5,509.3	609.2	503.5	-	6,622.0
<b>At 31<sup>st</sup> December 2017</b>					
Fixed rate asset products	3,046.0	1,256.4	562.7	1,340.4	6,205.5
Fixed rate liability products	5,386.9	533.1	503.6	-	6,423.6

Gains and losses recognised in the consolidated statement of income relating to fair value hedging relationships were as follows:-

	2018	2017
	US\$ millions	US\$ millions
Net gains on derivatives fair value hedging instruments	26.7	15.8
Net losses on hedged items attributable to the hedged risk	(26.7)	(15.8)

The notional amount, fair values, and changes in fair values of hedging instruments for the year ended 31<sup>st</sup> December 2018 used as the basis for recognising hedge ineffectiveness were as follows:-

	Notional amount	Fair value	Changes in fair value
	US\$ millions	US\$ millions	US\$ millions
<b>At 31<sup>st</sup> December 2018</b>			
<b>Financial assets</b>			
Interest rate contracts	7,975.4	80.4	26.7
<b>Financial liabilities</b>			
Interest rate contracts	5,643.5	(5.8)	-
	<u>13,618.9</u>	<u>74.6</u>	<u>26.7</u>
<b>At 31<sup>st</sup> December 2017</b>			
<b>Financial assets</b>			
Interest rate contracts	8,950.6	53.7	12.5
<b>Financial liabilities</b>			
Interest rate contracts	3,678.5	(5.8)	3.3
	<u>12,629.1</u>	<u>47.9</u>	<u>15.8</u>

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**31. Derivative and foreign exchange instruments** (continued)

**31.6 Hedge accounting** (continued)

The carrying amount, accumulative changes in fair values, and changes in fair values of hedged instruments for the years ended 31<sup>st</sup> December 2018 and 31<sup>st</sup> December 2017 used as the basis for recognising hedge ineffectiveness were as follows:-

	<u>Notional amount</u>	<u>Fair value</u>	<u>Changes in fair value</u>
	US\$ millions	US\$ millions	US\$ millions
<b>At 31<sup>st</sup> December 2018</b>			
<b>Financial assets</b>			
Placements and securities purchased under agreement to resell	3,039.1	(0.5)	0.8
Loans and advances	484.8	(10.3)	(2.5)
Investment securities	3,473.0	(65.6)	(25.5)
	<u>6,996.9</u>	<u>(76.4)</u>	<u>(27.2)</u>
<b>Financial liabilities</b>			
Deposits and securities sold under agreement to repurchase	6,151.5	(0.3)	(1.9)
Senior term financing	470.5	2.1	2.4
	<u>6,622.0</u>	<u>1.8</u>	<u>0.5</u>
	<u>13,618.9</u>	<u>(74.6)</u>	<u>(26.7)</u>
<b>At 31<sup>st</sup> December 2017</b>			
<b>Financial assets</b>			
Placements and securities purchased under agreement to resell	2,784.2	(1.3)	0.1
Loans and advances	474.4	(7.8)	1.4
Investment securities	2,946.9	(40.1)	(12.3)
	<u>6,205.5</u>	<u>(49.2)</u>	<u>(10.8)</u>
<b>Financial liabilities</b>			
Deposits and securities sold under agreement to repurchase	5,603.0	1.6	2.0
Senior term financing	820.6	(0.3)	(7.0)
	<u>6,423.6</u>	<u>1.3</u>	<u>(5.0)</u>
	<u>12,629.1</u>	<u>(47.9)</u>	<u>(15.8)</u>

There were no ineffective portions of derivative fair value or cash flow hedging transactions recognised in the consolidated statement of income in either the years ended 31<sup>st</sup> December 2018 or 31<sup>st</sup> December 2017.

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**32. Credit-related financial instruments**

Credit-related financial instruments include commitments to extend credit, standby letters of credit and guarantees which are designed to meet the financing requirements of customers. The credit risk on these transactions is generally less than the contractual amount. The notional principal amounts of outstanding credit-related contingent items and the risk-weighted exposures calculated in accordance with the CBB's Basel 3 guidelines were as follows:-

	<u>31.12.18</u>		<u>31.12.17</u>	
	<u>Notional principal amount</u>	<u>Risk-weighted exposure</u>	<u>Notional principal amount</u>	<u>Risk-weighted exposure</u>
	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>	<u>US\$ millions</u>
Direct credit substitutes	780.8	765.1	672.3	654.3
Transaction-related contingent items	1,959.7	772.4	2,020.7	785.2
Short-term self-liquidating trade-related contingent items	290.6	46.1	515.2	87.8
Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	1,505.3	691.5	1,819.7	830.2
	<b>4,536.4</b>	<b>2,275.1</b>	<b>5,027.9</b>	<b>2,357.5</b>

Commitments may be drawdown on demand.

Direct credit substitutes at 31<sup>st</sup> December 2018 included financial guarantees amounting to US\$651.2 million (2017: US\$544.8 million). Financial guarantees may be called on demand. Provisions in relation to credit-related financial instruments at 31<sup>st</sup> December 2018 amounted to US\$88.2 million (2017: US\$19.1 million).

The notional principal amounts reported above are stated gross before applying credit risk mitigants, such as cash collateral, guarantees and counter-indemnities. At 31<sup>st</sup> December 2018, the Group held cash collateral, guarantees, counter-indemnities or other high quality collateral in relation to credit-related contingent items amounting to US\$342.4 million (2017: US\$330.7 million).

**33. Contingent liabilities**

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

**34. Capital adequacy**

The Group adopted the Basel 3 capital adequacy framework with effect from 1<sup>st</sup> January 2015. The CBB's Basel 3 guidelines became effective on 1<sup>st</sup> January 2015 as the common framework for the implementation of the Basel Committee on Banking Supervision's (Basel Committee) Basel 3 capital adequacy framework for banks incorporated in the Kingdom of Bahrain. The Group complied with all externally imposed capital requirements for the years ended 31<sup>st</sup> December 2018 and 31<sup>st</sup> December 2017.

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**34. Capital adequacy** (continued)

The risk asset ratio calculated in accordance with the CBB's Basel 3 guidelines was as follows:

	<u>31.12.18</u>		<u>31.12.17</u>
	US\$ millions		US\$ millions
<b>Regulatory capital base</b>			
Tier 1 capital:			
Total equity	2,196.2		2,410.9
Tier 1 adjustments	-		-
Tier 1 capital	<u>2,196.2</u>		<u>2,410.9</u>
Tier 2 capital:			
Stage 1 and stage 2 provisions	145.2		152.6
Tier 2 capital	<u>145.2</u>		<u>152.6</u>
<b>Total regulatory capital base</b>	<u>2,341.4</u>		<u>2,563.5</u>
	<b>Notional</b>	<b>Risk-</b>	<b>Notional</b>
	<b>principal</b>	<b>weighted</b>	<b>principal</b>
	<b>amount</b>	<b>exposure</b>	<b>amount</b>
	<b>US\$ millions</b>	<b>US\$ millions</b>	<b>US\$ millions</b>
<b>Risk-weighted exposure</b>			
<i>Credit risk</i>			
Balance sheet items:			
Cash and other liquid assets	5,114.2	102.3	3,768.5
Securities purchased under agreements to resell	1,015.9	4.3	855.0
Placements	6,770.8	1,063.0	6,033.2
Investment securities	3,897.2	1,006.8	3,993.8
Loans and advances	9,817.8	9,297.5	10,043.1
Other assets, excluding derivative-related items	533.4	645.4	403.7
	<u>12,119.3</u>		<u>12,604.5</u>
Off-balance sheet items:			
Credit-related contingent items	4,536.4	2,275.1	5,027.9
Foreign exchange-related items	14,160.8	52.4	8,269.5
Interest rate-related items	22,759.9	265.4	20,915.4
Equity and commodity contracts	145.6	1.2	173.2
Repo counterparty risk	-	35.3	-
	<u>2,629.4</u>		<u>2,689.7</u>
<b>Credit risk-weighted exposure</b>	<u>14,748.7</u>		<u>15,294.2</u>
<i>Market risk</i>			
General market risk	575.3		379.6
Specific market risk	78.8		90.6
<b>Market risk-weighted exposure</b>	<u>654.1</u>		<u>470.2</u>
<i>Operational risk</i>			
<b>Operational risk-weighted exposure</b>	<u>705.5</u>		<u>645.9</u>
<b>Total risk-weighted exposure</b>	<u>16,108.3</u>		<u>16,410.3</u>
<b>Tier 1 risk asset ratio</b>	<u>13.6%</u>		<u>14.7%</u>
<b>Total risk asset ratio</b>	<u>14.5%</u>		<u>15.6%</u>



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**34. Capital adequacy** (continued)

For regulatory Basel 3 purposes, the Group has adopted the standardised approach for credit risk as mandated by CBB for all locally incorporated banks. For market risk, the Group uses the internal models approach. GIB applies the standardised approach for determining the capital requirement for operational risk.

In accordance with the capital adequacy guidelines of the CBB, revaluation gains and losses arising on the remeasurement to fair value of derivative cash flow hedging transactions are excluded from tier 1 capital, while unrealised gains and losses arising on the remeasurement to fair value of equity investment securities classified as fair value through other comprehensive income (FVTOCI) are included in tier 1 capital.

The Group calculates the regulatory capital requirement for general market risk using a Value-at-Risk model. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the Bank's regulator, the CBB. The multiplication factor to be applied to the Value-at-Risk calculated by the internal model has been set at 3.0 (2017: 3.0) by the CBB, representing the regulatory minimum. The CBB market risk framework includes metrics such as a 'stressed VaR' measure in the calculation of the regulatory capital requirement.

Value-at-Risk is calculated based on a 99 per cent confidence level, a ten-day holding period and a twelve-month historical observation period of unweighted data from the DataMetrics regulatory data set. Correlations across broad risk categories are excluded. Prescribed additions in respect of specific risk are made to the general market risk. The resultant measure of market risk is multiplied by 12.5, the reciprocal of the 8 per cent international minimum capital ratio, to give market risk-weighted exposure on a basis consistent with credit risk-weighted exposure.

The regulatory capital requirement for operational risk is calculated by the Group in accordance with the standardised approach. The regulatory capital requirement is calculated based on a range of beta coefficients, ranging from 12 to 18 per cent, applied to the average gross income for the preceding three financial years for each of eight predefined business lines.

**35. Fiduciary activities**

The Group conducts investment management and other fiduciary activities on behalf of clients. Assets held in trust or in a fiduciary capacity are not assets of the Group and accordingly have not been included in the consolidated financial statements. The aggregate amount of the funds concerned at 31<sup>st</sup> December 2018 was US\$15,628.1 million (2017: US\$15,925.3 million).

The Group acts as fund manager to a number of investment funds. In its capacity as fund manager, the Group is entitled to performance and management fees. The Group maintains an investment in the funds.

The basis for non-consolidation is as follows:-

- The investors are able to vote by simple majority to remove the Group as the fund manager, without cause, and the Group's aggregate economic interest is 20 per cent. As a result, the Group has concluded that it acts as agent for the investors in these cases, and therefore has not consolidated the fund.
- The Group has majority ownership of the fund, and while the fund meets the IFRS 10 criteria for consolidation, the Group has decided not to consolidate on grounds of materiality.

The maximum exposure to loss is equal to the carrying amount of the trading securities, which at 31<sup>st</sup> December 2018 amounted to US\$104.1 million (2017: US\$107.0 million).

**36. Related party transactions**

The Group is owned by the six Gulf Cooperative Council (GCC) governments, with the Public Investment Fund holding a majority (97.2 per cent) controlling stake. The Public Investment Fund is an investment body of the Kingdom of Saudi Arabia. At 31<sup>st</sup> December 2018, the Group reported deposits and their related interest expense of US\$1,663.5 million and US\$22.2 million respectively (2017: US\$1,104.2 million and US\$18.4 million respectively).

The Group transacts with various entities controlled, jointly controlled or significantly influenced by the six GCC governments, these transactions are conducted in the ordinary course of the Group's business on terms comparable to those with other entities that are not government-related.

The Group's other related party transactions are limited to the compensation of its directors and executive officers.

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**36. Related party transactions** (continued)

The compensation of key management personnel was as follows:-

	<u>2018</u>	<u>2017</u>
	US\$ millions	US\$ millions
Short-term employee benefits	13.7	12.6
Post-employment benefits	0.7	0.9
	<u>14.4</u>	<u>13.5</u>

Key management personnel comprise members of the Board of Directors, the Group Chief Executive Officer and the Managing Directors of the Group.

Post-employment benefits principally comprise compensation paid to personnel on retirement or resignation from the services of the Group.

**37. Fair value of financial instruments**

The Group's financial instruments are accounted for under the historical cost method with the exception of trading securities, equity investment securities and derivative financial instruments, which are accounted for at fair value. The fair value represents 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. Differences therefore can arise between book values under the historical cost method and fair value estimates. Underlying the definition of fair value is the presumption that the Group is a going concern without any intention or requirement to curtail materially the scale of its operation or to undertake a transaction on adverse terms. Generally accepted methods of determining fair value include reference to quoted prices (level 1 measurement) or to the pricing prevailing for similar financial instruments (level 2 measurement) and the use of unobservable inputs in estimation techniques such as discounted cash flow analysis (level 3 measurement).

The valuation methodologies applied are outlined below.

**37.1 Trading securities**

The fair values of trading securities are based on quoted prices (level 1) or valuation techniques (level 2 or 3).

**37.2 Investment securities**

The fair values of equity investment securities are based on quoted prices (level 1) or valuation techniques (level 2 or 3). The fair values of debt investment securities are based on quoted market prices (level 1) and approximate the carrying values.

**37.3 Loans and advances**

The fair values (level 2) of loans on a floating interest rate basis are principally estimated at book value. The fair values (level 3) of impaired loans are estimated at the recoverable amount, measured as the present value of expected future cash flows discounted based on the Group's weighted average discount rate. The fair values of fixed rate loans are estimated on a discounted cash flow basis utilising discount rates equal to prevailing market rates of interest in the respective currencies for loans of similar residual maturity and credit quality. The fair values (level 2) approximate the carrying values.

**37.4 Term financing**

The fair value of term financing is based on observable market data, including quoted market prices for debt instruments issued by similarly rated financial institutions and with similar maturities, or estimated on a discounted cash flow basis utilising currently prevailing spreads for borrowings with similar maturities. The fair values (level 2) of senior term financing at 31<sup>st</sup> December 2018 approximate the carrying values.

**37.5 Other on-balance sheet items**

The fair values of foreign exchange and derivative financial instruments are based on market prices, discounted cash flow techniques or option pricing models as appropriate. The fair values of all other on-balance sheet assets and liabilities approximate their respective book values due to their short-term nature.

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**37. Fair value of financial instruments** (continued)

**37.6 Credit-related contingent items**

There was no material fair value excess or shortfall in respect of credit-related off-balance sheet financial instruments, which include commitments to extend credit, standby letters of credit and guarantees, as the related future income streams reflected contractual fees and commissions actually charged at the balance sheet date for agreements of similar credit standing and maturity. Impairment provisions made in respect of individual transactions where a potential for loss has been identified are included in provisions for the impairment of loans and advances.

**37.7 Valuation basis**

The valuation basis for financial assets and financial liabilities carried at fair value was as follows:-

	Quoted prices (level 1)	Valuation based on observable market data (level 2)	Other valuation techniques (level 3)
	US\$ millions	US\$ millions	US\$ millions
<b>At 31<sup>st</sup> December 2018</b>			
Financial assets:			
Trading securities	151.8	0.7	25.2
Investment securities - equities	130.0	-	38.5
Derivative financial instruments	-	219.1	-
Financial liabilities:			
Derivative financial instruments	-	144.3	-
<b>At 31<sup>st</sup> December 2017</b>			
Financial assets:			
Trading securities	165.7	0.9	25.2
Investment securities - equities	108.4	-	62.3
Derivative financial instruments	-	182.2	-
Financial liabilities:			
Derivative financial instruments	-	131.5	-

Quoted prices include prices obtained from lead managers, brokers and dealers. Investment securities valued based on other valuation techniques comprise private equity investments that have been valued based on price / earnings and price / book ratios for similar entities, discounted cash flow techniques or other valuation methodologies.

During the year ended 31<sup>st</sup> December 2018, the value of investment securities whose measurement was determined by other valuation techniques (level 3 measurement) decreased by US\$23.8 million (2017: decrease of US\$13.5 million). The decrease principally comprised changes in assigned valuations.

No transfers out of the level 3 measurement classification occurred during the years ended 31<sup>st</sup> December 2018 and 31<sup>st</sup> December 2017. Similarly, no transfers between level 1 and level 2 measurement classifications were made during the years ended 31<sup>st</sup> December 2018 and 31<sup>st</sup> December 2017.

Sensitivity of the movement in the fair value of financial instruments in the level 3 category is assessed as not significant to other comprehensive income or total equity.

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**38. Earnings per share**

Basic earnings per share are calculated by dividing the net income attributable to the shareholders by the weighted average number of shares in issue during the year.

	<u>2018</u>	<u>2017</u>
Net (loss) / income (US\$ millions)	(227.0)	70.0
Weighted average number of shares in issue (millions)	2,500	2,500
<b>Basic earnings per share (US\$)</b>	<b>(0.09)</b>	<b>0.03</b>

The diluted earnings per share is equivalent to the basic earnings per share set out above.

**39. Principal subsidiaries**

The principal subsidiary companies were as follows:-

	<u>Principal activities</u>	<u>Country of incorporation</u>
Gulf International Bank (UK) Limited	Asset management	United Kingdom
GIB Capital C.J.S.C.	Asset management and investment banking	Kingdom of Saudi Arabia
GIB Markets Limited	Treasury-related	Cayman Islands

The Group's ownership interest in the principal subsidiary companies was 100 per cent for the years ended 31<sup>st</sup> December 2018 and 31<sup>st</sup> December 2017.

During the year ended 31<sup>st</sup> December 2017, GIB Capital's legal structure changed from a limited liability company (L.L.C.) to a closed joint stock company (C.J.S.C.).

**40. Average consolidated statement of financial position**

The average consolidated statement of financial position was as follows:-

	<u>31.12.18</u>	<u>31.12.17</u>
	US\$ millions	US\$ millions
<b>ASSETS</b>		
Cash and other liquid assets	6,416.4	4,744.8
Securities purchased under agreements to resell	937.7	735.8
Placements	5,592.9	5,168.7
Trading securities	192.3	162.8
Investment securities	3,948.0	3,922.6
Loans and advances	10,262.0	10,310.9
Other assets	697.5	550.2
<b>Total assets</b>	<b>28,046.8</b>	<b>25,595.8</b>
<b>LIABILITIES</b>		
Deposits from banks	2,092.0	2,275.6
Deposits from customers	19,222.3	16,122.6
Securities sold under agreements to repurchase	807.6	742.0
Other liabilities	510.2	507.8
Senior term financing	3,047.4	3,559.3
<b>Total liabilities</b>	<b>25,679.5</b>	<b>23,207.3</b>
<b>Total equity</b>	<b>2,367.3</b>	<b>2,388.5</b>
<b>Total liabilities &amp; equity</b>	<b>28,046.8</b>	<b>25,595.8</b>