BBK

بنك البحرين والكويت

New perspectives

Annual Report 2018

Contents

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BBK is licensed by the Central Bank of Bahrain as a Conventional Retail Bank
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Our vision

BBK will be the premier regional financial services enterprise in providing superior products and services of high quality through innovation, technology and lifelong client relationships.

Our mission

The Bank will expand its overseas presence in more locations in which it chooses to operate in order to satisfy the diversified needs of clients. We believe clients are the driving force in everything we do. We will not compromise on our absolute commitment to providing the very best in client service.

We believe our people are our number one asset, with the highest degree of competence, integrity and professionalism. We instil in our people the principles of entrepreneurship, decision-making and ownership through our commitment to training, development, delegation and performance-based reward systems.

We are determined to utilise cutting-edge technology, which we recognise as most critical in supporting our short, medium and long-term business objectives.

Our shareholders are the source of our financial strength and can expect continued growth and profitability. They are supportive and are confident of our vision of the future.

Our values

creative · passionate · pioneering · reliable

+20.9%

Net interest income for the year was BD 110.0 million.

+1.8%

Loans and advances increased to BD 1,773 million.

+14.4%

Net profit increased to BD 67.1 million.

H.M. King Hamad bin Isa Al Khalifa
King of the Kingdom of Bahrain

H.H. Sheikh Sabah Al Ahmed Al Sabah
Amir of the State of Kuwait

The goals for our 2016-18 strategic cycle have been largely achieved, highlights being the opening of our representative office in Turkey, introduction of our BBK Lite branches for migrant workers, the roll-out of BBK Privé, and launching new technology platforms within the Bank and its subsidiaries.

The dominant theme of our 2019-21 strategic cycle is fintech. BBK has long been a technology leader, but we need to move to the next level of digital innovation. We must respond to the rapidly changing digital environment and stay ahead of the market.

We are also extending our reach into countries such as Saudi Arabia and Oman, in addition to those where we have presence now: Kuwait, India, the UAE, Turkey, and the UK.

Financial highlights

	2014	2015	2016	2017	2018
Income statement highlights (BD millions)					
Net interest income	72.3	72.7	85.8	90.9	**110.0**
Other income	45.2	48.4	47.7	52.2	**51.2**
Operating expenses	46.2	49.8	53.1	54.0	**57.7**
Net profit	50.1	53.2	56.4	58.7	**67.1**
Cash dividend	20%	25%	30%	35%	**40%**
Stock dividend	5%	–	–	–	**–**
Financial statement highlights (BD millions)					
Total assets	3,501	3,646	3,703	3,763	**3,582**
Loans and advances	1,846	1,765	1,767	1,741	**1,773**
Investments	824	794	812	796	**863**
Customer deposits	2,471	2,643	2,494	2,624	**2,374**
Term borrowings	241	205	206	199	**145**
Total equity	359	361	474	501	**500**
Profitability					
Earnings per share (fils)	47	50	49	48	**56**
Cost/income	39.33%	41.14%	39.80%	37.75%	**35.81%**
Return on average assets	1.49%	1.44%	1.51%	1.62%	**1.79%**
Return on average equity	13.93%	14.79%	13.23%	12.07%	**13.65%**
Profit per employee (BD)	48,826	52,169	54,136	51,433	**51,788**
Capital					
Capital adequacy	15.63%	14.87%	18.48%	20.01%	**19.58%**
Equity/total assets	10.26%	9.89%	12.81%	13.31%	**13.97%**
Debt/equity	67.05%	56.74%	43.46%	39.74%	**28.88%**
Liquidity and business indicators					
Loans and advances/total assets	52.74%	48.40%	47.73%	46.26%	**49.49%**
Loans and advances/customer deposits	74.72%	66.78%	70.86%	66.35%	**74.65%**
Investments/total assets	23.53%	21.77%	21.93%	21.15%	**24.10%**
Liquid assets/total assets	29.19%	32.04%	32.61%	34.69%	**27.64%**
Net yield ratio	2.32%	2.12%	2.46%	2.69%	**3.14%**
Number of employees	1,026	1,020	1,042	1,141	**1,296**

Dear Shareholders

Against a backdrop of continuing economic challenges in Bahrain and the region, BBK continued to record strong performance as we completed the third year of our 2016-2018 strategic cycle, largely achieving our goals. We maintained our record of year-on-year profit growth, the Bank's equity surpassed BD 500 million for the second consecutive year, and better management of assets produced improved yields.

I take this opportunity to extend our appreciation to His Majesty King Hamad bin Isa Al Khalifa, the King of the Kingdom of Bahrain, and His Highness Sheikh Sabah Al Ahmad Al Sabah, the Amir of the State of Kuwait. I also extend thanks to their respective governments and regulatory authorities for their guidance during the year.

I thank the Board of Directors and all stakeholders for their support during 2018. As we enter our 2019-2021 strategic cycle, we can look forward to drawing on their wisdom and experience as invaluable support to realising our vision for growth.

Murad Ali Murad
Chairman

19.6%

Capital adequacy

Capital adequacy stood at 19.6 percent at end of 2018.

The Board of Directors is honoured to present the 47th annual report and consolidated financial statements of BBK and its subsidiaries (the Group) for the year ended 31 December 2018.

Operating environment

Throughout the difficult economic times that have prevailed since 2014, the fact that Bahrain has not experienced negative growth is testament to the Kingdom's sound fundamentals and the economic policies pursued.

Unemployment, always a primary indicator of economic downturn, has remained consistent, with no marked increase. Similarly, interest rates – another key indicator of economic health – have been reasonable, influenced mainly by the external environment and global movements.

These factors are very positive for a country with economic challenges. Bahrain has achieved moderate growth, with GDP rising by 3.9 percent in real terms in 2017, despite a contraction in the hydrocarbon sector.

Bahrain's headline real growth rate increased sharply in the second quarter of 2018 to an annualised 2.4 percent, according to the Bahrain Economic Development Board (EDB), which noted a broad-based recovery across the economy and a near-term outlook of relatively stable growth, around the 3 percent mark.

In particular, the EDB highlighted the expansion of Bahrain's non-oil GDP in the regional context. The oil industry now accounts for less than one-fifth of Bahrain's GDP, with growth dynamics critically linked to non-oil drivers.

Tourism was an important factor in Bahrain's non-oil growth, with visitor numbers up 5.8 percent year-on-year. Construction, up 6.7 percent, and manufacturing, up 4.5 percent, were also important contributors.

The World Bank forecast that full-2018 growth in Bahrain's economy would reach 3.2 percent, although it suggests a slight GDP decline in 2019. However, higher oil production – the result of a major refinery expansion – and a host of mega-projects in the pipeline give cause for optimism.

The discovery earlier in 2018 of at least 80 billion barrels of shale oil in Bahraini waters also boosts the Kingdom's prospects. The offshore field also contains an estimated 10-20 trillion cubic feet of deep gas reserves.

Economic policy

Support from our Gulf neighbours significantly reduced the risk of a debt crisis in Bahrain through a $10 billion aid package tied to fiscal reforms, while the Kingdom strengthened its reputation for economic management. The aid extended will support Bahrain's funding requirements in the form of phased long-term and interest-free loans.

At the same time, Bahrain has released a detailed programme to reduce debt and abolish its budget deficit by 2022. This is by far the most comprehensive plan to put Bahrain on a sustainable financial footing since oil prices plunged in 2014.

The reforms, focused mainly on taxation and subsidies, are spread over several years. They will enable Bahrain to retain borrowing powers in international markets, a facility in doubt earlier in the year when plans to sell US dollar bonds were dropped because of the high yields demanded.

Excluding the aid package, Bahrain had estimated its borrowing needs at $20 billion over five years. It now plans to use the aid to reduce that by $10 billion, while reforms aim to balance the budget and shrink the deficit from the current 9.9 percent of gross domestic product to 0.1 percent in 2022. Bahrain's public debt as a ratio of GDP is projected to fall to 82 percent in 2022 instead of the previously forecast 104 percent.

Bahrain will create new bodies to oversee government spending and borrowing, including a new debt management office. The plan promises to cut public spending with six task forces, introduce voluntary retirement for state employees, and mount an efficiency drive. Further changes include the introduction of value-added tax and changing the pensions system.

40 fils

Cash dividend

The Board has recommended a cash dividend of 40 fils per share.

Strategic cycle

The goals for our 2016-18 strategic cycle have been largely achieved, highlights being the opening of our representative office in Turkey, introduction of our BBK Lite branches for migrant workers, the roll-out of our private banking and wealth management offering, BBK Privé, and launching new technology platforms within the Bank and its subsidiaries. These and other achievements are fully detailed in the Chief Executive's review.

In terms of strategic objectives, and in the context of the prevailing market conditions, BBK's results are commendable. In such challenging times, many of our clients have been struggling, prompting requests for restructuring. This has led us to take more proactive measures and set aside the required provisioning to cater for any unexpected market downturns.

The Bank is witnessing a compound profit growth of 6-7 percent annually, but the application of the IFRS 9 requirements to make higher provisions for expected credit losses (rather than losses actually incurred) has affected BBK and the entire banking sector. With a market share of 15-20 percent, we continue to be one of the most important banks in Bahrain, with very strong corporate and government segments. We have also grown substantially in consumer and retail business and will be concentrating on further mobilising this sector in the upcoming cycle.

Our new three-year strategic plan has now been finalised, following an internal process supported by a leading worldwide management consulting firm.

The dominant theme of our 2019-21 strategic cycle is fintech. BBK has long been a technology leader, but others are catching up and we need to move to the next level of digital innovation. The Central Bank of Bahrain (CBB) is committed to the modernisation of the financial sector and we will be reviewing our platforms to introduce new channels and further enhance our security measures. BBK has done well in this area, but we must respond to the rapidly-changing digital environment and stay ahead of the market.

Financial highlights

BBK achieved a net profit of BD 67.1 million for 2018, 14.4 percent higher than the previous year's BD 58.7 million, equating to 56 fils earnings per share. Net interest income rose by 20.9 percent to BD 110 million, while total shareholders' equity marginally decreased by 0.1 percent to BD 500.4 million.

The profit increase is mainly attributable to the growth in the loans and investment portfolio, as well as improved margins resulting from higher global interest rates, all supported by highly effective management of assets and liabilities.

Other income also increased, mainly due to improved performance of the Bank's investment portfolio. On the other side, and as part of the prudent risk management practice, the Bank has taken higher net provisioning charges of BD 35.4 million in 2018 (2017: 29.0 million).

Operating costs increased by 6.9 percent to BD 57.7 million (2017: BD 54.0 million), the result of continuous investment in human capital, technology, and infrastructure. Nevertheless, our cost-to-income ratio improved to 35.8 percent (2017: 37.8 percent), reflecting BBK's ability to grow revenue streams and carefully control costs.

The Board has recommended a cash dividend of 40 fils per share.

Regulatory compliance

Ever more stringent regulatory requirements necessitate the increasing investment of time and money, but the benefits outweigh the costs and proved their value during the past year. By achieving compliance with new international financial reporting standards (IFRS 9) two years ahead of the January 2018 deadline, BBK was well-positioned to identify risk factors early and take remedial action where necessary.

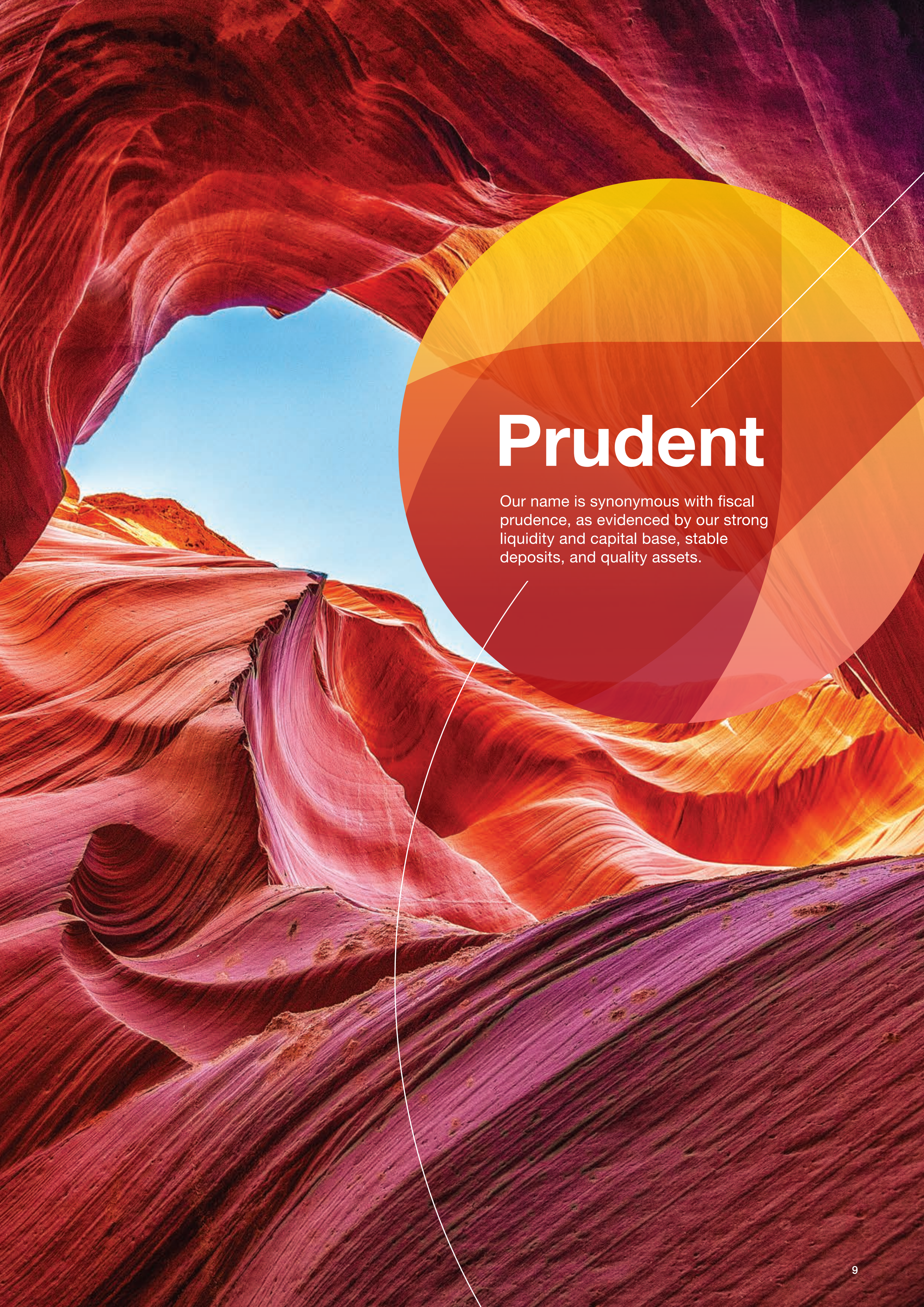
The CBB has been helpful in detailing the risks specified in the Basel III regulatory framework for banks, such as capital adequacy ratios as they apply to specific areas of operation. We are very comfortable with our compliance and continued ability to do so, even if the CBB introduces additional risk factors or raises capital adequacy requirements.

In some areas we have been ahead of CBB requirements, such as the recent ruling that Board members receive a minimum of 15 hours' training each year. BBK has long provided directors – and executive managers – with training in corporate governance and allied matters.

The CBB is exercising ever closer scrutiny of commercial banks, with more frequent inspections and heightened focus on issues such as fee structures, credit card interest rates, and foreign exchange charges. We welcome these measures as added consumer protection and an incentive for banks to reduce costs by making better use of technology.

Supporting society

As detailed in the Corporate Social Responsibility (CSR) section of this annual report, BBK continues to invest in a range of social initiatives, demonstrating our commitment to supporting the local communities we serve.



Prudent

Our name is synonymous with fiscal prudence, as evidenced by our strong liquidity and capital base, stable deposits, and quality assets.

Appropriations

The Board of Directors recommends the following appropriations of the Bank's net profit for approval by shareholders:

	BD'000
Retained earnings as at 1 January 2018	134,632
Profit for the year 2018	67,118
Proposed appropriation for donations	(1,600)
Distribution on Perpetual Tier 1 Convertible Capital Securities	(7,103)
Other negative changes in retained earnings	(1,063)
Retained earnings as at 31 December 2018 available for distribution (before proposed dividend)	191,984
Proposed cash dividends (40% of paid-up capital, net of treasury stock)	(43,017)
Retained earnings as at 31 December 2018 (after proposed dividend)	148,967

Fitch

	Rating
Long-term issuer default rating	BB-
Short-term issuer default rating	B
Viability rating	bb-
Support rating	3
Support rating floor	BB-
Outlook	Stable

Report issue date: 18 October 2018

Moody's

	Rating
Long-term debt	B2/NP
Baseline credit assessment	b2
Adjusted baseline credit assessment	b2
Counterparty risk assessment	B1
Senior unsecured	(P) B2/B2
Subordinate	(P)B3
Outlook	Stable

Report issue date: 19 December 2018

Fitch

Long-term issuer default rating

BB-

Moody's

Long-term debt

B2

56 fils

Earnings per share

Earnings per share for 2018 stood at 56 fils, up from 48 fils in 2017

CEO award

The Board takes great pleasure in congratulating BBK's Chief Executive, Reyadh Yousif Sater, on receiving the 'Top CEO' award that recognises the best performing leaders of companies listed on Gulf stock markets.

The honour was conferred at the Top CEO Awards and Conference 2018 event, where the organisers described Mr Sater's distinction as a transparent and stringent selection based on comprehensive evaluation by Trends Media and INSEAD Business School, making this award the region's most reputable leadership award and a benchmark for businessmen and their companies.

Appointment of auditors

At the Annual General Meeting held on 20 March 2018, Ernst & Young were re-appointed as external auditors to BBK for the financial year ending 31 December 2018.

Ratings

In October 2018, Fitch Rating Agency affirmed BBK's Long-Term Issuer Default Rating (IDR) at 'BB-' with a Stable Outlook, the same as Bahrain's sovereign ratings. It also affirmed the Viability Rating (VR) at 'bb-' and the Support Rating (SR) at '3'. Fitch says that BBK's IDRs are driven by its standalone creditworthiness, as reflected by its 'bb-' VR. The IDRs are also underpinned by potential sovereign support, as reflected by the Bank's Support Rating Floor (SRF) of 'BB-'.

BBK's VR is capped by the operating environment in Bahrain and, more specifically, by the Bahraini sovereign rating of 'BB-'. This reflects the fact that BBK is predominantly a domestic bank with significant exposure to the sovereign and the domestic operating environment. The VR also considers the Bank's impaired loans ratio, concentration risk and the adequate capital ratios, but also its well-entrenched domestic franchise, adequate margins, and consistent profitability.

In December 2018, Moody's Investors Service affirmed the long-term deposit and issuer ratings of BBK, along with three other retail banks it rates in Bahrain. Moody's also affirmed the Baseline Credit Assessments (BCA), adjusted BCAs, Counterparty Risk Assessments (CRAs) and Counterparty Risk Ratings (CRRs) of these banks. The outlook on BBK was changed to stable, from negative.

Moody's assigned B2 stable/Not-Prime long-term and short-term local-currency deposit ratings to BBK. The ratings capture the Bank's standalone credit strength, reflected in its Baseline Credit Assessment (BCA) of b2, which is at the same level as the Government of Bahrain's (B2 stable) rating.

BBK's b2 BCA captures its (1) strong domestic franchise, which supports its sound profitability, (2) solid liquidity buffers and resilient funding, and (3) adequate capital. These strengths are moderated by the Bank's high deposit and credit concentrations, and a difficult operating environment, which increases asset risks. BBK's long-term foreign-currency deposit rating of B3 is constrained by Bahrain's B3 country ceiling for such deposits, which captures foreign-currency transfer and convertibility risks.

Forward view

We look to the future with optimism, with Bahrain having made excellent progress to overcome its economic challenges during the year. As a bank, we will benefit in our domestic market and build on our operational achievements. With interest rates rising, our cost of funding will increase, as will our returns on new loans and assets. Nevertheless, reducing costs will remain a primary focus, as it has over the last strategic cycle.

Provisioning will remain a crucial area – understanding why we need to make such high provisions and identifying better ways to manage the challenge. We also need a strategy to counter new competitors entering BBK's traditional markets. We are considering a number of concepts as we look towards further diversification of our activities.

Appreciation

On behalf of the Board, I acknowledge the contributions of the ex-Deputy Chairman, Mr. Aref Saleh Khamis, and ex-Board Member Dr. Zakareya Sultan AlAbbasi, for their invaluable contributions to the Board and the success of the Bank throughout the years. They have been Directors since 2003 and 2012 respectively and have left the Board in December 2018.

In conclusion, we extend our thanks and appreciation to shareholders for their support, to clients for their trust, and to all Group employees for their dedication and efforts throughout the year.

On behalf of the Board of Directors.

Murad Ali Murad
Chairman

Board of Directors

Murad Ali Murad
Chairman

Chairman of the Nomination, Remuneration and Corporate Governance Committee

Chairman of the Audit and Compliance Committee

Chairman of Independent Directors' Committee

Director since 21 March 1999
(Independent)

Qualifications and experience

Fellow member of the Chartered Institute of Management Accountants, London, United Kingdom. Over 46 years' experience in the banking sector and has had his own business for the past 16 years.

Aref Saleh Khamis
Deputy Chairman until 2 December 2018

Director since 1 April 2003
(Non-executive)

Qualifications and experience

Master in Business Administration, King Fahad University of Petroleum and Minerals, Dhahran, Kingdom of Saudi Arabia. 34 years' experience in the government sector.

Nominated by:

Social Insurance Organization (SIO)

Jassem Hasan Ali Zainal
Deputy Chairman since 26 December 2018

Director since 22 November 1994
(Independent)

Qualifications and experience

Master in Civil Engineering, Kuwait University, State of Kuwait. 33 years' experience in the banking sector, 4 years in the government sector, 6 years with finance companies, 24 years with investment companies, and has had own business for 9 years.

Sh. Abdulla bin Khalifa bin Salman Al Khalifa
Board Member

Director since 2 March 2008
(Non-executive)

Qualifications and experience

Bachelor of Business Administration, George Washington University, United States of America. 18 years' experience in the banking and investment sector.

Sh. Khalifa bin Duaij Al Khalifa
Board Member

Director since 27 February 2005
(Independent)

Qualifications and experience

Master in Business Administration, Johns Hopkins University, United States of America.

Master in Social and Public Policy, Georgetown University, United States of America. 11 years' experience in the government sector (investment field) and 12 years in the diplomatic sector.

Marwan Mohammed Al Saleh
Board Member

Director since 30 December 2014
(Non-executive)

Qualifications and experience

Bachelor of Arts, Eckerd College, United States of America. 34 years in the investment sector.

Nominated by:

Kuwait Investment Authority

Mohamed Abdulrahman Hussain
Board Member

Chairman of the Executive Committee

Director since 2 March 2008
(Independent)

Qualifications and experience

Bachelor of Arts, Economics and Finance, University of Aleppo, Syria. Over 41 years' experience in the banking sector.

Hani Ali Al Maskati
Board Member

Chairman of the Risk Committee

Director since 29 March 2017
(Non-executive)

Qualifications and experience

Master of Business Administration, University of Hull, England. Over 31 years' experience in transaction banking.

Nominated by:

Ithmaar Holding B.S.C.

Edrees Musaed Ahmad
Board Member

Director since 29 March 2017
(Non-executive)

Qualifications and experience

Master of Economics, Kuwait University, State of Kuwait. Over 13 years' experience in the investment sector.

Dr. Zakareya Sultan AlAbbasi
Board Member until 2 December 2018

Director since 22 February 2012
(Non-executive)

Qualifications and experience

PhD., University of East Anglia, United Kingdom. 32 years' experience in the government sector (social insurance).

Nominated by:

Social Insurance Organization (SIO)

Ashraf Adnan Bseisu
Board Member

Director since 29 March 2017
(Non-executive)

Qualifications and experience

Bachelor of Science in Civil Engineering, Southern Methodist University, USA; Master of Science in Management Information System, London School of Economics, UK. Over 16 years' experience in investment management and over 26 years in the insurance and financial services sector.

Nominated by:

Ithmaar Holding B.S.C.

Yusuf Saleh Khalaf
Board Member

Director since 6 March 2011
(Independent)

Qualifications and experience

Associate of the Association of Chartered Certified Accountants, United Kingdom, with 38 years of experience in the banking and financial services sector.

Despite the challenges faced by Bahrain and the regional banking sector, BBK has maintained its record of sustained profitability and achieved growth of 14.4 percent in 2018, compared to 4.0 percent in 2017.

We welcome the Gulf Cooperation Council (GCC) aid package which was announced towards the end of the year. It will help relieve fiscal pressure and will hopefully reflect positively across all sectors of the economy. However, with our economy heavily dependent on the performance of the global oil and natural gas markets, recent price gyrations have led to a certain amount of uncertainty regarding the short-term impact on the regional economies.

Strategy

The banking industry will continue to transform by embracing digitisation and automation – this is the new reality and we have recognised the need to adapt and change. During the year, we retained the services of internationally-regarded consultants to help craft BBK's new three-year strategy, taking on the challenges of the global market for financial services.

As part of on-going improvement and efficiency efforts, we have studied cost-effective solutions by possibly outsourcing and forming alliances that can help us to improve services. This strategy is designed to strengthen our market share – not merely maintain it.

Our asset base is now well diversified, with healthy allocation between Bahrain and overseas. But revenue is mainly derived from Bahrain because our international branches and representative offices book much of their business through Bahrain.

We are also extending our reach into countries such as Saudi Arabia and Oman, in addition to those where we have presence now: Kuwait, India, the United Arab Emirates, Turkey, and the UK.

BBK Bahrain

Bahrain is our home and primary market, but the Kingdom has faced a number of economic challenges. This has reflected negatively on the sovereign rating and imposed certain constraints on banks.

The government has an ambitious programme to reduce Bahrain's fiscal deficit, including the introduction of value-added tax (VAT) on 1 January 2019. Bahrain citizens and residents will need to fully understand the VAT mechanism that will involve dealing with different parties, consumers, and taxpayers in collecting VAT – something entirely new to the country. At BBK, we have the theoretical knowledge to handle VAT, but we made the decision to retain a specialist consultant to help us prepare.

During 2018 we also focused on protecting BBK's domestic market share. Bahrain has numerous banks, mostly chasing the same business. We expect competitive challenges to intensify in the coming years.

The Central Bank of Bahrain (CBB) has categorised BBK a D-SIB (Domestic Systemically Important Bank) and issued a new rulebook module for governance. At BBK, we have welcomed this initiative, assuming additional responsibility for the Bahraini banking industry.

The launch of BBK Lite has brought innovative banking facilities to expatriate workers, a segment that has historically been underserved.

1.8%

Return on average assets was 1.8 percent in 2018, compared to 1.6 percent in 2017.

13.7%

Return on average equity improved to 13.7 percent in 2018, up from 12.1 percent in 2017

It aims to be the perfect match for employees and corporates who employ a large number of expatriates in sectors such as construction, hospitality, and general services.

For employers, BBK Lite provides state-of-the-art processing that simplifies transfers to employees' accounts through automated and cost-effective systems. For employees, it offers enhanced services such as low-cost remittances to loved ones anywhere in the world, new or top-up loans, and bespoke savings accounts that simplify their everyday banking.

BBK Lite was piloted in March 2018, with two further Lite branches subsequently opened, each offering a blend of personal services and the latest smart teller machines to create a welcoming environment that is convenient to our customers' workplaces and homes.

As part of the Bank's initiative to strengthen market position and enhance its range of client offerings, the Private Banking and Wealth Management Division was formed during 2018, under the brand name BBK Privé.

BBK Privé differentiates itself from the upper mass segment, giving affluent clients an integrated banking solution encompassing assets, liabilities, investment products, and other services to suit their particular needs.

The brand name and identity have been developed to position this exclusive offering as an integral part of BBK's brand and heritage. The BBK Privé team of wealth management specialists will continue to grow with new hires of experts, and will capitalise on the full spectrum of the Bank's resources to provide the ultimate level of service to our elite clients.

BBK Kuwait

Kuwait's external balance sheet is exceptionally strong, with sovereign net foreign assets estimated at 560 percent of GDP. However, the country is heavily oil-dependent, accounting for around 70 percent of budget revenues. The private sector largely relies on government projects and subsidies, limiting its shock-absorption capacity and fiscal flexibility.

Key areas of focus for BBK Kuwait have included maintaining the quality of its loan portfolio, diversifying sectoral exposures, reducing non-performing loans, and increasing fee-based income. Our performance in 2018 reflected improvements in each of these areas, with growth across the core business.

Inspection by the Central Bank of Bahrain during 2018 included assessment of the Kuwait branch's organisational structure, business strategy, performance, governance, and asset quality.

BBK India

India has emerged as the world's fastest-growing economy, with 8.2 percent GDP growth forecast for 2018. It is now the sixth largest economy, with GDP of $2.6 trillion, soon expected to overtake the UK in fifth place.

With four branches located in Mumbai, New Delhi, Hyderabad, and Kerala, BBK India is competing well in the country's highly dynamic banking sector.

During 2018, healthy growth was seen in deposits and net loans and advances. Asset growth was nearly double the industry average, while non-performing assets were extremely low, compared to the sector average.

BBK India's growth, profitability, and business quality have been consistent and sustainable. Having established strong relationships with reputed corporates, and well-planned diversification of revenue sources through our retail and related businesses, BBK India is expected to significantly enhance shareholder value in the future.

BBK Dubai

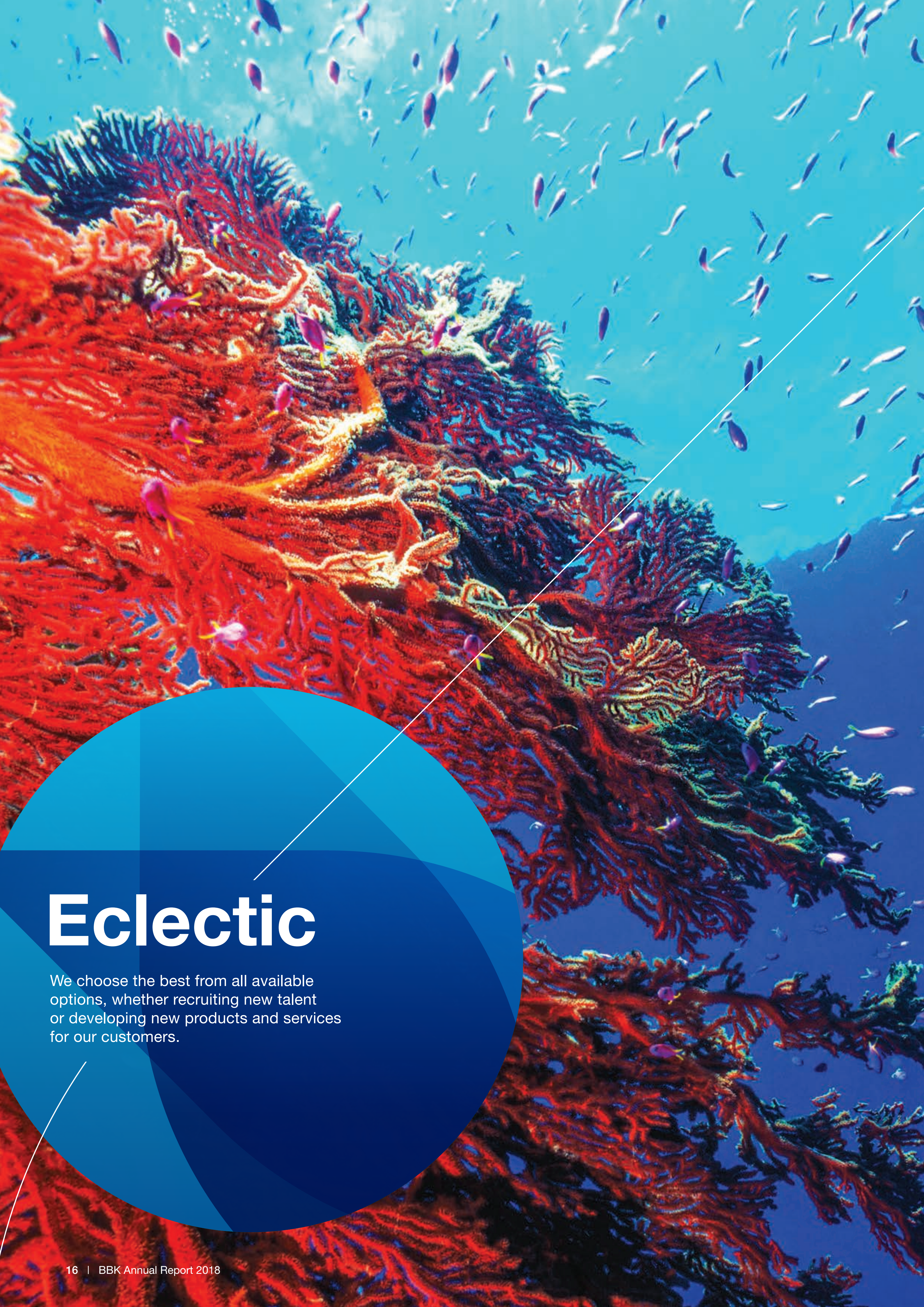
The Bank's UAE representative office, located in Dubai, is a highly active operation that has achieved steady business growth for many years. It primarily targets bilateral and syndicated corporate exposures, liaising with BBK Bahrain to provide term loans and related services to selected businesses operating across the seven emirates of the UAE.

BBK Dubai also supports the Bank's Mumbai branch in India, providing liaison services for non-resident Indian customers based in the Emirates.

BBK Istanbul

Turkey is the second most populous country in Europe. It has a highly diversified production base and a very much private-sector led economy, with an enterprise culture that goes back centuries.

During 2018 – the second year for BBK's Istanbul representative office – budget and net asset targets were achieved and exceeded. The focus has been on corporates and banks by participating in syndicated lending. A new relationship was established with the European Bank for Reconstruction and Development (EBRD) through participation in the first corporate loan to a Turkish client.



Eclectic

We choose the best from all available options, whether recruiting new talent or developing new products and services for our customers.

35.8%

Cost/income ratio improved to 35.8 percent, from 37.8 percent in 2017.

CrediMax

BBK subsidiary CrediMax is a pioneer credit card issuer and acquirer. The 2018 launch of MaxWallet illustrates how innovation has helped the company to maintain its market leadership status by further broadening and improving its range of services. The virtual wallet app enables customers to make purchases without presenting their credit cards. The app is available from the Apple and Google stores, and a growing number of merchants have signed up for their customers' convenience.

CrediMax continues to innovate by harnessing new technologies – such as enabling QR code acceptance and the introduction of the Thameen rewards programme, which credits customers with points that can then be redeemed for flights, hotel stays, and unique shopping experiences.

In the years ahead, as card products continue to evolve and align with new digital channels, we will continue to refine the business model of CrediMax, including considering new alliances with providers of goods and services to further simplify our customers' financial transactions.

Invita

BBK subsidiary Invita is a leading multi-lingual contact centre that provides a range of inbound and outbound services around the clock. The company operates across diverse industries including banking, insurance, retail, utilities, and airlines.

Technology has always provided Invita with a competitive edge, most recently with mobile apps and social media utilised as new customer touchpoints. Developing new concepts such as artificial-intelligence driven chatbots was a 2018 highlight, along with launching Bahrain's first digitised insurance claims processing service.

The Invita Training Centre passed its first audit by the Bahrain Quality Assurance Authority, and work continues to upgrade Invita's certifications. With the advances in fintech and other technologies further improving customer service, Invita looks forward to sustainable growth in the years to come.

A GCC-level forum of the Ministries of Labour and Social Affairs commended Invita for its efforts in creating jobs for Bahraini nationals. Invita has been coordinating with the Ministry of Labour on its hiring requirements, providing opportunities to candidates who have registered with the ministry. Invita's Training Centre contributes to the training and upskilling of such candidates.

Aegila

In its first full year of operation, Aegila Capital Management has become established in its core target markets and rapidly developed its network across Europe. The firm's nascent advisory business, servicing Middle Eastern and European investors, has also undertaken its first assignments.

Aegila completed two important transactions in 2018: the €86.5 million acquisition of Unilever's headquarters building in Rotterdam, Netherlands, and the €145 million purchase of a 56,000 m² office building in Essen, Germany, tenanted by Evonik Industries and Thyssen Krupp.

Over the coming year, the firm will focus on growing its real estate investment advisory business and its corporate finance advisory activities.

Our people

Training and skills development continue to be a BBK priority, with 2018 activities embracing the full spectrum of management and employees. Among an extensive range of courses and subject matters, four are particularly noteworthy.

At managerial level, 20 staff members have embarked on a high-grade leadership programme in cooperation with UK-based business school, Ashridge Executive Education. The eight-month course is aligned with the Bank's succession planning, which seeks to nurture a culture of continuous learning and has been customised for BBK's leadership competencies framework.

A further 20 employees are undertaking an early leadership training programme accredited by the Institute of Leadership and Management, one of the largest professional leadership and management bodies in the UK.

All branch and financial mall managers completed a first-of-its-kind branch management simulation programme in collaboration with the Bahrain Institute of Banking & Finance. The programme was specifically tailored for BBK and simulates real business cases and situations.

e-Learning continues to be a primary focus, with an increasing number of employees benefiting from studying specialisations that range from credit and investment to professional banker certification.

The Bank strengthens its bonds with valued former employees through the BBK Alumni Club. Held in 2018, the club's third annual reunion again showed appreciation for the contribution of alumni to BBK's long history of success.

Technology

The world of banking is rapidly changing. Well established systems and services that were previously sufficient are becoming outdated, and digitisation and automation are accelerating this trend. Today, competitors are not necessarily located in the countries in which we operate. Customers are using internet-based devices to handle many of their financial needs – no matter where they are, where they reside, or where their bank is domiciled.

In response to this global trend, we not only have to follow – we have to develop new products and services that match and improve on what the international market has to offer.

+12.6%

Total income

Total income was 161.2 million in 2018, up from 143.1 million in 2017.

Underlining BBK's commitment to technology, the Bank hosted Bahrain's first Emtech Summit & Expo, in cooperation with the Bahrain Institute of Banking & Finance. The theme of the two-day event in October was 'Technology that Changes the Paradigm', focusing on the importance of emerging technologies and how they will reshape the economy. Local and international experts came together to deliver insightful sessions and panel discussions on new topics relevant to emerging technologies and the economic conditions that will impact the Bahraini market.

BBK is also a founding partner in Bahrain FinTech Bay (BFB), the largest dedicated fintech hub in the Middle East and Africa. The partnership aims to accelerate the pace of innovation in the banking sector and create opportunities and solutions that further promote the development of Bahrain. BFB comprises state-of-the-art facilities, co-working spaces, communal areas, and a variety of other shared infrastructure. As a co-founding partner, BBK has its own station in the fintech incubator.

Internal control

The Group maintains a sound adequate internal control system and processes which are in place across all BBK departments, branches, and entities with the objective of safeguarding the Group assets. The dedicated Internal Control Unit has implemented well-designed and comprehensive systems and procedures that assist in identifying and managing risks that could arise in the course of conducting business. These controls are reviewed and updated periodically and as required.

Certification

BBK again achieved 2018 certification for compliance with the Payment Card Industry Data Security Standards (PCI DSS), the only standard dedicated to security of cardholder data and rated as one of the most stringent security standards.

Successful completion of the demanding compliance audit was the result of cooporation between Bank departments and the support of management. Organisations holding PCI DSS certification have demonstrated their ability to maintain payment account security throughout the transaction process and experience minimal data breaches.

Awards

For the fifth consecutive year, BBK was awarded by Global Banking and Finance Review. It was designated 'Best Corporate Governance Bank in Bahrain, 2018' and 'Best Online Bank in Bahrain, 2018'. These awards are highly reputed within the global banking and financial community and BBK is proud to be recognised once again because of its achievements, dedication to retail banking, and performing highly against the judging panel's key benchmarks, especially in the corporate governance area.

BBK has also received the prestigious Straight Through Processing (STP) Quality Award 2018 from Citi, recognising outstanding performance in executing international payments in US dollars. These awards are given to banks that demonstrate the highest standards in clearing client funds transfer, trade finance and international settlements, achieving the highest STP rates, i.e. percentage of automated payment transactions completed without additional manual intervention.

Our subsidiary CrediMax was also awarded by Capital Finance International for its e-wallet, MaxWallet named as '2018 Best Digital Wallet GCC'.

Outlook

The GCC's $10 billion long-term aid package and Bahrain's programme of economic reforms are only a start to improving the domestic economy. There are high expectations from government, the commercial sector, and the public. Bahrain's sovereign rating is expected to improve, considering the recent move by rating agencies to revise the country's outlook from negative to stable, which should help the government and banks to borrow at more reasonable rates.

Another challenge will be the impact of the introduction of value-added tax, from both a managerial and social point of view. We have studied the situation carefully and believe that BBK will be successful in implementing the required changes.

Our priorities remain quality of management, quality of assets, and service to our customers. We are also actively pursuing the direction and sophistication of banking in the decade ahead, particularly as it relates to digitisation.

Expansion and diversification initiatives such as BBK Lite and BBK Privé are still at an early stage and, although our rationale is long-term, they are already showing great promise.

Even the first BBK Lite branch had a much broader offering than originally envisaged, and we now have locations identified and property agreements signed for several more. Their percentage contribution to revenue will be low to begin with, but it takes time for a new business to mature and we are confident that the contribution will grow to a significant level.

The same applies to BBK Privé, primarily a niche offering to serve affluent clients, but a market of considerable value and regional potential. We are confident that, in time, it will make a proportionate contribution to revenues.

Appreciation

On behalf of all my management colleagues, I express appreciation to our Board of Directors for the support and guidance they consistently extend to us. Similarly, our thanks go to the supervisory authorities in the territories where we operate – the Central Bank of Bahrain, the Bahrain Bourse, and the regulators of the State of Kuwait, the Republic of India, the United Arab Emirates, the Republic of Turkey, and the United Kingdom.

Finally, I extend whole-hearted appreciation to our loyal clients and our employees, whose dedication contributes so much to BBK's continued success.

Reyadh Yousif Sater
Chief Executive

Innovative

We have many banking ‘firsts’ to our name, from the introduction of ATMs to credit cards, mobile and phone banking, and adoption of digital technology.

Executive management

Reyadh Yousif Sater
Chief Executive

Qualifications and experience:
MBA, University of Glamorgan, United Kingdom (2001).

41 years' banking experience.

Joined BBK in 1978.

Abdulrahman Ali Saif
Deputy Chief Executive
Wholesale Banking Group

Qualifications and experience:
PhD in Economics, University of Leicester, United Kingdom (1992).

36 years' banking experience.

Joined BBK in 2008.

Mohammed Ali Malik
Deputy Chief Executive
Retail Banking Group

Qualifications and experience:
BSc in Computer Science, University of Petroleum and Minerals, Kingdom of Saudi Arabia (1984).

33 years' work experience.

Joined BBK in 2000.

Rashad Ahmed Akbari
Assistant General Manager
Operations

Qualifications and experience:
MSc in Marketing, University of Stirling, United Kingdom (1997).

32 years' work experience, of which 17 years in banking.

Joined BBK in 2000.

Raj Dugar
Assistant General Manager
Group Chief Internal Auditor

Qualifications and experience:
ACA, Institute of Chartered Accountants of India (1987),

29 years' banking experience, of which 18 years in internal audit.

Joined BBK in 2000.

C. K. Jaidev
Assistant General Manager
International Banking

Qualifications and experience:
MBA, Indian Institute of Management, Republic of India (1989).

29 years' banking experience.

Joined BBK in 1996.

Nadeem A. Aziz Kooheji
Assistant General Manager
Corporate Banking

Qualifications and experience:
BA in Finance and International Business, University of Texas, United States of America (1988).

11 years' audit and 21 years' banking experience.

Joined BBK in 1999.

Jamal Mohamed Al Sabbagh
General Manager
Information Technology and
Operations Group

Qualifications and experience:
MBA, University of Glamorgan, United Kingdom (2001).

38 years' banking experience.

Joined BBK in 1980.

Hassaan Mohammed Burshaid
General Manager
Human Resources and
Administration Group

Qualifications and experience:
MSc, Human Resources Management, DePaul University, United States of America (2006).

24 years' experience in the field of human resources.

Joined BBK in 1998.

Mohammed Abdulla Isa
General Manager
Financial Planning and
Control Group

Qualifications and experience:
Certified Public Accountant (CPA), American Institute of Certified Public Accountants, Delaware State Board of Accountancy, United States of America (2001).

27 years' finance experience.

Joined BBK in 2001.

Adel Abdulla Salem
Assistant General Manager
Retail Banking

Qualifications and experience:
PHD in Management, Monarch Business School - Switzerland (2015),

31 years' banking experience in retail banking, business of cards and telecoms.

Joined BBK in 2017.

Neil Sharp
Assistant General Manager
Treasury and Investment

Qualifications and experience:
Associate member of the Association of Corporate Treasurers.

32 years' banking experience in the treasury business.

Joined BBK in 2009.

C. V. Murthy
Assistant General Manager
Risk, Credit and Compliance

Qualifications and experience:
MSc in Agricultural Economics (1984).

34 years of banking experience, of which 21 years in risk management.

Joined BBK in 2002.

Vivid

We have built an enviable reputation, respected and trusted locally and internationally as a vibrant symbol of integrity.

BBK supports a diversity of community related projects and worthwhile societal causes, providing substantial donations and sponsorship. In 2018, an appropriation for donations amounting to BD 1.4 million was approved by shareholders for distribution.

We believe that involvement in effective social projects helps build and sustain long-term relationships with the Bank's customers and the community at large.

In addition to fully supporting the Kingdom of Bahrain's vision for growth and the development of its citizens, BBK's support extends to 13 key areas, some of which are: philanthropy, special needs, education, medical, social, sport, culture, the elderly, national causes, environmental, and orphans. Highlights of 2018 activities across these categories include:

Backing Bahrain's financial sector

BBK's status as a Domestic Systemically Important Bank (D-SIB) means that the Bank has a major responsibility in the development of Bahrain's economy and financial sector, acting as a global ambassador for Bahrain.

In 2018, BBK held the first Emtech Summit & Expo, a two-day event that focused on the importance of emerging technologies and how they reshape Bahrain's economy. Under the patronage of the Central Bank of Bahrain, the summit's theme was 'Technology that Changes the Paradigm'. International and local experts delivered insightful sessions, and stimulating panel discussions covered new topics relevant to emerging technologies and the Bahraini market.

The international expo showcased the latest IT trends and gave participants a comprehensive overview of economic prospects and potential threats to financial stability, backed by potential support for entrepreneurs in the Kingdom.

The Bank was again a lead sponsor of the annual Euromoney GCC Financial Forum, hosted by the Bahrain Economic Development Board. More than 500 business leaders and policymakers from 24 countries attended the 2018 conference, the seventh in the series.

BBK's long-standing sponsorship of the Gulf region's first educational dealing room, established by the Bahrain Institute of Banking & Finance (BIBF), has continued, along with the Bahrain Bourse's Trade Quest competition – a stock trading simulation programme for high school students to help young Bahrainis learn about banking and investment.

Supporting employees

BBK is proud that 95 percent of our employees are Bahraini nationals. We are thoroughly committed to enhancing employee career development and empowering our people with greater responsibilities. In 2018, a high-grade leadership programme began, in cooperation with UK-based business school Ashridge Executive Education. An early leadership training programme was also launched, in collaboration with another UK based business school.

Branch management simulation programmes were presented in collaboration with the BIBF, and all the Bank's employees participated in e-Learning courses and banking specialisations.

BBK's generous employee benefits include share incentives, retirement programmes, and health and life insurance, reinforcing its status as an employer of choice. Employees who make outstanding contributions and those completing 5-45 years of service (marking every fifth anniversary of their joining the Bank) are recognised and honoured for their achievements.

Former employees are encouraged to maintain links with the Bank. The Alumni Club for former employees was established so that past and present members of the BBK family can meet periodically and not lose their commonality.

Women empowerment

BBK's commitment to empowering women is evident in the Bank's high ratio of female employees, currently standing at 39 percent, an increase of 18 percent over the last five years. The policy begins at Board level, specified in a powerful document that supports and complements Bahrain's Women Empowerment Strategy.

Strong supporter of

SUSTAINABLE DEVELOPMENT GOALS

4 QUALITY EDUCATION

5 GENDER EQUALITY

8 DECENT WORK AND ECONOMIC GROWTH

17 PARTNERSHIPS FOR THE GOALS

To support the achievement of policy objectives, the Bank has a very active Women's Empowerment Committee, responsible for developing plans that help women reach their full potential, achieve their career goals, and maintain their work/life balance.

Expanding and reinforcing relationships with women-owned ventures, including small businesses and entrepreneurs, is a strategic business priority. The Bank also helps women gain independence and education by supporting the goals of women's societies and associations in Bahrain.

Addressing community needs

A dedicated fund to support future CSR mega projects was established by BBK in 2012. The fund's value grew to BD 2.485 million during 2018. While continuing to build the fund, we are studying the needs of society and how the fund's resources can best be used to meet them. In previous years, BBK has financed projects such as the BBK Health Centre in Hidd and the BBK Rehabilitation Centre.

Special needs

Integration and support for customers with special needs ranks highly in BBK's priorities and we continue to invest in better accessibility to bank facilities for those with special needs. They are also exempt from fees and charges on withdrawals at counters, as well as minimum account balance requirements, whenever applicable.

Apart from its investment in facilities, BBK also allocates more than 15 percent of its total donation budget to special needs societies and associations.

Education

Learning features strongly in the Bank's external social responsibility work, with around 30 percent of the 2018 budget allocated to education. Investment in education is part of the Bank's forward-looking philosophy, supporting young Bahraini talent on the path to becoming a new generation of informed and productive citizens.

As a long-standing Platinum Sponsor of the Crown Prince's International Scholarship Programme, BBK is committed to funding that enables Bahrain's most outstanding young people to study at top international universities and colleges. And in its commitment to the Isa bin Salman Education Charitable Trust, the Bank contributes to helping students pursue their studies.

Further contributions to youth empowerment include training employees' children, university students, and Injaz Bahrain students through work experience that supplements classroom learning.

Healthcare

BBK's community contributions also have a strong emphasis on health and well-being awareness, with financial support extended consistently to medical entities and research institutes active in fighting diseases such as diabetes, sickle cell anaemia, and cancers. BBK has continued to support a range of health-related causes including the Mohammed Bin Khalifa Bin Salman Al Khalifa Cardiac Centre.

Sport

The Bank also recognises the benefits flowing from active participation in sport, regularly increasing its investment in sport promotion. In 2018, BBK organised its second annual sports day for nearly 350 employees, in line with the national directive of dedicating a sports day across the Kingdom.

Over decades, BBK has a proud record of donations and sponsorships that have supported football, junior tennis, and equestrianism, among others. In 2018, sponsorship support included Bahrain's Pro-Cycling team Merida, which participates in international cycling tours.

Culture

The Bank contributes to various initiatives for cultural preservation and the restoration of historical facilities through the Bahrain Authority for Culture and Antiquities, and the Sheikh Ibrahim Bin Mohammed Al Khalifa Centre for Culture and Research. Once again, the Bank co-sponsored the annual Spring of Culture.

Environmental

Reducing environmental impact is an ongoing project, with the Bank constantly seeking and implementing new ways to reduce its carbon footprint and contribute to environmental sustainability. Refining digital services plays an import role in the process, along with energy-saving practices and recycling of waste paper. BBK also supports the Supreme Council for Environment every year in its conservation work with Al Areen Wildlife Park.

Other philanthropic support

Renewed financial support for the Ministry of Social Development NGO Fund amounted to BD 30,000 during 2018. The fund provides grants to societies and charitable organisations for development initiatives. The Bank also donated a further BD 150,000 to care homes for the elderly and organisations that benefit orphans, as well as other philanthropic societies.

Part II

Reports and disclosures

Proud

Having been founded in 1971, the same year that Bahrain achieved its independence, BBK has a distinguished heritage of constant innovation.

Good corporate governance is considered central to achieving the Bank's objectives, and fundamental in maintaining a leading position within the local and regional banking sectors.

BBK takes pride in ensuring exceptional standards of corporate governance are met. Our corporate governance policy is underpinned by international standards of best practice.

Initiatives in 2018

BBK implemented initiatives in the first half of 2018 to fulfil its corporate governance strategy. The evaluation process for the Board and its committees was successfully completed and recommendations made for improvement. An action plan was put in place for short-term and long term recommendations. The role of corporate secretariat was expanded to include the Bank's wholly-owned subsidiaries, and corporate governance norms in wholly-owned subsidiary companies were improved to meet that expected at Group level. Corporate secretariat also assumed responsibility for the secretariat of the Shariah Supervisory Board, so as to apply the same corporate governance norms for this committee. The Board reviewed the independence of directors through an annual exercise taking into consideration the regulatory requirements as well as best market practice. Many awareness programmes were arranged for the Board and Executive Management with the objective of continuous development and keeping abreast of updates in the Banking and technology sectors.

Corporate governance philosophy

BBK shall continue its endeavour to enhance shareholders' value, protect their interests, and defend their rights by practising the pursuit of excellence in corporate life. The Bank shall not only comply with all statutory requirements – including the Corporate Governance Code of the Kingdom of Bahrain and the High Level Controls Module of the Central Bank of Bahrain – but also formulate and adhere to strong corporate governance practices.

BBK shall continuously strive to best serve the interests of its stakeholders, including shareholders, clients, employees, and the public at large.

The adoption and implementation of corporate governance is the direct responsibility of the Board of Directors, and this endeavour is in line with the policies of regulatory authorities and statutory requirements in the Kingdom of Bahrain and other countries where BBK operates.

Risk appetite statement

Risk appetite is the level and type of risk that the Bank is willing to assume to achieve its strategic and business objectives, keeping in perspective the obligations to its stakeholders.

The risk appetite of the Bank is both a qualitative and quantitative measure and reflects its level of risk tolerance in normal as well as in stressed scenarios. It is expressed as a measurable key performance indicator (KPI), a tolerance limit, or as a qualitative guideline.

The Bank has a well-defined Risk Appetite Framework, that consists of the Risk Appetite Statement along with: (a) well-defined performance metrics in the form of KPIs; (b) risk limits, exposure criteria, restrictions and controls, lending and investment standards as laid out in the internal risk policies and procedures manual; (c) capital and liquidity benchmarks, which are monitored in the Asset Liability Management Committee meetings; (d) key business and risk management objectives, goals, and strategy, which are defined in business, investment and risk management strategies; and (e) management and oversight structures in the Bank through Management and Board committees. Our risk appetite defines the desired performance levels, which, in turn, are embedded into management of the various risks within the Bank as well as the capital of the Bank. Our risk appetite is integrated into the strategic, capital, and risk management planning process across business verticals.

The Bank measures the contribution of each business vertical against KPIs.

The Bank aims to optimise the risk-reward for the benefit of all stakeholders, and this is reviewed and implemented through strategies (business, investment, risk management, ICAAP), which are closely reviewed annually. The Bank's primary exposure is to credit risk along with other Pillar 1 and Pillar 2 risks assumed in the normal course of its business. The risk appetite statement is also reviewed though a Risk Management Strategy document by management, and recommended for approval to the Risk Committee and the Board annually. The Bank's risk appetite requires, among other things:

- A high level of integrity, ethical standards, respect, and professionalism in our dealings.
- Taking only those risks which are transparent and understood, and those which can be measured, monitored, and managed.
- Ensuring that the Bank has adequate levels of capital adequacy on an ongoing basis as mandated by the regulator (currently 12.5 percent), and as assessed by the Bank in its ICAAP document; ensuring that the capital requirements and capital planning are incorporated in the Bank's capital management strategy.
- Ensuring that the Bank has access to adequate levels of stable, efficient, and cost-effective funding to support liquidity and lending or investing requirements on an ongoing basis; that the Bank has in place a robust liquidity management framework and contingency plans to monitor and manage liquidity both in normal and stress liquidity conditions, in addition to monitoring key liquidity ratios (internal and regulatory) in Asset Liability Management Committee meetings on a monthly basis.
- Adhering to the core principles of lending, which are enshrined in the general lending policy of the Bank.
- Maintaining a robust credit management framework with focus on geographies where the Bank has physical presence (Kuwait, India, Dubai and Turkey), GCC, and select MENA and other countries; undertaking exposures to countries within the directives of the Country Risk Committee, which reviews country risk and the Bank's strategy in those countries on a dynamic basis.
- Having in place a defined monitoring, collection, and restructuring framework for effective recovery mechanism.
- Limiting exposures to high-risk activities which may culminate in tail-end risks, jeopardising the Bank's capital and creditworthiness.
- Striving for optimum profitability through income generation, cost efficiency, and low impairment.
- Widening the product basket and delivery channels for increasing customer satisfaction; assessing new credit products in a structured form for approval by appropriate authorities, so that the underlying risks, benefits, operational processes, system/technology requirements, and legal requirements are understood and managed.
- Protecting the Bank's and the customers' interests through robust operational procedures, internal controls, system support, training, and operational risk management processes to mitigate operational risk.
- Ensuring full compliance with legal, statutory, and regulatory requirements; ensuring adherence to anti-money laundering (AML) and other obligations under international law; providing adequate training and guidance to mitigate compliance and AML risks.

Shareholder information

BBK's shares are listed on the Bahrain Bourse. The Bank has issued 1,081,647,952 equity shares, each with a face value of 100 fils. All shares are fully paid.

Annual Ordinary General Meeting and Extraordinary General Meeting

The Annual Ordinary General Meeting (AGM) and Extraordinary General Meeting (EGM) were held on 20 March 2018.

The EGM approved amendment to the Bank's Articles of Association to be in line with the recent amendments on the Commercial Companies Law No (21) of the year 2001 in terms of Law No (1) for the year 2018. Minutes of both the AGM and EGM are published in the annual report.

The Bank submits a corporate governance report to the AGM annually, covering the status on compliance with the related regulatory requirements. The Bank discloses and/or reports to the shareholders at the AGM the details under the Public Disclosure module of the Central Bank of Bahrain's Rule Book. Such disclosures include the total remuneration paid to the Board of Directors, the executive management, and the external auditors. The total amount paid to directors and executive management is also contained in the annual report.

Board of Directors' information

Board composition

The Board's composition is based on the Bank's Memorandum of Association and Articles of Association, and comprises 12 members. The Board represents a mix of high-level professional skills and expertise. Furthermore, in compliance with corporate governance requirements, the Board Committees consist of members with adequate professional background and experience. Consequently, the Board has five independent Directors. The Board periodically reviews its composition and the contribution of Directors and Committees.

The appointment of Directors is subject to CBB approval. The classification of Executive Directors, Non-Executive Directors, and Independent Non-Executive Directors follows the definitions stipulated by the CBB. The current term of the Board began in March 2017 and ends in March 2020.

Directors are elected/appointed by shareholders at the AGM. Experts who are non-shareholders or promoters of the Bank may also be elected as Directors. Election or re-election of a Director at the AGM shall be accompanied by a recommendation from the Board, based on a recommendation from the Nomination, Remuneration, and Corporate Governance Committee, with specific information such as biographical and professional qualifications and other directorships held.

Group Corporate Secretary

The Board is supported by the Group Corporate Secretary, who provides professional and administrative support to the General Assembly, the Board, its Committees, and members. The Group Corporate Secretary also assumes the responsibilities of the Group Corporate Governance Officer and in this context supports the processes of performance evaluation for the Board, the Board Committees and individual Directors, as well as the process of access to independent advice and other relevant issues on a Group level. The appointment of the Group Corporate Secretary is subject to the approval of the Board.

BBK's Group Corporate Secretary is Ahmed A. Qudoos Ahmed, who joined the Bank in 2009. His qualifications include a BSc in Engineering from the University of Bahrain in 1996. He is qualified in Board Secretarial practices from George Washington University and he has attended many advance training programmes in corporate governance both in Bahrain and abroad, accumulating over 22 years of experience in the financial sector.

Directors' roles and responsibilities

The Board of Directors oversees the implementation of the Bank's strategic initiatives and its functioning within the agreed framework, in accordance with relevant statutory and regulatory structures. The Board ensures the adequacy of financial and operational systems and internal control, as well as the implementation of Corporate Ethics and the Code of Conduct.

The Board reserves a formal schedule of matters for its decision to ensure that the direction and control of the Bank rest with the Board. This includes strategic issues and planning, performance reviews, material acquisition and disposal of assets, capital expenditure, authority levels, appointment of auditors and review of the financial statements, financing and borrowing activities including annual operating plan and budget, ensuring regulatory compliance, and reviewing the adequacy and integrity of internal controls.

The Board shall exercise judgment in establishing and revising the delegation of authority for Board Committees and Management. This delegation could be for authorisation of expenditure, approval of credit facilities, or for other corporate actions. Such delegation may be approved and expressed under various policies of the Bank. The thresholds for the identified authorities will depend upon the operating requirements of the Bank.

Shareholders

Name	Country of origin	Number of shares	% holding
Citizens of the Kingdom of Bahrain and Others	–	246,605,845	22.79
Ithmaar Holding B.S.C.	Kingdom of Bahrain	274,493,028	25.38
Social Insurance Organisation (SIO)			
– Formerly Pension Fund Commission	Kingdom of Bahrain	203,020,288	18.77
– Formerly General Organisation for Social insurance (GOSI)	Kingdom of Bahrain	144,294,820	13.34
Kuwait Investment Authority	State of Kuwait	202,229,987	18.70
Global Investment House	State of Kuwait	11,003,984	1.02

Distribution schedule of each class of equity

Category	Number of shares	Number of shareholders	% of outstanding shares
Less than 1%	236,917,711	2,348	21.90
1% to less than 5%	66,031,260	3	6.10
5% to less than 10%	68,422,459	1	6.33
10% to less than 20%	435,783,494	3	40.29
20% to less than 50%	274,493,028	1	25.38
50% and above	0	0	0

The issues of major capital expenditure, divestitures, mergers and acquisitions, and certain strategic investments would be within the Board's authority.

Each Director holds the position for three years, after which he must present himself to the Annual General Meeting of shareholders for reappointment. The majority of BBK Directors (including the Chairman and/or Deputy Chairman) are required to attend Board meetings to ensure a quorum. The Board Charter is published on the Bank's website.

Material transactions that need Board approval

Lending transactions to Directors, at a certain level of exposure, require Board approval. Credit and investment applications exceeding certain pre-defined exposure levels also require Board approval.

Similarly, related party transactions involving members of the Board require Board approval.

Independent professional assistance

The Bank has procedures approved by the Board for allowing Board members to obtain independent professional advice relating to the affairs of the Bank or to their individual responsibilities as members, subject to approval by the Board.

Directors' induction and professional development

The Board is required to be up to date with current business, industry, regulatory, and legislative developments and trends that affect the Bank's business operations. Immediately after appointment, the Bank provides formal induction for a full day.

Meetings will also be arranged with executive management. This will foster a better understanding of the business environment and markets in which the Bank operates. A continuing awareness programme is essential and may take many forms, through distribution of publications, workshops, presentations at Board meetings, and attendance at conferences encompassing topics on directorship, business, industry, and regulatory developments. In terms of the Training and Competency Model of the CBB, each approved person (including members of the Board of Directors) is required to complete 15 hours of continued professional development.

Board and Committee evaluation

The Board performs a self-evaluation annually. The Board annually reviews its Charter and its own effectiveness, and initiates suitable steps for any amendments. The Board will also review self-evaluations of individual Board members and the Board Committees and consider any recommendations arising out of such evaluation. The relevant policy is published on the Bank's website.

Remuneration of Directors

The Board has adopted a remuneration policy for Directors with well-defined procedures to apply to the Directors' various remuneration and compensation components, reflective of their involvement and contributions in the activities of the Board of Directors and its ad hoc, temporary, and permanent committees. The basic guideline of the policy is that participation would be considered in terms of attendance at meetings. Participation in a meeting via telephone/video conference shall be considered as attendance of the meeting. The relevant policy is reviewed periodically to ensure it is in line with regional best practice. Directors' remuneration is governed by Commercial Companies Law No 21 for the year 2001, and therefore all payments comply with the provision of the law.

Insurance coverage

The Bank provides personal accident insurance coverage for Board Members during travel on Bank assignments. The Bank also has a liability insurance policy for Directors.

Whistle-blowing policy

The Bank has a whistle-blowing policy with designated officials whom the employee can approach.

The policy provides adequate protection for the employees for any reports made in good faith. The Board's Audit Committee oversees this policy. The whistle-blowing policy is published on the Bank's website.

Key persons (KP) policy

The Bank has established a 'Key Persons' policy to ensure that key persons are aware of the legal and administrative requirements regarding holding and trading of BBK shares, with the primary objective of preventing abuse of inside information. Key persons are defined to include the Directors, executive management, designated employees, and persons under guardianship or control of Key Persons. Ownership of the Key Persons policy is entrusted to the Board's Audit Committee. The Key Persons policy is posted on the Bank's website.

Code of Conduct

The Board has an approved Code of Conduct for BBK Directors. The Board has also approved a Code of Ethics for the Executive Management and employees. These codes outline areas of conflict of interest, confidentiality, and the responsibilities of signatories to adhere to best practices. The high-level responsibility for monitoring the codes lies with the Board of Directors. The Directors' Code of Conduct is published on the Bank's website.

Relative Recruitment/Appointment Policy

The Bank has in place policies that govern the recruitment/ appointment of relatives in the Bank and across its wholly owned subsidiaries. The policies are:

1 Employment of relatives of first and second degrees shall be prohibited, whereas employment of relatives of third and fourth degree may be approved by the management provided it does not lead to a conflict of interest.

2 Employment of relatives at the Bank's wholly-owned subsidiaries of first and second degree shall be prohibited for senior managers and above; any exception must approved by the Chief Executive.

3 As part of the annual reporting, the Chief Executive must disclose to the Board of Directors on an annual basis those individuals who are occupying controlled functions and who are relatives of any other approved persons within the Bank and its wholly-owned subsidiaries.

Conflict of interest

The Bank has a documented procedure for dealing with situations involving conflict of interest of Directors. In the event of the Board or its Committees considering any issues involving conflict of interest of Directors, decisions are taken by the full Board/Committees.

The concerned Director shall leave the meeting room during the discussion of these issues. These events are recorded in the Board/ Committee proceedings. The Directors are required to inform the entire Board of conflicts of interest (potential or otherwise) in their activities with, and commitments to, other organisations as they arise, and to abstain from voting on the matter. This disclosure includes all material facts in the case of a contract or transaction involving the Director.

Development programmes arranged for Board members during 2017

Key: ⦿ Attended ○ Absent

Board of Directors	Course: "Fin-Tech Awareness" Date: 18/02/2018 2.5 hours	Course: "Value added Tax VAT for Financial Sector" Date: 18/02/2018 2.5 hours	Course: "Risk Management" Date: 14/05/2018 2.5 hours	Course: "Organisation culture and values, the role of the Board" Date: 14/05/2018 2.5 hours	Course: "Regional and Global Market practice Pertaining to Remuneration" Date: 30/09/2018 2.5 hours	Course: "cloud computing" Date: 30/09/2018 2.5 hours	Other training hours or outside the Bank
Murad Ali Murad*	⦿	⦿	⦿	⦿	⦿	⦿	21 hours
Aref Saleh Khamis*	○	○	○	○	○	○	57 hours
Mohamed A.Rahman Hussain*	⦿	⦿	○	○	○	⦿	33 hours
Jassem Hasan Ali Zainal*	⦿	⦿	⦿	⦿	○	○	5 hours
Dr. Zakareya Sultan AlAbbasi*	○	○	○	○	○	○	16 hours
Sh. Abdulla Khalifa Salman Al-Khalifa*	○	○	○	○	○	○	29 hours
Sh. Khalifa Bin Duaij Al Khalifa*	○	○	○	○	○	○	54 hours
Marwan Mohammed Al Saleh*	○	○	○	○	⦿	⦿	32 hours
Yusuf Saleh Khalaf*	⦿	⦿	⦿	⦿	⦿	⦿	7 hours
Edrees Musaed Ahmad*	⦿	⦿	⦿	⦿	○	○	9 hours
Hani Ali Al Maskati*	⦿	⦿	⦿	⦿	⦿	⦿	14 hours
Ashraf Adnan Bseisu*	⦿	⦿	⦿	⦿	○	○	33 hours

* Attended other training sessions or sessions outside the Bank

Corporate social responsibility

BBK's contribution towards the well-being of the community is an integral part of its corporate role. This corporate social responsibility is translated by the Bank through annual appropriation of a budget allocated for donations to finance community-related projects and initiatives. The projects may vary in nature but ought to fall into any one of the following fields: charity, culture, research, education, philanthropy, environmental protection, and sports.

BBK has an approved high-level donation policy for the distribution of the donation budget. The policy outlines guiding principles and sets criteria for the evaluation and selection of donation requests, with the ultimate objective of maximising the return on both the Bank's social image and the benefit of the community.

Disclosures relating to the Board of Directors

Directors' external appointments

Murad Ali Murad		
Chairman of the Board	Bahrain Kuwait Insurance Company (BSC)	Kingdom of Bahrain
Chairman of the Committee	Nomination Remuneration and Governance Committee – Bahrain Kuwait Insurance Company (BSC)	Kingdom of Bahrain
Vice-Chairman	Bahrain Institute of Banking & Finance (BIBF)	Kingdom of Bahrain
Chairman of the Committee	Audit and Risk Committee – Bahrain Institute of Banking & Finance (BIBF)	Kingdom of Bahrain
Chairman of the Board	Al Janabeya Company WLL (Family Company)	Kingdom of Bahrain

Aref Saleh Khamis		

Mohamed Abdulrahman Hussain		
Vice-Chairman and Chairman of Executive Committee	Eskan Bank BSC	Kingdom of Bahrain
Board Member	Investcorp Saudi Arabia Financial Investment Company	Kingdom of Saudi Arabia
Board Member	The K Hotel WLL	Kingdom of Bahrain
Independent Director	A. M. Yateem brothers WLL	Kingdom of Bahrain

Directors' external appointments continued

Jassem Hasan Ali Zainal		
Vice-Chairman and CEO	Arzan Financial Group for Financing and Investment	State of Kuwait
Chairman and CEO	Addax Investment Bank	Kingdom of Bahrain
Board Member	Kuwait International Bank	State of Kuwait
Board Member	Al-Masah Capital Limited	Dubai, UAE
Board Member	Miami International Securities Exchange LLC (MIAX)	United States of America

Dr Zakareya Sultan AlAbbasi		
Board Member	Eskan Bank BSC	Kingdom of Bahrain

Sh Abdulla bin Khalifa bin Salman Al Khalifa		
Chief Executive Officer	Osool Asset Management BSC	Kingdom of Bahrain
Chairman	Securities & Investment Company (SICO) BSC	Kingdom of Bahrain
Chairman	Bahrain Telecommunications Company (Batelco)	Kingdom of Bahrain
Board Member and Chairman of the Executive Committee	Amanat Holdings PJSC	United Arab Emirates

Sh Khalifa bin Duaij Al Khalifa		
President	Court of HRH the Crown Prince	Kingdom of Bahrain
Board Member	Crown Prince's International Scholarship Programme	Kingdom of Bahrain
Board Member	Isa Bin Salman Educational Charitable Trusts	Kingdom of Bahrain
Board Member	Palm Capital Company WLL	Kingdom of Bahrain
Board Member	Arab Thought Foundation	Lebanon

Marwan Mohammed Al Saleh		
Director of Fixed Income	Kuwait Investment Authority	State of Kuwait

Edrees Musaed Ahmad		
Investment Manager	Kuwait Investment Authority (KIA) Employee	State of Kuwait

Hani Ali Al Maskati		
Co-Founder & Managing Partner	Cash Management Matters (CMM)	Kingdom of Bahrain
Chairman of the Audit Committee	Solidarity Saudi Takaful Company	Kingdom of Saudi Arabia
Board Member	Blu Solution Ltd	British Virgin Islands

Yusuf Saleh Khalaf		
Managing Director	Vision Line Consulting WLL	Kingdom of Bahrain

Ashraf Adnan Bseisu		
Group Chief Executive	Solidarity Group Holding Company (BSC)	Kingdom of Bahrain
Chairman	Solidarity First Insurance Company (PLC)	Hashemite Kingdom of Jordan
Vice-Chairman	Solidarity Bahrain Takaful Company (BSC)	Kingdom of Bahrain
Vice-Chairman	Solidarity Saudi Takaful Company	Kingdom of Saudi Arabia
Board Member	BIBF	Kingdom of Bahrain
Board Member	United Insurance Company	Kingdom of Bahrain

Directors' and related parties' interests

The number of securities held by Directors as of 31 December 2018 was as follows:

Name of Director	Type of shares	31 Dec 2018	31 Dec 2017	Bonds 31 Dec 2018	Bonds 31 Dec 2017
Murad Ali Murad	Ordinary	853,977	853,977	197,778	197,778
Aref Saleh Khamis	Ordinary	–	–	–	–
Mohamed Abdulrahman Hussain	Ordinary	178,402	153,402	–	–
Jassem Hasan Ali Zainal	Ordinary	190,286	190,286	30,000	30,000
Sh Abdulla bin Khalifa bin Salman Al Khalifa	Ordinary	127,050	127,050	50,000	50,000
Sh Khalifa bin Duaij Al Khalifa	Ordinary	138,326	138,326	–	–
Marwan Mohammed Al Saleh	–	–	–	–	–
Yusuf Saleh Khalaf	Ordinary	152,050	152,050	39,057	39,057
Ashraf Adnan Bseisu	Ordinary	14,707	14,707	–	–

Related parties

1) Al Janabeya Company WLL (a family company owned by Mr Murad Ali Murad and his family) owns 987,825 shares, 91,326 bonds, and is related to the Chairman of the Board.

2) Arzan Financial Group – Board Member Mr. Jassem Hasan Zainal is the Vice Chairman & CEO of this group, that has a term loan facility with the Bank of KD 1.1 MM (BD 1.4 MM) maturing in May 2021.

Nature and extent of transactions with related parties

None.

Approval process for related parties' transactions

The Bank has a due process for dealing with transactions involving Directors and related parties. Any such transaction will require the approval of the Board of Directors.

Material contracts and loans involving Directors

Name of the Director	Relationship with Director	Purpose of loan	Amount of loan	Interest Rate	Terms of payment of interest	Repayment of the principal	Security
Murad Ali Murad	Chairman	Personal banking needs	BD 300,000	Fixed deposit rate over 1% pa	On demand	On demand	100% cash collateral
Jassem Hasan Ali Zainal	Board Member	Personal banking needs	USD 66,000	LIBOR + 3%	On demand	On demand	Shares 43% plus fixed deposit of 3%
			BD 115,000	BIBOR + 3%			

Note: 1) The materiality amount for such disclosures is considered above BD 100,000.
2) 7 Board members hold CrediMax Credit cards with a total limit of BD 97,100 and outstanding amount at the end of December 2018 of BD 5,649.014.

Directors' trading of BBK shares during 2018

None.

Board meetings

The Board of Directors meet at the summons of the Chairman (or Deputy Chairman in event of his absence or disability) or, if requested to do so, by at least two Directors. The Board meets at least four times a year. A meeting of the Board of Directors is deemed valid if attended by more than half of the members.

Meetings of Independent Directors

Since 2012 the Board of Directors has held separate meetings for Independent Directors. In terms of the Board Charter, minority shareholders look to Independent Directors for representation. For this purpose, regular Board meetings are preceded by a meeting of Independent Directors, unless the Independent Directors decide that there are no issues to discuss.

The agendas for this forum's meetings are the same as those for the regular Board meetings. During these meetings the Independent Directors express their views about certain issues, especially those relating to minority shareholders. The summary of the proceedings of such meetings is recorded by the Group Corporate Secretary and shared with the Independent Directors.

Board meeting attendance

During 2018, seven Board meetings were held in the Kingdom of Bahrain in the following manner:

Key: ⦿ Attended ○ Absent ⦸ was not a member during this period

Board meetings 2018

	Quarterly meetings				Other meetings		
Members	19 Feb	30 Apr	23 Jul	22 Oct	20 Mar	*19 Nov	26 Dec
Murad Ali Murad	⦿	⦿	⦿	⦿	⦿	⦿	⦿
Aref Saleh Khamis	⦿	⦿	⦿	⦿	⦿	⦿	⦸
Mohamed Abdulrahman Hussain	⦿	⦿	⦿	⦿	⦿	⦿	⦿
Jassem Hasan Ali Zainal	⦿	⦿	⦿	⦿	⦿	⦿	⦿
Dr Zakreya Sultan AlAbbasi	⦿	⦿	⦿	⦿	⦿	○	⦸
Sh Abdulla bin Khalifa bin Salman Al Khalifa	⦿	⦿	○	⦿	⦿	⦿	⦿
Sh Khalifa bin Duaij Al Khalifa	⦿	⦿	○	○	⦿	⦿	⦿
Marwan Mohammed Al Saleh	⦿	⦿	○	⦿	⦿	⦿	⦿
Yusuf Saleh Khalaf	⦿	⦿	⦿	⦿	⦿	⦿	⦿
Edrees Musaed Ahmad	⦿	⦿	⦿	○	⦿	⦿	⦿
Hani Ali Al Maskati	⦿	⦿	⦿	⦿	⦿	⦿	⦿
Ashraf Adnan Bseisu	⦿	⦿	⦿	⦿	⦿	⦿	⦿

* The 3-year strategy review meeting was held on 19 November 2018

Major issues discussed by the Board during 2018

(Subjects that fall under Board Committees' scope are recommended by the respective Committee for the Board's approval.)

Date of meeting	Subject
19 February 2018	1 Recommendation to the AGM concerning amendments to the Articles of Association of the Bank due to amendments to the Commercial Companies Law 2 Corporate Governance report to AGM 3 Quarterly Liquidity Report 4 Investment Portfolio performance 5 Financial Results 6 Re-appointment of external auditors and their fees 7 Anti-Money Laundering annual report 2017 8 Succession Plan 9 Risk Policies for review
20 March 2018	1 Board Chairmanship and Board Committees' Composition 2 Board Evaluation
30 April 2018	1 Review of the Board Charter 2 Financial Results for First Quarter of 2018 and reviewing related press release 3 Cyber Security 4 Review of the Audit Committee's Terms of Reference 5 Investment Strategy 6 Risk Policies for review

Date of meeting	Subject
23 July 2018	1 Review of the Bank's Strategy for the years 2016 to 2018 2 Financial Results for Second Quarter of 2018 and reviewing related press release 3 CBB Examination Report 2017 4 Amendment of the Key Persons Trading Policy 5 Review of the Key Persons Trading Policy 6 Independent Board Member Evaluations 7 Quarterly Liquidity Report 8 Risk Policies for review 9 Succession Plan
22 October 2018	1 Financial Results for Third Quarter of 2018 and reviewing the related press release 2 Schedule of Meeting of the Board of Director and its Committees for the year 2019 3 Succession plan 4 Compensation policy for Turkey representative office 5 HR Policy review 6 Risk Policies for review
19 November 2018	1 Presenting the new three years Strategy 2019 to 2021
26 December 2018	1 The Budget For The Year 2019 2 Strategy updates 3 Regulatory updates

Board committees

The Board Committees are formed and their members are appointed by the Board of Directors each year after the Annual General Meeting. They are considered the high-level link between the Board and the Executive Management. The objective of these Committees is to assist the Board in supervising the actual operations of the Bank, by reviewing any issues that are submitted by the Executive Management and making recommendations to the Board for their final review.

The Board reserves the right to form temporary Committees and discontinue them from time to time, as necessary. Furthermore, members of the Board are provided with copies of the meeting minutes of the said Committees, as required by the regulators. There are no significant issues of concern to report relating to the work of the Board Committees during the year 2018. The Board formed an ad hoc committee during 2018 with the objective of enhancing the credit approvals process and framework.

The full text of the Terms of Reference for Board Committees (Executive Committee, Audit and Compliance Committee, Nomination, Remuneration and Corporate Governance Committee, Risk Committee, and Independent Members Committee) are published on the Bank's website.

Board Committees' composition, roles and responsibilities

Executive Committee

Members	Summary terms of reference, roles and responsibilities	Summary of responsibilities
Mohamed Abdulrahman Hussain Chairman **Aref Saleh Khamis** Deputy Chairman until 2 December 2018 **Sh Abdulla bin Khalifa bin Salman Al Khalifa** Member **Yusuf Saleh Khalaf** Member **Ashraf Adnan Bseisu** Member **Reyadh Yousif Sater** Member	• No fewer than five members are appointed for a one-year term • Minimum number of meetings required each year: 8 (actual meetings in 2018: 10) • The Chairman and Deputy Chairman must be a Director and elected by the members of the Committee in the first meeting following the appointment of its members • The quorum shall be more than half of the members and must include the Chairman or the Deputy Chairman; attendance by proxies is not permitted • The Chairman or Deputy Chairman shall be available at the Annual General Meeting to answer questions relating to the Committee's functions • The Committee conducts an annual self-assessment of the performance of the Committee/members, and reports conclusions and recommendations to the Board	Reviews, approves and directs the executive management on matters raised to the Board of Directors such as business plans, donations, credit/investment applications, and such other proposals within its authority, and the periodic review of the Bank's achievements

Audit and Compliance Committee

Members	Summary terms of reference, roles and responsibilities	Summary of responsibilities
Murad Ali Murad Chairman (Independent) **Jassem Hasan Zanial** Deputy Chairman (Independent) **Sh Khalifa bin Duaij Al Khalifa** Member (Independent) **Edrees Musaed Ahmad** Member	• The Board appoints no fewer than three members for a one-year term • The Chairman must be elected by the members of the Committee, from among the Independent Non-Executive Directors, in its first meeting after the appointment of the members; the majority of members should also be independent • Minimum number of meetings required each year: 4 (actual meetings in 2018: 4) • Quorum shall be more than half of the members and must include the Chairman; attendance by proxies is not permitted • The Chairman or Deputy Chairman shall be available at the Annual General Meeting to answer questions relating to the Committee's functions • The Committee conducts an annual self-assessment of the performance of the Committee/members, and reports conclusions and recommendations to the Board	Reviews the internal audit programme and internal control system, considers major findings of internal audit reviews, investigations and management's response, ensures coordination among internal and external auditors, monitors trading activities of key persons, and ensures prohibition of the abuse of inside information and disclosure requirements Approves and periodically reviews the Internal Audit Charter Document, which defines the purpose, authority, responsibilities and other aspects of the internal audit activity. The Internal Audit Charter document is available to internal & external stakeholders upon specific request addressed to the Board Secretary.

Nomination, Remuneration and Corporate Governance Committee

Members	Summary terms of reference, roles and responsibilities	Summary of responsibilities
Murad Ali Murad Chairman (Independent) **Sh Khalifa bin Duaij Al Khalifa** Deputy Chairman (Independent) **Marwan Mohammed Al Saleh** Member **Mohamed Abdulrahman Hussain** Member (Independent)	• The Board appoints no fewer than three members for a one-year term. The Chairman is an Independent Director and the majority of members should also be independent • The Chairman and the Deputy Chairman must be elected by members of the Committee in its first meeting after the appointment of the members • Minimum number of meetings required each year: 2 (actual meetings in 2018: 4) • Quorum shall be more than half of the members and must include the Chairman or the Deputy Chairman attendance by proxies is not permitted • The Chairman or Deputy Chairman shall be available at the Annual General Meeting to answer questions relating to the Committee's functions • The Committee conducts an annual self-assessment of the performance of the Committee/members, and reports conclusions and recommendations to the Board	Assess, evaluate and advise to the Board of Directors on all matters associated with nominations and remunerations of the Directors and the Executive Management. Also, to ensure that the Bank adopts and enhances sound corporate governance practices, which are consistent with the Corporate Governance Code of the Kingdom of Bahrain and the regulatory requirements, and which also reflect best market practices in corporate governance, and makes recommendations to the Board as appropriate

Risk Committee

Members	Summary terms of reference, roles and responsibilities	Summary of responsibilities
Hani Ali Al Maskati Chairman (Non-executive) **Jassem Hasan Ali Zainal** Deputy Chairman (Independent) **Dr Zakareya Sultan AlAbbasi** Member until 2 December 2018 **Edrees Musaed Ahmad** Member	• At least four members are appointed for a one-year term • The Chairman and Deputy Chairman must be a Director and elected by the members of the Committee in its first meeting following the appointment of its members • Minimum number of meetings required each year: 4 (actual meetings in 2018: 4) • The quorum shall be more than half of the members and must include the Chairman or the Deputy Chairman; attendance by proxies is not permitted • The Chairman or Deputy Chairman shall be available at the Annual General Meeting to answer questions relating to the Committee's functions • The Committee conducts an annual self-assessment of the performance of the Committee/members and reports conclusions and recommendation to the Board	Reviews risk policies and recommends to the Board of Directors for approval. Also examines and monitors the risk issues to the Bank's business and operations and directs the management appropriately

Independent Directors Committee

Members	Summary terms of reference, roles and responsibilities	Summary of responsibilities
Murad Ali Murad Chairman (Independent) **Jassem Hasan Zanial** Member (Independent) **Sh Khalifa bin Duaij Al Khalifa** Member (Independent) **Mohammed Abdulrahman Hussain** Member (Independent) **Yusuf Saleh Khalaf** Member (Independent)	• The Committee is composed of Independent Directors • The Committee meets at least once a year • The meetings are attended by Independent Directors and the Group Corporate Secretary only • Attendance should be in person • The Committee discusses issues on the Board agenda according to its terms of reference	Providing independent views on certain issues, especially pertaining to minority shareholders

Board Committee meetings and record of attendance

Key: ⦿ Attended ○ Absent ⦸ was not a member during this period

Executive Committee meetings in 2018

Members	11 Feb	14 Mar	23 Apr	13 May	13 Jun	16 Jul	17 Sep	18 Oct	13 Nov	24 Dec
Mohamed Abdulrahman Hussain	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿
Aref Saleh Khamis	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦸
Sh Abdulla bin Khalifa bin Salman Al Khalifa	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿
Reyadh Yousif Sater	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿
Ashraf Adnan Bseisu	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿
Yusuf Saleh Khalaf	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿	⦿

Audit and Compliance Committee meetings in 2018

Members	11 Feb	22 Apr	17 Jul	17 Oct
Murad Ali Murad	⦿	⦿	⦿	⦿
Sh Khalifa bin Duaij Al Khalifa	⦿	○	○	⦿
Jassem Hasan Ali Zainal	⦿	⦿	○	⦿
Edrees Musaed Ahmad	⦿	⦿	⦿	⦿

Nomination, Remuneration and Corporate Governance Committee meetings in 2018

Members	11 Feb	27 Feb	9 July*	18 Oct
Murad Ali Murad	⦿	⦿	⦿	⦿
Mohamed Abdulrahman Hussain	⦿	⦿	⦿	⦿
Sh Khalifa bin Duaij Al Khalifa	⦿	⦿	⦿	⦿
Marwan Mohammed Al Saleh	○	⦿	○	○

* Unscheduled meetings

Risk Committee meetings in 2018

Members	12 Feb	22 Apr	15 Jul	17 Oct
Hani Ali Al Maskati	⦿	⦿	⦿	⦿
Jassem Hasan Ali Zainal	⦿	⦿	⦿	⦿
Dr Zakareya Sultan AlAbbasi	⦿	⦿	⦿	⦿
Yusuf Saleh Khalaf	⦿	⦿	⦿	⦿
Edrees Musaed Ahmad	⦿	⦿	⦿	⦿

Independent Directors' Committee meetings in 2018

Members	19 Feb
Murad Ali Murad	⦿
Jassem Hasan Ali Zainal	⦿
Sh Khalifa bin Duaij Al Khalifa	⦿
Mohamed Abdulrahman Hussain	⦿
Yusuf Saleh Khalaf	⦿

Other Meetings

Mr. Murad Ali Murad, the Chairman of the Board attended the periodical CBB prudential meetings on the following dates: 5 February and 24 September 2018.

Shariah Supervisory Board disclosures

Since 2016, the Bank has established a Shariah Supervisory Board, as the Bank conducts some of its transactions according to the Islamic Shariah and must ensure that these transactions are within Shariah standards and norms as required by the regulatory authority in the Kingdom. The AGM in its meeting dated 29/3/2017 had approved forming the Shariah Supervisory Board and nomination of its members for three renewable years. The Shariah Supervisory Board members and the meetings during 2018 are as follows:

Shariah Supervisory Board attendance in 2018:

Members	18 Feb	24 May	24 Oct	27 Dec
Dr Osama Bahar (Chairman)	⦿	⦿	⦿	⦿
Sh Abdulnasser Al Mahmood (Member)	⦿	⦿	⦿	⦿
Dr Adel Al Marzooqi (Member)	⦿	⦿	⦿	⦿

Compliance and anti-money laundering

Compliance with regulatory and statutory requirements is an ongoing process. The Bank is conscious of its responsibilities in observing all regulatory provisions and best international practices in its functioning. The Bank has established an independent compliance function in keeping with Basel and CBB guidelines. The unit acts as a focal point for all regulatory compliance and for adapting other best practice compliance principles. The Bank continuously strives to improve the level of compliance in all its activities. The Bank's adopted corporate philosophy is: 'BBK shall continue its endeavour to enhance shareholders' value, protect their interests, and defend their rights by practising pursuit of excellence in corporate life.' Anti-money laundering measures form an important area of the compliance function, in addition to areas of corporate governance, disclosure standards, insiders'/key persons' trading, conflict of interest, and adherence to best practices.

Starting from 2014, BBK began implementation of an automated compliance system for the monitoring and management of regulatory requirements across the Bank. This system facilitates the prompt reporting of any compliance concerns or non-compliance incidents as and when they arise. In 2017 and 2018, the system was rolled over to most concerned divisions as part of system overall implementation across the Bank.

The Bank has documented an anti-money laundering programme, including periodic awareness training for employees, record-keeping, and a designated Money Laundering Reporting Officer (MLRO). The AML policy and procedures are updated annually and were last approved by the Board of Directors in April 2018.

The Bank has deployed a risk-based automated transaction monitoring system in keeping with the anti-money laundering regulations of the CBB. In September 2018, an upgrade of the Bank's AML monitoring system was implemented.

The Bank's anti-money laundering measures are regularly audited by the internal auditors, who report to the Audit and Compliance Committee of the Board. The Central Bank performs periodic inspections of the Bank's compliance with anti-money laundering regulations; the last AML/CFT examination by the Central Bank was concluded in October 2016. The annual inspection of the central bank covers all areas in the bank including Compliance and AML activities. Additionally, the Bank's anti-money laundering measures are audited by independent external auditors every year and their report is submitted to the CBB. The overseas branches in India and Kuwait and the subsidiary, CrediMax, have designated compliance and MLRO functions to ensure implementation of local regulations and also to meet CBB requirements as applicable. The Bank is committed to combating money-laundering and, towards this end, implements all 'Prevention of Money Laundering Regulations' as stipulated in the Financial Crimes Module of the CBB Rulebook and other guidelines issued by the CBB. These regulations and guidelines are consistent with the revised FATF recommendations, 'Customer Due Diligence for Banks' paper of the Basel Committee, and best international practices.

Communication strategy

The Bank has an open policy on communication with its stakeholders, and has adopted a communication disclosure policy consistent with Basel II requirements. Shareholders are invited by the Chairman to attend the annual general meeting (AGM). The Chairman and other Directors attend the AGM and are available to answer any questions. The Bank is at all times mindful and conscious of its regulatory and statutory obligations regarding dissemination of information to its stakeholders.

The Bank provides information on all events that merit announcement, either on its website – www.bbkonline.com – or through other forms of publication. The Bank's annual report and three years' financial statements are also published on the website, as well as the Bank's Corporate Governance Report, Corporate Governance Framework, Whistle-Blowing Policy, Board Charter, Code of Conduct, Key Persons' Dealing Policy, and Terms of Reference of all Board Committees. Shareholders can complete an online form, which can be found on the website, to forward any queries they may have.

The Bank uses a bulletin board for communicating with its employees on general matters, and sharing information of common interest and concern.

The Bank follows a total compensation approach to remuneration. This includes the Bank's variable remuneration policy for rewarding performance as well as providing competitive fixed remuneration for attracting and retaining talent.

The Bank adopted regulations concerning sound remuneration practices issued by the Central Bank of Bahrain in 2014, and consequently revised its variable remuneration framework. The revised policy framework and incentive components were approved by the shareholders in the Annual General Meeting on March 10th, 2015.

The key features of the remuneration framework are summarised below.

Remuneration strategy

The Bank's basic compensation philosophy is to provide a competitive level of total compensation to attract and retain qualified and competent employees. The Bank's variable remuneration policy is driven primarily by a performance-based culture that aligns employee interests with those of the shareholders of the Bank. These elements support the achievement of the objectives through balancing rewards for both short-term results and long-term sustainable performance. The strategy is designed to share the success of the Bank and to align employees' incentives with the risk framework and risk outcomes.

The quality and long-term commitment of all of the employees is fundamental to the success of the Bank. We therefore aim to attract, retain and motivate the very best people who are committed to maintaining a career with the Bank, and who will perform their role in the long-term interests of our shareholders. The Bank's reward package comprises the following key elements:

1 Fixed pay

2 Benefits

3 Annual (short term) performance bonus

4 Annual (long term) performance bonus

5 Subsidiaries Board Remuneration

A robust and effective governance framework ensures that the Bank operates within clear parameters of its remuneration strategy and policy. All remuneration matters, and overall compliance with regulatory requirements, are overseen by the Board Nomination, Remuneration and Corporate Governance Committee (NRCG).

The Bank's remuneration policy in particular considers the role of each employee and sets the criteria to determine whether an employee is a material risk-taker and/or an approved person in a business line, control or support function.

An approved person is an employee whose appointment requires prior regulatory approval because of the significance of his role within the Bank, and an employee is considered a material risk-taker if they are the head of a significant business line or any individuals within their control who have a material impact on the Bank's risk profile.

In order to ensure alignment between what we pay our people and our business strategy, we assess individual performance against annual and long-term financial and non-financial objectives, summarised in our performance management system.

This assessment also takes into account adherence to the Bank's values, risks and compliance measures, and, above all, integrity. Altogether, performance is therefore judged not only on what is achieved over the short and long term but, importantly, also on how it is achieved in order to ensure the long-term sustainability of the business.

Nomination, Remuneration and Corporate Governance Committee (NRCG) role and focus

The NRCG has oversight of all reward policies for the Bank's employees. The NRCG is the supervisory and governing body for compensation policy, practices, and plans. It is responsible for determining, reviewing, and proposing variable remuneration policy for approval by the Board. It is responsible for setting the principles and governance framework for all remuneration decisions. The NRCG ensures that all persons must be remunerated fairly and responsibly. The remuneration policy is reviewed on a periodic basis to reflect changes in market practices, the business plan, and risk profile of the Bank.

The responsibilities of the NRCG with regards to the Bank's variable remuneration policy, as stated in its mandate, include but are not limited to the following:

- Approve, monitor and review the remuneration system to ensure the system operates as intended.
- Review and recommend remuneration for the approval of the Board.
- Approve the remuneration amounts for each approved person and material risk-taker, as well as total variable remuneration to be distributed, taking account of total remuneration including salaries, contributions, expenses, bonuses and other employee benefits.
- Recommend the Chief Executive's remuneration for the Board of Directors' approval.
- Ensure remuneration is adjusted for all types of risks and that the remuneration system takes into consideration employees that generate same short-run profit but take different amount of risk on behalf of the Bank.
- Ensure that for material risk-takers, variable remuneration forms a substantial part of their total remuneration.
- Review the stress testing and back testing results before approving the total variable remuneration to be distributed including salaries, fees, expenses, bonuses, and other employee benefits.
- Carefully evaluate practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. The NRCG will question payouts for income that cannot be realised or whose likelihood of realisation remains uncertain at the time of payment.
- Ensure that for approved persons in risk management, internal audit, operations, financial control, and compliance functions, the mix of fixed and variable remuneration is weighted in favour of fixed remuneration.
- Recommend Board member remuneration based on their attendance and performance and in compliance with Article 188 of the Bahrain Commercial Companies Law.
- Ensure appropriate compliance mechanisms are in place to ensure that employees commit themselves not to use personal hedging strategies or remuneration and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements.

NRCG Members

As outlined in the Corporate Governance section of the annual report, the Board is satisfied that all Directors are non-executive and that the majority of the NRCG members are independent including the Chairman of the Committee. The NRCG comprises the following members:

NRCG member name	Appointment date	Number of meetings attended in 2018
Murad Ali Murad	20 June 2004	4
Sh Khalifa bin Duaij Al Khalifa	6 March 2011	4
Marwan Mohammed Al Saleh	10 March 2015	1
Mohamed Abdulrahman Hussain	29 March 2017	4

The aggregate remuneration paid to NRCG members during the year in the form of sitting fees amounted to BD 7,500 [2017: BD 8,000].

External consultancy

A consultant was appointed during the year to enhance the Risk Assessment Framework by reviewing the assigned weights of all risk elements and to inculcate an additional one to create more emphasis on the return measures and quality of earning; and to reflect the adoption of IFRS 9.

Scope of application of the remuneration policy

The variable remuneration policy is adopted on a group basis covering BBK Bahrain and BBK Kuwait. BBK India is excluded from the policy because they follow the Reserve Bank of India in this regard. Invita and CrediMax are excluded because the new guidelines are not applicable to them.

Board remuneration

The Bank's Board remuneration is determined in line with the provisions of Article 188 of the Bahrain Commercial Companies Law, 2001. The Board of Directors' remuneration will be capped so that total remuneration (excluding sitting fees) does not exceed 10 percent of the Bank's net profit after all required deductions in any financial year. Board remuneration is subject to approval of the shareholders in the annual general meeting. Remuneration of non-executive Directors does not include performance-related elements such as grants of shares, share options or other deferred stock-related incentive schemes, bonuses, or pension benefits.

Employees' variable remuneration

Variable remuneration is performance-related and consists primarily of the annual performance bonus award and long-term incentives for future performance. As a part of our staff's variable remuneration, the annual bonus rewards delivery of operational and financial targets set each year, the individual performance of the employees in achieving those targets, and their contribution to delivering the Bank's strategic objectives.

The Bank has adopted a Board-approved framework to develop a transparent link between variable remuneration and performance. The framework is designed on the basis of meeting both satisfactory financial performance and the achievement of other non-financial factors, that will, all other things being equal, deliver a target bonus pool for employees, prior to consideration of any allocation to business lines and employees individually. In the framework adopted for determining the variable remuneration pool, the NRCG aims to balance the distribution of the Bank's profits between shareholders and employees.

Key performance metrics at the Bank level include a combination of short-term and long-term measures and include profitability, solvency, liquidity, and growth indicators. The performance management process ensures that all goals are appropriately cascaded down to respective business units and employees.

In determining the amount of variable remuneration, the Bank starts from setting specific targets and other qualitative performance measures that result in a target bonus pool. The bonus pool is then adjusted to take account of risk via the use of risk-adjusted measures including forward-looking considerations.

The NRCG carefully evaluates practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. NRCG demonstrates that its decisions are consistent with an assessment of the Bank's financial condition and future prospects.

The Bank uses a formalised and transparent process to adjust the bonus pool for quality of earnings and risk profile. It is the Bank's objective to pay bonuses out of realised and sustainable profits. If the quality of earnings is not strong, the profit base could be adjusted based on the discretion of the NRCG.

For the overall Bank to have any funding for distribution of a bonus pool, threshold financial targets have to be achieved. The performance measures ensure that total variable remuneration is general considerably contracted where subdued or negative financial performance of the Bank occurs. Furthermore, the target bonus pool as determined above is subject to risk adjustments in line with the risk assessment and linkage framework.

Remuneration of control and support functions

The remuneration level of employees in the control and support functions allows the Bank to employ qualified and experienced personnel in these functions. The Bank ensures that the mix of fixed and variable remuneration for control and support function personnel is weighted in favour of fixed remuneration. The variable remuneration of control functions is based on function-specific objectives and is not determined by the financial performance of the business areas they monitor.

The Bank's performance management system plays a major role in deciding the performance of the support and control units on the basis of the objectives set for them. Such objectives are more focused on non-financial targets that include risk, control, compliance and ethical considerations as well as the market and regulatory environment, apart from value-adding tasks which are specific to each unit.

Variable compensation for business units

The variable remuneration of the business units is primarily determined by key performance objectives set through the performance management system of the Bank. Such objectives contain financial and non-financial targets, including risk control, compliance and ethical considerations, and market and regulatory requirements. The consideration of risk assessments in the performance evaluation of individuals ensures that any two employees who generate the same short-run profits but take different amounts of risk on behalf of the Bank are treated differently by the remuneration system.

Risk assessment framework

The purpose of risk linkages is to align variable remuneration to the risk profile of the Bank. In its endeavour to do so, the Bank considers both quantitative measures and qualitative measures in the risk assessment process. Both quantitative measures and human judgement play a role in determining any risk adjustments. The risk assessment process encompasses the need to ensure that the remuneration policy as designed reduces employees' incentives to take excessive and undue risks, is symmetrical with risk outcomes, and delivers an appropriate mix of remuneration that is risk aligned.

The Bank's NRCG considers whether the variable remuneration policy is in line with the Bank's risk profile and ensures that through the Bank's ex-ante and ex-post risk assessment framework and processes, remuneration practices where potential future revenues whose timing and likelihood remain uncertain are carefully evaluated.

Risk adjustments take into account all types of risk, including intangible and other risks such as reputation risk, liquidity risk and the cost of capital. The Bank undertakes risk assessments to review financial and operational performance against business strategy and risk performance prior to distribution of the annual bonus.

The Bank ensures that total variable remuneration does not limit its ability to strengthen its capital base. The extent to which capital needs to be built up is a function of the Bank's current capital position and its ICAAP.

The size of the variable remuneration pool and its allocation within the Bank takes into account the full range of current and potential risks, including:

(a) The cost and quantity of capital required to support the risks taken

(b) The cost and quantity of the liquidity risk assumed in the conduct of business

(c) Consistency with the timing and likelihood of potential future revenues incorporated into current earnings

Risk adjustments

The Bank has an ex-post risk assessment framework which is a qualitative assessment to back-test actual performance against prior risk assumptions.

In years where the Bank suffers material losses in its financial performance, the risk adjustment framework will work as follows:

- There will be considerable contraction of the Bank's total variable remuneration
- At an individual level, poor performance by the Bank will mean individual KPIs are not met and hence employee performance ratings will be lower
- Reduction in the value of deferred shares or awards
- Possible changes in vesting periods and additional deferral applied to unvested rewards
- Lastly, if the qualitative and quantitative impact of a loss incident is considered significant, a malus or claw back of previous variable awards may be considered

The NRCG, with the Board's approval, can rationalise and make the following discretionary decisions:

- Increase/reduce the ex-post adjustment
- Consider additional deferrals or increase in the quantum of non- cash awards
- Recovery through malus and claw back arrangements

Malus and claw back framework

The Bank's malus and claw back provisions allow the Bank's Board of Directors to determine that, if appropriate, unvested elements under the deferred bonus plan can be forfeited/adjusted or the delivered variable remuneration recovered in certain situations. The intention is to allow the Bank to respond appropriately if the performance factors on which reward decisions were based turn out not to reflect the corresponding performance in the longer term. All deferred compensation awards contain provisions that enable the Bank to reduce or cancel the awards of employees whose individual performance has had a materially detrimental impact on the Bank during the concerned performance year.

Any decision to take back an individual's award can only be made by the Bank's Board of Directors.

The Bank's malus and claw back provisions allow the Bank's Board to determine that, if appropriate, vested/unvested elements under the deferred bonus plan can be adjusted/cancelled in certain situations. These events include the following:

- Reasonable evidence of wilful misbehaviour, material error, negligence or incompetence of the employee causing the Bank/ the employee's business unit to suffer material loss in its financial performance, material misstatement of the Bank's financial statements, material risk management failure or reputational loss or risk due to such employee's actions, negligence, misbehaviour or incompetence during the concerned performance year.
- The employee deliberately misleads the market and/or shareholders in relation to the financial performance of the Bank during the concerned performance year.

Claw back can be used if the malus adjustment on the unvested portion is insufficient given the nature and magnitude of the issue.

Components of variable remuneration

Variable remuneration has the following main components:

Upfront cash	The portion of the variable compensation that is awarded and paid out in cash on conclusion of the performance evaluation process for each year.
Deferred cash	The portion of variable compensation that is awarded and paid in cash on a pro-rata basis over three years
Upfront short-term share awards	The portion of variable compensation that is awarded and issued in the form of shares on conclusion of the performance evaluation process for each year.
Deferred short-term share awards	The portion of variable compensation that is awarded and paid in the form of shares on a pro-rata basis over three years
Long-term performance share awards	Share-based reward schemes, under which the Bank allocates certain numbers of shares every year to executive management and senior employees based on performance, potential, and job criticality level. Following the assessment of the performance of the Bank against the target performance conditions stipulated for the period, the ownership of the vested shares is transferred to the individual employee.
Subsidiaries Board remuneration	The portion of variable compensation that is awarded and paid out at the end of the financial year to an employee representing the Bank as director on the board of any of its wholly owned subsidiaries and/or associated companies of BBK, excluding the sitting fees.

All deferred and long-term awards are subject to malus provisions. All share awards and related dividends are released to the benefit of the employee after a six-month retention period from the date of vesting. The number of equity share awards is linked to the Bank's share price as per the rules of the Bank's Share Incentive Scheme.

All the shares and deferred cash components of the variable remuneration are being held and administered in a trust registered in the Kingdom of Bahrain.

Deferred compensation

All employees at senior management level and above or earning BD 100,000 per annum in Bahrain and overseas branches, excluding India, are subject to the following rules of deferral:

1 The CEO, his deputies and business line General Managers:

Element of variable remuneration	Payout percentages	Vesting period	Retention	Malus*	Claw back*
Upfront cash	40%	immediate	–	–	Yes
Deferred cash	10%	3 years	–	Yes	Yes
Deferred share awards	50%	3 years	6 months	Yes	Yes

2 All other covered staff:

Element of variable remuneration	Payout percentages	Vesting period	Retention	Malus*	Claw back*
Upfront cash	50%	immediate	–	–	Yes
Upfront share awards	10%	immediate	6 months	Yes	Yes
Deferred share awards	40%	3 years	6 months	Yes	Yes

The NRCG, based on its assessment of role profile and risk taken by an employee, could increase the coverage of employees that will be subject to deferral arrangements.

Details of remuneration paid

(a) Board of Directors

	2018	2017
Sitting fees and travel allowance	84,463	80,150
Remuneration	585,000	577,500
Others	27,505	25,018
BBK subsidiaries' Board remuneration, sitting fees and other related expenses	164,180	151,024

(b) Board of Directors of wholly owned subsidiaries

	2018	2017
Sitting fees and travel allowance	4,200	6,200
Remuneration	108,300	91,200
Others	–	–
Total	112,500	97,400

(c) Employees

1 Employee remuneration

BD 000's	2018 Number of staff	Fixed remuneration Cash	Sign on bonuses (Cash/ shares)	Guaranteed bonuses (Cash/ shares)	Variable remuneration Upfront Cash	Variable remuneration Upfront Shares	Variable remuneration Deferred Cash	Variable remuneration Deferred Shares	Variable remuneration Deferred Others	Total
Approved Persons Business lines	14	2,898	–	–	930	12	175	938	–	4,952
Approved Persons Control & support	9	1,522	–	–	422	69	–	297	–	2,310
Other material risk-takers	35	3,711	–	–	588	110	10	488	–	4,907
Other Staff Bahrain Operations	546	13,552	–	–	2,619	–	–	–	–	16,171
Other Staff Branches & Subsidiaries	524	7,987	–	–	622	–	–	–	–	8,609
Total	1,128	29,669	–	–	5,181	191	185	1,723	–	36,949

The number of staff includes BBK, its overseas branches and direct wholly owned subsidiaries.

The net impact of other indirect staff costs amounting BD 211,297 has been included in the table above.

Board Remuneration and Sitting Fees received by Members of Executive Management for representing the Bank in the boards of wholly owned subsidiaries and / or associate companies of BBK amounting BD 329,879 have been included in the table above.

The total amount of remuneration includes severance payments (early retirement) made during the year which amounted to BD 1,409,465 of which the highest paid to a single person amounted to BD 151,056.

BD 000's	2017 Number of staff	Fixed remuneration Cash	Sign on bonuses (Cash/ shares)	Guaranteed bonuses (Cash/ shares)	Variable remuneration Upfront Cash	Variable remuneration Upfront Shares	Variable remuneration Deferred Cash	Variable remuneration Deferred Shares	Variable remuneration Deferred Others	Total
Approved Persons Business lines	15	2,578	–	–	1,046	14	202	1,044	–	4,884
Approved Persons Control & support	9	1,306	–	–	451	77	–	324	–	2,158
Other material risk-takers	36	3,182	–	–	520	97	9	433	–	4,241
Other Staff Bahrain Operations	566	12,816	–	–	2,619	–	–	–	–	15,435
Other Staff Branches & Subsidiaries	520	7,296	–	–	580	–	–	–	–	7,876
Total	1,146	27,178	–	–	5,215	188	211	1,801	–	34,593

The number of staff includes BBK, its overseas branches and direct wholly owned subsidiaries.

The net impact of other indirect staff costs amounting BD 273,700 have not been considered in the table above.

Board Remuneration and Sitting Fees received by Members of Executive Management for representing the Bank in the boards of wholly owned subsidiaries and / or associate companies of BBK amounting BD 257,854 have been included in the table above.

2 Deferred awards

	2018 Cash BD '000	Shares Number	Shares BD '000	Total BD '000
Opening balance	623	17,169,886	6,521	7,143
Awarded during the period*	191	4,269,141	1,938	2,129
Paid out/released during the period	(213)	(4,838,600)	(1,947)	(2,160)
Service, performance and risk adjustments	–	–	–	–
Bonus share adjustment	–	–	–	–
Closing balance	600	16,600,427	6,512	7,112

* The number of shares for the 2018 Deferred Awards has been calculated using the year-end closing share price at 0.454 fils per share, as the award price will be determined 14 days after the AGM.

	2017 Cash BD '000	Shares Number	Shares BD '000	Total BD '000
Opening balance	561	16,443,303	5,998	6,559
Awarded during the period**	211	4,509,320	1,993	2,204
Paid out/released during the period	(149)	(3,782,737)	(1,470)	(1,619)
Service, performance and risk adjustments	–	–	–	–
Bonus share adjustment	–	–	–	–
Closing balance	623	17,169,886	6,521	7,143

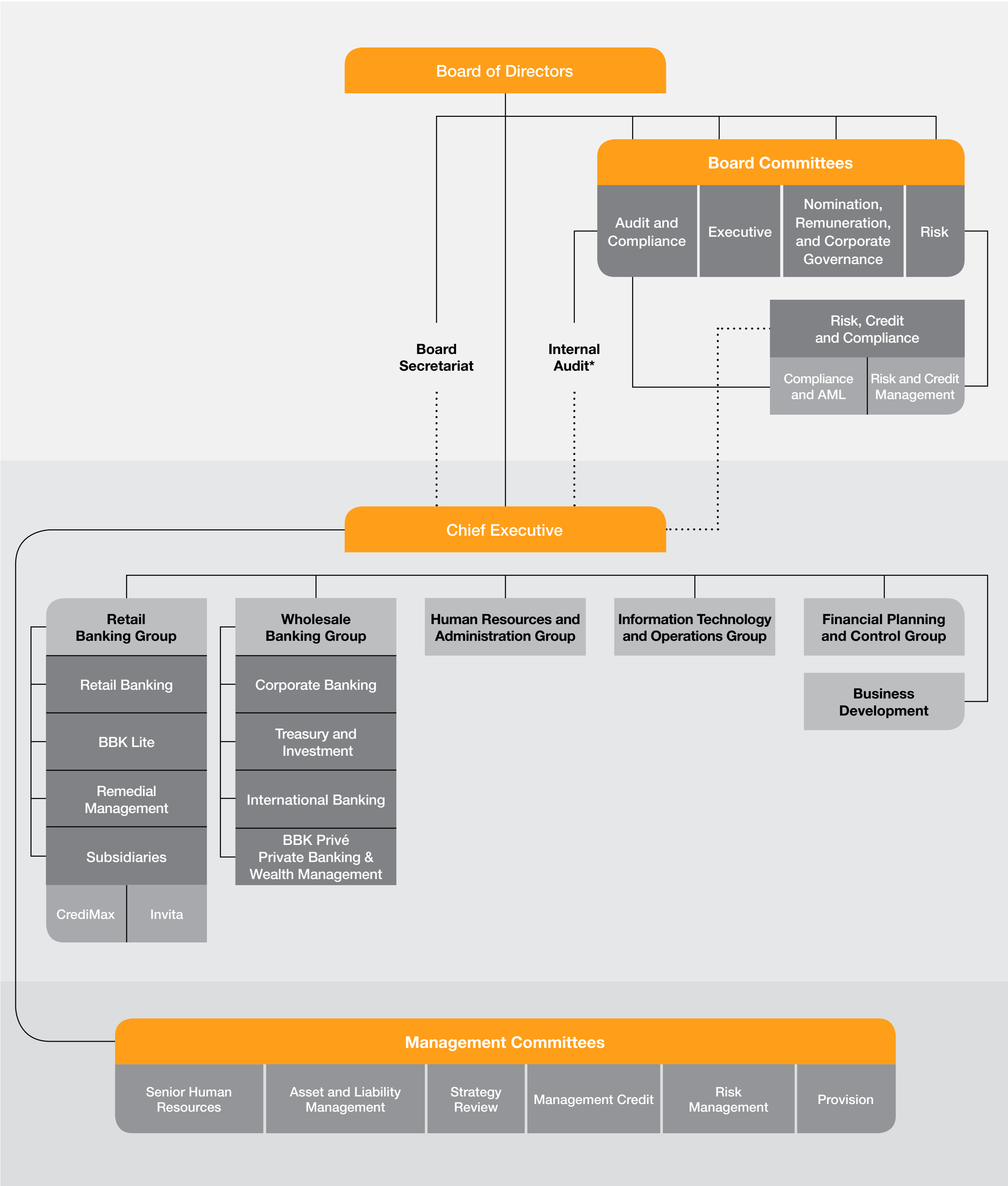
** The number of shares for the 2017 Deferred Awards have been recomputed based on the share price 14 days after the AGM of the Bank at 0.442 fils per share, and updated for the actual awards distributed to staff during 2017.

In the case of long-term incentive plan awards, the shares awarded have been included for the purposes of the table above assuming probability of vesting.

Information on share awards included above also include components of long-term performance-based incentive awards (LTIP shares). The amounts included in the tables are based on total awards granted for the performance year and may not necessarily match the accounting charge which factors probability of vesting.

Organisation information

Organisation structure



* To ensure independence, Internal Audit reports functionally to the Audit & Compliance Committee, and administratively to the Chief Executive. It is responsible to advise all levels of Management and the Board (through its Audit & Compliance Committee) on the quality of the Bank's operations, with particular emphasis on systems of control.

Executive management interests

The number of shares and bonds held by members of the Executive Management team as of 31 December 2018 was as follows:

				Bonds	
Name	Type of shares	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017
Reyadh Yousif Sater	Ordinary	171,643	1,171,643	300,000	300,000
Abdulrahman Ali Saif	Ordinary	387,237	387,237	90,000	90,000
Mohammed Ali Malik	Ordinary	430,812	430,812	–	–
Jamal Mohamed Al Sabbagh	Ordinary	538,864	397,170	–	–
Hassaan Mohammed Burshaid	Ordinary	463,160	463,160	–	–
Mohammed Abdulla Isa	Ordinary	97,029	97,029	30,000	30,000
Rashad Ahmed Akbari	Ordinary	396,036	283,183	–	–
C. K. Jaidev	–	–	–	–	–
Nadeem A. Aziz Kooheji	Ordinary	–	30,207	–	–
C. V. Murthy	Ordinary	228,686	228,686	10,000	10,000
Neil Sharp	–	–	–	–	–
Adel Abdulla Salem	–	–	–	–	–
Raj Dugar	Ordinary	76,905	76,905	7,000	7,000

Executive Senior Management trading of the Bank's shares and bonds during 2018

Name	Trading through Bahrain Bourse	Date of trading
Reyadh Yousif Sater	Sold 1,000,000 shares	9 July 2018
Nadeem A.Aziz Kooheji	Sold 30,207 shares	25 February 2018

Management Committees

Management Committees are chaired by the Chief Executive. Committee members are heads of the relevant divisions appointed by the Committee Chairman.

Committee	Summary terms of reference, roles and responsibilities:	Frequency of meetings:
Senior Human Resources	Establishes appropriate policies, procedures and guidelines for the management of human resources.	Once every other month.
Asset and Liability Management	Establishes policies and guidelines for the overall management of the statement of financial position and its associated risks.	At least once a month.
Strategy Review	Reviews and monitors progress on strategic initiatives.	Twice a year.
Management Credit	Approves credit and investment proposals above a certain limit. Also reviews and recommends any proposal requiring Executive Committee or Board approval.	Once a week.
Risk Management	Identifies, measures, monitors and controls risk by establishing risk policies and procedures.	Once every quarter.
Provision	Reviews and establishes provisioning requirements for loans, advances and investments.	Once every quarter.

Major BBK shareholdings as of 31 December 2018

The company's ownership in other companies listed on the Bahrain Bourse (5% and above)

Name/Entity	Nationality/ Headquarters	Legal status	Ownership date	%	Number of shares	
					31 Dec 2017 Previous	31 Dec 2018 Current
Bahrain Kuwait Insurance (BKIC)	Bahrain	BSC (c)	2006	6.82%	4,879,818	**4,879,818**
Securities Investment Company	Bahrain	BSC (c)	2006	7.91%	41,250,000	**33,896,140**
Bahrain Commercial Facilities Company	Bahrain	BSC (c)	1994	23.03%	37,618,691	**37,618,691**

Major shareholders of the company's outstanding shares (5% and above)

Name/Entity	Nationality/ Headquarters	Legal status	Ownership date	%	Number of shares	
					31 Dec 2017 Previous	31 Dec 2018 Current
Ithmaar Bank	Bahrain	BSC	2008	25.38%	274,493,028	**274,493,028**
Pension Fund Commission (PFC)	Bahrain	Governmental Institution	1986	18.77%	203,020,288	**203,020,288**
Kuwait Investment Authority (KIA)	Kuwait	Investment Company	1990	18.70%	202,229,987	**202,229,987**
Social Insurance Organization (GOSI)	Bahrain	Governmental Institution	1986	13.34%	144,294,820	**144,294,820**

The Bank's holdings in other companies (Quoted / unquoted in / out Kingdom of Bahrain) (10% and above)

Name/Entity	Nationality/ Headquarters	Legal status	Ownership date	%	Number of shares	
					31 Dec 2017 Previous	31 Dec 2018 Current
CrediMax	Bahrain	BSC (c)	1999	100.00%	10,000,000	**10,000,000**
Invita	Bahrain	BSC (c)	2006	100.00%	1,000,000	**1,000,000**
Global Payment Services (1)	Bahrain	WLL	2005	55.00%	10,000	**10,000**
Sakana Holistic Housing Solutions	Bahrain	BSC (c)	2006	50.00%	500,000	**0**
The Benefit Company	Bahrain	BSC (c)	1997	22.00%	6,843	**6,843**
Naseej Company	Bahrain	BSC	2009	15.15%	163,636,370	**163,636,370**
Alosra Bank	Bahrain	BSC (c)	2009	10.00%	5,000,000	**5,000,000**
Diyaar Al Harameen Al Ola Limited	Cayman Islands	WLL	2011	35.00%	16,450,000	**16,450,000**
BBK Geojit Securities KSC	Kuwait	KSC	2012	40.00%	2,000,000	**2,000,000**
Invita – Kuwait (2)	Kuwait	KSCC	2014	60.00%	600,000	**600,000**
Aegila Capital Management Limited	London	LTD	2015	50.00%	1	**1**
Bahrain Liquidity Fund	Bahrain	LTD	2016	24.27%	10,000	**10,000**
Magnum Partners Holding Limited	Jersey	LTD	2018	49.96%	0	**6,958,001**
Evoque Holdings Jersey Limited	Jersey	LTD	2018	24.99%	0	**6,082,500**
Invita Claims Management Company (2)	Bahrain	BSC (c)	2017	70.00%	0	**350,000**

(1) Shareholding through CrediMax.
(2) Shareholding through Invita

BBK offices and overseas branches

For contact details of our local and international offices and branches, please visit our website www.bbkonline.com.
The Bank is headquartered in Bahrain and also operates in Dubai, Turkey, Kuwait, and India.

Part III

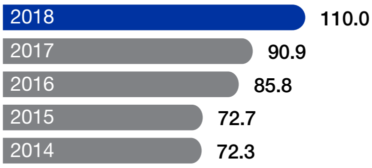
Financial information

Astute

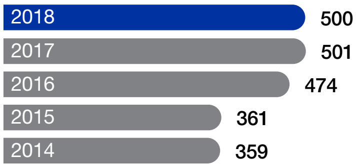
Our long record of consistent year-on-year performance improvements demonstrates impeccable skills in financial management.

Financial review

Net interest income
BD millions

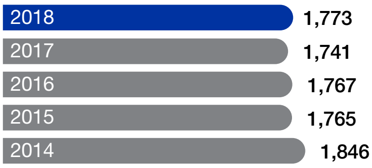


Total equity
BD millions

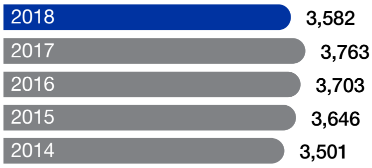


Customer deposits
BD millions

Loans and advances
BD millions



Total assets
BD millions



The key financial indicators of the Bank remain healthy with a return on average assets of 1.8 percent and a return on average equity of 13.7 percent.

Overview

Despite the challenges faced by Bahrain and the regional banking sector, the Bank managed to maintain its high performance in 2018, achieving record profitability of BD 67.1 million attributable to shareholders for the year ended 31 December 2018, representing an increase of BD 8.4 million or 14.4 percent growth over 2017 results.

The key financial indicators of the Bank remain healthy with a return on average assets of 1.8 percent and a return on average equity of 13.7 percent. The basic earnings per share increased from 48 fils to 56 fils. The Bank's liquidity position remains comfortable with liquid assets to total assets at 27.6 percent (2017: 34.7 percent).

This section provides a review of our Group's financial performance, focusing on the consolidated operating results and BBK's consolidated statement of financial position, including its overseas branches, subsidiaries, joint ventures, associated companies, and indirect investment in associates through subsidiaries.

The consolidated financial statements have been prepared and are presented in accordance with the International Financial Reporting Standards, Bahrain Commercial Companies Law, Central Bank of Bahrain (CBB) and Financial Institutions law and CBB rulebook requirements.

Operating results

The year 2018 was the last year of BBK's three-year strategic plan in which the Bank continued its steady and consistent performance, maintaining proactive management of risks and costs while focusing on developing domestic and cross-border business opportunities.

Despite the general weakness in economic trends regionally and globally, the Net Profit for 2018 (attributable to the owners of the Bank) increased by 14.4 percent from last year, amounting to BD 67.1 million. The total operating income for the year increased by BD 18.1 million or 12.6 percent and stood at BD 161.2 million, reflecting the success in diversifying sources of income.

Continuing BBK's prudent approach to risk management and provisioning, the Bank conservatively provided for adequate provisioning levels in 2018, applying the IFRS 9 accounting standard. This standard considers expected credit losses instead of the incurred losses mandated by the previous IAS 39 to measure impaired exposures caused by market turbulences.

Net interest income

Net interest income increased by 20.9 percent to BD 110.0 million (2017: BD 90.9 million). This was achieved through deploying more funds in higher yielding and liquid investments and treasury bills, respectively reporting increases of 32.0 percent and 46.5 percent.

As a result of the strong growth in total earning assets, active management of balance sheet and increase in market interest rates, the net interest yield ratio increased from 2.7 to 3.1 percent.

Other income

Other operating income consists of non-interest income, derived from business activities such as dealing in foreign currencies, investing in funds other than fixed-income funds, the sale of corporate banking and retail banking services, investment trading, and income from associated companies and joint ventures.

Total other income reported for year 2018 stood at BD 51.2 million compared to BD 52.2 million reported for 2017. The net fees and commissions, being the main component of total other income; stood at BD 28.2 million, compared to BD 31.1 million reported last year, while income from associated companies stood at BD 4.1 million (2017: BD 5.5 million) due to impact of implementation of IFRS 9 by the associated companies. Other income relating to foreign exchange, and investment income increased by 6.5 percent to BD 15.3 million, (2017: BD 14.3 million).

Summary statement of profit or loss

BD millions	2018	2017	Variance BD millions	Change percent
Net interest income	**110.0**	90.9	19.0	20.9%
Other income	**51.2**	52.2	(0.9)	-1.8%
Total income	**161.2**	143.1	18.1	12.6%
Operating expenses	**57.7**	54.0	3.7	6.9%
Provisions	**35.4**	29.0	6.4	21.9%
Profit before taxation	**68.1**	60.0	8.1	13.5%
Taxation/non-controlling interest	**(1.0)**	(1.4)	0.4	26.3%
Net profit	**67.1**	58.7	8.4	14.4%

Operating expenses

Due to the continuous investment in human capital resources and technologies, the Bank's operating expenses increased by 6.9 percent, from BD 54.0 million to BD 57.7 million. Staff costs increased by 5.0 percent, while non-staff related costs increased by 10.2 percent to reach BD 21.3 million (2017: BD 19.3 million). Nevertheless, the Bank's prudent cost control policy and strong revenue-generating capability enabled improvement in its cost to income ratio to 35.8 percent (2017: 37.8 percent).

Net provisions

The Bank follows the International Financial Reporting Standard 9 (IFRS 9) with regards to accounting for the impairment of financial assets. IFRS 9 replaces the incurred loss model in IAS 39 with an expected credit loss model. The new impairment model also applies to certain loan commitments and financial guarantee contracts. Under IFRS 9, credit losses are recognised earlier than under IAS 39. The Group applies a three-stage approach to measuring expected credit losses on financial assets carried at amortised cost and debt instruments classified as FVOCI (fair value through other comprehensive income). Assets migrate through three stages based on the change in credit quality since initial recognition. This approach of provisioning for impairment of the Bank's financial assets is aimed at providing more realistic estimates of the impairment in the value of assets.

The net provision charges during 2018 amounted to BD 35.4 million, compared to BD 29.0 million in 2017. The increase came mainly due to overall market sentiments and the bank's conservative approach in ensuring a high degree of coverage for its Non Performing Loans (NPLs).

Comprehensive income

The Bank's total comprehensive income attributed to the owners stood at BD 47.4 million for the year ended 31 December 2018, compared to BD 65.0 million at the end of 2017. While the core operating activities of the bank remained robust and resulted in higher net profit, the bank's other comprehensive income has been impacted negatively by the instability and volatility in financial markets which led to unrealized negative valuations on investment securities and foreign currency translation adjustments.

Financial position

The Group maintained its strong financial position and comfortable liquidity.

As at 2018 year-end, the total footing of the group stood at BD 3,581.7 million (2017: BD 3,763.1 million).

The Bank has been consistent in achieving a good balance between deposits and loans and advances with a comfortable ratio of net loans and advances to customer deposits of 74.6 percent as of end of 2018 (2017: 66.3 percent).

Assets

While the core lending and investing activities remained robust and continued to grow, the decrease in total assets was attributed to the decrease in cash and balances with central banks. Loans and advances increased by 1.8 percent, mainly due to growth in the retail loans portfolio. Non-trading investment securities increased by 6.8 percent reaching BD 800.3 million at the end of 2018 (2017: BD 749.0 million). This was mainly due to the increase in investment activities in selective domestic and international markets. The investments portfolio is dominated by regional governments' bonds and sukuk and is substantially hedged against exposure to interest rate risk. The loans and advances and investment securities are well diversified across various economic sectors and counterparties.

Consolidated statement of financial position

BD millions	2018	2017	Variance BD millions	Change percent
Assets				
Cash and balances with central banks	**191.0**	469.4	(278.4)	-59.3%
Treasury bills	**410.4**	427.1	(16.8)	-3.9%
Deposits and amounts due from banks and other financial institutions	**239.2**	223.8	15.4	6.9%
Loans and advances to customers	**1,772.5**	1,740.7	31.9	1.8%
Non-trading investment securities	**800.3**	749.0	51.3	6.8%
Investments in associated companies and joint ventures	**62.9**	47.0	16.0	34.0%
Interest receivable and other assets	**77.9**	79.7	(1.8)	-2.3%
Premises and equipment	**27.5**	26.4	1.1	4.2%
Total assets	**3,581.7**	3,763.1	(181.4)	-4.8%
Liabilites and Equity				
Liabilities				
Deposits and amounts due to banks and other financial institutions	**258.7**	193.5	65.2	33.7%
Borrowings under repurchase agreement	**199.0**	161.3	37.7	23.4%
Term borrowings	**144.5**	199.0	(54.5)	-27.4%
Customers' current, savings and other deposits	**2,374.5**	2,623.6	(249.1)	-9.5%
Interest payable and other liabilities	**104.6**	84.9	19.7	23.2%
Total liabilities	**3,081.3**	3,262.3	(181.0)	-5.5%
Equity attributable to the owners of the Bank	**497.7**	498.6	(0.9)	-0.2%
Non-controlling interest	**2.7**	2.2	0.5	24.0%
Total equity	**500.4**	500.8	(0.4)	-0.1%
Total liabilities and equity	**3,581.7**	3,763.1	(181.4)	-4.8%

Liabilities

The funding structure of the bank continued to be very robust with low reliance on the interbank market. Customer deposits remained the dominant source of funding, representing 77.1% of total liabilities. While the bank continued to grow its retail customer base, increasing its retail liabilities to BD 823.8 million (2017: BD 791.5 million), the total customer deposits decreased to BD 2,374.5 million as of end of December 2018 (2017: BD 2,623.6 million) due to overall reduction of liquidity from the GCC markets. Borrowing under repurchase agreements and Term borrowing are integral parts of the bank's medium and stable funding sources. As of end of December 2018, Borrowing under repurchase agreements stood at BD 199.0 million (2017: BD 161.3 million) and the Term borrowing stood at BD 144.5 million (2017: BD 199.0 million).

Capital adequacy

The Bank has implemented the Basel III framework for the calculation of capital adequacy since January 2015, in accordance with Central Bank of Bahrain guidelines.

Total equity attributable to the owners of the Bank stood at BD 497.7 million at the end of 2018 (2017: BD 498.6 million). The Bank continued to maintain a comfortable capital adequacy ratio of 19.6 percent (2017: 20.0 percent), well above CBB's minimum regulatory requirement of 14.0 percent for Domestic Systemically Important Banks (D-SIBs). The Group is keen to maintain strong capitalisation to support future strategic plans, through adoption of dynamic profit retention policy.

Our noticeable growth over the years is a result of our sustained culture of superior performance, our widespread participation in both local and international markets, and excellent customer service, which enables us to sustain the momentum we have built over the years and to enhance value for shareholders.

Building a better working world

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

Opinion

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

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

Basis for opinion

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the year ended 31 December 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.

Key audit matter	How the key audit matter was addressed in the audit
Impairment of carrying value of loans and advances	
The process for estimating impairment provision on credit risk associated with loans and advances in accordance with IFRS 9 Financial instruments (IFRS 9) is a significant and complex area. IFRS 9 requires use of the Expected Credit Loss (ECL) model for the purposes of calculating impairment provision. ECL model requires the Group to exercise significant judgment using subjective assumptions when determining both the timing and the amounts of ECL for loans and advances. Due to the complexity of requirements under IFRS 9, significant judgments applied and the Group's exposure to loans and advances forming a major portion of the Group's assets, the audit of ECL for loans and advances is a key area of focus.	Our approach included testing the controls associated with the relevant processes for estimating ECL and performing substantive procedures on such estimates. Our procedures, among others, focused on following: • We assessed: - the Group's IFRS 9 based impairment provisioning policy including significant increase in credit risk criteria with the requirements of IFRS 9; - Group's ECL modeling techniques and methodology against the requirements of IFRS 9; and - the theoretical soundness and tested the mathematical integrity of the models. • We obtained an understanding of the design and tested the operating effectiveness of relevant controls over ECL model, including model build and approval, ongoing monitoring / validation, model governance and mathematical accuracy. We have also checked completeness and accuracy of the data used and the reasonableness of the management assumptions; • We understood and assessed the significant modeling assumptions for exposures as well as overlays with a focus on: - Key modeling assumptions adopted by the Group; and - Basis for and data used to determine overlays. • For a sample of exposures, we performed procedures to evaluate: - Appropriateness of exposure at default, probability of default and loss given default (including collateral values used) in the calculation of ECL; - Timely identification of exposures with a significant increase in credit risk and appropriateness of the Group's staging; and - ECL calculation.

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS continued

Key audit matter	How the key audit matter was addressed in the audit
Impairment of carrying value of loans and advances continued	
As at 31 December 2018, the Group's gross loans and advances amounted to BD 1,897 million and the related ECL amounted to BD 124 million, comprising BD 37 million of ECL against Stage 1 and 2 exposures and BD 87 million against exposures classified under Stage 3. The basis of calculation of ECL is disclosed in the summary of significant accounting policies and in note 32 to the consolidated financial statements.	• For forward looking information used by the Group's management in its ECL calculations, we held discussions with management and checked internal approvals by the management for economic outlook used for purposes of calculating ECL; • In addition, to obtain comfort on the overall model and significant assumptions used in applying IFRS 9, we reviewed the independent validation report prepared by the Group's consultant. Further, we performed procedures to ensure the competence, capabilities, objectivity and independence of the Group's consultant; and • We considered the adequacy of the disclosures in the consolidated financial statements in relation to impairment of loans and advances as required under IFRS 9. We also involved our internal specialists where their specific expertise was required. Refer to the significant accounting estimates and judgments, disclosures of loans and advances and credit quality in notes 3.4, 7 and 32 to the consolidated financial statements.

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 Board of Directors' report, which will form part of the annual report, and the remaining sections of the annual report are expected to be made available to us after that date.

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

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

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

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

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

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

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

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

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

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

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

a) The Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
b) The financial information contained in the report of the Board of Directors' is consistent with the consolidated financial statements;
c) We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 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 Mr. Essa Al-Jowder.

Ernst + Young

Partner's registration no. 45
18 February 2019
Manama, Kingdom of Bahrain

Consolidated statement of financial position

As at 31 December 2018

	Notes	2018 BD '000	2017 BD '000
ASSETS			
Cash and balances with central banks	4	**191,028**	469,436
Treasury bills	5	**410,380**	427,130
Deposits and amounts due from banks and other financial institutions	6	**239,174**	223,824
Loans and advances to customers	7	**1,772,528**	1,740,651
Investment securities	8	**800,263**	748,985
Investments in associated companies and joint ventures	9	**62,935**	46,958
Interest receivable and other assets	10	**77,849**	79,680
Premises and equipment	11	**27,543**	26,436
TOTAL ASSETS		**3,581,700**	3,763,100
LIABILITIES AND EQUITY			
Liabilities			
Deposits and amounts due to banks and			
other financial institutions		**258,676**	193,472
Borrowings under repurchase agreement		**198,997**	161,314
Term borrowings	12	**144,542**	199,012
Customers' current, savings and other deposits	13	**2,374,480**	2,623,577
Interest payable and other liabilities	14	**104,566**	84,890
Total liabilities		**3,081,261**	3,262,265
Equity			
Share capital	15	**108,165**	108,165
Treasury stock	15	**(2,521)**	(998)
Perpetual tier 1 convertible capital securities	15	**86,098**	86,098
Share premium	15	**41,016**	41,016
Statutory reserve	15	**54,082**	54,082
General reserve	15	**54,082**	54,082
Cumulative changes in fair values	16	**(25,105)**	(8,349)
Foreign currency translation adjustments		**(11,711)**	(9,271)
Retained earnings		**148,967**	134,632
Proposed appropriations	17	**44,617**	39,161
Attributable to the owners of the Bank		**497,690**	498,618
Non-controlling interest		**2,749**	2,217
Total equity		**500,439**	500,835
TOTAL LIABILITIES AND EQUITY		**3,581,700**	3,763,100

Murad Ali Murad
Chairman

Jassem Hasan Zainal
Deputy Chairman

Reyadh Yousif Sater
Chief Executive

The attached notes 1 to 45 form part of these consolidated financial statements

Consolidated statement of profit or loss

Year ended 31 December 2018

	Notes	2018 BD '000	2017 BD '000
Interest and similar income	18a	**165,828**	136,983
Interest and similar expense	18b	**(55,878)**	(46,077)
Net interest and similar income		**109,950**	90,906
Fee and commission income – net	19	**28,187**	31,094
Other income	20	**18,925**	15,540
Total operating income		**157,062**	137,540
Staff costs		**(36,408)**	(34,659)
Depreciation	11	**(3,654)**	(3,435)
Other expenses		**(17,664)**	(15,914)
Total operating expenses		**(57,726)**	(54,008)
Net provision for impairment/ECL on loans and advances to customers	7	**(35,048)**	(28,912)
Net provision for impairment/ECL on investments	8	**(313)**	(98)
Net operating income		**63,975**	54,522
Share of profit from associated companies and joint ventures	9	**4,142**	5,519
PROFIT FOR THE YEAR BEFORE TAXATION		**68,117**	60,041
Net tax provision	21	**(408)**	(810)
PROFIT FOR THE YEAR AFTER TAXATION		**67,709**	59,231
Attributable to:			
Owners of the Bank		**67,118**	58,685
Non-controlling interest		**591**	546
		67,709	59,231
Basic earnings per share (BD)	22	**0.056**	0.048
Diluted earnings per share (BD)	22	**0.052**	0.045

Murad Ali Murad
Chairman

Jassem Hasan Zainal
Deputy Chairman

Reyadh Yousif Sater
Chief Executive

The attached notes 1 to 45 form part of these consolidated financial statements

Consolidated statement of other comprehensive income

Year ended 31 December 2018

	Notes	2018 BD '000	2017 BD '000
Profit for the year		**67,709**	59,231
Other comprehensive (loss) income:			
Items that will not be reclassified to profit or loss			
Fair value through other comprehensive income reserve (equity instruments)		**6,496**	(8,466)
Items that are or may be reclassified subsequently to profit or loss			
Movement in translation reserve:			
Foreign currency translation adjustments		**(2,440)**	2,287
Movement in hedging reserve:			
Effective portion of changes in fair value	16	**443**	284
Movement in fair value reserve:			
Net change in fair value	16	**(21,266)**	15,603
Net amount transferred to profit or loss	16	**(2,936)**	(3,427)
Other comprehensive (loss) income for the year		**(19,703)**	6,281
Total comprehensive income for the year		**48,006**	65,512
Attributable to:			
Owners of the Bank		**47,415**	64,966
Non-controlling interest		**591**	546
		48,006	65,512

The attached notes 1 to 45 form part of these consolidated financial statements

Consolidated statement of changes in equity

Year ended 31 December 2018

		Attributable to the owners of the Bank and capital securities' holders												
	Notes	Share capital BD '000	Treasury stock BD '000	Perpetual tier 1 convertible capital securities BD '000	Share premium BD '000	Statutory reserve BD '000	General reserve BD '000	Cumulative changes in fair values BD '000	Foreign currency translation adjustments BD '000	Retained earnings BD '000	Proposed appropriations BD '000	Total BD '000	Non-controlling interest BD '000	Total equity BD '000
Balance at 1 January 2017		108,165	(1,206)	86,098	39,919	54,082	54,082	(13,669)	(11,558)	122,830	33,666	472,409	1,806	474,215
Profit for the year		–	–	–	–	–	–	–	–	58,685	–	58,685	546	59,231
Other comprehensive income		–	–	–	–	–	–	5,320	2,287	(1,326)	–	6,281	–	6,281
Total comprehensive income		–	–	–	–	–	–	5,320	2,287	57,359	–	64,966	546	65,512
Share – based payments	40	–	–	–	–	–	–	–	–	699	–	699	–	699
Distribution on perpetual tier 1 convertible capital securities		–	–	–	–	–	–	–	–	(7,103)	–	(7,103)	–	(7,103)
Dividends paid	17	–	–	–	–	–	–	–	–	–	(32,266)	(32,266)	(135)	(32,401)
Donations	17	–	–	–	–	–	–	–	–	–	(1,400)	(1,400)	–	(1,400)
Movement in treasury stock	15	–	208	–	1,097	–	–	–	–	–	–	1,305	–	1,305
Unclaimed dividends	15	–	–	–	–	–	–	–	–	8	–	8	–	8
Proposed appropriations	17	–	–	–	–	–	–	–	–	(39,161)	39,161	–	–	–
Balance at 31 December 2017		**108,165**	**(998)**	**86,098**	**41,016**	**54,082**	**54,082**	**(8,349)**	**(9,271)**	**134,632**	**39,161**	**498,618**	**2,217**	**500,835**
Profit for the year		**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**67,118**	**–**	**67,118**	**591**	**67,709**
Other comprehensive loss		**–**	**–**	**–**	**–**	**–**	**–**	**(16,756)**	**(2,440)**	**(507)**	**–**	**(19,703)**	**–**	**(19,703)**
Total comprehensive income		**–**	**–**	**–**	**–**	**–**	**–**	**(16,756)**	**(2,440)**	**66,611**	**–**	**47,415**	**591**	**48,006**
Share – based payments	40	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(578)**	**–**	**(578)**	**–**	**(578)**
Distribution on perpetual tier 1 convertible capital securities		**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(7,103)**	**–**	**(7,103)**	**–**	**(7,103)**
Dividends paid	17	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(37,761)**	**(37,761)**	**(210)**	**(37,971)**
Donations	17	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(1,400)**	**(1,400)**	**–**	**(1,400)**
Movement in treasury stock	15	**–**	**(1,523)**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(1,523)**	**–**	**(1,523)**
Movement in non-controlling interest		**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**151**	**151**
Unclaimed dividends	15	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**22**	**–**	**22**	**–**	**22**
Proposed appropriations	17	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(44,617)**	**44,617**	**–**	**–**	**–**
Balance at 31 December 2018		**108,165**	**(2,521)**	**86,098**	**41,016**	**54,082**	**54,082**	**(25,105)**	**(11,711)**	**148,967**	**44,617**	**497,690**	**2,749**	**500,439**

The attached notes 1 to 45 form part of these consolidated financial statements

Consolidated statement of cash flows

Year ended 31 December 2018

	Notes	2018 BD '000	2017 BD '000
OPERATING ACTIVITIES			
Profit for the year before taxation		**68,117**	60,041
Adjustments for non-cash items:			
Net provision for impairment/ECL relating to:			
Loans and advances to customers	7	**35,048**	28,912
Investment securities	8	**313**	98
Share of profit from associated companies and joint ventures	9	**(4,142)**	(5,519)
Depreciation	11	**3,654**	3,435
Realised gains on sale of investment securities	20	**(3,249)**	(3,965)
Accrual on term borrowings		**745**	1,412
Operating profit before changes in operating assets and liabilities		**100,486**	84,414
(Increase) decrease in operating assets			
Mandatory reserve deposits with central banks		**4,696**	(2,952)
Treasury bills having original maturity of 90 days or more		**16,750**	(25,495)
Deposits and amounts due from banks and other financial institutions		**(9,198)**	17,824
Loans and advances to customers		**(66,925)**	(2,425)
Interest receivable and other assets		**(7,342)**	(14,627)
Increase (decrease) in operating liabilities			
Deposits and amounts due to banks and other financial institutions		**65,204**	(66,439)
Borrowings under repurchase agreements		**37,683**	(22,703)
Customers' current, savings and other deposits		**(249,097)**	129,862
Interest payable and other liabilities		**15,615**	299
Income tax paid		**(16)**	(100)
Net cash (used in) from operating activities		**(92,144)**	97,658
INVESTING ACTIVITIES			
Purchase of investment securities		**(407,548)**	(250,123)
Redemption/sale of investment securities		**354,205**	275,668
Net investment in associated companies	9	**(14,654)**	500
Dividends received from associated companies	9	**3,074**	2,394
Other movements in investment in associated companies	9	**288**	(68)
Purchase of premises and equipment		**(4,761)**	(5,688)
Net cash (used in) from investing activities		**(69,396)**	22,683
FINANCING ACTIVITIES			
Payment of dividend and donations	17	**(39,161)**	(33,666)
Term borrowings		**(55,215)**	(8,509)
Payment of interest on perpetual tier 1 convertible capital securities		**(7,103)**	(7,103)
Movement in treasury stock		**(1,523)**	1,305
Movement in share-based payments		**(578)**	699
Net cash used in financing activities		**(103,580)**	(47,274)
Foreign currency translation adjustments – net		**(2,440)**	2,287
NET CHANGE IN CASH AND CASH EQUIVALENTS		**(267,560)**	75,354
Cash and cash equivalents at beginning of the year		**612,958**	537,604
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	24	**345,398**	612,958
Additional Information:			
Interest received		**163,650**	138,393
Interest paid		**46,611**	44,654

The attached notes 1 to 45 form part of these consolidated financial statements

1 ACTIVITIES

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

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

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors of the Bank on 18 February 2019.

2 BASIS OF PREPARATION

Statement of compliance

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

Accounting convention

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

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

Basis of consolidation

These consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries (the "Group"). The year end of the Bank and all of its subsidiaries is 31 December. The Bank has the following principal subsidiaries:

Name	Ownership	Country of incorporation	Activity
CrediMax B.S.C. (c)	100%	Kingdom of Bahrain	Credit card operations
Invita Company B.S.C. (c)	100%	Kingdom of Bahrain	Business process outsourcing services

CrediMax B.S.C. (c) owns 55% (2017: 55%) of the share capital of Global Payment Services W.L.L., which is established in the Kingdom of Bahrain and engaged in processing and backup services relating to credit, debit and charge cards.

Invita Company B.S.C. (c) owns 60% (2017: 60%) interest in Invita Kuwait K.S.C.C., which is established in the State of Kuwait and engaged in business processing and outsourcing services. It also owns 70% (2017: Nil) stake in Invita Claims Management Company, which is established in the Kingdom of Bahrain and engaged in Third Party Administrators (TPA) services.

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

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

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

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

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

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

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

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

3 ACCOUNTING POLICIES

3.1 New Standards and Interpretations issued but not yet effective

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

- IFRS 16 Leases (effective 1 January 2019)
- IFRIC Interpretation 23 Uncertainty over Income Tax Treatment (effective 1 January 2019)
- Amendments to IFRS 9 Prepayment features with negative compensation (effective 1 January 2019)

Annual improvements 2015-2017 cycle (issued in December 2017)

- IFRS 3 Business combinations (effective 1 January 2019)
- IAS 12 Income taxes (effective 1 January 2019)
- IAS 23 Borrowing costs (effective 1 January 2019)

The Group does not expect any significant impact on the Groups' financial position and results for the standards that are not yet adopted.

3.2 New Standards and Interpretations issued and effective

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in previous year, except for the adoption of the following new standards or amendments to existing standards, applicable to the Group, and which are effective for annual periods beginning on or after 1 January 2018:

- IFRS 7 (revised) Financial instruments: Disclosures (IFRS 7R)
- IFRS 15 Revenue from Contracts with Customers
- IFRIC Interpretation 22 Foreign currency transactions and advance considerations

The above new standards, interpretations and amendments to IFRSs which are effective for annual accounting periods starting from 1 January 2018, did not have any material impact on the accounting policies, financial position or performance of the Group. However, the adoption of IFRS 7R resulted in additionnal disclosures.

3.3 Summary of significant accounting policies

(a) Financial assets and financial liabilities

(i) Recognition and initial measurement

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

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

(ii) Classification

Financial assets

On initial recognition, a financial asset is classified as at amortised cost, Fair Value Through Other Comprehensive Income (FVOCI) or FVTPL. A financial asset is measured at amortised cost if it meets both the following conditions and is not designated as at FVTPL:

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

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

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

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

All other financial assets are classified as measured at FVTPL.

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

Financial assets designation at fair value through profit or loss

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

Business model assessment

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

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

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

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

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

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

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

Reclassifications

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

Financial liabilities

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

iii. Derecognition

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, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value.

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

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

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

Financial liabilities

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

(b) Deposits and due from banks and other financial institutions

These are stated at cost, adjusted for effective fair value hedges (if any), less any amounts written off and related expected credit losses.

(c) Loans and advances

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method, and adjusted for effective fair value hedges (if any) and net of interest suspended, expected credit losses and any amounts written off.

(d) Investment securities

The investment securities includes:

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

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

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

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

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

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

(e) Fair value measurement

The Group measures financial instruments, such as, derivatives at fair value at each balance sheet date.

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

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

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

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

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

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

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

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

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

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

For the purpose of fair value disclosures, the Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the assets or liabilities and the level of the fair value hierarchy as explained above.

(f) Impairment of financial assets

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

- Financial assets that are debt instruments;
- Loans and advances at amortised cost;
- Financial guarantee contracts issued; and
- Loan commitments issued.

No impairment loss is recognised on equity investments.

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

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

3 ACCOUNTING POLICIES continued

3.3 Summary of significant accounting policies continued

(g) Measurement of ECL

ECL is a probability-weighted estimate of credit losses. It is measured as follows:

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

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

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

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

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

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

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

(h) Credit-impaired financial assets

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

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

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

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

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

The exposure to the home country sovereign i.e. Bahrain is considered to be low risk and fully recoverable and hence no ECL is measured. Refer to note 32 for further details.

(i) Presentation of allowance for ECL in the statement of financial position

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

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

(j) Write-off

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

(k) Renegotiated loans

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

(l) Term borrowings

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

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

(m) Investment in associated companies and joint ventures

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

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

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

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

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

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

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

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

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

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

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

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

(p) Deposits
These are carried at amortised cost, less amounts repaid.

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

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

(r) Taxation
There is no tax on corporate income in the Kingdom of Bahrain. Taxation on foreign operations is provided in accordance with the fiscal regulations of the respective countries in which the Group operates. In India, the Bank makes provision for income tax after considering both current and deferred taxes. The tax effect of timing differences between the book profit and taxable profits are reflected through Deferred Tax Asset (DTA)/Deferred Tax Liability (DTL). Current tax is determined in accordance with the provisions of Income Tax Act, 1961 and rules framed there under after considering the contested past adjustments on a prudent basis based on management estimates.

(s) Employees' end of service benefits
Costs relating to employees' end of service benefits are accrued in accordance with actuarial and other valuations as required by regulations applicable in each jurisdiction where the Group operates.

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

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

(v) Treasury stock
Treasury stock is deducted from equity and is stated at consideration paid. No gain or loss is recognised in the consolidated statement of profit or loss on the purchase, sale, issue or cancellation of own equity instruments.

(w) Non-controlling interests
Non-controlling interests represents the portion of profit or loss and net assets in the subsidiaries not attributable to the Bank's equity shareholders. Any change in Group's ownership interest in the subsidiary that does not result in a loss of control is accounted for as an equity transaction.

(x) Perpetual Tier 1 capital securities
Perpetual Tier 1 capital securities of the Group are recognised under equity in the consolidated statement of financial position and the corresponding distribution on those securities are accounted as a debit to retained earnings.

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

3 ACCOUNTING POLICIES continued

3.3 Summary of significant accounting policies continued

(z) Financial guarantees

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

(aa) Derivatives

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

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

(ab) Hedge accounting

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

Hedge accounting model introduced under IFRS 9 is designed to better align hedge accounting with risk management activities; permit a greater variety of hedging instruments and risks eligible for hedge accounting; and removed rule based thresholds for testing hedge effectiveness by bringing principle based criteria. Retrospective assessment of hedge effectiveness is no longer required and current accounting treatments of fair value, cashflow and net investment hedge accounting have been retained.

IFRS 9 provides an accounting choice to continue to apply IAS 39 hedge accounting rules until the IASB finalizes its macro hedge accounting project. The Group has adopted IFRS 9 hedge accounting and has determined that all hedge relationships that were designated as effective hedging relationships under IAS 39 would continue to qualify for hedge accounting under IFRS 9.

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

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

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

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

Classification of hedge accounting

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

(i) Fair value hedges

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

(ii) Cash flow hedges

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

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

Discontinuation of hedges

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

(ac) Fiduciary assets

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

(ad) Offsetting

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

(ae) Recognition of income and expenses

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

Interest income and loan commitment fees, which are considered an integral part of the effective yield of a financial asset, are recognised using the effective yield method unless collectability is in doubt. The recognition of interest income is suspended when loans become non-performing i.e. are classified under Stage 2 (when overdue by more than ninety days). Notional interest is recognised on impaired loans and other financial assets based on the rate used to discount future cash flows to their net present value based on the original effective interest rate.

Interest expense is recognised using the effective yield method.

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

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

The Group recognises dividend income when the right to receive payment is established.

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

(af) Foreign currencies

(i) Transactions and balances

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

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

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

(ii) Group companies

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

(ag) Cash and cash equivalents

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

3.4 Significant accounting judgments and estimates

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

Going concern

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

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, these are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgment is applied to establish fair values. These judgment include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities.

Business model

In making an assessment of whether a business model's objective is to hold assets in order to collect contractual cash flows, the Group considers at which level of its business activities such assessment should be made. Generally, a business model is a matter of fact which can be evidenced by the way business is managed and the information provided to management.

In determining whether its business model for managing financial assets is to hold assets in order to collect contractual cash flows, the Group considers:

- Management's stated policies and objectives for the portfolio and the operation of those policies in practice;
- Management's evaluation of the performance of the portfolio; and
- Management's strategy in terms of earning contractual interest revenues or generating capital gains.

Impairment of financial instruments

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

The measurement of the ECL for financial assets measured at amortised cost and FVTOCI is an area that requires the use of complex models and significant assumptions about future economic conditions, credit behavior (e.g. the likelihood of customers defaulting and the resulting losses), estimation of the amount and timing of the future cash flows and collateral values. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Group's ECL calculation are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. A number of significant judgments are also required in applying the accounting requirements for measuring ECL, such as:

- Internal credit rating model, which assigns PDs to the individual ratings;
- The Group calculates PiT PD estimates under three scenarios, a base case, good case and bad case. An appropriate probability weighted ECL is then calculated by assigning probabilities, based on current market conditions, to each scenario;
- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs;
- Selection and relative weightings of forward-looking scenarios to derive the economic inputs into the ECL models;
- Establishing groups of similar financial assets for the purposes of measuring ECL; and
- Determining relevant period of exposure with respect to the revolving facilities and facilities undergoing restructuring at the time of the reporting date.

4 CASH AND BALANCES WITH CENTRAL BANKS

	2018 BD '000	2017 BD '000
Cash in hand and vaults	**20,334**	18,597
Current accounts and placements with central banks	**95,088**	370,537
Mandatory reserve deposits with central banks	**75,606**	80,302
	191,028	469,436

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

5 TREASURY BILLS

These are short-term treasury bills issued by the Government of the Kingdom of Bahrain which are carried at amortised cost, and Republic of India which are carried at FVOCI amounting to BD 405,802 thousand and BD 4,578 thousand (31 December 2017: BD 418,093 thousand and BD 9,037 thousand) respectively. As at 31 December 2018, the ECL on the same is BD 0.100 thousand (31 December 2017: BD 0.351 thousand).

At 31 December 2018, treasury bills issued by Government of the Kingdom of Bahrain includes short-term Islamic Sukuk amounting to BD Nil (31 December 2017: BD 5,000 thousand).

6 DEPOSITS AND AMOUNTS DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	2018 BD '000	2017 BD '000
Deposits with banks and other financial institutions	**195,077**	190,416
Other amounts due from banks (Nostro and Current Accounts)	**44,098**	33,409
Less: Allowance for impairment/ECL	**(1)**	(1)
	239,174	223,824

7 LOANS AND ADVANCES TO CUSTOMERS

	2018 BD '000	2017 BD '000
Loans and advances to customers at amortised cost:		
Commercial loans and overdrafts	**1,343,052**	1,337,637
Consumer loans	**553,539**	515,341
	1,896,591	1,852,978
Less: Allowance for impairment/ECL	**(124,063)**	(112,327)
	1,772,528	1,740,651

Movements in allowance for impairment/ECL are as follows:

(i) Commercial loans and overdrafts

	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit – impaired BD '000	Stage 3: Lifetime ECL credit – impaired BD '000	Total BD '000
2018				
Balance at 1 January	**4,629**	**30,933**	**58,026**	**93,588**
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	**80**	**(80)**	**–**	**–**
- Transferred to lifetime ECL not credit – impaired	**(204)**	**204**	**–**	**–**
- Transferred to lifetime ECL credit – impaired	**(20)**	**(38,724)**	**38,744**	**–**
Net remeasurement of loss allowance	**1,768**	**27,451**	**10,514**	**39,733**
Recoveries/write-backs	**–**	**–**	**(6,086)**	**(6,086)**
Amounts written off during the year	**–**	**–**	**(18,949)**	**(18,949)**
Foreign exchange and other movements	**–**	**1,041**	**(563)**	**478**
Balance at 31 December	**6,253**	**20,825**	**81,686**	**108,764**
2017				
Balance at 1 January	2,623	38,597	67,331	108,551
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	1,600	(1,600)	–	–
- Transferred to lifetime ECL not credit – impaired	(208)	12,099	(11,891)	–
- Transferred to lifetime ECL credit – impaired	(16)	(25,062)	25,078	–
Net remeasurement of loss allowance	630	6,684	24,052	31,366
Recoveries/write-backs	–	–	(4,690)	(4,690)
Amounts written off during the year	–	–	(42,575)	(42,575)
Foreign exchange and other movements	–	215	721	936
Balance at 31 December	4,629	30,933	58,026	93,588

(ii) Consumer loans

	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit – impaired BD '000	Stage 3: Lifetime ECL credit – impaired BD '000	Total BD '000
2018				
Balance at 1 January	**4,152**	**6,351**	**8,236**	**18,739**
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	**986**	**(986)**	**–**	**–**
- Transferred to lifetime ECL not credit – impaired	**(59)**	**59**	**–**	**–**
- Transferred to lifetime ECL credit – impaired	**(1)**	**(103)**	**104**	**–**
Net remeasurement of loss allowance	**–**	**(645)**	**3,038**	**2,393**
Recoveries/write-backs	**–**	**–**	**(992)**	**(992)**
Amounts written off during the year	**–**	**–**	**(4,841)**	**(4,841)**
Balance at 31 December	**5,078**	**4,676**	**5,545**	**15,299**
2017				
Balance at 1 January	2,951	5,085	10,315	18,351
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	440	(440)	–	–
- Transferred to lifetime ECL not credit – impaired	(38)	38	–	–
Net remeasurement of loss allowance	799	1,668	912	3,379
Recoveries/write-backs	–	–	(1,143)	(1,143)
Amounts written off during the year	–	–	(2,322)	(2,322)
Foreign exchange and other movements	–	–	474	474
Balance at 31 December	4,152	6,351	8,236	18,739

At 31 December 2018, interest in suspense on past due loans that are fully impaired amounting to BD 15,907 thousand (31 December 2017: BD 15,049 thousand) are treated as a memorandum account.

The fair value of the collateral consisting of cash, securities and real estate that the Group holds relating to loans individually determined to be impaired at 31 December 2018 amounts to BD 59,819 thousand (31 December 2017: BD 25,712 thousand).

At 31 December 2018, loans and advances include Islamic financing facilities provided by the Group to corporates amounting to BD 98,605 thousand (31 December 2017: BD 108,525 thousand). These mainly consist of Murabaha and Ijarah financing facilities.

8 INVESTMENT SECURITIES

	FVTPL BD '000	FVOCI * BD '000	Amortised cost BD '000	2018 Total BD '000
Quoted investments				
Government bonds	**–**	**275,678**	**20,164**	**295,842**
Other bonds	**677**	**311,238**	**–**	**311,915**
Equities	**–**	**38,264**	**–**	**38,264**
	677	**625,180**	**20,164**	**646,021**
Unquoted investments				
Government bonds	**–**	**–**	**125,672**	**125,672**
Other bonds	**75**	**–**	**–**	**75**
Equities	**–**	**28,166**	**–**	**28,166**
Managed funds	**819**	**–**	**–**	**819**
	894	**28,166**	**125,672**	**154,732**
	1,571	**653,346**	**145,836**	**800,753**
Less: ECL on investments	**–**	**(485)**	**(5)**	**(490)**
Balance at 31 December 2018	**1,571**	**652,861**	**145,831**	**800,263**

	FVTPL BD '000	FVOCI * BD '000	Amortised cost BD '000	2017 Total BD '000
Quoted investments				
Government bonds	–	354,128	13,400	367,528
Other bonds	3,184	206,804	–	209,988
Equities	–	35,242	–	35,242
	3,184	596,174	13,400	612,758
Unquoted investments				
Government bonds	–	–	105,458	105,458
Other bonds	82	584	69	735
Equities	–	29,457	–	29,457
Managed funds	1,196	–	–	1,196
	1,278	30,041	105,527	136,846
	4,462	626,215	118,927	749,604
Less: ECL on investments	–	(615)	(4)	(619)
Balance at 31 December 2017	4,462	625,600	118,923	748,985

* At 31 December 2018, investment securities include government bonds and other bonds of BD 286,105 thousand (31 December 2017: BD 229,726 thousand), which are pledged against the borrowings under repurchase agreements.

At 31 December 2018, investment securities include long-term Islamic Sukuk amounting to BD 72,660 thousand (31 December 2017: BD 79,481 thousand).

8 INVESTMENT SECURITIES continued

Movements in allowance for impairment/ECL of investment securities are as follows:

	Stage 1: 12-month ECL* BD '000	Stage 2: Lifetime ECL not credit – impaired BD '000	Stage 3: Lifetime ECL credit – impaired BD '000	Total BD '000
2018				
Government and other bonds at FVOCI or amortized cost				
Balance at 1 January	**87**	**532**	**–**	**619**
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	**81**	**(81)**	**–**	**–**
- Transferred to lifetime ECL not credit – impaired	**(17)**	**17**	**–**	**–**
Net remeasurement of loss allowance	**8**	**305**	**–**	**313**
Financial assets that have been derecognised	**(10)**	**(199)**	**–**	**(209)**
Foreign exchange and other movements	**–**	**(233)**	**–**	**(233)**
Balance at 31 December	**149**	**341**	**–**	**490**
2017				
Government and other bonds at FVOCI or amortized cost				
Balance at 1 January	164	445	–	609
Changes due to financial assets recognised in opening balance that have:				
- Transferred to 12 month ECL	92	(92)	–	–
- Transferred to lifetime ECL not credit – impaired	(44)	44	–	–
Net remeasurement of loss allowance	(87)	185	–	98
Financial assets that have been derecognised	(38)	(50)	–	(88)
Foreign exchange and other movements	–	–	–	–
Balance at 31 December	87	532	–	619

The loss allowance of the FVOCI is not recognised in the consolidated statement of financial position because the carrying amount of debt investment securities at FVOCI is at their fair value.

* The above table includes ECL of government and other bonds measured at amortized cost of BD 5 thousand (31 December 2017: BD 4 thousand).

9 INVESTMENTS IN ASSOCIATED COMPANIES AND JOINT VENTURES

The Group has a 23.03% (2017: 23.03%) equity interest in Bahrain Commercial Facilities Company B.S.C. ("BCFC"), incorporated in the Kingdom of Bahrain, which is engaged in consumer financing, insurance, dealing in real estate and automobiles.

The Group has a 50% (2017: 50%) stake in Sakana Holistic Housing Solutions B.S.C. (c) ("Sakana"), a jointly controlled company incorporated in the Kingdom of Bahrain which is engaged in Islamic real estate financing, which is under liquidation.

The Group has a 22% (2017: 22%) shareholding in The Benefit Company B.S.C. (c) incorporated in the Kingdom of Bahrain, which is engaged in ancillary services to provide payment systems and other related financial services for the benefit of commercial banks and their customers in the Kingdom of Bahrain.

The Group has a 40% (2017: 40%) stake in BBK Geojit securities K.S.C., a jointly controlled company incorporated in the State of Kuwait.

The Group has a 24.27% (2017: 24.27%) stake in Bahrain Liquidity Fund, an investment vehicle established in the Kingdom of Bahrain to enhance liquidity in the market and to close the valuation gap between securities listed on Bahrain Bourse and their regional peers.

The Group has a 50% (2017: 50%) stake in Aegila Capital Management Limited, a joint venture company incorporated in the United Kingdom which is engaged in capital market advisory services for alternative investments with particular focus in real estate.

The Group has a 50% (2017: Nil) stake in Magnum Partners Holding Limited, a joint venture company incorporated in Jersey to indirectly acquire real estate investments in Netherlands.

The Group has a 25% (2017: Nil) stake in Evoque Holdings Jersey Limited, a joint venture company incorporated in Jersey to indirectly acquire real estate investments in Germany.

	2018 BD '000	2017 BD '000
Carrying amount of investment in associated companies and joint ventures		
At 1 January	**46,958**	43,923
Acquisitions during the year	**15,204**	–
Share of profit	**4,142**	5,519
Dividends received from associated companies	**(3,074)**	(2,394)
Change in unrealised fair values – associated companies (note 16)	**543**	342
Change in foreign exchange translation adjustments	**(288)**	68
Capital distribution	**(550)**	(500)
At 31 December	**62,935**	46,958

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

	2018 BD '000	2017 BD '000
Share of associated companies and joint ventures statements of financial position		
Current and non-current assets	**118,882**	102,965
Current and non-current liabilities	**(55,947)**	(56,007)
Net assets	**62,935**	46,958
Share of associated companies and joint ventures revenues		
Revenue	**12,555**	11,650

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

	2018 BD '000	2017 BD '000
Net interest income	**24,987**	23,569
Gross profit on automotive sales	**7,212**	6,497
Other operating income	**13,087**	11,805
Total operating income	**45,286**	41,871
Operating expenses	**(21,063)**	(19,081)
Other expenses	**(2,773)**	(3,568)
Profit for the year	**21,450**	19,222
Group's share of profit for the year	**4,940**	4,427

	2018 BD '000	2017 BD '000
Assets		
Cash and balances with banks	**4,725**	2,868
Loans and advances to customers	**304,913**	290,606
Inventories	**28,981**	38,196
Other assets	**52,057**	47,911
Total assets	**390,676**	379,581
Liabilities		
Bank overdrafts	**959**	1,598
Trade and other payables	**19,452**	18,483
Bank term loans	**184,118**	184,344
Bonds issued	**39,953**	39,882
Total liabilities	**244,482**	244,307
Donation reserve	**(910)**	(679)
Equity	**145,284**	134,595
Proportion of the Group's ownership	**23.03%**	23.03%
	33,459	30,997

The figures reported above for BCFC are based on 30 September 2018 reviewed financial statements adjusted for expected performance in the last quarter ended 31 December 2018 (2017: same).

The market value of the Group's investment in BCFC is BD 28,966 thousand (2017: BD 25,957 thousand) compared to the carrying value of BD 33,459 thousand (2017: BD 30,997 thousand) as at 31 December 2018.

10 INTEREST RECEIVABLE AND OTHER ASSETS

	2018 BD '000	2017 BD '000
Accounts receivable	**23,116**	29,458
Interest receivable	**15,551**	13,373
Collateral pending sale	**13,530**	9,439
Positive fair value of derivatives (note 27)	**11,268**	7,714
Prepaid expenses	**1,206**	1,677
Deferred tax asset (note 21)	**1,092**	1,631
Others	**12,086**	16,388
	77,849	79,680

11 PREMISES AND EQUIPMENT

	Freehold land BD '000	Properties and buildings BD '000	Furniture and equipment BD '000	Capital work in progress BD '000	Total BD '000
Net book value at 31 December 2018	**8,849**	**11,899**	**6,570**	**225**	**27,543**
Net book value at 31 December 2017	8,849	11,173	5,310	1,104	26,436

The depreciation charge for the year amounted to BD 3,654 thousand (2017: BD 3,435 thousand).

12 TERM BORROWINGS

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

Rate of interest	Maturity Year	2018 BD '000	2017 BD '000
Libor + 1.75%	2018	**–**	48,212
3.50%	2020	**144,542**	150,800
		144,542	199,012

13 CUSTOMERS' CURRENT, SAVINGS AND OTHER DEPOSITS

	2018 BD '000	2017 BD '000
Term deposits	**1,259,419**	1,392,623
Savings accounts	**571,318**	532,588
Current accounts	**484,704**	628,389
Other accounts	**59,039**	69,977
	2,374,480	2,623,577

14 INTEREST PAYABLE AND OTHER LIABILITIES

	2018 BD '000	2017 BD '000
Accrued expenses	**37,559**	38,182
Interest payable	**24,095**	14,828
Accounts payable	**14,249**	14,815
Allowance for impairment/ECL*	**986**	1,408
Negative fair value of derivatives (note 27)	**4,801**	6,639
Others	**22,876**	9,018
	104,566	84,890

* This represents allowance for impairment/ECL on financial contracts issued as of 31 December.

15 EQUITY

(i) Share capital

	2018 BD '000	2017 BD '000
Authorised		
1,500,000,000 shares of BD 0.100 each	**150,000**	150,000
Issued and fully paid		
1,081,647,952 shares (2017: 1,081,647,952 shares) of BD 0.100 each	**108,165**	108,165

(ii) Treasury stock

Treasury stock represents the Bank's purchase of its own shares. At the end of the year, the Bank held 6,213,641 (2017: 2,774,562) of its own shares.

	2018 BD '000	2017 BD '000
Consideration paid	**(2,521)**	(998)

(iii) Share premium

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

(iv) Employee Performance Share Plan

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

(v) Unclaimed dividends

During the year, the Group transferred BD 22 thousand (2017: BD 8 thousand) to equity as unclaimed dividends by the shareholders. As per the Group policies and procedures, any unclaimed dividends in excess of 10 years are transferred to equity, however are available to the respective shareholder for any future claims.

(vi) Perpetual tier 1 convertible capital securities

During the year 2016, the Bank completed an issue of BD 86,098 thousand Basel III compliant Additional Tier I Convertible Perpetual Capital Securities. Distribution Payment Amounts shall be payable subject to and in accordance with terms and conditions on the outstanding nominal amount of the Capital Securities at rate of 8.25 percent per annum. These securities are recognised under equity in the consolidated statement of financial position and the corresponding coupon on those securities are accounted as appropriation of profits. Expenses relating to this issuance have been included in retained earnings during 2016. Securities' holders will not have a right to claim the coupon and such event will not be considered as event of default.

(vii) Statutory reserve

The statutory reserve has been created in accordance with the BCCL. The Bank transfers 10% of its annual profits to its statutory reserve till such time as the reserve equals 50% of the issued share capital of the Bank. During the year, the Bank had not transferred to statutory reserve (2017: Nil) as the statutory reserve equals 50% of the issued share capital. The reserve is not available for distribution, except in circumstances as stipulated in the BCCL and following the approval from the CBB.

(viii) General reserve

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

16 CUMULATIVE CHANGES IN FAIR VALUES

	2018 BD '000	2017 BD '000
Fair value through other comprehensive income		
At 1 January	**(8,573)**	(13,609)
Transfer to retained earnings on sale/write off of equity securities	**507**	1,325
Transfer to profit or loss on sale of investment securities	**(3,249)**	(3,525)
Transferred to profit or loss on impairment	**313**	98
Fair value changes on investment securities carried at FVOCI	**(14,770)**	7,138
At 31 December	**(25,772)**	(8,573)
Cash flow hedges		
At 1 January	**224**	(60)
Change in unrealised fair values	**(100)**	(58)
Change in unrealised fair values – associated companies (note 9)	**543**	342
At 31 December	**667**	224
	(25,105)	(8,349)

17 PROPOSED APPROPRIATIONS

	2018 BD '000	2017 BD '000
Cash dividend	**43,017**	37,761
Donations	**1,600**	1,400
	44,617	39,161

The Board of Directors has proposed cash dividend of BD 0.040 per share (2017: BD 0.035 per share), net of treasury stock as of 31 December 2018. The Bank paid dividend of BD 0.035 per share (2017: BD 0.030 per share).

The above appropriations will be submitted for approval at the Annual General Assembly of the Shareholders to be held on 20 March 2019. The payment of dividend is also subject to the approval of the CBB.

18 NET INTEREST AND SIMILAR INCOME

	2018 BD '000	2017 BD '000
a) Interest and similar income		
Loans and advances to customers	**107,691**	94,030
Investment securities	**33,455**	25,349
Treasury bills	**16,032**	10,943
Deposits and amounts due from banks and other financial institutions	**8,650**	6,661
	165,828	136,983
b) Interest and similar expense		
Customers' deposits	**(39,577)**	(28,842)
Deposits and amounts due to banks and other financial institutions	**(16,301)**	(17,235)
	(55,878)	(46,077)
Net interest and similar income	**109,950**	90,906

19 FEE AND COMMISSION INCOME – NET

	2018 BD '000	2017 BD '000
Fee and commission income	**49,161**	49,253
Fee and commission expense	**(20,974)**	(18,159)
	28,187	31,094

Included in fee and commission income is BD 70 thousand (2017: BD 42 thousand) relating to trust and other fiduciary activities.

20 OTHER INCOME

	2018 BD '000	2017 BD '000
Dividend income	**6,216**	3,828
Gain on foreign exchange	**5,302**	5,214
Realised gains on investment securities	**3,249**	3,965
Others	**4,158**	2,533
	18,925	15,540

21 TAXATION

	2018 BD '000	2017 BD '000
Consolidated statement of financial position		
Deferred tax asset (note 10)	**1,092**	1,631
Consolidated statement of profit or loss		
Current tax expense on foreign operations	**–**	94
Deferred tax expense on foreign operations	**408**	716
	408	810

Current tax is measured at the amount expected to be paid in respect of taxable income for the year in accordance with the Income Tax Act, 1961. Deferred tax assets and liabilities are recognised for the future tax consequences of timing differences being the difference between the taxable income and the accounting income that originate in one period and are capable of reversal in one or more subsequent period. Deferred tax assets on account of timing differences are recognised only to the extent there is reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

The Group's tax expense includes all direct taxes that are accrued on taxable profits of entities to the authorities in the respective countries of incorporation, in accordance with the tax laws prevailing in those jurisdictions. Consequently, it is not practical to provide a reconciliation between the accounting and taxable profits together with the details of effective tax rates. Effective tax rate for the current year ended 31 December 2018 is 43.68% (2017: 43.26%). In the current year, tax is payable as per Minimum Alternate Tax (MAT), under Section 115J of the Income Tax Act, 1961.

22 BASIC AND DILUTED EARNINGS PER SHARE

Basic earnings per share

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

Diluted earnings per share

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

	2018	2017
Profit for the year attributable to the owners of the Bank (BD '000)	**67,118**	58,685
Less: Distribution on perpetual tier 1 convertible capital securities (BD '000)	**(7,103)**	(7,103)
Adjusted net profit for the year attributable to the owners of the Bank (BD '000)	**60,015**	51,582
Weighted average number of shares, net of treasury stock, outstanding during the year	**1,076,676,556**	1,077,809,434
Basic earnings per share (BD)	**0.056**	0.048
Weighted average number of ordinary shares adjusted for the effect of dilution	**1,291,920,336**	1,293,053,214
Diluted earnings per share (BD)	**0.052**	0.045

23 OPERATING SEGMENTS

Segment information

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

Retail banking

Principally handling individual customers' deposits and providing consumer finance type loans, overdrafts, credit facilities and funds transfer facilities, credit cards and foreign exchange.

Corporate banking

Principally handling loans and other credit facilities, deposit and current accounts for corporate and institutional customers in Bahrain.

International banking

Principally handling loans and other credit facilities, deposit and current accounts for international corporate and institutional customers. This also covers the operations of the overseas units.

Investment, treasury and other activities

Principally providing money market, trading and treasury services as well as the management of the Group's funding operations. Investment activities involve handling investments in local and international markets, investment advisory services and funds management. Other activities also include business process outsourcing services.

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

23 OPERATING SEGMENTS continued

Segment information continued

Segment information for the year ended 31 December 2018 was as follows:

	Retail banking BD '000	Corporate banking BD '000	International banking BD '000	Investment, treasury and other activities BD '000	Total BD '000
Interest income	**32,270**	**41,417**	**41,420**	**50,721**	**165,828**
Interest expense	**(3,636)**	**(10,896)**	**(12,686)**	**(28,660)**	**(55,878)**
Internal fund transfer price	**3,348**	**(2,135)**	**(7,843)**	**6,630**	**–**
Net interest income	**31,982**	**28,386**	**20,891**	**28,691**	**109,950**
Other operating income	**21,223**	**3,481**	**5,197**	**17,211**	**47,112**
Operating income before share of profit from associated companies and joint ventures	**53,205**	**31,867**	**26,088**	**45,902**	**157,062**
Net provision for impairment on loans and advances to customers	**328**	**(26,433)**	**(8,943)**	**–**	**(35,048)**
Net provision for impairment on investments	**–**	**–**	**–**	**(313)**	**(313)**
Segment result	**26,191**	**(9,197)**	**1,779**	**44,794**	**63,567**
Share of profit from associated companies and joint ventures	**4,466**	**–**	**–**	**(324)**	**4,142**
Profit for the year					**67,709**
Profit attributable to non-controlling interest					**(591)**
Profit for the year attributable to the owners of the Bank					**67,118**
Segment assets	**643,060**	**661,296**	**992,669**	**1,175,918**	**3,472,943**
Investment in associated companies and joint ventures	**37,934**	**–**	**–**	**25,001**	**62,935**
Common assets					**45,822**
Total assets					**3,581,700**
Segment liabilities	**823,768**	**702,141**	**803,339**	**693,246**	**3,022,494**
Common liabilities					**58,767**
Total liabilities					**3,081,261**

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

	Retail banking BD '000	Corporate banking BD '000	International banking BD '000	Investment, treasury and other activities BD '000	Total BD '000
Interest income	29,080	37,107	32,379	38,417	136,983
Interest expense	(3,159)	(10,094)	(8,937)	(23,887)	(46,077)
Internal fund transfer price	(1,715)	(1,686)	(6,167)	9,568	–
Net interest income	24,206	25,327	17,275	24,098	90,906
Other operating income	23,246	4,399	5,619	13,370	46,634
Operating income before share of profit from associated companies and joint ventures	47,452	29,726	22,894	37,468	137,540
Net provision for impairment on loans and advances to customers	(5,082)	(18,089)	(5,741)	–	(28,912)
Net provision for impairment on investments	–	–	–	(98)	(98)
Segment result	17,093	(2,344)	1,987	36,976	53,712
Share of profit from associated companies and joint ventures	5,448	–	–	71	5,519
Profit for the year					59,231
Profit attributable to non-controlling interest					(546)
Profit for the year attributable to the owners of the Bank					58,685
Segment assets	588,906	681,463	1,250,222	1,152,594	3,673,185
Investment in associated companies and joint ventures	35,377	–	–	11,581	46,958
Common assets					42,957
Total assets					3,763,100
Segment liabilities	791,506	856,957	980,667	584,234	3,213,364
Common liabilities					48,901
Total liabilities					3,262,265

Geographic information

The Group operates in two geographic markets: Domestic (Bahrain), Others (Middle East/Africa, Europe, North America and Asia). The following tables show the distribution of the Group's revenue and non-current assets by geographical segment, allocated based on the location in which the assets and liabilities are located, for the years ended 31 December 2018 and 2017:

	Domestic BD '000	**Others BD '000**	**Total BD '000**
31 December 2018			
Net interest income	**94,996**	**14,954**	**109,950**
Share of profit from associated companies and joint ventures	**4,466**	**(324)**	**4,142**
Other income	**43,639**	**3,473**	**47,112**
	143,101	**18,103**	**161,204**
Non-current assets*	**22,513**	**5,030**	**27,543**

	Domestic BD '000	Others BD '000	Total BD '000
31 December 2017			
Net interest income	80,040	10,866	90,906
Share of profit from associated companies and joint ventures	5,448	71	5,519
Other income	43,092	3,542	46,634
	128,580	14,479	143,059
Non-current assets*	21,380	5,056	26,436

* Non-current assets represent premises and equipment.

24 CASH AND CASH EQUIVALENTS

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

	2018 BD '000	2017 BD '000
Cash in hand and vaults (note 4)	**20,334**	18,597
Current accounts and placements with central banks (note 4)	**95,088**	370,537
Deposits and amounts due from banks and other financial institutions having original maturities of ninety days or less	**229,976**	223,824
	345,398	612,958

25 RELATED PARTY TRANSACTIONS

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

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

	Major shareholders BD '000	Associated companies and joint ventures BD '000	Directors and key management personnel BD '000	Total BD '000
2018				
Loans and advances to customers	**–**	**23,312**	**3,020**	**26,332**
Investments in associated companies and joint ventures	**–**	**62,935**	**–**	**62,935**
Customers' current, savings and other deposits	**185,440**	**3,082**	**6,838**	**195,360**
2017				
Loans and advances to customers	–	24,812	3,132	27,944
Investments in associated companies and joint ventures	–	46,958	–	46,958
Customers' current, savings and other deposits	216,848	3,848	8,004	228,700

For the years ended 31 December 2018 and 2017, the Group has not recorded any impairment provision/ECL on the amounts due from related parties.

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

	Major shareholders BD '000	Associated companies and joint ventures BD '000	Directors and key management personnel BD '000	Total BD '000
2018				
Interest income	**–**	**1,378**	**27**	**1,405**
Interest expense	**6,107**	**63**	**102**	**6,272**
Share of profit from associated companies and joint ventures	**–**	**4,142**	**–**	**4,142**
2017				
Interest income	–	992	30	1,022
Interest expense	3,561	71	119	3,751
Share of profit from associated companies and joint ventures	–	5,519	–	5,519

Compensation of the key management personnel is as follows:

	2018 BD '000	2017 BD '000
Employee benefits	**10,969**	11,260

For key management personnel interest in an employee share incentive scheme (refer to note 40).

26 MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The maturity profile of the assets and liabilities at 31 December 2018 and 2017 given below has been determined on the basis of the remaining period at the statement of financial position date to the contractual maturity date, except in the case of customer deposits. The liquidity profile of customer deposits has been determined on the basis of the effective maturities indicated by the Group's deposit retention history.

31 December 2018	Within 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 to 12 months BD '000	Subtotal BD '000	1 to 5 years BD '000	5 to 10 years BD '000	10 to 20 years BD '000	More than 20 years BD '000	Total BD '000
Assets										
Cash and balances with central banks	115,422	–	–	–	115,422	–	–	–	75,606	191,028
Treasury bills	62,576	123,292	99,185	125,327	410,380	–	–	–	–	410,380
Deposits and amounts due from banks and other financial institutions	195,224	37,735	–	6,215	239,174	–	–	–	–	239,174
Loans and advances to customers	247,176	143,168	108,928	136,032	635,304	812,032	236,200	29,031	59,961	1,772,528
Investment securities	33,636	24,724	29,669	18,729	106,758	299,725	260,265	28,325	105,190	800,263
Investments in associated companies and joint venture	–	–	–	–	–	–	–	–	62,935	62,935
Interest receivable and other assets	64,319	–	–	–	64,319	13,530	–	–	–	77,849
Premises and equipment	–	–	–	–	–	24,470	280	1,150	1,643	27,543
Total assets	718,353	328,919	237,782	286,303	1,571,357	1,149,757	496,745	58,506	305,335	3,581,700
Liabilities										
Deposits and amounts due to banks and other financial institutions	156,763	79,267	22,646	–	258,676	–	–	–	–	258,676
Borrowings under repurchase agreement	–	–	1,996	–	1,996	197,001	–	–	–	198,997
Term borrowings	–	–	–	–	–	144,542	–	–	–	144,542
Customers' current, savings and other deposits	258,525	34,925	87,692	99,156	480,298	16,102	–	–	1,878,080	2,374,480
Interest payable and other liabilities	104,566	–	–	–	104,566	–	–	–	–	104,566
Total liabilities	519,854	114,192	112,334	99,156	845,536	357,645	–	–	1,878,080	3,081,261
Net	198,499	214,727	125,448	187,147	725,821	792,112	496,745	58,506	(1,572,745)	500,439
Cumulative	198,499	413,226	538,674	725,821		1,517,933	2,014,678	2,073,184	500,439	

31 December 2017	Within 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 to 12 months BD '000	Subtotal BD '000	1 to 5 years BD '000	5 to 10 years BD '000	10 to 20 years BD '000	More than 20 years BD '000	Total BD '000
Assets										
Cash and balances with central banks	389,127	–	–	–	389,127	–	–	–	80,309	469,436
Treasury bills	49,929	135,727	124,197	117,277	427,130	–	–	–	–	427,130
Deposits and amounts due from banks and other financial institutions	185,205	38,619	–	–	223,824	–	–	–	–	223,824
Loans and advances to customers	247,871	158,996	121,825	160,358	689,050	729,709	237,247	45,105	39,540	1,740,651
Investment securities	29,085	29,727	12,182	7,547	78,541	305,248	226,442	26,891	111,863	748,985
Investments in associated companies and joint venture	–	–	–	–	–	–	–	–	46,958	46,958
Interest receivable and other assets	70,241	–	–	–	70,241	9,439	–	–	–	79,680
Premises and equipment	–	–	–	–	–	23,163	304	1,257	1,712	26,436
Total assets	971,458	363,069	258,204	285,182	1,877,913	1,067,559	463,993	73,253	280,382	3,763,100
Liabilities										
Deposits and amounts due to banks and other financial institutions	168,761	24,711	–	–	193,472	–	–	–	–	193,472
Borrowings under repurchase agreement	–	–	–	40,804	40,804	120,510	–	–	–	161,314
Term borrowings	–	–	48,212	–	48,212	150,800	–	–	–	199,012
Customers' current, savings and other deposits	344,710	76,611	56,839	35,405	513,565	53,550	–	–	2,056,462	2,623,577
Interest payable and other liabilities	84,890	–	–	–	84,890	–	–	–	–	84,890
Total liabilities	598,361	101,322	105,051	76,209	880,943	324,860	–	–	2,056,462	3,262,265
Net	373,097	261,747	153,153	208,973	996,970	742,699	463,993	73,253	(1,776,080)	500,835
Cumulative	373,097	634,844	787,997	996,970		1,739,669	2,203,662	2,276,915	500,835	

27 DERIVATIVES

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

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

31 December 2018	**Positive fair value BD '000**	**Negative fair value BD '000**	**Notional amount BD '000**
Derivatives held for trading			
Forward foreign exchange contracts	**468**	**458**	**125,773**
Derivatives held as fair value hedges			
Interest rate swaps	**10,800**	**4,343**	**586,804**
	11,268	**4,801**	**712,577**

31 December 2017	Positive fair value BD '000	Negative fair value BD '000	Notional amount BD '000
Derivatives held for trading			
Forward foreign exchange contracts	147	647	104,161
Derivatives held as fair value hedges			
Interest rate swaps	7,467	5,992	535,170
Derivatives held as cash flow hedges			
Interest rate swaps	100	–	49,010
	7,714	6,639	688,341

Derivative product types

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

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

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

Derivatives held or issued for trading purposes

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

Derivatives held or issued for hedging purposes

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

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

Fair value hedges

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

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

At 31 December 2018, the Group held the following interest rate swaps as hedging instruments in fair value hedges of interest risk:

	Less than 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	More than 5 years
Hedge of Investment Securities					
31 December 2018					
Nominal amount (BD '000)	**3,770**	**–**	**14,401**	**255,500**	**313,133**
Average fixed interest rate	**3%**	**0%**	**5%**	**5%**	**6%**
31 December 2017					
Nominal amount (BD '000)	–	471	15,080	250,387	269,232
Average fixed interest rate	0%	3%	3%	5%	5%

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

27 DERIVATIVES continued

Fair value hedges continued

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

	2018		2017	
	Carrying amount BD '000	**Accumulated fair value hedge adjustments on the hedged item included in the carrying amount BD '000**	Carrying amount BD '000	Accumulated fair value hedge adjustments on the hedged item included in the carrying amount BD '000
Bonds (Investment securities)	**574,355**	**(7,964)**	521,316	(4,047)

For the year ended 31 December 2018, the Group recognised a net loss of BD 1.4 thousand (2017: net loss of BD 0.5 thousand), representing the loss on the hedging instruments. The total gain on hedged items attributable to the hedged risk amounted to BD 299 thousand (2017: loss of BD 190 thousand).

Cash flow hedges

At 31 December 2018, the Group did not hold any instruments to hedge exposures to changes in interest rates and foreign currency. As at 31 December 2017, the Group held the following instruments to hedge exposures to changes in interest rates and foreign currency:

	3 months to 1 year	1 to 5 years
Interest rate swaps		
31 December 2017		
Nominal amount (BD '000)	49,010	–
Average fixed interest rate	3%	0%

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

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

	2018		2017	
	Carrying amount BD '000	**Cash flow Reserve BD '000**	Carrying amount BD '000	Cash flow Reserve BD '000
Term Borrowings	**–**	**–**	49,010	100

28 COMMITMENTS AND CONTINGENT LIABILITIES

Credit-related commitments

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

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

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

The Group has the following credit related commitments:

31 December 2018	**On demand BD '000**	**Less than 3 months BD '000**	**3 to 12 months BD '000**	**Total BD '000**
Contingencies				
Letters of credit	**2,374**	**16,082**	**13,903**	**32,359**
Guarantees	**231,625**	**–**	**–**	**231,625**
				263,984
Commitments				
Undrawn loan commitments	**120,649**	**–**	**–**	**120,649**
				120,649
				384,633

31 December 2017	On demand BD '000	Less than 3 months BD '000	3 to 12 months BD '000	Total BD '000
Contingencies				
Letters of credit	1,307	17,481	18,467	37,255
Guarantees	230,620	–	–	230,620
				267,875
Commitments				
Undrawn loan commitments	117,670	–	–	117,670
				117,670
				385,545

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

Operating lease commitments – Group as lessee

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

	2018 BD '000	2017 BD '000
Within one year	**785**	815
After one year but not more than five years	**1,720**	1,939
More than five years	**3,603**	4,039
	6,108	6,793

29 RISK MANAGEMENT

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

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

The Board of Directors of the Bank has overall responsibility for managing risks within the Bank. Whilst the Board approves and periodically reviews risk management policies and strategies based on the recommendations of the Board Risk Committee, the management establishes procedures to implement the policies and strategies.

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

The Risk and Credit Management Division (RCMD) is responsible for oversight of risk management within the Bank. It is responsible for looking into risk characteristics inherent in new and existing products, activities, countries, regions, industries and making necessary recommendations to the appropriate authorities. It is also responsible for introducing or amending risk policies, procedures and exposure limits to mitigate these risks with approval from Board Risk Committee and Board or the Risk Management Committee, as applicable. The RCMD also establishes systems and processes for monitoring market and operational risks, and is also responsible for introducing risk management tools. The RCMD processes credit applications and ensures that the provisions of credit risk policies are complied with. The RCMD generates regular reports on credit risk exposures, performs credit rating reviews and monitors credit limits. The Designated Credit Officer/Designated Investment Officer in RCMD is one of the signatories in the credit/investment approval chain and provides independent view on credit and investment proposals. The Chief Risk Officer is the Head of RCMD and reports directly to the Board Risk Committee, thereby ensuring the independence of the risk management process. In addition to the above, RCMD in collaboration with Financial Control and Planning Division, prepares the Risk Appetite and the ICAAP document for the Bank. The ICAAP document assesses the Pillar 2 risks at length and prescribes the required level of capital buffer for the Bank. RCMD is also responsible for ensuring adherence to regulatory and statutory requirements related to risk management such as introducing use of IFRS 9 guidelines, ICAAP etc. in the Bank.

The internal audit department assess whether the policies and procedures are complied with and, if necessary, suggest ways of further improving internal guidelines and procedures. The various risks to which the Group is exposed to and how the Group manages them is discussed in the notes below.

30 CREDIT RISK AND CONCENTRATION OF CREDIT RISK

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

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

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

The Group has well defined policies and procedures for identifying, measuring, monitoring and controlling credit risk in all of the Group's activities, at the level of individual credit as well as at a portfolio level.

Credit limits are approved after a thorough assessment of the creditworthiness of the borrower or counterparty, including the purpose and structure of the credit, and its source of repayment. Credit proposals are reviewed by the RCMD, which is independent of business units, before approval of the appropriate approving authority is obtained. The Bank has a tiered approval authority level matrix depending on the extent of risk, comprising individuals with proven credit and investment credentials, Management Credit Committee and Board Committees. All policies relating to credit are reviewed by the Board Risk Committee and approved by the Board of Directors. An Executive Committee, consisting of Board of Directors, reviews and approves larger credits. In addition, all larger credits in excess of the approval authority of the Executive Committee are approved by the Board of Directors.

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

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

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

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

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

	2018 BD '000	2017 BD '000
Balances with central banks	**170,694**	450,839
Treasury bills	**410,380**	427,130
Deposits and amounts due from banks and other financial institutions	**239,174**	223,824
Loans and advances to customers	**1,772,528**	1,740,651
Investment securities	**733,014**	683,090
Interest receivable and other assets	**62,021**	66,933
	3,387,811	3,592,467
Contingent liabilities	**263,984**	267,875
Commitments	**120,649**	117,670
	384,633	385,545
	3,772,444	3,978,012

31 CONCENTRATION RISK

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

	2018			2017		
	Assets BD '000	**Liabilities BD '000**	**Credit commitments and contingencies BD '000**	Assets BD '000	Liabilities BD '000	Credit commitments and contingencies BD '000
Gulf Co-operation Council countries	**2,968,454**	**2,581,019**	**327,549**	3,222,728	2,756,671	340,220
North America	**42,340**	**12,538**	**258**	37,547	6,776	11
Europe	**250,740**	**337,751**	**6,073**	217,202	351,458	3,428
Asia	**259,918**	**134,574**	**49,307**	224,268	133,420	41,550
Others	**60,248**	**15,379**	**1,445**	61,355	13,940	336
	3,581,700	**3,081,261**	**384,632**	3,763,100	3,262,265	385,545
Trading and manufacturing	**673,005**	**102,187**	**186,349**	619,928	226,838	180,861
Banks and other financial institutions	**695,749**	**1,344,115**	**25,024**	655,062	1,240,487	27,018
Construction and real estate	**385,094**	**69,872**	**135,120**	392,225	62,305	128,840
Government and public sector	**1,013,544**	**368,843**	**1,413**	1,368,621	498,373	3,485
Individuals	**496,662**	**934,255**	**428**	441,848	914,531	624
Others	**317,646**	**261,989**	**36,298**	285,416	319,731	44,717
	3,581,700	**3,081,261**	**384,632**	3,763,100	3,262,265	385,545

32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS

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

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

The Group utilises a scale ranging from 1 to 10 for credit relationships, with 1 to 8 denoting performing grades and 9 and 10 as non-performing grades, in line with Basel III guidelines. Grades 1 to 3 represent high grade (undoubted through to good credit risk), 4 to 6 represent standard grade (satisfactory through to adequate credit risk) and 7 to 8 represent sub-standard grade (satisfactory through to high credit risk).

The Group's rating method comprises 19 rating levels for debt instruments. The master scale maps the external credit ratings of rating agencies for debt instruments in to high, standard, substandard and past due or individually impaired. Grades 1 to 7 represent high grade (AAA to A-), 8 to 16 represent standard grade (BBB+ to B-) and 17 to 19 represent sub-standard grade (CCC+ to CCC-).

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

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

32.1 Credit quality analysis

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

	Stage 1: 12-month ECL BD '000	**Stage 2: Lifetime ECL not credit-impaired BD '000**	**Stage 3: Lifetime ECL credit -impaired BD '000**	**Total BD '000**
31 December 2018				
Loans and advances to customers – Commercial loans and overdrafts at amortised cost				
High (Grade 1 to 3)	**237,343**	**5,473**	**–**	**242,816**
Standard (Grade 4 to 6)	**669,365**	**156,423**	**–**	**825,788**
Substandard (Grade 7 to 8)	**9,558**	**124,530**	**–**	**134,088**
Non-performing (Grade 9 to 10)	**–**	**–**	**140,360**	**140,360**
	916,266	**286,426**	**140,360**	**1,343,052**
Loss allowance/ECL	**(6,253)**	**(20,825)**	**(81,686)**	**(108,764)**
Net carrying amount	**910,013**	**265,601**	**58,674**	**1,234,288**
31 December 2017				
Loans and advances to customers – Commercial loans and overdrafts at amortised cost				
High (Grade 1 to 3)	174,550	751	–	175,301
Standard (Grade 4 to 6)	725,813	202,911	–	928,724
Substandard (Grade 7 to 8)	16,464	120,795	–	137,259
Non-performing (Grade 9 to 10)	–	–	96,353	96,353
	916,827	324,457	96,353	1,337,637
Loss allowance/ECL	(4,629)	(30,933)	(58,026)	(93,588)
Net carrying amount	912,198	293,524	38,327	1,244,049

	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
31 December 2018				
Loans and advances to customers – Consumer loans at amortised cost				
High (Grade 1 to 3)	**523,768**	**–**	**–**	**523,768**
Standard (Grade 4 to 6)	**–**	**8,403**	**–**	**8,403**
Substandard (Grade 7 to 8)	**–**	**10,939**	**–**	**10,939**
Non-performing (Grade 9 to 10)	**–**	**–**	**10,429**	**10,429**
	523,768	**19,342**	**10,429**	**553,539**
Loss allowance/ECL	**(5,078)**	**(4,676)**	**(5,545)**	**(15,299)**
Net carrying amount	**518,690**	**14,666**	**4,884**	**538,240**
31 December 2017				
Loans and advances to customers – Consumer loans at amortised cost				
High (Grade 1 to 3)	478,888	–	–	478,888
Standard (Grade 4 to 6)	–	12,544	–	12,544
Substandard (Grade 7 to 8)	–	12,731	–	12,731
Non-performing (Grade 9 to 10)	–	–	11,178	11,178
	478,888	25,275	11,178	515,341
Loss allowance/ECL	(4,152)	(6,351)	(8,236)	(18,739)
Net carrying amount	474,736	18,924	2,942	496,602

31 December 2018	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
Debt investment securities at FVOCI				
High (AAA to A-)	**144,526**	**–**	**–**	**144,526**
Standard (BBB+ to B-) *	**308,837**	**138,131**	**–**	**446,968**
Total	**453,363**	**138,131**	**–**	**591,494**
Loss allowance/ECL	**(145)**	**(340)**	**–**	**(485)**
Net carrying amount	**453,218**	**137,791**	**–**	**591,009**
Debt investment securities at amortised cost				
High (AAA to A-)	**74,254**	**–**	**–**	**74,254**
Standard (BBB+ to B-) *	**458,595**	**18,789**	**–**	**477,384**
Total	**532,849**	**18,789**	**–**	**551,638**
Loss allowance/ECL	**(5)**	**–**	**–**	**(5)**
Net carrying amount	**532,844**	**18,789**	**–**	**551,633**
Loan commitments and financial guarantees				
High (Grade 1 to 3)	**112,954**	**–**	**–**	**112,954**
Standard (Grade 4 to 6)	**160,720**	**43,158**	**–**	**203,878**
Substandard (Grade 7 to 8)	**635**	**61,296**	**–**	**61,931**
Non-performing (Grade 9 to 10)**	**–**	**–**	**5,870**	**5,870**
Total	**274,309**	**104,454**	**5,870**	**384,633**
Loss allowance/ECL	**(525)**	**(461)**	**–**	**(986)**
Net carrying amount	**273,784**	**103,993**	**5,870**	**383,647**

31 December 2017	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
Debt investment securities at FVOCI				
High (AAA to A-)	169,790	–	–	169,790
Standard (BBB+ to B-) *	239,283	161,480	–	400,763
Total	409,073	161,480	–	570,553
Loss allowance/ECL	(83)	(532)	–	(615)
Net carrying amount	408,990	160,948	–	569,938
Debt investment securities at amortised cost				
High (AAA to A-)	64,251	–	–	64,251
Standard (BBB+ to B-) *	449,049	23,720	–	472,769
Total	513,300	23,720	–	537,020
Loss allowance/ECL	(4)	–	–	(4)
Carrying amount	513,296	23,720	–	537,016
Loan commitments and financial guarantees				
High (Grade 1 to 3)	112,579	–	–	112,579
Standard (Grade 4 to 6)	192,760	31,459	–	224,219
Substandard (Grade 7 to 8)	6,887	40,407	–	47,294
Non-performing (Grade 9 to 10) **	–	6	1,447	1,453
Total	312,226	71,872	1,447	385,545
Loss allowance/ECL	(564)	(844)	–	(1,408)
Net carrying amount	311,662	71,028	1,447	384,137

* Standard grade includes unrated investments amounting to BD 6,149 thousand (2017: BD 1,469 thousand).
** These off-balance sheet exposures mainly include performance guarantees.

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

	2018 BD '000	2017 BD '000
Debt investment securities		
High (AAA to A-)	**–**	3,266
Standard (BBB+ to B-)	**752**	–
Total carrying amount	**752**	3,266

32.2 Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

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

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

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

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

32 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS continued

32.2 Collateral and other credit enhancements continued

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

	2018 BD '000	2017 BD '000
Derivative assets held for risk management	**9,165**	11,383
Loans and advances:		
- Cash	**60,916**	116,792
- Mortgage lending	**978,694**	806,957
- Financial Instruments	**42,409**	34,686
- Others*	**80,571**	8,684

* Others include assignments of right, bank guarantees, general documents, insurance policies, offering letters, promissory notes, term loan agreements and tugs and ships.

32.3 Inputs, assumptions and techniques used for estimating impairment

(a) Significant increase in credit risk

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

(b) Credit risk grades

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

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

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

(d) Determining whether credit risk has increased significantly

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

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

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

(e) Renegotiated/Modified financial assets

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

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

(f) Definition of default and cure

The Group considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. 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, indications that it is probable that the borrower will enter bankruptcy or other significant 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 are written off after all restructuring and collection activities have taken place and there is no realistic prospect of recovery.

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

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

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances. The definition of default largely aligns with that applied by the Group for regulatory capital purposes.

A financial instrument is considered as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least twelve consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

(g) Incorporation of forward-looking information

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

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

(h) Measurement of ECL

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

i) Probability of default (PD);

ii) Loss given default (LGD); and

iii) Exposure at default (EAD).

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

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

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

LGD estimations are estimations of:

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

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

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

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

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

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

i) Credit risk gradings;

ii) Product type; and

iii) Geographic location of the borrower.

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

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

i) Banks and financial institutions;

ii) Sovereign; and

iii) Investment securities (debt instruments).

33 CARRYING AMOUNT OF FINANCIAL ASSETS WHOSE TERMS HAVE BEEN RENEGOTIATED

The Group sometimes makes concessions or modifications to the original terms of loans as a response to the borrower's financial difficulties, rather than taking possession or to otherwise enforce collection of collateral. The Group considers a loan forborne when such concessions or modifications are provided as a result of the borrower's present or expected financial difficulties and the Group would not have agreed to them if the borrower had been financially healthy.

The table below shows the carrying amount for financial assets by class that are renegotiated during the year:

	2018 BD '000	2017 BD '000
Loans and advances to customers		
Commercial loans	**42,151**	83,884
Consumer loans	**3,099**	5,855
	45,250	89,739

34 MARKET RISK

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

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

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

	2018 BD '000	2017 BD '000
Foreign exchange	**199**	147
Interest rate	**2**	2
	201	149

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

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

35 INTEREST RATE RISK

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

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

Based on the consolidated statement of financial position as at 31 December 2018 an increase of 200 basis points in interest rates, with all variables held constant, will result in an increase in the net interest income, for the following next 12 months, by approximately BD 22,568 thousand (2017: increase by BD 17,738 thousand). However, further downward movement of interest rates by 200 basis points might not be practical assumption in the current environment, given the current low levels of interest rates, and hence capping the downward movement of interest rates at 0%, the negative impact on the net interest income as at 31 December 2018 of BD 22,452 thousand (2017: BD 16,115 thousand). On the other hand, the scope for interest rates increase from its current levels is most probable which the Bank shall benefit.

	Rate Shock Forecasting (+200 bps)		Rate Shock Forecasting (-200 bps)	
	2018 BD '000	2017 BD '000	**2018 BD '000**	2017 BD '000
Bahraini Dinar	**12,010**	11,557	**12,010**	11,557
US Dollar	**10,448**	5,468	**10,448**	4,269
Kuwaiti Dinar	**919**	1,471	**803**	1,047
Others	**(809)**	(758)	**(809)**	(758)
Total	**22,568**	17,738	**22,452**	16,115

An increase of 200 basis points in interest rates, with all other variables held constant, will result in a negative impact on capital of approximately 4.6% amounting to BD 24,160 thousand (2017: 7.2%, BD 37,955 thousand). Similarly, a decrease of 200 basis points in interest rates, with all other variables held constant, will result in a positive impact on capital of approximately 4.6% amounting to BD 24,160 thousand (2017: 7.2%, BD 37,955 thousand).

36 CURRENCY RISK

Currency risk is the risk that the functional currency value of a financial instrument will fluctuate due to changes in foreign exchange rates. The functional currency of the Group is the Bahraini Dinar.

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

	2018 BD '000 equivalent long (short)	2017 BD '000 equivalent long (short)
US dollar	**82,825**	63,540
Euro	**3,387**	147
GCC currencies (excluding Kuwaiti dinar)	**12,695**	2,886
Kuwaiti dinar	**(614)**	1,039
Others	**(1,127)**	285

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

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

37 EQUITY PRICE RISK

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

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

	Trading Equities		Effect on equity		
	2018 BD '000	2017 BD '000	% change in Index	**Total 2018 BD '000**	Total 2017 BD '000
Bahrain Bourse	**11,460**	9,160	± 15%	**1,719**	1,374
Other stock exchanges	**26,804**	26,082	± 15%	**4,021**	3,912
				5,740	5,286

38 LIQUIDITY RISK

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

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

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

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

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

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

31 December 2018	On Demand BD '000	Within 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 to 12 months BD '000	1 to 5 years BD '000	5 to 10 years BD '000	10 to 20 years BD '000	More than 20 years BD '000	Total BD '000
Deposits and due to banks and other financial institutions	**109,761**	**47,093**	**70,732**	**32,712**	**159**	**1,207**	**–**	**–**	**–**	**261,664**
Borrowings under repurchase agreement	**–**	**591**	**783**	**3,929**	**3,325**	**208,582**	**–**	**–**	**–**	**217,210**
Term borrowings	**–**	**–**	**2,558**	**–**	**2,558**	**147,113**	**–**	**–**	**–**	**152,229**
Customers' current, savings and other deposits	**1,104,193**	**243,049**	**161,670**	**366,735**	**446,086**	**100,772**	**2**	**–**	**–**	**2,422,507**
Total undiscounted financial liabilities	**1,213,954**	**290,733**	**235,743**	**403,376**	**452,128**	**457,674**	**2**	**–**	**–**	**3,053,610**
Letter of Guarantees	**231,625**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**231,625**
Undrawn loan commitments	**120,649**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**120,649**
Derivative financial instruments										
Contractual amounts payable	**–**	**(7,187)**	**(4,673)**	**(15,555)**	**(22,613)**	**(359,318)**	**(303,932)**	**(57,353)**	**(56,614)**	**(827,245)**
Contractual amounts receivable	**–**	**7,276**	**4,694**	**16,247**	**23,955**	**366,896**	**305,595**	**57,505**	**56,610**	**838,778**
	–	**89**	**21**	**692**	**1,342**	**7,578**	**1,663**	**152**	**(4)**	**11,533**

31 December 2017	On Demand BD '000	Within 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 to 12 months BD '000	1 to 5 years BD '000	5 to 10 years BD '000	10 to 20 years BD '000	More than 20 years BD '000	Total BD '000
Deposits and due to banks and other financial institutions	66,154	103,880	25,108	59	46	282	–	–	–	195,529
Borrowings under repurchase agreement	–	552	492	1,230	43,155	128,652	–	–	–	174,081
Term borrowings	–	–	2,947	48,637	2,668	158,820	–	–	–	213,072
Customers' current, savings and other deposits	1,249,748	354,293	297,100	277,695	214,300	272,698	6	–	–	2,665,840
Total undiscounted financial liabilities	1,315,902	458,725	325,647	327,621	260,169	560,452	6	–	–	3,248,522
Letter of Guarantees	230,620	–	–	–	–	–	–	–	–	230,620
Undrawn loan commitments	117,670	–	–	–	–	–	–	–	–	117,670
Derivative financial instruments										
Contractual amounts payable	–	(2,789)	(4,839)	(63,630)	(20,888)	(339,168)	(239,130)	(58,546)	(69,590)	(798,580)
Contractual amounts receivable	–	2,411	4,231	63,076	19,707	331,190	233,521	52,771	66,053	772,960
	–	(378)	(608)	(554)	(1,181)	(7,978)	(5,609)	(5,775)	(3,537)	(25,620)

39 FAIR VALUES OF FINANCIAL INSTRUMENTS

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

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The significant inputs for valuation of equities classified under Level 3 are annual growth rate of cash flows and discount rates, and for funds it is the illiquidity discount. Lower growth rate and higher discount rate, illiquidity discount will result in a lower fair value. The impact on the consolidated statement of financial position or the consolidated statement of shareholders' equity would be immaterial if the relevant risk variables used to fair value the unquoted securities were altered by five percent. There were no material changes in the valuation techniques used for the purpose of measuring fair value of investment securities as compared to the previous year.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy at 31 December 2018 and 2017:

31 December 2018	Level 1 BD'000	Level 2 BD'000	Level 3 BD'000	Total BD'000
Financial assets				
Bonds	**587,108**	**–**	**75**	**587,183**
Equities	**38,264**	**6,478**	**21,688**	**66,430**
Managed funds	**–**	**819**	**–**	**819**
Derivatives held for trading	**–**	**468**	**–**	**468**
Derivatives held as fair value hedges	**–**	**10,800**	**–**	**10,800**
	625,372	**18,565**	**21,763**	**665,700**
Financial liabilities				
Derivatives held for trading	**–**	**458**	**–**	**458**
Derivatives held as fair value hedges	**–**	**4,343**	**–**	**4,343**
	–	**4,801**	**–**	**4,801**

31 December 2017	Level 1 BD'000	Level 2 BD'000	Level 3 BD'000	Total BD'000
Financial assets				
Bonds	563,502	–	666	564,168
Equities	35,242	6,737	22,720	64,699
Managed funds	–	1,196	–	1,196
Derivatives held for trading	–	147	–	147
Derivatives held as fair value hedges	–	7,467	–	7,467
Derivatives held as cash flow hedges	–	100	–	100
	598,744	15,647	23,386	637,777
Financial liabilities				
Derivatives held for trading	–	647	–	647
Derivatives held as fair value hedges	–	5,992	–	5,992
	–	6,639	–	6,639

Transfers between Level 1, Level 2 and Level 3

During the reporting year ended 31 December 2018, there were no transfers into or out of Level 3 fair value measurements.

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

2018	Carrying value BD '000	Fair value BD '000	Difference BD '000
Financial liabilities			
Term borrowings	**144,542**	**140,617**	**(3,925)**
Financial assets			
Investment securities	**145,831**	**144,141**	**(1,690)**

2017	Carrying value BD '000	Fair value BD '000	Difference BD '000
Financial liabilities			
Term borrowings	199,012	193,941	(5,071)
Financial assets			
Investment securities	118,923	117,233	(1,690)

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

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

40 SHARE – BASED PAYMENTS

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

	2018 BD '000	2017 BD '000
Expense arising from equity-settled share-based payment transactions	**81**	1,242
Shares vested during the year	**(659)**	(543)

During 2010, the Nomination and Remuneration Committee of the Bank modified the employees stock option plans for the previously granted stock options. The existing plan was discontinued with effect from 31 March 2010. In 2014, the Bank adopted regulations concerning sound remuneration practices issued by the CBB and consequently revised its variable remuneration framework. The revised policy framework and incentive components were approved by the shareholders in their Annual General Meeting on 10 March 2015.

The new share plan has been combined with the newly revised remuneration framework mandated by the CBB and is referred to as Short-Term Incentive Plan (STIP) and Long-Term Incentive Plan (LTIP). Details of the plan are described below:

Short-Term and Long-Term Shares Incentive Plan

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

The Bank utilizes its existing treasury shares for both plans and may also choose to issue new shares to settle the share plan in the future. The price of the shares granted was equal to the market price of the Bank's shares on the grant date. As at 31 December 2018, there has been a transfer of 1,028,457 shares (2017: 4,636,928 shares) from treasury stock to BBK Employee Benefit Trust to meet the number of shares required for the STIP and LTIP.

41 CAPITAL ADEQUACY

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

	2018 BD '000	2017 BD '000
CET1 capital	**404,573**	408,784
Additional Tier 1 capital	**86,098**	86,098
Tier 2 capital	**29,729**	29,578
Total capital base (a)	**520,400**	524,460
Credit risk weighted exposure	**2,378,282**	2,366,212
Operational risk weighted exposure	**242,277**	226,425
Market risk weighted exposure	**37,613**	28,050
Total risk weighted exposure (b)	**2,658,172**	2,620,687
Capital adequacy (a/b*100)	**19.58%**	20.01%
Minimum requirement	**14.00%**	12.50%

Capital management

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

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

Basel III and capital management

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

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

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

42 LEGAL AND OPERATIONAL RISK

Legal risk

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

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

As at 31 December 2018, there was a legal case pending against the Group aggregating to BD 795 thousand (2017: BD 795 thousand). Based on the opinion of the Group's legal advisors, the management believes that no liability is likely to arise from these cases.

Operational risk

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

The Operational Risk Department operates independently from other units of the Bank and reports to the Chief Risk Officer. It conducts regular reviews of all business areas of the Bank and reports control deficiencies and exceptions to the Bank's policies and procedures. It also recommends measures to mitigate operational risk, which are implemented by management immediately.

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

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

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

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

43 DEPOSIT PROTECTION SCHEME

Deposits held with the Bahrain operations of the Bank are covered by the Deposit Protection Scheme established by the CBB regulation concerning the establishment of the Deposit Protection Scheme and Deposit Protection Board. This scheme covers eligible "natural persons" (individuals) up to a maximum of BD 20,000 as set by the CBB requirements. A periodic contribution as mandated by CBB is paid by the Bank under the scheme.

44 STAFF SAVING SCHEME

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

As at 31 December 2018, the total contribution fund including the earned income stands at BD 17,219 thousand (2017: BD 17,044 thousand). Out of the total fund amount, payment of the principal amount equal to BD 15,087 thousand (2017: BD 14,927 thousand) consisting of the respective staff and Bank's contribution is guaranteed by the Bank to employees participating in the scheme within the applicable law. Out of the principal amount, BD 8,233 thousand (2017: BD 6,069 thousand) is invested in Bahraini Sovereign Bonds.

45 CLASSIFICATION OF ASSETS AND LIABILITIES

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

31 December 2018	Designated as at FVTPL BD '000	FVOCI – debt instruments BD '000	FVOCI – equity instruments BD '000	Amortised cost/others BD '000	Total BD '000
Cash and balances with central banks	–	–	–	191,028	191,028
Treasury bills	–	4,578	–	405,802	410,380
Deposits and amounts due from banks and other financial institutions	–	–	–	239,174	239,174
Loans and advances to customers	–	–	–	1,772,528	1,772,528
Investment securities	1,571	586,431	66,430	145,831	800,263
Investments in associated companies and joint ventures	–	–	–	62,935	62,935
Interest receivable and other assets	–	–	–	77,849	77,849
Premises and equipment	–	–	–	27,543	27,543
Total assets	**1,571**	**591,009**	**66,430**	**2,922,690**	**3,581,700**
Deposits and amounts due to banks and other financial institutions	–	–	–	258,676	258,676
Borrowings under repurchase agreement	–	–	–	198,997	198,997
Term borrowings	–	–	–	144,542	144,542
Customers' current, savings and other deposits	–	–	–	2,374,480	2,374,480
Interest payable and other liabilities	–	–	–	104,566	104,566
Total liabilities	**–**	**–**	**–**	**3,081,261**	**3,081,261**

31 December 2017	Designated as at FVTPL BD '000	FVOCI – debt instruments BD '000	FVOCI – equity instruments BD '000	Amortised cost/others BD '000	Total BD '000
Cash and balances with central banks	–	–	–	469,436	469,436
Treasury bills	–	9,037	–	418,093	427,130
Deposits and amounts due from banks and other financial institutions	–	–	–	223,824	223,824
Loans and advances to customers	–	–	–	1,740,651	1,740,651
Investment securities	4,462	560,901	64,699	118,923	748,985
Investments in associated companies and joint ventures	–	–	–	46,958	46,958
Interest receivable and other assets	–	–	–	79,680	79,680
Premises and equipment	–	–	–	26,436	26,436
Total assets	4,462	569,938	64,699	3,124,001	3,763,100
Deposits and amounts due to banks and other financial institutions	–	–	–	193,472	193,472
Borrowings under repurchase agreement	–	–	–	161,314	161,314
Term borrowings	–	–	–	199,012	199,012
Customers' current, savings and other deposits	–	–	–	2,623,577	2,623,577
Interest payable and other liabilities	–	–	–	84,890	84,890
Total liabilities	–	–	–	3,262,265	3,262,265

1 EXECUTIVE SUMMARY

This report has been prepared in accordance with Pillar III disclosure requirements prescribed by the Central Bank of Bahrain, herein referred to as "CBB". The report has been designed to provide BBK Group's stakeholders with detailed information on the Bank's approach in managing capital and risk, having due regard to the operating environment.

The Bank applies the Basel framework in the measurement of its capital adequacy, and in its capital management strategy and risk management framework. CBB's Basel III capital rules and guidelines became effective on 1st January 2015 as the common framework for the implementation of the Basel Committee on Banking Supervision's (Basel Committee) Basel III capital adequacy framework for banks incorporated in the Kingdom of Bahrain.

The disclosures in this report are in addition to the disclosures set out in the consolidated financial statements for the year ended 31 December 2018 presented in accordance with the International Financial Reporting Standards (IFRSs). Disclosures with respect to Corporate Governance and Remuneration are provided in relevant sections of the Annual Report.

2 INTRODUCTION TO THE BASEL III FRAMEWORK

The CBB's Basel III capital framework is based on three pillars consistent with the Basel III framework developed by the Basel Committee, as follows:

- Pillar I: calculation of the Risk Weighted Assets (RWAs) and capital requirement.
- Pillar II: the supervisory review process, including the Internal Capital Adequacy Assessment Process (ICAAP).
- Pillar III: rules for the disclosure of risk management and capital adequacy information.

Pillar I

Pillar I prescribes the basis for the calculation of the regulatory capital adequacy ratio. Pillar I sets out the definition and calculations of the RWAs, and the derivation of the regulatory total capital. Capital adequacy ratios are calculated by dividing regulatory capital by the total RWAs.

Basel III focuses on increasing both the quantity and quality of bank's capital. To this end, Tier 1 capital "T1" must be the main component of capital, and the predominant form of T1 capital must be common shares and reserves. Deductions from capital and prudential filters are generally applied at the level of common equity. The remainder of T1 capital base must be comprised of instruments that are subordinated, have fully discretionary noncumulative dividends or coupons and have neither a maturity date nor an incentive to redeem. In addition, Tier 2 capital "T2" instruments are restricted and have a limit on their contribution to total regulatory capital. Furthermore, Basel III introduced a number of capital buffers to promote the conservation of capital (Capital Conservation Buffer or "CCB"), the build-up of adequate buffers above the minimum required capital during times of good economic conditions that can be drawn down in periods of stress (countercyclical capital buffer) and the high loss absorbency buffer for Domestic Systemically Important Banks (DSIBs).

CBB minimum required total capital adequacy ratio (including CCB) is increased from 12 percent to 12.5 percent, compared to 10.5 percent recommended by the Basel Committee. Moreover, there are newly introduced limits and minima by the CBB under Basel III, such as minimum Common Equity Tier 1 Capital Ratio "CET1" of 9 percent (including CCB) and minimum T1 Capital Ratio of 10.5 percent (including CCB). In the event that the total capital adequacy ratio falls below 12.5 percent, additional prudential reporting requirements apply, and a formal action plan setting out the measures to be taken to restore the ratio above the minimum required level is to be formulated and submitted to the CBB. BBK had been designated as a DSIB by the CBB. Consequently, the CBB requires BBK to maintain an effective minimum total capital adequacy ratio above 14 percent including 1.5 percent as a DSIB buffer.

The table below summarizes the approaches available for calculating RWAs for each risk type in accordance with the CBB's Basel III capital adequacy framework:

Credit Risk	Market Risk	Operational Risk
Standardised Approach	Standardised Approach	Basic Indicator Approach
	Internal Models Approach	Standardised Approach

The approach applied by BBK for each risk type is as follows:-

(i) Credit Risk

For regulatory reporting purposes, BBK is using the Standardised Approach for credit risk. Credit risk constitutes nearly 90 percent of the overall risk for the Bank. The Bank has a robust credit risk management architecture which is explained in greater detail in Note 29 and 30 of the Annual Report. The credit RWAs are determined by multiplying the credit exposure by a risk weight factor dependent on the type of counterparty and the counterparty's external rating, where available.

(ii) Market Risk

For the regulatory market risk capital requirement, BBK is using the Internal Model Approach based on Value-at-Risk (VaR) model. The use of the Internal Model Approach for the calculation of regulatory market risk capital has been approved by the CBB and the model is subject to periodic independent internal and external validation.

(iii) Operational Risk

All banks incorporated in Bahrain are required to apply the Basic Indicator Approach for operational risk unless approval is granted by the CBB to use the Standardised Approach. The CBB's capital framework does not currently permit the use of the Advanced Measurement Approach (AMA) for operational risk. For regulatory reporting purposes, BBK is currently using the Basic Indicator Approach whereby, the operational risk weighted exposures and regulatory capital requirement are calculated by applying an alpha co-efficient of 15 percent to the average gross income for the preceding three financial years.

2 INTRODUCTION TO THE BASEL III FRAMEWORK continued

Pillar II

Pillar II defines the process of supervisory review of an institution's risk management framework and, ultimately, its capital adequacy.

Under the CBB's Pillar II guidelines, all banks incorporated in Bahrain are required to maintain total capital adequacy ratio above 12.5 percent, except those assigned as DSIB where the minimum capital is 14 percent.

Pillar II comprises two processes:

- an Internal Capital Adequacy Assessment Process (ICAAP), and
- a supervisory review and evaluation process.

The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the bank is exposed. BBK has developed an ICAAP document and it addresses all components of BBK's risk management, from the daily management of more material risks to the strategic capital management of the Group. The projected growth in risk assets, operating profit, shareholders' funds and the corresponding capital requirement are estimated by the bank as part of the 3 years strategy approved by the Board. In addition, the bank also forecasts the Capital Base whenever there is likely reduction in the capital components, and necessary actions are taken in order to ensure regulatory compliance. The bank has also a Dividend Policy in place as part of capital management strategy. The Bank is evaluating the gaps in current document and the way forward for implementation of the CBB requirements for ICAAP issued in 2018, in line with the timelines specified by CBB.

The Bank uses the RAROC model in its credit decisions in order to assess risk-reward matrix for each credit exposure. The Bank has adopted a Risk Appetite Framework which is reviewed periodically. The Bank also adopts a Risk Management Strategy annually covering all types of relevant risks.

The supervisory review and evaluation process represents the CBB's review of the Group's capital management and an assessment of internal controls and corporate governance. The supervisory review and evaluation process is designed to ensure that institutions identify their material risks, allocate adequate capital, and employ sufficient management processes to support such risks. The supervisory review and evaluation process also encourages institutions to develop and apply enhanced risk management techniques for the measurement and monitoring of risks in addition to the credit, market and operational risks addressed in the core Pillar I framework. Other risk types which are not covered by the minimum capital requirements in Pillar I include liquidity risk, interest rate risk in the banking book, strategic risk, concentration risk, reputational risk, and residual risk. These are covered either by capital, or risk management and mitigation processes under Pillar II.

BBK conducts stress testing of its portfolio as part of the ICAAP process. The Bank is evaluating the gaps in current document and the way forward for implementation of the CBB requirements for Stress Testing issued in 2018, in line with the timelines specified by CBB.

Pillar III

Pillar III deals with the Market Discipline guidelines of the regulator to ensure adequate disclosure of risk management practices, corporate governance standards and capital adequacy information. The Bank publishes regulatory disclosures periodically and in the Annual Report.

The disclosures comprise detailed qualitative and quantitative information. The purpose of the Pillar III disclosure requirements is to complement the first two pillars and the associated supervisory review process. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all banks, via market pressures, to move toward more advanced forms of risk management.

Under the current regulations, partial disclosure consisting mainly of quantitative analysis is required during half year reporting, whereas full disclosure is required to coincide with the financial year end reporting.

Regulatory Reforms

During the second half of 2018, the CBB issued its regulations on Liquidity Risk Management and Leverage Ratio with an effective date of during 2019. The minimum Liquidity Coverage Ratio, Net Stable Funding Ratio and Leverage Ratio will be part of the Pillar 1 framework.

The Bank is evaluating Expected Credit Losses as per the guidelines in IFRS 9.

3 GROUP STRUCTURE

The Group's financial statements are prepared and published on a full consolidation basis, with all subsidiaries being consolidated in accordance with IFRSs. For capital adequacy purposes, all financial subsidiaries are included within the Group structure. However, the CBB's capital adequacy methodology accommodates both normal and aggregation forms of consolidation.

The principal subsidiaries, associates and joint ventures and basis of consolidation for capital adequacy purposes are as follows:

Subsidiaries	Domicile	Ownership	Consolidation basis
CrediMax B.S.C. (c)	Kingdom of Bahrain	100%	Full Consolidation
Invita Company B.S.C. (c)	Kingdom of Bahrain	100%	Risk Weighted
Invita Claims Management Company*	Kingdom of Bahrain	70%	Risk Weighted
Invita - Kuwait K.S.C.C.*	State of Kuwait	60%	Risk Weighted
Global Payment Services W.L.L. (GPS)**	Kingdom of Bahrain	55%	Full Consolidation
Associates			
Bahrain Liquidity Fund	Kingdom of Bahrain	24%	Risk Weighted
Bahrain Commercial Facilities Company B.S.C.	Kingdom of Bahrain	23%	Risk Weighted
The Benefit Company B.S.C (c)	Kingdom of Bahrain	22%	Risk Weighted
Joint Venture			
Sakana Holistic Housing Solutions B.S.C. (c)	Kingdom of Bahrain	50%	Risk Weighted
Aegila Capital Management Limited	United Kingdom	50%	Risk Weighted
Magnum Partners Holding Limited	Jersey	50%	Risk Weighted
BBK Geojit Securities K.S.C.	State of Kuwait	40%	Risk Weighted
Evoque Holdings Jersey Limited	Jersey	25%	Risk Weighted

* Shareholding through Invita Subsidiary

** Shareholding through CrediMax Subsidiary

There are no restrictions on the transfer of funds or regulatory capital within the Group.

4 STATEMENT OF FINANCIAL POSITION UNDER THE REGULATORY SCOPE OF CONSOLIDATION

The table below shows the link between the statement of financial position in the published financial statements (accounting statement of financial position) and the regulatory statement of financial position.

	Statement of financial position as in published financial statements BD '000	Statement of financial position as per Regulatory Reporting BD '000	Reference
Assets			
Cash and balances with central banks	**191,028**	**191,028**	
Treasury bills	**410,380**	**410,380**	
Deposits and amounts due from banks and other financial institutions	**239,174**	**239,148**	
Loans and advances to customers	**1,772,528**	**1,772,528**	
Of which Expected Credit Loss (1.25% of Credit risk weighted assets)	29,729	29,729	a
Of which net loans and advances (gross of Expected Credit Loss)	1,742,799	1,742,799	
Investment securities	**800,263**	**800,263**	
Of which investments in financial entities under CET1	–	23,361	b
Of which investments in financial entities under Tier 2	–	11,355	c
Of which related to other investments	–	765,547	
Investments in associated companies and joint ventures	**62,935**	**65,616**	
Of which Investment in own shares	820	820	d
Of which equity investments in financial entities	34,061	34,061	e
Of which other investments	28,054	30,735	
Interest receivable and other assets	**77,849**	**76,962**	
Of which deferred tax assets due to temporary differences	1,092	1,092	f
Of which Intangibles	3,167	3,167	g
Of which Interest receivable and other assets	73,590	72,703	
Premises and equipment	**27,543**	**27,277**	
Total assets	**3,581,700**	**3,583,202**	
Liabilities and Equities			
Liabilities			
Deposits and amounts due to banks and other financial institutions	**258,676**	**258,676**	
Borrowings under repurchase agreement	**198,997**	**198,997**	
Term borrowings	**144,542**	**144,542**	
Customers' current, savings and other deposits	**2,374,480**	**2,377,730**	
Interest payable and other liabilities	**104,566**	**103,827**	
Total liabilities	**3,081,261**	**3,083,772**	
Equity			
Share capital	**108,165**	**108,165**	h
Treasury stock	**(2,521)**	**(2,521)**	i
Perpetual tier 1 convertible capital securities	**86,098**	**86,098**	j
Share premium	**41,016**	**41,016**	k
Statutory reserve	**54,082**	**54,082**	l
General reserve	**54,082**	**54,082**	m
Cumulative changes in fair values	**(25,105)**	**(25,105)**	
of which cumulative changes in fair values on bonds and equities	(25,772)	(25,772)	n
of which Fair value changes in cash flow hedges	667	667	o
Foreign currency translation adjustments	**(11,711)**	**(11,711)**	
Of which related to unconsolidated subsidiary	–	(76)	p
Of which related to Parent	–	(11,635)	q
Retained earnings	**148,967**	**148,441**	
Of which employee stock options	2,468	2,468	
Of which Retained earnings	146,499	145,973	r
Appropriations	**44,617**	**44,617**	s
Attributable to the Owners Of the Bank	**497,690**	**497,164**	
Non-controlling interest	**2,749**	**2,266**	
Total equity	**500,439**	**499,430**	
Total liabilities and equity	**3,581,700**	**3,583,202**	

4 STATEMENT OF FINANCIAL POSITION UNDER THE REGULATORY SCOPE OF CONSOLIDATION continued

Legal entities included within the accounting scope of consolidation but excluded from the regulatory scope of consolidation:

Name	Principle activities	Total Assets	Total Equities
Invita Company B.S.C. (c)	Business processing and outsourcing services	4,429	3,690

5 CAPITAL COMPONENTS – CONSOLIDATED

Under the CBB's Basel III capital framework, total regulatory capital consists of Tier 1 capital "T1" and Tier 2 capital "T2". T1 capital is further divided into Common Equity Tier 1 capital "CET1" and Additional Tier 1 capital "AT1". CET1 capital consists of: (a) Issued and fully paid common shares that meet the criteria for classification as common shares for regulatory purposes, (b) Disclosed reserves including: i) General reserves; ii) Legal / statutory reserves; iii) Share premium; iv) Fair value reserves arising from fair valuing financial instruments; and v) Retained earnings or losses (including net profit/ loss for the reporting period, whether reviewed or audited), (c) Common shares issued by consolidated subsidiaries and held by third parties (i.e. minority interest) that meet the criteria for inclusion in CET1, and (d) Regulatory adjustments applied in the calculation of CET1. AT1 capital consists of: (a) Instruments issued by the bank that meet the criteria for inclusion in AT1, (b) Share premium resulting from the issue of instruments included in AT1, (c) Instruments issued by consolidated subsidiaries and held by third parties that meet the criteria for inclusion in AT1 and are not included in CET1, and (d) Regulatory adjustments applied in the calculation of AT1. T2 capital consists of: (a) Instruments issued by the bank that meet the criteria for inclusion in T2, (b) premium resulting from the issue of instruments included in T2, (c) Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in T2 capital and are not included in T1, (d) Expected Credit Loss reserve for stage 1 and 2 exposures, (e) Asset revaluation reserves which arise from the revaluation of fixed assets and investment properties from time to time in line with the change in market values, and (f) Regulatory adjustments applied in the calculation of T2. At present, the T2 capital of BBK consists solely of Expected Credit Losses reserve for stage 1 and 2 exposures.

The CBB applies various limits and minima to the components of the regulatory capital, as shown in the below table. There is also a restriction on the amount of Expected Credit Losses (ECL) reserve that may be included as part of T2 capital, which should be a maximum of 1.25 percent of the credit risk weighted assets.

	Optional	Minimum Ratio
Components of Consolidated CAR		
Core Equity Tier 1 (CET 1)		6.50%
Additional Tier 1 (AT1)	1.50%	
Tier 1 (T1)		8.00%
Tier 2 (T2)	2.00%	
Total Capital		10.00%
Capital Conservation Buffer (CCB)		2.50%
Domestically Systemic Important Bank (D-SIB) Buffer		1.50%
CAR including Buffers		
CET 1 plus Buffers		10.50%
Tier 1 plus Buffers		12.00%
Total Capital plus CCB		12.50%
Total Capital plus CCB and DSIB Buffer		14.00%

	Optional	Minimum Ratio
Components of Solo CAR		
Core Equity Tier 1 (CET 1)		4.50%
Additional Tier 1 (AT1)	1.50%	
Tier 1 (T1)		6.00%
Tier 2 (T2)	2.00%	
Total Capital		8.00%
Capital Conservation Buffer (CCB)		0.00%

In accordance with the CBB's Basel III capital adequacy framework, certain exposures are required to be deducted from regulatory capital rather than included in RWAs. The CBB's Basel III capital adequacy framework requires that most of the deductions to be made from the CET1.

There are no impediments on the transfer of funds or regulatory capital within the Group other than restrictions over transfers to ensure that minimum regulatory capital requirements are met for subsidiary companies.

The table below provides a detailed breakdown of the bank's regulatory capital components, including all regulatory adjustments. The table also provides reference to the comparison displayed in the previous table between accounting and regulatory statement of financial positions.

	Component of regulatory capital	Amounts subject to pre-2015 treatment	Source based on reference letters of the statement of financial positions under the regulatory scope of consolidation
Common Equity Tier 1: Instruments and reserves			
Directly issued qualifying common share capital plus related stock surplus	146,660		h+i+k
Retained earnings	190,512		p+r+s
Accumulated other comprehensive income and losses (and other reserves)	71,422		l+m+n+o+q
Common Equity Tier 1 capital before regulatory adjustments	**408,594**	**–**	
Common Equity Tier 1 capital: regulatory adjustments			
Other intangibles other than mortgage servicing rights (net of related tax liabilities)	2,534	633	g
Cash flow hedge reserve	667		o
Investments in own shares	820		d
Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)	–	23,361	b
Total regulatory adjustments to Common equity Tier 1	**4,021**	**23,994**	
Common Equity Tier 1 capital (CET1)	**404,573**		

	Component of regulatory capital	Amounts subject to pre-2015 treatment	Source based on reference letters of the statement of financial positions under the regulatory scope of consolidation
Additional Tier 1 capital: instruments			
Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	86,098		j
of which: classified as equity under applicable accounting standards	86,098		
Additional Tier 1 capital before regulatory adjustments	**86,098**	**–**	
Additional Tier 1 capital: regulatory adjustments			
Total regulatory adjustments to Additional Tier 1 capital	–	–	
Additional Tier 1 capital (AT1)	**86,098**	**–**	
Tier 1 capital (T1 = CET1 + AT1)	**490,671**		
Tier 2 capital: instruments and provisions			
Provisions	29,729		
Tier 2 capital before regulatory adjustments	**29,729**		
Tier 2 capital: regulatory adjustments			
Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)	–	11,355	c
Total regulatory adjustments to Tier 2 capital	–	11,355	
Tier 2 capital (T2)	**29,729**		
Total capital (TC = T1 + T2)	**520,400**		
Total risk weighted assets	**2,658,172**		
Capital ratios and buffers			
Common Equity Tier 1 (as a percentage of risk weighted assets)	15.22%		
Tier 1 (as a percentage of risk weighted assets)	18.46%		
Total capital (as a percentage of risk weighted assets)	**19.58%**		
Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus D-SIB buffer requirement, expressed as a percentage of risk weighted assets)	10.50%		
of which: capital conservation buffer requirement	2.50%		
of which: bank specific countercyclical buffer requirement	N/A		
of which: D-SIB buffer requirement	1.50%		
Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets)	15.22%		
National minima (where different from Basel III)			
CBB Common Equity Tier 1 minimum ratio	10.50%		
CBB Tier 1 minimum ratio	12.00%		
CBB total capital minimum ratio	14.00%		
Amounts below the thresholds for deduction (before risk weighting)			
Non-significant investments in the capital of other financials	34,716		b+c
Significant investments in the common stock of financials	34,061		e
Deferred tax assets arising from temporary differences (net of related tax liability)	1,092		f
Applicable caps on the inclusion of provisions in Tier 2			
Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	38,309		
Cap on inclusion of provisions in Tier 2 under standardised approach	29,729		a

6 CAPITAL ADEQUACY

The Group's policy is to maintain a strong capital base so as to preserve 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 recognized, 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 other discretionary payments and the issue of new shares and other capital instruments.

As per its ICAAP, BBK aims to maintain a minimum total capital adequacy ratio in excess of the capital assessed as per its ICAAP document of 15.95 percent (considering DSIB and CCB). The CBB's current minimum total capital adequacy ratio (including CCB and DSIB) for banks incorporated in Bahrain is set at 14 percent. The total capital adequacy ratio of the Group as at 31 December 2018 was 19.58 percent.

Strategies and methods for maintaining a strong capital adequacy ratio

BBK prepares multi-year strategic projections on a rolling annual basis which include an evaluation of short-term capital requirements and a forecast of longer-term capital resources.

Capital ratios - consolidated and subsidiaries above 5% of group capital

	Total capital ratio	Tier 1 capital ratio
BBK - Consolidated	19.58%	18.46%
CrediMax	71.46%	71.46%

7 CREDIT RISK – PILLAR III DISCLOSURES

This section describes the BBK's exposure to credit risk, and provides detailed disclosures on credit risk in accordance with the CBB's Basel III framework, in relation to Pillar III disclosure requirements.

Definition of exposure classes

BBK has a diversified on and off statement of financial position credit portfolio, the exposures of which are divided into the counterparty exposure classes defined by the CBB's Basel III capital adequacy framework for the standardised approach for credit risk. A high-level description of the counterparty exposure classes, referred to as standard portfolios in the CBB's Basel III capital adequacy framework, and the generic treatments, i.e. the risk weights to be used to derive the RWAs, are as follows:

Sovereigns portfolio

The sovereigns portfolio comprises exposures to governments and their respective central banks. The risk weights are zero percent for exposures in the relevant domestic currency, or in any currency for exposures to GCC sovereigns. Foreign currency claims on other sovereigns are risk weighted based on their external credit ratings.

Certain multilateral development banks as determined by the CBB may be included in the sovereigns portfolio and treated as exposures with a zero percent risk weighting.

Public Sector Entities (PSE) portfolio

Claims on Bahraini PSEs, and claims on PSEs on domestic currency - which are assigned a zero percent risk weight by their respective country regulator, can be assigned a zero percent risk weight. All other PSEs are risk weighted according to their external ratings.

Banks portfolio

Claims on banks are risk weighted based on their external credit ratings. A preferential risk weight treatment is available for qualifying short term exposures. Short term exposures are defined as exposures with an original tenor of three months or less. The Bank's portfolio also includes claims on certain investment firms which are risk weighted based on their external credit ratings, though without any option for preferential treatment for short term exposures.

Corporates portfolio

Claims on corporates are risk weighted based on their external credit ratings. A 100 percent risk weight is assigned to exposures to unrated corporates. A preferential risk weight treatment is available for certain corporates owned by the Government of Bahrain, as determined by the CBB, which are assigned a zero percent risk weight.

Regulatory retail portfolio

Claims on retail portfolio are risk weighted at 75%, except for past due portfolio.

Mortgage portfolio

Claims which are fully secured by first mortgages on residential property that is or will be occupied by the borrower, or that is leased, must carry a risk weighting of 75 percent. Claims secured by mortgages on commercial real estate are subject to a minimum of 100 percent risk weight. If the borrower is rated below BB-, the risk-weight corresponding to the rating of the borrower must be applied.

Equities portfolio

The equities portfolio comprises equity investments in the banking book. A 100 percent risk weight is assigned to listed equities while unlisted equities are weighted at 150 percent, unless subject to the following treatments. The amount of any significant investments in commercial entities (A "significant investment" in a commercial entity is defined as any investment in the capital instruments of a commercial entity by the bank which is equivalent to or more than 10 percent of the issued common share capital of the issuing commercial entity) above 15 percent (individually) and 60 percent (collectively) of the bank's capital (the "Total Capital materiality thresholds") must be risk weighted at 800 percent. Moreover, significant investments in the common shares of unconsolidated financial entities must be risk weighted at 250 percent.

In addition to the standard portfolios, other exposures are assigned to the following exposure classes:

Investments in funds portfolio

The risk weight for claims on corporate will be used to determine the risk weight for investments in rated funds. Unrated funds will be assigned a risk weight of 100% if listed, and 150% if not listed.

Past due exposures

This includes claims, for which the repayment is overdue for more than ninety days or more. The risk weighting applied for such loans is either 100 percent or 150 percent, depending on the level of provisions maintained against the loan.

Holding of real estate

All holding of real estate by banks (owned directly or by the way of investments in real estate companies, subsidiaries or associated companies or other arrangements such as trusts, funds or REITS) must be risk weighted at 200 percent. Premises occupied by the bank are weighted at 100 percent.

Other assets and holdings of securitisation tranches

Other assets are risk weighted at 100 percent, whereas securitization exposures are risk weighted at 20 percent to 1,250 percent, depending on the external rating.

All BBK's holding of securitizations if any is reported part of the bank's investment portfolio.

Large exposures

The excess amount of any exposure above 15% of the bank's regulatory capital to any counterparty or a group of closely related counterparties must be risk weighted at 800%, unless it is an exempted exposure in accordance with the requirements of the CBB Rulebook.

External rating agencies

BBK uses ratings issued by Moody's and Fitch to derive the risk weightings under the CBB's Basel III capital adequacy framework. Where ratings vary between rating agencies, the highest rating from the lowest two ratings is used to represent the rating for regulatory capital adequacy purposes.

Credit risk presentation under Basel III

The credit risk exposures presented in most of this report differ from the credit risk exposures reported in the consolidated financial statements. Differences arise due to the application of different methodologies, as illustrated below:-

- Under the CBB's Basel III framework, off statement of financial position exposures are converted into credit exposure equivalents by applying a credit conversion factor (CCF). The off statement of financial position exposure is multiplied by the relevant CCF applicable to the off statement of financial exposure position category. Subsequently, the exposure is treated in accordance with the standard portfolios as referred to above in this report, in the same manner as on statement of financial position exposures.
- In case of Over-the-Counter (OTC) derivative contracts, in addition to the default risk capital requirements for counterparty credit risk, the bank must add a capital charge to cover the risk of mark-to-market losses on the expected counterparty risk (such losses being known as credit value adjustments or CVA).
- Credit risk exposure reporting under Pillar III is frequently reported by standard portfolios based on the type of counterparty. The financial statement presentation is based on asset class rather than the relevant counterparty. For example, a loan to a bank would be classified in the Bank's standard portfolio under the capital adequacy framework although is classified in loans and advances in the consolidated financial statements.
- Certain eligible collateral is applied to reduce exposure under the Basel III capital adequacy framework, whereas no such collateral netting is applicable in the consolidated financial statements.
- Based on the CBB's Basel III guidelines, certain exposures are either included in, or deducted from, regulatory capital rather than treated as an asset as in the consolidated financial statements.

8 CAPITAL REQUIREMENT FOR RISK WEIGHTED EXPOSURE

	Gross credit exposures (before risk mitigation) BD '000	Eligible financial collateral BD '000	Credit risk after risk mitigation BD '000	Risk weighted asset BD '000	Regulatory capital required 14.0% BD '000
Sovereign	936,977	–	936,977	33,750	4,725
Public sector entities	12,462	–	12,462	–	–
Banks	460,888	–	460,888	260,507	36,471
Corporates	1,510,820	16,543	1,494,277	1,279,375	179,112
Regulatory retail	446,413	356	446,057	334,543	46,836
Mortgage	90,349	96	90,253	67,690	9,477
Investment in securities	97,618	–	97,618	154,578	21,641
Past Due	63,558	102	63,456	66,181	9,265
Real Estate	67,183	–	67,183	117,699	16,478
Other assets and cash items	92,223	–	92,223	63,959	8,954
Total Credit Risk	**3,778,491**	**17,097**	**3,761,394**	**2,378,282**	**332,959**
Market Risk	–	–	–	37,613	5,266
Operational Risk*	–	–	–	242,277	33,919
Total Risk Weighted Exposure	**3,778,491**	**17,097**	**3,761,394**	**2,658,172**	**372,144**

* The Bank is currently using the Basic Indicator Approach whereby the operational risk weighted exposures and regulatory capital requirement are calculated by applying an alpha co-efficient of 15 percent to the average gross income for the preceding three financial years adjusted for exceptional income. The amount of adjusted average gross income for the year 2018 is BD 129,214 thousand.

Credit Risk Mitigation and Collateral valuation policy

BBK employs a range of techniques to mitigate risk in its credit portfolio. Credit risk mitigation includes an objective assessment of the counterparty's capacity and willingness to meet its commitments in the normal course. The bank strives to optimize facility structure, collateral, lending covenants, terms and conditions.

The Bank has detailed policies and procedures for valuing collateral/ securities offered for various credit facilities. The collateral is valued, at minimum, quarterly or annually, based on the type of security. More frequent valuations are also considered if warranted by market volatility and declining trends in valuations are observed. The collaterals and support include mortgages, cash collaterals, marketable securities, personal and corporate guarantees and guarantees from sovereigns and financial institutions. The basis of valuation for different types of securities such as equity, debt, and real estate is also clearly defined in the policies.

9 FUNDED, UNFUNDED AND AVERAGE CREDIT EXPOSURE

Total gross credit exposures	Total funded credit exposure BD '000	Total un-funded credit exposure BD '000	Average quarterly credit exposure BD '000
Sovereign	936,488	489	967,767
Public sector entities	12,462	–	13,718
Banks	437,473	23,415	441,222
Corporates	1,359,774	151,046	1,562,501
Regulatory retail	446,413	–	430,885
Mortgage	90,349	–	91,919
Investment in securities	97,618	–	100,021
Past due	63,558	–	53,174
Real estate	67,183	–	61,890
Other assets and cash items	92,223	–	91,947
Total credit risk	**3,603,541**	**174,950**	**3,815,044**

10 CONCENTRATION OF CREDIT RISK BY REGION (EXPOSURES SUBJECT TO RISK WEIGHTING)

	GCC BD '000	North America BD '000	Europe BD '000	Asia BD '000	Others BD '000	Total BD '000
Cash and balances with central banks	186,218	–	–	4,810	–	**191,028**
Treasury bills	405,802	–	–	4,578	–	**410,380**
Deposits in banks and other financial institutions	156,115	32,878	29,651	20,445	60	**239,149**
Loans and advances to customers	1,538,494	52	105,457	131,357	34,000	**1,809,360**
Investments in associated companies	47,400	–	14,715	–	–	**62,115**
Investment securities	566,535	9,412	102,007	95,948	26,809	**800,711**
Other assets	85,235	–	747	4,816	–	**90,798**
Total funded exposure	**2,985,799**	**42,342**	**252,577**	**261,954**	**60,869**	**3,603,541**
Unfunded commitments and contingencies	140,673	189	14,006	19,768	314	**174,950**
Total credit risk	**3,126,472**	**42,531**	**266,583**	**281,722**	**61,183**	**3,778,491**

11 CONCENTRATION OF CREDIT RISK BY INDUSTRY (EXPOSURES SUBJECT TO RISK WEIGHTING)

	Trading and manufacturing BD '000	Banks and other financial institutions BD '000	Construction and real estate BD '000	Government and public sector BD '000	Individuals BD '000	Others BD '000	Total BD '000
Cash and balances with central banks	–	20,334	–	170,694	–	–	**191,028**
Treasury bills	–	–	–	410,380	–	–	**410,380**
Deposits in banks and other financial institutions	–	239,149	–	–	–	–	**239,149**
Loans and advances to customers	572,711	221,583	355,590	9,276	506,983	143,217	**1,809,360**
Investments in associated companies	–	43,156	14,353	–	–	4,606	**62,115**
Investment securities	112,444	175,193	22,388	423,384	–	67,302	**800,711**
Other assets	–	–	–	–	–	90,798	**90,798**
Total funded exposure	**685,155**	**699,415**	**392,331**	**1,013,734**	**506,983**	**305,923**	**3,603,541**
Unfunded commitments and contingencies	90,556	26,051	40,115	206	126	17,896	**174,950**
Total credit risk	**775,711**	**725,466**	**432,446**	**1,013,940**	**507,109**	**323,819**	**3,778,491**

12 CONCENTRATION OF CREDIT RISK BY MATURITY (EXPOSURES SUBJECT TO RISK WEIGHTING)

	Within 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 to 12 months BD '000	1 to 5 years BD '000	5 to 10 years BD '000	10 to 20 years BD '000	Above 20 years BD '000	Total BD '000
Cash and balances with central banks	115,423	–	–	–	–	–	–	75,605	**191,028**
Treasury bills	62,576	123,292	99,185	125,327	–	–	–	–	**410,380**
Deposits in banks and other financial institutions	195,199	37,735	–	6,215	–	–	–	–	**239,149**
Loans and advances to customers	252,312	146,143	111,192	138,859	828,905	241,108	29,634	61,207	**1,809,360**
Investments in associated companies	–	–	–	–	–	–	–	62,115	**62,115**
Investment securities	38,574	19,786	29,669	18,729	300,215	260,266	28,325	105,147	**800,711**
Other assets	56,269	–	–	–	31,792	249	1,024	1,463	**90,798**
Total funded exposure	**720,353**	**326,956**	**240,046**	**289,130**	**1,160,912**	**501,623**	**58,983**	**305,537**	**3,603,541**
Unfunded commitments and contingencies	43,146	21,853	25,407	58,103	14,978	8,709	731	2,023	**174,950**
Total credit risk	**763,499**	**348,809**	**265,453**	**347,233**	**1,175,890**	**510,332**	**59,714**	**307,560**	**3,778,491**

13 IMPAIRED LOANS AND PROVISIONS

	Impaired loans BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Stage 1: 12 month ECL and Stage 2: Lifetime ECL not credit-impaired BD '000	Net specific charges during the year BD '000	Write off during the year BD '000
Trading and manufacturing	100,525	55,704	17,003	2,976	3,042
Banks and other financial institutions	4,456	4,795	421	306	–
Construction and real estate	19,304	9,115	6,501	112	9,485
Government and public sector	16,188	8,860	–	–	–
Individuals	8,247	7,767	10,649	2,525	11,263
Others	2,069	990	2,258	556	–
Total	**150,789**	**87,231**	**36,832**	**6,474**	**23,790**

14 AGEING OF IMPAIRED AND PAST DUE LOANS BY REGION

	GCC BD '000	North America BD '000	Europe BD '000	Asia BD '000	Others BD '000	Total BD '000
3 months up to 1 year	76,162	–	3,007	4,058	–	**83,227**
1 to 3 years	61,632	–	–	6	–	**61,638**
Over 3 years	5,911	–	–	13	–	**5,924**
Total past due and impaired loans	**143,705**	**–**	**3,007**	**4,077**	**–**	**150,789**
Stage 3: Lifetime ECL credit- impaired	(86,162)	–	–	(1,069)	–	**(87,231)**
Stage 1: 12-month ECL and stage 2 : Lifetime ECL not credit- impaired	(35,816)	–	(150)	(785)	(81)	**(36,832)**

15 AGEING OF IMPAIRED AND PAST DUE LOANS BY INDUSTRY

	Trading and manufacturing BD '000	Banks and other financia institutions BD '000	Construction and real estate BD '000	Government and public sector BD '000	Individuals BD '000	Others BD '000	Total BD '000
3 months up to 1 year	63,195	3,007	12,697	–	2,349	1,979	**83,227**
1 to 3 years	37,252	1,449	3,996	16,188	2,689	64	**61,638**
Over 3 years	78	–	2,611	–	3,209	26	**5,924**
Total past due and impaired loans	**100,525**	**4,456**	**19,304**	**16,188**	**8,247**	**2,069**	**150,789**

16 RESTRUCTURED LOANS

	BD '000
Loans restructured during the year	45,250
Impact of restructured facilities and loans on provisions	2,427

The above restructuring did not have any significant impact on present and future earnings and were primarily extensions of the loan tenor, revisions in interest rate, and additional collateral received.

17 MARKET RISK DISCLOSURES FOR BANKS USING THE INTERNAL MODELS APPROACH (IMA) FOR TRADING PORTFOLIOS

The "Market Risk Internal Model" is being used to measure Value-at-Risk (VaR) for calculating Capital Charge arising from Market Risk exposures (mainly Foreign Exchange and Interest Rate Risk positions) of the Trading Book. The VaR Model quantifies the maximum potential loss that could occur in the Trading book risk positions under normal market conditions, at 99% confidence level, on a 10-day horizon.

BBK maintains a prudent approach to Manage Market Risk exposures guided by Market Risk Policy and Procedure. The Position, Stoploss and VaR limits are monitored by Treasury Middle Office (reporting to Risk and Credit Administration Department and Independent of Business unit) and a daily risk report is circulated to the Senior Management.

In addition to the above, the Treasury Middle Office also carries out valuation of the Investment Portfolio independently as per the internal policies and procedures. Furthermore BBK also conducts Stress Testing and Back Testing of Market Risk positions.

The summary of VaR of the trading book for the period January 2018 to December 2018 is as follows:

VaR Results for 2018 (10 day 99%)

Global (BAHRAIN and KUWAIT)

1 January 2018 to 31 December 2018

Asset class	Limit BD '000	VaR 31 December 2018 BD '000	High VaR BD '000	Low VaR BD '000	Average VaR BD '000
Foreign exchange	641	199	260	125	178
Interest rate	151	2	5	0	1
	792	**201**	**262**	**127**	**179**

The Bank conducts Backtesting of VaR on a daily basis in compliance with CBB regulations to validate the internal VaR model and to check whether or not the model can predict potential losses with a fair degree of accuracy. Under Backtesting, the daily VaR numbers are compared with the mark-to-market profit or loss figures (on actual average Profit and Loss basis and also hypothetical Profit and Loss basis). If this comparison is close enough, the Backtest raises no issues regarding quality of the risk measurement model.

The Backtesting results for the period January-December 2018 confirmed that there was Nil occasion on which a daily trading loss exceeded VaR figure.

17 MARKET RISK DISCLOSURES FOR BANKS USING THE INTERNAL MODELS APPROACH (IMA) FOR TRADING PORTFOLIOS continued

Stress Testing

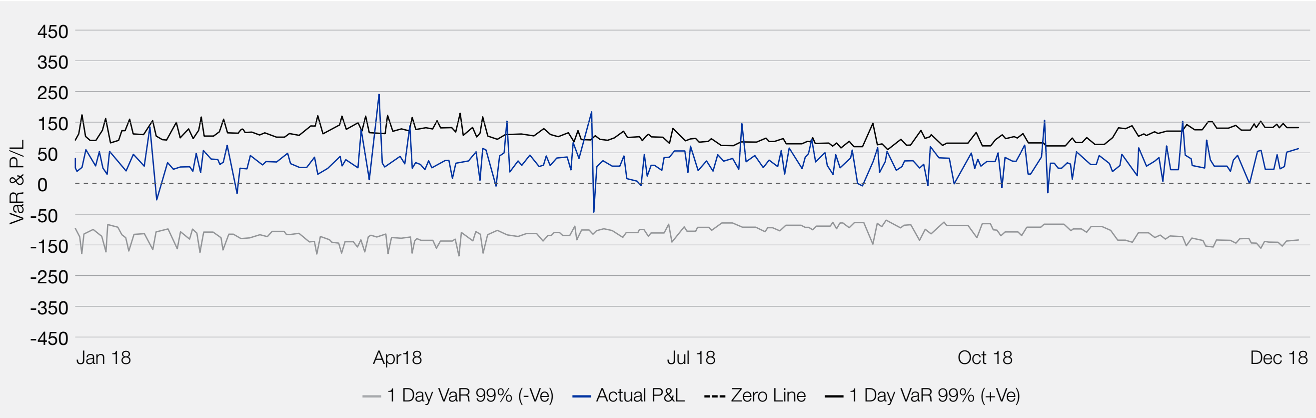
The Bank conducts stress testing of VaR, under various 'What If' scenarios such as increasing volatility and varying correlations. The stress testing methodology uses historical data capturing periods of significant disturbance and covering all types of risks associated with the asset classes which are included in the trading book of the Bank.The stress VaR are then tabulated under each "what if" scenario and compared with corresponding Capital Adequacy Ratio (CAR). It was observed that the CAR was within the norm prescribed by CBB, under each stressed scenario.

Month end VaR (10 day 99%)

Month	VaR in BD'000
January 2018	199
February 2018	181
March 2018	181
April 2018	204
May 2018	200
June 2018	196
July 2018	163
August 2018	127
September 2018	142
October 2018	152
November 2018	196
December 2018	201

The following graph shows the daily average Profit and Loss (Actual Average P&L basis) vis-à-vis one day VaR, for the review period.

Value- at-Risk Backtesting January – December 2018



18 CONCENTRATION RISK TO INDIVIDUALS WHERE THE TOTAL EXPOSURE IS IN EXCESS OF SINGLE OBLIGOR LIMIT OF 15%

	BD '000
Sovereign	846,273
Total	**846,273**

19 CREDIT DERIVATIVES EXPOSURE

BBK is not exposed to any credit derivatives as at 31 December 2018.

20 EQUITY POSITIONS IN THE BANKING BOOK

	BD '000
Publicly traded equity shares	42,941
Privately held equity shares	23,489
Total	**66,430**
Capital required	9,300

21 GAINS ON EQUITY INSTRUMENTS

	BD '000
Realised gains/ losses in statement of profit or loss	–
Realised gains/ losses in retained earnings	(507)
Unrealised gains/ losses in CET1 Capital	(13,527)