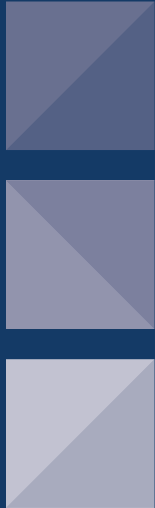
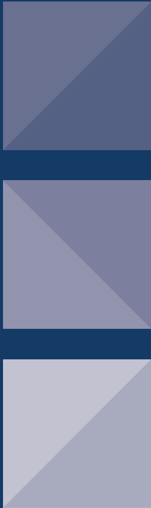
ANNUAL REPORT 2018

بنك الخليج المتحد ش.م.ب.(مقفلة)

United Gulf Bank B.S.C. (c)

A member of the KIPCO Group





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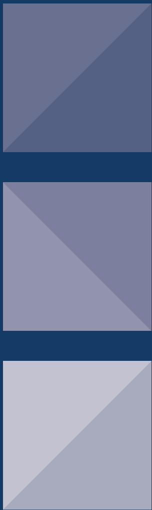
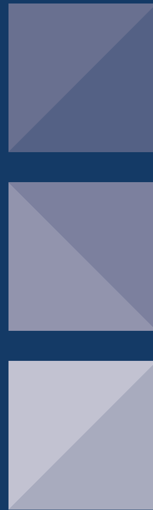


H.M. KING HAMAD BIN ISA AL KHALIFA

King of the Kingdom of Bahrain



H.H. SHEIKH SABAH AL-AHMAD
AL-JABER AL-SABAH

Amir of the State of Kuwait

CORPORATE PROFILE

United Gulf Bank (UGB, The Bank)

Established in 1980 and operating under a conventional wholesale banking licence from the Central Bank of Bahrain, UGB is the merchant banking arm of the KIPCO Group. A leading asset management and investment banking group headquartered in the Kingdom of Bahrain, its operations span the MENA region. UGB's proprietary investments include assets in commercial banking, real estate, private equity, and quoted securities. As at 31 December 2018, assets under management totalled US$ 12.6 billion (31 December 2017: US$ 10.8 billion).

UGB's core subsidiaries and associates are KAMCO Investment Company (KAMCO), Global Investment House (GIH), United Gulf Realty International Ltd (UGRIL), and United Gulf Financial Services - North Africa.

UGB and its subsidiary KAMCO have a proven track record of successfully completing more than 60 investment banking transactions for clients since 2001, with an aggregate value of over US$ 10 billion including corporate finance, advisory, new issue placement and underwriting, corporate restructuring, bond issuance, and mergers and acquisitions.

UGB is a member of the KIPCO Group, one of the biggest holding companies in the Middle East and North Africa.

The KIPCO Group

The KIPCO Group is one of the biggest holding companies in the Middle East and North Africa, with consolidated assets of US$ 34 billion as at 31 December 2018. The Group has significant ownership interests in over 60 companies operating across 24 countries. The Group's main business sectors are financial services, media, real estate and manufacturing. Through its core companies, subsidiaries and affiliates, KIPCO also has interests in the education and medical sectors.

KIPCO holds UGB through United Gulf Holding Company B.S.C. (UGH) which holds 100% shareholding in UGB. A subsidiary of the KIPCO Group, UGH conducts merchant banking activities through its regional network of subsidiaries and associates.

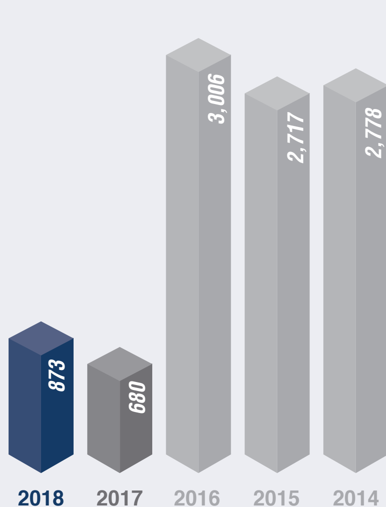
Major Subsidiaries

الخليج المتحد للخدمات المالية شمال افريقيا
United Gulf Financial Services North Africa

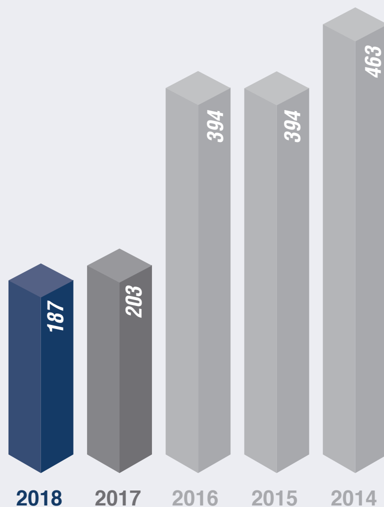
United Gulf Bank B.S.C. (c)
PO Box 5964, Diplomatic Area
UGB Tower, Manama, Kingdom of Bahrain
Tel: (+973) 17 533 233
Fax: (+973) 17 533 137
Email: info@ugbbah.com
www.ugbbh.com
Licensed as a Conventional Wholesale Bank by the Central Bank of Bahrain

FINANCIAL HIGHLIGHTS 2018

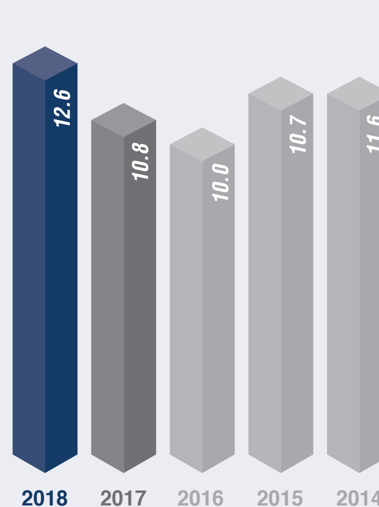
Total Assets
US$ million



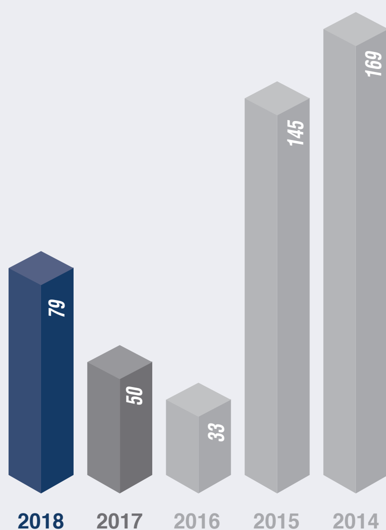
Shareholders' Equity
US$ million



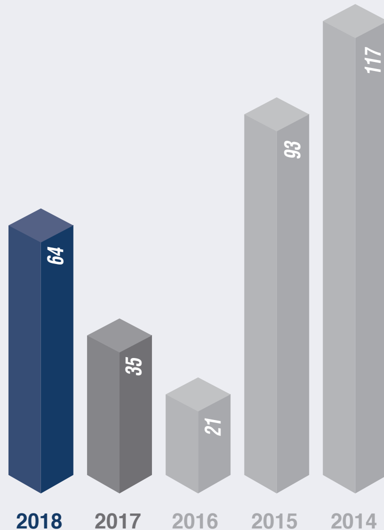
Assets Under Management
US$ billion



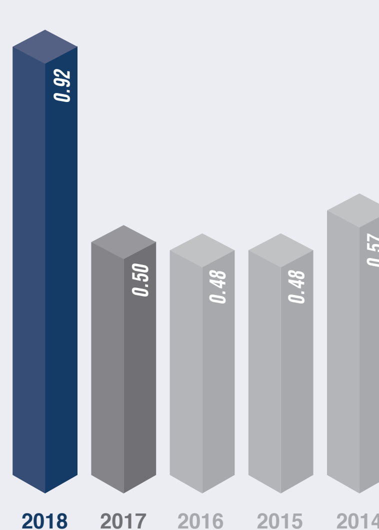
Total Income
US$ million



Operating Income
US$ million



Book Value Per Share
US$



US$
873 million
Total Assets

15.5 %
Capital Adequacy Ratio

US$
12.6 billion
Assets Under Management

1. Figures in KD have been converted into US$ at the exchange rate of US$:KD=1:0.30363.
2. Consolidated.

FINANCIAL SUMMARY

	2018	2017	2016	2015	2014
US$ million			Restated		
Total Income	78.9	50.3	32.8	144.8	169.1
Investment income	28.7	23.8	9.8	7.7	44.2
Operating income	64.2	35.1	21.1	93.3	117.4
Shareholders' Equity	187.0	203.0	394.0	394.0	462.9
Total Assets	873.5	680.1	3,005.7	2,716.5	2,777.8
Net Income Attributable to Shareholders of the Parent	10.1	(79.9)	6.3	11.2	18.8
%					
Return on Average Equity	5.18%	(26.77%)	1.59%	2.62%	4.19%
Return on Average Assets	1.30%	(4.34%)	0.22%	0.41%	0.93%
Operating Expense/ Operating Income	79.4%	74.1%	97.5%	87.3%	58.6%
Average Equity to Average Assets	30.4%	16.2%	13.8%	15.6%	22.3%
US$					
Book Value per share	0.92	0.50	0.48	0.48	0.57
Earnings per share	0.05	(0.20)	0.01	0.02	0.03
Comparative Average balances					
(based on quarterly averages)					
US$ million					
Assets	748.7	2,508.9	2,990.9	2,645.7	2,617.8
Liabilities	461.5	2,031.1	2,455.0	2,122.5	2,056.4
Minority Interest	59.9	86.4	107.0	113.5	99.0
Shareholders' Equity	227.3	391.4	428.9	409.7	462.5
	748.7	2,508.9	2,990.9	2,645.7	2,617.8
Guarantees and commercial LC	1.2	49.3	65.3	78.0	145.3
Commitments	6.4	183.2	100.5	62.4	133.9
Assets under management (US$ billion)	12.6	10.8	10.0	10.7	11.8

CHAIRMAN'S STATEMENT

On behalf of the Board of Directors, I have the privilege to present the annual report and consolidated financial statements of United Gulf Bank (UGB) for the year ended 31 December 2018. This witnessed the successful completion of UGB's corporate reorganisation and strategic realignment, which was reflected in the Bank's stronger financial performance for 2018.

Economic Environment

A sustained increase in oil prices over the past two years has driven an economic recovery in GCC countries, according to the World Bank. With fiscal and external imbalances narrowing, the region has remained largely immune to the financial volatility that beset other emerging market economies in mid-2018. Despite challenging global headwinds, the IMF expects the GCC region to achieve GDP growth of 2.4 per cent in 2018 after a 0.4 per cent contraction in 2017. This positive forecast is supported by the sustained improvement in oil prices, a slower pace of fiscal consolidation, and the impact of economic transformation programmes by governments across the region.

The regional banking sector recovered in 2018 after witnessing two years of considerable pressure. This was primarily due to stronger economic growth across the GCC, fueled by improving oil prices and increased government spending on public infrastructure projects. Banks have recognised the strategic necessity to transform their business models, and adapt to a more technology-driven and competitive market; while complying with rapidly-changing and stricter regulatory requirements. This has led to a recent upsurge in banking mergers across the region, driven by the need for banks to have a stronger capital and customer deposit base; greater diversification of products and services; and enhanced synergies from improved operating and cost efficiencies.

Acquisition of Global Investment House

In a notable strategic development, KAMCO Investment Company (KAMCO) completed the acquisition of a 71.18 per cent equity stake in Global Investment House (GIH); which is a prominent regional asset management and investment banking firm based in Kuwait, with offices in major capital markets across the MENA region. The acquisition will leverage the synergies between KAMCO and GIH from both a Group and asset management standpoint. The two entities have complementary products; with KAMCO focused primarily on managing assets under custody, and GIH providing higher-yielding private equity accounts. Significantly, the acquisition will enable KAMCO and its parent United Gulf Bank to expand their footprint in the region, most notably in Saudi Arabia and the UAE.

Consequently, the acquisition and integration of GIH will enhance business volumes, profitability and net margins; and bring greater cost efficiency to the combined operations. The Group is excited about the prospects since this acquisition is a major step towards making KAMCO one of the leading asset management companies in the region.

Financial Results

I am pleased to report that UGB posted a stronger financial performance for 2018. Total income before interest and other expenses increased to US$ 78.9 million compared with US$ 50.3 million in 2017. Total expenses rose to US$ 50.6 million from US$ 25.6 million in 2017, due to the GIH consolidation and its acquisitions related cost incurred by KAMCO. Net profit for the year before reclassification adjustments grew to US$ 11.1 million from US$ 8.4 million a year earlier. Total assets under management increased significantly by 16.7 per cent to US$ 12.6 billion, following the acquisition of a controlling stake in GIH by KAMCO.

At the end of 2018, total assets stood at US$ 873.5 million compared with US$ 680.1 million at the end of the previous year, while total equity was US$ 314.9 million against US$ 262.9 million at the end of 2017. UGB's consolidated capital adequacy ratio was 15.5 per cent compared with 21.5 per cent in 2017, with the decrease reflecting the consolidation of GIH assets post its acquisition.

To further strengthen its capital base, the Bank is planning to increase its capital by US$ 15 million, subject to final regulatory and shareholder approval. Liquidity levels remained healthy, with total liquid assets of US$ 379.1 million representing 43.4 per cent of the balance sheet at the end of the year. During 2018, UGB successfully refinanced medium-term funding facilities of US$ 200 million, reflecting continued market confidence in the Bank.

Track Record

Significantly, our financial results for 2018 mark the Bank's 28th consecutive year of operating profitability and the 35th year of positive performance, since its establishment in 1980. This further reinforces UGB's successful track record as a leading asset management and investment banking group in the MENA region.

In June 2018, Capital Intelligence Ratings affirmed the long-term and short-term foreign currency ratings (FCRs) of UGB at 'BBB' and 'A3' respectively, and revised the outlook upwards to 'Stable'. The agency cited the Bank's strong ownership and the demonstrated financial and liquidity support from related entities within the KIPCO Group; its good loan repayment history and ongoing access to long term debt, as well as short-term funding; a marked improvement in historical asset concentrations; and profitability expected to continue improving during 2019. We regard this latest affirmation of UGB's ratings as an important independent validation of the success of actions we have taken to realign the Bank's strategic direction, strengthen the balance sheet, and optimise its strong underlying fundamentals.

Subsidiaries

The main contributors to UGB's results in 2018 were Kuwait based KAMCO Investment Company (KAMCO) and Global Investment House (GIH); and United Gulf Realty International Limited (UGRIL), a US based real estate investment company.

Institutional Capability

During the year, the Bank completed all regulatory formalities for its conversion to a closed Bahraini shareholding company following its delisting from the Bahrain Bourse. This is in line with the corporate reorganisation plan approved by shareholders in September 2017. We continued to invest in further strengthening UGB's support infrastructure in 2018. Key developments include a major upgrade of the core banking system with completion planned for the middle of 2019; together with implementation of a new automated procurement system and human resources management system.

The Bank places the highest importance on sound corporate governance and risk management. During 2018, we maintained our compliance with the latest regulatory requirements of the Central Bank of Bahrain; designed and rolled out a new corporate governance system; and enhanced our risk management framework to ensure that UGB remains robust and resilient in the face of challenging market conditions. We also continued to implement the Bank's corporate responsibility programme, with a special emphasis on education and career development for young Bahrainis; development of the regional banking sector; women's empowerment; and support for charitable and community based activities.

Looking Ahead

Despite the threat of global headwinds, the consensus outlook for the GCC remains positive. The IMF is forecasting regional GDP growth to reach 3.0 per cent in 2019, underlined by strong growth by all six Gulf states. In particular, GDP of Kuwait – UGB's core market – is estimated to grow to 4.06 per cent this year, one of the highest projected rates in the GCC. The IMF outlook is based on a continuation of higher oil prices; stronger non-oil sector growth; and improved economic and market conditions arising from government reform programmes. These factors are likely to translate into a more favorable operating environment that should benefit the regional banking sector, which is expected to remain relatively stable following its recovery in 2018.

As a result of our corporate reorganisation and strategic realignment, together with the successful achievements of 2018, UGB is more strongly placed to withstand the impacts of continued economic and market volatility, and unexpected external shocks. The Board has full confidence in the ability of the Management team to adapt to changing market dynamics and seize promising new business opportunities. As such, we are optimistic about UGB's prospects in 2019, although we recognise that it will be another testing period for the region.

Acknowledgements

On behalf of the Board of Directors, I gratefully acknowledge the guidance and encouragement that we continue to receive from the Central Bank of Bahrain, Bahrain Bourse, and Ministry of Industry, Commerce & Tourism; as well as from the various regulatory and supervisory authorities of the different jurisdictions in which UGB operates.

I also express my sincere thanks for the ongoing financial support and confidence of our shareholders; the trust and loyalty of our clients; and the collaboration of our business partners. Finally, I would like to pay special tribute to the professionalism and commitment of the Bank's management team and staff, and their positive contribution to another challenging but successful year for UGB.

Masaud M. J. Hayat
Chairman of the Board

BOARD OF DIRECTORS

Masaud M. J. Hayat

Chairman

Chairman of the Executive Committee

- Group Chief Executive Officer, Burgan Bank - Kuwait
- Chairman, United Gulf Holding Company - Bahrain
- Chairman and Chairman of the Executive Committee, Tunis International Bank - Tunisia
- Vice Chairman and Chairman of the Executive Committee, Gulf Bank Algeria - Algeria
- Vice Chairman and Chairman of the Executive Committee, Bank of Bagdad - Iraq
- Vice Chairman, FIMBank plc - Malta
- Board Member, United Gulf Financial Services North Africa - Tunisia
- Vice Chairman, Burgan Bank - Kuwait
- Board Member, Jordan Kuwait Bank - Jordan
- Board Member, KAMCO Investment Company K.S.C. (Public) - Kuwait
- Board Member, North Africa Holding Company - Kuwait
- Board Member, Mashare'a Al Khair Est. - Kuwait

Over 42 years of experience in the financial sector

Degree in Economics, Kuwait University

Diploma in Banking Studies, Institute of Banking Studies, Kuwait

Faisal Hamad M. Al Ayyar

Vice Chairman

Member of the Executive Committee

Member of the Board Audit Committee

- Vice Chairman (Executive), Kuwait Projects Company (Holding) - Kuwait
- Chairman, Panther Media Group - Dubai, UAE
- Vice Chairman, United Gulf Holding Company - Bahrain
- Vice Chairman, Gulf Insurance Group - Kuwait
- Vice Chairman, Jordan Kuwait Bank - Jordan
- Vice Chairman, Mashare'a Al-Khair Est. - Kuwait
- Vice Chairman, Saudia Dairy & Foodstuff Co. - Saudi Arabia
- Board Member, Gulf Egypt for Hotels & Tourism Co - Egypt
- Trustee, American University of Kuwait - Kuwait
- Honorary Chairman, Kuwait Association for Learning Differences - Kuwait
- Award Winner, Kuwait Financial Forum 2009, for contributions to the Kuwait investment sector and success in global financial markets
- Award Winner, Tunis Arab Economic Forum 2007
- Recipient of Lifetime Achievement Award, Beirut Arab Economic Forum 2007
- Recipient of the Arab Bankers Association of North America (ABANA) Achievement Award 2005
- Recognized by Kuwait's Al Anba newspaper as the leading Business and Investment Personality for 2018.

Over 32 years of experience in the financial sector

Graduated as a fighter pilot with the Kuwait Air Force in the USA

BOARD OF DIRECTORS

Samer Khanachet

Executive Director

Member of the Executive Committee

- Group Chief Operating Officer, Kuwait Projects Company (Holding) - Kuwait
- Chairman, Takaud Savings & Pensions B.S.C. (c) - Bahrain
- Chairman, United Gulf Management, Inc. - USA
- Board Member, Burgan Bank - Kuwait
- Board Member, United Real Estate Company - Kuwait
- Director, United Gulf Management Ltd. - UK
- Board Member, United Gulf Investments Ltd. - Cayman Islands
- Trustee, American University of Kuwait - Kuwait
- Member, Corporation Development Committee and Educational Council of the Massachusetts Institute of Technology, Cambridge, MA, USA
- Past President of the Arab Bankers Association of North America - New York, NY, USA

Over 42 years of experience in the financial sector

MBA, Harvard Business School, Boston, MA, USA

BSc, Chemical Engineering and BSc, Management Science – Massachusetts Institute of Technology, Cambridge, MA, USA

Sheikh Abdullah Nasser Sabah Al Ahmad Al Sabah

Executive Director

- Board Member, Kuwait Projects Company (Holding) - Kuwait
- Advisor to the Chairman of the Board of Directors of Kuwait Projects Company (Holding) - Kuwait
- Chairman, KAMCO Investment Company K.S.C. (Public) - Kuwait
- Vice-Chairman, Al Daiya United Real Estate Company - Kuwait

Over 22 years of experience in the financial sector

Graduate of the Royal Military Academy, Sandhurst, UK

BSc, Business Administration, New York Institute of Technology, USA

Mubarak Mohammed Al-Maskati

Independent Director

Chairman of the Board Nominating & Remuneration Committee and Member of the Board Audit Committee

- Board Member, United Gulf Holding Company B.S.C.
- Board Member, Royal Aviation Company - Kuwait
- Former Board Member, Kuwait Projects Company (Holding), and Kuwait Aviation Services Company - Kuwait
- Manager of the Amiri Fleet, Amiri Diwan

Over 32 years of experience in the financial sector

BSc, Political Studies and Economics, Pennsylvania State University, USA

Bader Al Awadi

Independent Director

Member of the Board Nominating & Remuneration Committee

- Board Member, United Gulf Holding Company B.S.C.
- Member of Board of Directors, Member of Board Audit Committee and Member of the Board Corporate Governance Committee of Tunis International Bank - Tunisia
- Independent Director Assoufid BV - Morocco;
- Board Member, Manar Interholdings SL - Spain
- Founder of Mada Alsharqia Real Estate Development Company - Saudi Arabia

Over 32 years of experience in the financial and investment sectors

BSc, Industrial Engineering, University of Miami, USA.

Completed General Manager Program, Harvard Business School, Boston, USA

Completed Program for Management Development, Harvard Business School, Boston, USA

Mohammed Haroon

Independent Director

Chairman of the Board Audit Committee and Member of the Nominating & Remuneration Committee

- Chairman & CEO, Haroon Holding Co.
- Board Member, United Gulf Holding Company B.S.C.
- Former Advisor to the Board of Directors, United Gulf Bank B.S.C.(c) - Bahrain
- Former Acting Chief Executive and Deputy Chief Executive Officer, United Gulf Bank B.S.C.(c) - Bahrain
- Previously held various management positions at National Bank of Pakistan in Bahrain and Pakistan, and Investment Corporation of Pakistan

Over 49 years of experience in the financial industry

BSc (Hons), Peshawar University, Pakistan

Diploma in Banking

EXECUTIVE MANAGEMENT

Hussain A. Lalani FCA CISA

Chief Executive Officer

Mr. Lalani joined UGB in 2002 and was appointed as the Acting CEO in September 2015 and subsequently CEO in April 2019. His career extends over 22 years, and he has worked extensively with the Board of Directors on advisory transactions in his previous capacity as the Bank's Chief Financial Officer, and partnered with business divisions to support growth and business plans. Mr. Lalani was previously employed by Ernst & Young (Bahrain) and PriceWaterhouse Coopers (Pakistan). He is a Board Member of Takaud Savings & Pensions B.S.C. (c), Bahrain; Global Banking Corporation, Bahrain; United Gulf Financial Services – North Africa, Tunisia; FIMBank plc. – Malta and Assoufid B.V. Netherlands. He is also a Non-Executive Director of Takaud Savings & Pensions (DIFC). A Chartered Accountant and a Certified Information Systems Auditor, Mr. Lalani holds a Bachelor of Commerce degree from the University of Karachi, Pakistan.

Deepa Chandrasekhar APRM CAMS FICA CFE Chartered MCSI

Senior Vice President, Chief Compliance Officer & MLRO

Mrs. Chandrasekhar joined UGB in 2008. She has over 30 years' experience in the areas of risk management, treasury, operations, internal audit and compliance. She holds an MBA degree from the University of Alberta, Canada; as well as several professional certifications. Mrs. Chandrasekhar is a member of the Steering Committee of the Professional Risk Managers International Association (PRMIA), Bahrain Chapter; and the Advisory Council of the Chartered Institute of Securities and Investment (CISI), Bahrain Chapter. She also serves as an international moderator in the field of compliance and corporate governance for the Finance Accreditation Agency, Malaysia. Mrs. Chandrasekhar is a frequent speaker at professional forums, and has published several financial articles.

Mohammed Alqumaish CIA CISA MBA

Assistant General Manager, Chief Audit Executive and Corporate Secretary

Mr. Alqumaish joined UGB in September 2001. He has more than 22 years of regional, commercial and investment banking experience in internal auditing, risk assessment, compliance, corporate governance and quality assurance services. He previously worked with Ahli United Bank and Shamil Bank in Bahrain. Mr. Alqumaish is a Director, Board Audit Committee member and Nominating & Remuneration Committee member of Tunis International Bank, Tunisia; Director, Board Audit Committee member and Nominating & Remuneration Committee member of Syria Gulf Bank, Syria; and a Director of Al Ameen Real Estate Investment Company, Iraq. He also serves as an external Board Committee member of Gulf Bank Algeria, Algeria; and Bank of Baghdad, Iraq. A Certified Internal Auditor (CIA) and Certified Information Systems Auditor (CISA), Mr. Alqumaish holds an MBA from the University of Strathclyde Business School, UK.

Syed Rehan Ashraf FCA MBA

Chief Financial Officer

Mr. Ashraf joined UGB in 2005. He was appointed CFO in October 2015 after serving as Head of Credit and Risk Management since October 2007. He has more than 21 years of experience in the areas of credit, risk management, advisory, compliance and assurance services – with Islamic and conventional banks – and the big four audit firms. He previously worked with Shamil Bank, Bahrain; Deloitte & Touche, Pakistan; Faysal Bank, Pakistan; and PriceWaterhouse Coopers, Pakistan. A Fellow Chartered Accountant (FCA) from the Institute of Chartered Accountants of Pakistan, Mr. Ashraf also holds an MBA from DePaul University of Chicago, USA.

EXECUTIVE MANAGEMENT

Adel Al-Arab, CRA

Senior Vice President, Head of Operations

Mr. Al Arab joined UGB in 1994. He has over 22 years of experience in the field of operations, credit and risk management. Mr. Al Arab holds a Bachelor of Science degree in Business Administration from the University of Bahrain. He is a Chartered Risk Analyst (CRA) from the Global Academy of Finance and Management, USA; and was awarded the Certificate of ISMA Foundation Program from the International Securities Market Association, Zurich. Mr. Al Arab has attended several professional courses in banking, finance, and risk management.

Abbas Al Tooq APRM MBA

Assistant Vice President, Head of Credit & Risk Management

Mr. Al Tooq joined UGB in 1999. He assumed the role of Head of the Credit and Risk Management in October 2015. He has more than 22 years of experience in the areas of credit, risk management, operations and audit. He previously worked with Jawad Habib Coopers & Lybrand, Daiwa Middle East Bank, and The Arab Investment Company. Mr. Al Tooq holds an MBA degree from DePaul University, Chicago, USA; and is an Associate Professional Risk Manager (APRM) from the Professional Risk Managers International Association.

Nirmal Parik CFA MBA

Vice President, Head of Asset Management & Investment Banking

Mr. Parik joined UGB in 2007. He was appointed Head of Asset Management & Investment Banking in October 2015. He has more than 16 years of experience in the financial services industry in investment banking, asset management and corporate banking. Prior to joining UGB, Mr. Parik worked in various capacities with multinational firms including ING Investment Management (I) Pvt. Ltd., the asset management arm of ING Group NV, Netherlands. He currently serves as a Board Member of International Innovative Technologies Ltd., UK. Mr. Parik is a Chartered Financial Analyst (CFA), and holds an MBA degree with specialisation in Finance.

Hamid M. Al Hashimi

Vice President, Head of Treasury

Mr. Al Hashimi joined UGB in March 2017. He has over 16 years of experience within Treasury, across all asset classes including structuring, sales and trading; as well as a syndication team leader for a number of regional capital market fixed income issuances. Mr. Al Hashimi has held several positions within Treasury at various international and regional financial institutions, both conventional and Islamic. He holds a Bachelor's Degree with Honours in Business Administration (with emphasis on Economics) from the University of Bradford, UK including an indepth dissertation on the impact of e-Commerce on Treasury.

BUSINESS REVIEW

STRATEGY AND BUSINESS OVERVIEW

The strategic objective of United Gulf Bank B.S.C. (c) is to create the MENA region's premier asset management, merchant banking and investment banking group. UGB seeks to be the preferred gateway to the region for its clients and global partners through the delivery of both conventional and Shari'ah-compliant services, backed by worldclass standards of support, infrastructure and process. The Bank works with strategic partners to create opportunities that position UGB as a leading financial institution for the region.

Either directly or through its subsidiaries, UGB engages primarily in asset and fund management, investment banking, private equity and corporate banking. Other business activities include proprietary investments and treasury.

ASSET MANAGEMENT AND INVESTMENT BANKING

Asset Management

Asset and fund management activities – covering local, regional and international markets – comprise discretionary and non-discretionary portfolio management; securities trading; portfolio structuring and asset allocation advice; mutual funds; investments and structuring; and alternative structured investments.

Investment Banking

Conventional and Islamic investment banking activities cover equity and debt underwriting, private placements, capital restructuring, and merger and acquisitions.

Private Equity

Private equity activity focuses on key growth or demand sectors such as telecommunications, media, technology, and energy.

Corporate Banking

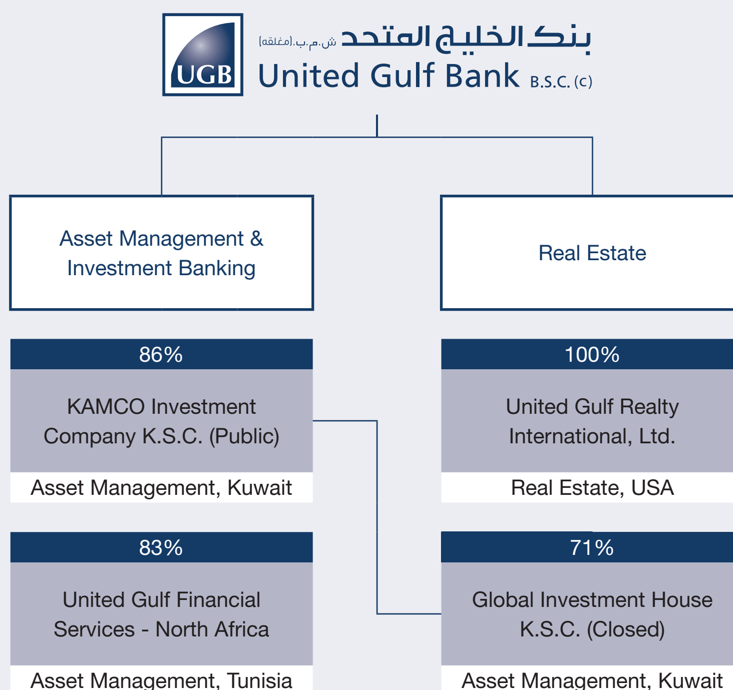
Corporate banking advisory services include IPO and private placement advisory and execution, business valuation and financial feasibility studies, project finance and due diligence.

KEY DEVELOPMENTS IN 2018

- Assets under management with UGB stood at US$ 12.6 billion at the end of 2018 compared with US$ 10.8 billion at the end of the previous year.
- The main contributors to the share of results from the Bank's subsidiaries in 2018 were KAMCO Investment Company (KAMCO), Global Investment House (GIH) and United Gulf Realty International Ltd. (UGRIL).
- Through KAMCO, UGB completed the acquisition of a 71.18 per cent in Global Investment House, a prominent regional asset management and investment banking firm based in Kuwait with offices in major capital markets across the MENA region. The acquisition was ranked by Kuwait Financial Centre (Markaz) as one of the top five regional M&A transactions in 2018.
- UGB further increased the capital of United Gulf Realty International Ltd. during the year and continued to be actively involved in its day-to-day management.
- The Bank exited its opportunistic investment in Fairfax India Holdings Corporation, generating a return on investment of 70 per cent.

BUSINESS REVIEW

UGB SUBSIDIARIES AND ASSOCIATES



UGB consolidated holdings, as at 31 December 2018

SUBSIDIARIES

KAMCO Investment Company K.S.C. (Public) (KAMCO)

Consolidated Subsidiary based in Kuwait

Established in 1998, KAMCO is a leading asset management and financial institution, with one of the largest private sector assets under management (AUM) in the GCC region. Its three principal business lines are asset management, financial services, and investment advisory research services, which are offered to a diverse local, regional and international client base. UGB owns 86 per cent of KAMCO, which is listed on the Kuwait Stock Exchange.

Global Investment House K.S.C. (c) (Global GIH)

Consolidated Subsidiary based in Kuwait

Established in 1998, Global is a prominent regional asset management and investment banking firm headquartered in Kuwait with offices in major capital markets across the MENA region, including Saudi Arabia and the UAE. Through KAMCO, UGB has a total consolidated interest of 71.18 per cent in Global, whose shares are not listed.

United Gulf Financial Services Company - North Africa (UGFS-NA)

Consolidated Subsidiary based in Tunisia

Commencing operations in 2009, UGFS-NA is an asset management company regulated by the Tunisian Capital Market Authority – Conseil du Marché Financier. The Company is primarily involved in three main activities: fund services, portfolio management services, and corporate finance services. UGB has a total consolidated interest of 83 per cent in UGFS-NA, whose shares are unlisted.

United Gulf Realty International, Ltd. (UGRIL)

Consolidated Subsidiary based in USA

UGRIL was incorporated in 2012. Through its wholly owned subsidiary, Federal Street 176 Holdings, Inc., the Company has a 100 per cent ownership in a prime commercial real estate property located in the financial district submarket in Boston, USA. Originally constructed in 1901, the building underwent a significant renovation in 1986. UGB has a total consolidated interest of 100 per cent in UGRIL, whose shares are unlisted.

BUSINESS REVIEW

SHARED SERVICES

Treasury

Treasury manages UGB's liquidity and funding requirements and also implements the Bank's hedging strategies in terms of foreign exchange and interest rate exposures. During 2018, UGB continued to build upon its successful track record and benefit from KIPCO Group synergies; strengthened its counterparty relationships with both conventional and Shari'ah-compliant institutions; and continued to make use of hedging instruments to counter market volatility. Deposits from banks, financial institutions and customers totaled US$ 253.5 million in 2018, reflecting UGB's strong reputation in the market. The Bank retained a robust balance sheet with a consolidated capital adequacy ratio (CAR) of 15.5 per cent as at the end of 2018, higher than the Central Bank of Bahrain's minimum requirement of 12.5 per cent. This is despite the acquisition of Global Investment House (GIH) during the year. Liquidity remained very healthy, with total liquid assets of US$ 379.1 million representing 43.4 per cent of the balance sheet at the end of the year. During 2018, the Group repaid financing facilities with regional banks totalling US$ 54.5 million, and raised additional financing of US$ 22.9 million.

Operations

The main activities of the Operations department include settlement of foreign exchange and money market transactions; handling payments and funding in coordination with Treasury; and facilitating transfers. During the year, UGB continued to enhance and streamline its critical back office operating processes and procedures in order to improve efficiency and productivity. Key developments in 2018 included collaborating with Information Technology on a major upgrade of the core banking system, and implementing a new procurement system. Operations also worked closely with Compliance in the submission of the FATCA and CRS statutory reports required by the Central Bank of Bahrain.

Human Resources

UGB places the highest importance on the professional development of its people. During 2018, focus was placed on building leadership skills and investing in future leaders, as well as supporting the professional and personal development of all employees. Over 50 per cent of staff attended training and development programmes, while the Bank continued to encourage and support staff to obtain appropriate professional qualifications and certification. Mandatory regulatory related training, such as Anti-Money Laundering and Code of Conduct was conducted in-house for all staff. Relevant staff attended external workshops covering the implications of IFRS 9 from a compliance and risk perspective, and the impact of VAT. The Bank's merit-based Mashare'a Al Khair Scholarship Programme continued to assist dependants of Bank staff to obtain degrees from accredited colleges, universities and other academic institutions during the year. In addition, the Internship Programme was redesigned to introduce a formal mentoring process and action plan for identifying the more talented internees.

Information Technology

During 2018, UGB continued to invest in further strengthening and enhancing its information and communications technology framework. Key developments included a major upgrade of the core banking system with completion planned for the middle of 2019; together with implementation of a new automated procurement system and human resources management system. In light of increasing cyber-attacks, external consultants continued to review the Bank's vulnerability to various cyber security risks, which entailed extensive vulnerability assessment and penetration testing of IT systems, and further updating the IT Policy Manual to ensure that appropriate processes and procedures are in place to detect, monitor, mitigate and report cyber-attacks. UGB also conducted two successful tests of its business continuity planning (BCP) process during 2018 in line with regulatory requirements of the CBB. The second test involved a special simulation exercise at the offsite BCP site under the scenario of staff being unable to access their offices, and being directed to the BCP site to resume their work.

During the year, the IT team studied latest FinTech developments currently under consideration by the Central Bank of Bahrain, for potential adoption by the Bank as critical business enablers. These include Amazon AWS Cloud-based services, digital transformation and Blockchain.

FINANCIAL REVIEW

This review provides a detailed description of the financial performance of United Gulf Bank B.S.C. (c) (“UGB” or “the Bank”) for the year ended 31 December 2018.

The notes to UGB’s Consolidated Financial Statements provide additional relevant details, with some of these notes being cross referenced here. Figures contained in the Financial Review are subject to rounding adjustments and, in certain instances, the sum of the numbers in a column or row may not conform exactly to the total figure given for that column or row.

INCORPORATION AND ACTIVITIES

UGB is a wholesale conventional bank regulated by the CBB. As at 31 December 2018, the Bank’s parent company United Gulf Holding Company B.S.C. (UGH) holds 100% shares of UGB. The Kuwait Projects Company (Holding) (KIPCO) continues to be the ultimate parent company owning directly and indirectly 98% of UGH’s outstanding shares on a consolidated basis.

ACQUISITION OF GIH

During September 2018, the Group (through its subsidiary KAMCO) acquired a 71.18% effective equity interest of Global Investment House K.S.C. (Closed) (“GIH”), a Kuwaiti Shareholding Company, regulated by the CMA as an investment company and by the CBK for financing activities. GIH is principally engaged in the provision of asset management, investment banking and brokerage activities.

The acquisition was carried out for a total cash consideration of US$ 157.8 million, which resulted in a gain on bargain purchase of US$ 23.9 million. Of the total consideration to be paid to GIH’s previous owners, an amount of US$ 8.3 million is outstanding as payable as at 31 December 2018.

From the date of acquisition, GIH contributed US$ 11.8 million of revenue and US$ 0.1 million net loss to the net profit from continuing operations of the Group.

REVENUES

UGB’s total revenues were US$ 78.9 million in 2018 compared with US$ 50.3 million in 2017, as indicated below:

Total revenues US$ million	2018	2017
Gain on bargain purchase of a subsidiary	23.9	-
Credit related fees and commission	21.4	2.3
Management fees from fiduciary activities	15.0	16.0
Advisory fees	6.6	7.2
Interest Income	6.4	4.4
Real Estate	3.6	7.5
Dividend	1.7	1.9
Foreign currency translation gains / (losses) - net	1.6	(0.4)
Financial Services	1.3	(1.9)
Realised gain on non - trading investments	-	4.4
Gain on sale due to reclassification of investment	-	3.0
(Loss) / gain on sale of associates	(0.5)	2.7
Trading (loss) / gain	(0.8)	3.9
Other Associates	(1.7)	(1.0)
Other income	0.4	0.3
Total	78.9	50.3

During 2018, the increase in total revenues was mainly attributed to the gain on bargain purchase on the acquisition of GIH by KAMCO, higher credit related fees and commissions, interest income, foreign currency gains and income from financial services. The impact was partially offset because of trading losses, losses on sale of associates, and no gains on reclassifications or sale of non-trading investments.

Gain on bargain purchase

In accordance with requirements of the IFRS, the Group carried out a Purchase Price Allocation exercise after the acquisition of GIH, which resulted in a gain from business combination, since the fair value of the net assets acquired exceeded the purchase consideration paid and related transaction expenses.

FINANCIAL REVIEW

Financial Services

UGB's financial services related revenues were derived from its investment in associates involved in asset management, investment banking and brokerage.

Results from financial associates recorded an income of US$ 1.3 million compared with a loss of US$ 1.9 million in 2017. The increase was mainly due to the increase in income from KAMCO Investment Fund (which was classified as an associate in 2017).

The table below indicates the performance of UGB's financial associates:

Revenues - Financial Associates US$ million	2018	2017
Al Sharq Financial Brokerage Co.	-	0.1
KAMCO Investment Fund	1.7	(1.8)
Manafae Investment Company	(0.4)	(0.2)
Total	1.3	(1.9)

Real Estate

UGB's real estate revenues were derived mainly from rental income from its real estate properties in Bahrain, Kuwait and the USA. The decrease was mainly due to a US$ 1.4 million unrealised gain on investment properties in the USA being offset by a US$ 1.3 million loss on investment property in the GCC.

Revenues - Real Estate US$ million	2018	2017
N.S. 88	(0.4)	-
Rental income	3.9	4.8
Unrealised gain on investment properties	0.1	2.7
Total	3.6	7.5

Other Associates

Losses from other associates of UGB increased from US$ 1.0 million in 2017 to US$ 1.7 million in 2018.

Revenues - Non-financial Associates US$ million	2018	2017
United Capital Transport Company	(1.9)	(2.1)
Kuwait Education Fund	0.2	1.1
Total	(1.7)	(1.0)

Fees and Commission Income

Credit related fees and commission income increased to US$ 21.4 million in 2018 from US$ 2.3 million in 2017, mainly due to US$ 6.8 million recorded at the UGB level and new mandates at KAMCO and GIH.

Management Fees from Fiduciary Activities

Management fees decreased moderately from US$ 16.0 million in 2017 to US$ 15.0 million in 2018, mainly due to the overall decline in regional stock markets during the year, resulting in lower performance and management fees on fiduciary assets. The decrease was mainly from fewer mandates at the KAMCO level.

Advisory Fees

Advisory fee income decreased slightly to US$ 6.6 million in 2018 from US$ 7.2 million in 2017.

Interest Income

The main source of interest income for UGB was derived from interbank placements. Interest income increased from US$ 4.4 million in 2017 to US$ 6.4 million in 2018, mainly due to the increase in LIBOR, placement of funds raised by KAMCO through its bond sale, and excess funds at UGB.

Trading gains / losses

Trading positions recorded a loss of US$ 0.8 million in 2018 compared with a profit of US$ 3.9 million for 2017. Trading losses were recorded mainly due to the subdued performance of regional stock markets during the year.

Dividend Income

Dividend income decreased marginally to US$ 1.7 million in 2018 compared with US$ 1.9 million in 2017.

Foreign Currency Translation gains / losses

Foreign currency translation gains of US$ 1.6 million were recorded in 2018 compared with losses of US$ 0.4 million in 2017. This was attributed mainly to the gains on derivative products booked on behalf of UGH.

EXPENSES

Interest Expense

Interest expense decreased from US$ 15.2 million in 2017 to US$ 14.7 million in 2018, despite an increase in interest rates, mainly due to a reduction in overall borrowing levels.

Operating Expenses

Operating expenses increased by 98% to US$ 50.6 million in 2018 compared with US$ 25.6 million in 2017. Salaries and benefits increased to US$ 30.3 million (2017: US$ 15.9 million) largely due to the consolidation of GIH.

General and administration expenses increased to US$ 20.3 million (2017: US$ 9.7 million). This originated mainly due to the consolidation of GIH, and accrual of expenses for advisory and legal fee related to the acquisition of GIH.

FINANCIAL REVIEW

Operating expenses US$ million	2018	2017
Salaries and benefits	30.3	15.9
General and administrative expenses	20.3	9.7
Total	50.6	25.6

Taxation

A net tax income of US$ 0.1 million was recorded in 2018 compared with an expense of US$ 1.0 million in 2017. The tax income for 2018 related mainly to income booked at United Gulf Realty International, Ltd.

Provisions

UGB made total provisions of US$ 3.1 million in 2018 compared with US$ 3.4 million in 2017. Provisions for 2018 mainly resulted due to provisions for an unfunded participation at the UGB level, and provisions against other receivables at KAMCO and GIH.

Provisions for impairment US$ million	2018	2017
Impairment loss on investments	-	(0.5)
Provision for losses against unfunded participation	(0.8)	-
Expected credit losses / provision	(2.3)	(2.9)
Total	(3.1)	(3.4)

Net income from discontinued operations

Income from discontinued operations for 2018 of US$ 0.5 million relates to income earned by KAMCO on SPVs used to buy and sell properties in the UK and USA.

Net Income Attributable to Parent

Net income attributable to parent in 2018 increased to US$ 10.1 million from a loss of US$ 79.9 million in 2017. Losses in 2017 included a reclassification adjustment of US$ 87.8 million, comprising foreign currency losses of US$ 27.9 million and fair value losses of US$ 59.8 million. These were transferred to the consolidated statement of income as part of the Group's restructuring in 2017.

CONSOLIDATED BALANCE SHEET

Consolidated Assets

UGB's consolidated assets stood at US$ 873.5 million at 31 December 2018 compared with US$ 680.1 million at the end of 2017. A comparison of the two years is provided below:

Assets US$ million	2018	2017
Demand and call deposits with banks	143.5	98.0
Placements with banks	108.5	68.6
Investments carried at fair value through statement of income	81.9	19.3
Non-trading investments	167.6	221.6
Held-to-maturity investments	0.5	-
Loans and receivables	25.2	4.2
Other assets	61.2	31.7
Investments in associates	71.5	77.5
Investment properties	107.6	105.1
Property and equipment	39.4	1.7
Goodwill and other intangible assets	66.6	52.4
Total	873.5	680.1

Demand, Call Deposits and Placements with Banks

Demand, call and placements with banks were US$ 252.0 million in 2018 compared with US$ 166.6 million in 2017, as liquid funds at GIH were consolidated. Total liquid assets comprising cash, deposits, liquid securities and other assets, represented 43.4% of the balance sheet as at 31 December 2018 (2017: 33.5%).

Investments carried at fair value through the statement of income

Investments carried at fair value through the statement of income were US$ 81.9 million in 2018 compared with US$ 19.3 million in 2017. This portfolio mainly comprises quoted equities, debt securities, and unquoted managed funds designated as fair value through statement of income. The increase was due to the GIH consolidation, and reclassifications as a result of IFRS 9 adoption.

Non-trading Investments

Non-trading investments were US$ 167.6 million in 2018 compared with US$ 221.6 million in 2017. The total portfolio mainly comprises listed equities of US$ 45.2 million (2017: US$ 42.1 million), unlisted equities of US$ 120.3 million (2017: US$ 143.1 million) and other managed funds of US$ 2.0 million (2017: US$ 36.4 million).

FINANCIAL REVIEW

The major investments classified under the non-trading investments portfolio as at 31 December 2018, were:

Orbit Showtime Network (OSN): UGB holds a 0.93% stake in Panther Media Group Limited ("PMGL") known as "OSN", an entity incorporated in Dubai and registered in the Dubai International Financial Center. OSN is engaged in providing satellite encrypted pay television services across the Middle East and North Africa region.

Advanced Technologies Company (ATC): UGB holds a 5.2% stake in ATC, which is a leading medical equipment and turnkey solution provider. It was established in Kuwait in 1981 and listed on the Kuwait Stock Exchange in 2007. It offers over 1,000 products to customers in the public and private sectors, focusing on medical, pharmaceutical, dental and laboratory equipment. ATC provides its products and services to over 500 health care facilities, and has circa 45% share of the Kuwait medical sector.

Assoufid B.V.: Assoufid is a Morocco-based real estate development company. Its prime property is the Assoufid high end mixed use development in Marrakech. The property is spread over 222 hectares. The first phase is the award winning Assoufid Golf Club, which has been completed. The second phase currently underway, includes a 5-star hotel and luxury branded golf villas.

Kuwait Energy plc: This is an independent oil and gas company actively engaged in the exploration, appraisal, development and production of hydrocarbons in the MENA region. As at 31 December 2018, UGB owned an equity stake of 1.2% (2017: 1.2%) in Kuwait Energy plc.

BBK: (formerly known as The Bank of Bahrain and Kuwait): BBK was established as a commercial bank in 1971 and is one of the largest commercial banks in the Kingdom of Bahrain. BBK 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. GIH owns a 1.02% stake in BBK.

Loans and Advances

Loans and advances in 2018 amounted to US$ 25.2 million (2017: US$ 4.2 million).

Details of the loan book are as follows:

Loans and Advances US$ million	2018	2017
Loans to customers	32.4	4.1
Staff loans	4.0	2.6
Gross loans and advances	36.4	6.7
Less: Provision for impairment	(11.2)	(2.5)
Total	25.2	4.2

Past due and impaired loans amounted to US$ 10.5 million (2017: nil) against which specific provisions of US$ 10.5 million (2017: nil) and collective provisions of US$ 0.7 million (2017: US$ 2.5 million) were recorded. Past due loans were acquired as part of the GIH acquisition.

Investments in Associated Companies

Investments in UGB's associated companies decreased to US$ 71.5 million in 2018 compared with US$ 77.5 million in 2017, mainly due to the Group's share of losses and other comprehensive income (losses) recorded by the associates. The Group's associated companies contributed a net loss of US$ 0.8 million in 2018 (2017: net loss of US$ 2.9 million), with the key contributors being United Capital Transport Company (US$ 2 million loss) and KAMCO Investment Fund (US$ 1.7 million income).

Investment Properties

UGB's investment properties mainly comprise real estate properties in Kuwait, United States of America and the Kingdom of Bahrain. Rental income on these investments amounted to US$ 3.9 million (2017: US$ 4.8 million).

FINANCIAL REVIEW

Consolidated Liabilities

UGB's consolidated liabilities increased to US$ 558.6 million in 2018 from US$ 417.2 million in 2017, as KAMCO issued new 5-year bonds to fund the acquisition of GIH.

Liabilities US$ million	2018	2017
Due to banks and other financial institutions	220.9	250.2
Deposits from customers	32.6	31.0
Loans payable	67.0	98.7
Long term bonds	131.7	-
Other liabilities	106.4	37.3
Total	558.6	417.2

Total Equity

The issued and fully paid up share capital as at 31 December 2018 comprised 202,263,041 shares of US$ 0.50 each (2017: 404,526,082 shares of US$ 0.25 each). As at 31 December 2018, UGB's equity stood at US$ 314.9 million (2017: US$ 262.9 million).

Equity US$ million	2018	2017
Share capital	101.1	101.1
Share premium	5.7	5.7
Statutory reserve	50.9	49.9
General reserve	30.6	29.6
Fair value reserve	(10.1)	12.9
Foreign currency translation reserve	(4.5)	(3.9)
Retained earnings	13.3	7.7
Capital and reserves attributable to the shareholders of the parent	187.0	203.0
Perpetual Tier 1 capital	33.0	33.0
Non-controlling interests in equity	94.9	26.9
Total Equity	314.9	262.9

The major movements in equity from 31 December 2017 to 31 December 2018 were:

- Net profit attributable to parent of US$ 10.1 million.
- Negative fair value reserve movement mainly due to opening adjustments upon adoption of IFRS9 and fair value losses on UGB and KAMCO's FVOCI portfolio.
- Interest paid of US$ 3.5 million on the US$ 33 million perpetual Tier 1 capital.
- Minority interest increased by US$ 68.0 million, representing just under 29% minority stake in GIH.

OFF-BALANCE SHEET COMMITMENTS

UGB's off-balance sheet commitments comprise guarantees and undrawn investment commitments; financial instruments to cover foreign exchange risks; forward purchase and sales contracts; and interest rate and currency swaps. The Bank's investments and credit-related commitments aggregated to US$ 7.3 million as at 31 December 2018 (2017: US$ 4.8 million). Further details regarding off-balance sheet commitments are provided in Note 29 to the Consolidated Financial Statements for the year ended 31 December 2018.

CAPITAL ADEQUACY

UGB's consolidated capital adequacy ratio of 15.5% at 31 December 2018 (2017: 21.5%) under the Basel III regulations, as mandated by the Central Bank of Bahrain, was above the minimum requirement of 12.5%.

US$ million	2018	2017
Capital base:		
Tier 1 capital	147.3	188.7
Tier 2 capital	6.2	3.4
Total capital base (a)	153.5	192.1
Credit risk weighted exposure	944.5	750.0
Market risk weighted exposure	10.4	87.5
Operational risk weighted exposure	38.4	54.4
Total risk weighted exposure (b)	993.3	891.9
Capital adequacy (a/b * 100)	15.5%	21.5%
Minimum requirement	12.5%	12.5%

The decrease in the capital adequacy ratio is mainly due to the consolidation of GIH's assets. This resulted in an increase in risk weighted assets and a decrease in regulatory capital due to capital deductions.

RISK MANAGEMENT REVIEW

UGB's robust risk management framework provides comprehensive controls and ongoing management of major risks inherent in the Bank's business model and operational activities.

Key Developments in 2018

- Risk Management collaborated with the Compliance and the Accounts & Finance Departments to ensure that the Bank was fully compliant with CBB regulatory requirements pertaining to the introduction of IFRS 9 on 1st January 2019, with appropriate policies and procedures, and Expected Credit Loss (ECL) systems, being put in place.
- The Bank has hired external consultants to assist in reviewing the new Risk Management related modules of the CBB Rulebook which come into effect during 2019, The modules, among other topics, cover Reputational Risk, Internal Capital Adequacy Assessment Process, Internal Liquidity Assessment Process and Stress Testing.
- Following the acquisition of a 71.18 per cent stake in Global Investment House by KAMCO, the Bank held meetings with the CBB to discuss the likely impact on UGB's capital adequacy ratios, and its plans to increase the Bank's capital.
- During the year, the Bank embarked on enhancing the capabilities of its core banking platform through implementation of the latest version of Mysis. Once implemented, the system will enhance the data capturing and reporting capabilities across all operations of the Bank.
- UGB maintained its focus on operational consolidation and strengthening liquidity in order to achieve financial efficiency across Bank-wide operations.
- The scope of quarterly reporting to the Board, its Committees, and Management on liquidity and investment reviews, was further enhanced during the year.

Risk Philosophy

The Bank's risk philosophy is based on the following five principles:

1. Sound knowledge base, experience and judgement of Senior Management and Risk Management staff, are the cornerstone of successful risk mitigation.
2. Vigilance, discipline and attention to detail are mandatory.
3. Complete segregation of duties and reporting authorities must exist between business lines and support functions.
4. Policies and procedures must be clear, properly documented, well-communicated, understood, and implemented in both letter and spirit.
5. Well-established processes and systems provide the backbone of risk management practices at the Bank.

Responsibilities

The Board of Directors of UGB has the ultimate authority for setting the overall risk appetite, risk tolerance, parameters and limits, within which the Bank operates. The Board approves the Bank's overall risk profile and significant risk exposures, as well as the policies, procedures and controls that have been extensively documented.

The Board has delegated day-to-day decision making to the Executive Committee (EC) that comprises three Executive Directors. The EC meets between Board meetings to approve all proposals that exceed the threshold of the Investment Committee.

The Investment Committee (IC) is responsible for approving or recommending approvals to the Executive Committee; limits for individual exposures; investments; and concentrations towards banks, countries, industries, risk-rating classes or other special risk asset categories.

The Risk and Compliance Committee (RCC) supervises the adoption of best practice in the areas of risk and compliance. It acts as the steering committee for risk and compliance initiatives, responsible for monitoring the progress and facilitating a smooth transition towards complete compliance with provisions of the New Capital Accord and other regulatory requirements. During 2018, the Committee met three times.

Further information on the constitution and responsibilities of these committees is disclosed in the Corporate Governance Report available on the Bank's website: www.ugbbh.com.

UGB's ability to properly identify, assess, manage, measure, monitor and report risk is critical to its financial strength and profitability. A comprehensive set of risk management policies, processes and limits are in place to provide guidelines and parameters. These are continuously updated with the objective of incorporating best practice, changes in market factors, and changes in the regulatory environment in the various jurisdictions in which the Bank operates.

Risk Management Strategy

The overall risk management strategy of UGB focuses on optimising the risk-return profile of the Bank's exposures (a portfolio approach) as well as avoiding losses. The risk management philosophy of the Bank for managing the main types of risk to which it is exposed, is summarised below:

Risk Type	Risk Management Philosophy
Credit	Discipline its lending activities and ensure that credit facilities are granted on a sound basis; and that the Bank's funds are invested in a profitable manner.
Market	Minimise the loss of the value of financial instruments or a portfolio of financial instruments, due to an adverse change in market prices or rates.

RISK MANAGEMENT REVIEW

Interest Rate	Capture all material sources of interest rate risk, and assess the effect of interest rate changes on the income stream and equity of the Bank.
Liquidity	Identify, capture, monitor and manage the various dimensions of liquidity risk with the objective of protecting asset values and income streams, such that the interests of the Bank's shareholders are safeguarded, while maximising returns to shareholders.
Operational	Mitigate or insure the risk of loss arising from a failure in UGB's internal processes due to inadequate internal controls and procedures, human error, deliberate acts, and/or business interruptions caused by technology, systems or external disasters that are beyond the Bank's control.

Types of Risk

The major types of risk to which UGB is primarily exposed include credit, market, operational, liquidity and funding, interest rate, concentration, reputational and legal risks. Details on each of these are provided in the Basel III Pillar III Risk Management and Capital Adequacy Disclosures available on the Bank's website at: www.ugbbh.com.

The following section provides a brief synopsis of the different types of risk and the processes adopted to identify, assess and monitor them.

Credit Risk

Credit risk arises mainly from the extension of credit facilities in the UGB Group's commercial banking, investment banking and trading activities, where there is a possibility that a counterparty may fail to honour its commitments.

The Bank identifies and manages credit risk inherent in all products and activities, and ensures that such risks are assessed in depth and are well understood. These activities are then subject to adequate risk management procedures and controls which are approved by the Board of Directors prior to implementation.

The Bank mitigates its credit risk through:

- Establishing an appropriate credit risk environment
- Operating under a sound credit and investment approval process
- Ensuring adequate controls over the credit risk management process
- Knowledge of target markets, borrowers and counterparties
- Maintaining appropriate credit administration, measurement and monitoring processes

The Bank's policies and procedures provide the guidelines for credit risk management. UGB manages credit risk through its limit structure, which controls the amount of risk that it is willing to accept for individual counterparties, related parties, and for geographical and industry concentrations. Exposures with respect to the adherence of these limits are monitored on a regular basis.

There is a two-tier committee structure to approve and review credit and investment risk. The Investment Committee (IC) includes the Chief Executive Officer, the Head of Asset Management and Investment Banking, and the Chief Financial Officer. The Head of Credit and Risk Management is a non-voting member on the Committee and acts as its secretary. Exposures beyond IC-delegated limits are approved by the Board's Executive Committee or the full Board of Directors.

The credit risk inherent in trading activities is also actively managed, and in case of exposures to counterparties, is calculated daily as the sum of mark-to-market values. In certain cases, the Bank has entered into legally-enforceable netting agreements covering its money market and foreign exchange trading activities. In areas where UGB acts as an agent for commodity trading on behalf of certain Islamic financial institutions, the risk is managed through simultaneous spot and forward trading in commodities, through well-established financial and commodity trading institutions that have been subjected to a detailed credit review. The Bank does not trade in derivatives. Continuous monitoring of the Bank's assets through various reports and reviews is critical to early and timely identification of any impairment. A monthly risk asset review report is produced by the Credit and Risk Management Department and reviewed monthly by the Management Committee and quarterly by the Risk & Compliance Committee. All investments are assessed based on rating, industry and geographic exposure, in addition to a number of other parameters. The purpose of this report is also to ensure compliance with external regulatory requirements and internal risk policy guidelines. Additionally, a semi-annual review of all investments is conducted for monitoring performance and highlighting any recent developments. A quarterly review of loans is prepared for the purpose of identifying impairments and providing an update on the status of each facility. The risk asset review report is reviewed on a monthly basis by Management, and quarterly by the Risk and Compliance Committee.

UGB has adopted the Standardized Approach for calculating the charge for credit risk. Non-performing loans for the Group stood at US$ 10.5 million as at 31 December 2018 (2017: nil) against which specific provisions of US$ 10.5 million (2017: nil) and collective provisions of US$ 0.7 million (2017: US$ 2.5 million) exist.

RISK MANAGEMENT REVIEW

Credit Risk (continued)

The Bank has established overall credit limits at the level of individual borrowers and counterparties, as well as groups of connected or comparable counterparties. These are aggregated in a meaningful manner to indicate different types of exposures in the banking and trading book, and on and off the balance sheet. The credit limits recognise and reflect the risks associated with the near-term liquidation of positions in the event of counterparty default. Limits also factor in any unsecured exposure in a liquidation scenario. All extensions of credit are made on an arm's length basis. Any credit extended to companies and individuals that are outside the approved policy parameters are avoided, or are authorised on an exception basis by the appropriate authorities. A detailed review of connected party exposure is conducted on a monthly basis and reported to Central Bank of Bahrain.

Detailed information on the Bank's credit risk exposures, including geographical distribution, industry and sector allocation, details of the collaterals and other credit enhancements, and bifurcation based on internal ratings, is provided in Note 31(b) to the Consolidated Financial Statements.

Market Risk

Market risk is defined as the risk of losses in the value of on or off-balance sheet financial instruments caused by a change in market prices or rates (including changes in interest rates and foreign exchange rates). UGB's policy guidelines for market risk have been vetted by the Board of Directors in accordance with the rules and guidelines provided by the Central Bank of Bahrain.

UGB has adopted the Standardized Approach for the measurement of its market risk. This involves a 'building block' methodology that aggregates charges for interest rate exposure, equities, foreign exchange, commodities and options. The Bank has entered into forward contracts and interest rate swaps for hedging purposes, and does not trade in commodities or derivatives. Consequently, UGB's market risk capital adequacy requirements cover the securities trading book and the foreign exchange book.

The minimum capital charge for interest rate exposure is expressed as the sum of the specific and general market risk of each position. For the general market risk capital charge, the Bank applies the maturity method with its respective rules. Information on the interest rate sensitivity in the Bank's asset and liability structure is detailed in Note 31(c) to the Consolidated Financial Statements.

The capital charge for equities held in the Bank's trading book is also an aggregate of 'specific risk' of holding a long or short position in an individual equity; and the 'general market risk' of holding that position in the market as a whole. In case of foreign exchange risk, the open currency position is taken both in the banking and the trading book. The sensitivity towards currency movements on the Bank's equity is detailed in Note 31(c) to the Consolidated Financial Statements.

The Bank seeks to manage the market risks that it faces through diversification of exposures across dissimilar markets, industries and products. In addition to the exercise of business judgement and management experience, UGB utilises limit structures related to positions, portfolios, maturities and maximum allowable losses, to control the extent of such risk.

Interest Rate Risk in the Banking Book

Interest rate risk in the banking book arises as a result of mismatches in the re-pricing or maturity of interest rate sensitive financial assets and liabilities. This is also known as re-pricing risk. Additionally, UGB is exposed to minimal basis risk which results from a change in the relationship between the yields/yield curves of long and short positions with the same maturity in different financial instruments. In effect, this means that the long and short positions no longer fully hedge each other.

The Bank clearly identifies the sources of interest rate risk, and the interest rate risk-sensitive products and activities. It proactively measures and monitors the interest rate risk in the banking book. UGB also periodically carries out stress tests to assess the effect of extreme movements in interest rates that could expose the Bank to high risks. A conscious effort is also made to match the amount of floating rate assets with floating rate liabilities in the banking book. All new transactions are evaluated with respect to their inherent interest rate risk, and the identification of mitigating factors. UGB also enters into certain transactions in order to hedge exposures arising from day-to-day banking and investment activities. These hedge transactions include instruments such as interest rate swaps (IRS) and floating rate notes (FRN), to convert a floating rate asset/liability into a fixed rate one or vice-versa. The Bank continuously monitors the effectiveness of the hedges.

Operational Risk

Operational risk is defined as the risk of losses arising from a failure in UGB's internal processes due to inadequate internal controls and procedures, human error, deliberate acts and/ or business interruptions caused by technology, systems or external disasters beyond the Bank's control.

In accordance with Basel guidelines, UGB has developed a comprehensive operational risk framework, whereby all activities and processes of the Bank are analysed and residual risks are identified, measured and reported as appropriate.

Internal control systems have been introduced that are based on the tenet of adequate segregation of duties. Exception and excess exposure reporting by the Credit and Risk Management Department, succession planning and business continuity planning, reliable management reporting, and supervision of the Internal Audit and Quality Assurance Department and the Board Audit Committee, is also adhered to by the Bank. Anti-money laundering procedures and controls are also in place to mitigate any possible misuse of the Bank's services. These are reviewed by the external auditors on a yearly basis, and their report is forwarded to the Central Bank of Bahrain as mandated by local regulations.

RISK MANAGEMENT REVIEW

The management of operational risk in the Bank is the responsibility of every employee. The operational risk framework is built around a detailed Risk Control Self-Assessment (RCSA) that identifies all risks stemming from activities of each department of the Bank. The probability of occurrence and potential severity of the risks are assessed; existing controls against each probable risk event are plotted and reviewed in terms of their effectiveness; residual risks after taking into account the effectiveness of controls are documented; and action plans are developed to reduce or mitigate the residual risks. The results of the RCSA are periodically reviewed by the Risk and Compliance Committee. Heat maps are produced to alert Senior Management to areas that may be subject to an increased level of operational risk.

In line with CBB guidelines, UGB uses the Basic Indicator Approach (BIA) to calculate the capital charge for operational risk. This is prescribed as 15% of the average annual gross income of the current year and the preceding two years. The detailed working for the capital charge on operational risk is provided in the Prudential Disclosures related to Basel III - Pillar III, which are posted on the Bank's website at: www.ugbbh.com.

UGB has enhanced its Operational Risk framework by implementing a fully-automated Operational Risk System. The system comprises four key modules: loss database, risk and control self-assessment, key risk indicators, and exposure monitoring. This enables the Bank to monitor, mitigate and report its operational risk exposures in a structured and robust manner.

Liquidity Risk and Funding

Liquidity risk stems from the inability to procure sufficient cash flow to meet UGB's financial obligations as and when they fall due. The risk arises due to the timing differences between the maturity profile of the Bank's assets and liabilities. In order to ensure that the Bank can meet its financial obligations as they fall due, the tenors of UGB's assets and liabilities are closely monitored across different maturity time bands.

The Asset and Liability Committee evaluates the balance sheet from a structural, liquidity and sensitivity point of view. The whole process is aimed at ensuring availability of sufficient liquidity to fund the Bank's ongoing business activities; effectively managing maturity mismatches between assets and liabilities; managing market sensitivities; and ensuring the Bank's ability to fund its obligations as they fall due. Daily and weekly reports are generated, which monitor deposits by counterparties to ensure maintenance of a diversified funding base in terms of individual depositors, their ratings, geographical concentration and maturities.

A diversified funding base has evolved around the deposits raised from the interbank market, Shari'ah-compliant market deposits received from customers, and medium-term funds raised through syndicated borrowings. Access to available but uncommitted short-term funding from the Bank's established relationships, internationally and across the MENA region, provides additional comfort.

Liquidity risk is minimised by actively managing mismatches, and through diversification of assets and liabilities. The Bank uses a combination of maturity gap limits and liquidity ratio limits to ensure that liquidity risk is managed and controlled from the asset and liability perspective:

- Maturity gap limits: assets and liabilities in the Bank's balance sheet are grouped in specific maturity time buckets. The maximum liquidity mismatch between assets and liabilities in each defined time bucket (e.g. one to seven days, eight days to one month, one to three months, three to six months, six to twelve months, one to three years, three to five years, and more than five years), is controlled by gap limits that have been set for each time bucket. The Risk Management team tracks these limits.
- Liquidity ratio limits: UGB has limits on a set of ratios which it uses proactively for monitoring liquidity risk. These include the current ratio, liquid assets as a percentage of total assets, liquid assets as a percentage of total liabilities, and short-term liabilities as a percentage of total liabilities.

Information on the liquidity risk and maturity profile of UGB's asset and liability structure as at the end of 2018 is detailed in Note 31(d) to the Consolidated Financial Statements. As of this date, 53% of total assets and 64% of total liabilities were contracted to mature within one year (2017: 38% and 89% respectively). A significant portion of assets with longer-term maturities comprise readily realisable securities or listed assets with active markets. A significant portion of liabilities with short-term contractual maturities comprise of term deposits from KIPCO Group entities that are expected to roll-over.

Concentration Risk

Concentration of exposures in credit portfolios is an important aspect of credit risk that is monitored separately in UGB. This risk can be considered from either a micro (idiosyncratic) or a macro (systemic) perspective. The first type – name concentration – relates to imperfect diversification of risk in the portfolio, either because of its small size or because of large exposures to specific individual obligors/investments. The second type – sector concentration – relates to imperfect diversification across systemic components of risk, namely industry sectoral factors.

Concentration risk is captured in UGB's framework through the use of internal and external regulations that cap the maximum exposure to any single obligor/investment. There are established limits in place that set thresholds for aggregate industry, geography, and counterparty. The actual levels of exposure are monitored against approved limits and regularly reviewed by Senior Management and the Board of Directors.

The Bank pursues a set of internal policies and limits that ascertain to a large extent, that no defined exposure limits referred to in its various policies are exceeded. If any potential exposure is deemed to result in breach of regulatory and/or internal limits, the Bank obtains due approvals from the appropriate authority (Central Bank of Bahrain and/or the Bank's relevant approving authority) before executing the respective business transaction.

RISK MANAGEMENT REVIEW

Legal Risk

Legal risk is defined as the loss that may arise as a result of the inability to enforce contracts and agreements entered into, the failure of these to adequately cover the risks, and liabilities the Bank may face, and their inability to protect the Bank's interests. In order to mitigate legal risk, UGB uses industry standard master agreements wherever available. Expert legal advice is sought on all legal structures and arrangements to which the Bank is a party. A retainer agreement is maintained with a Bahrain law firm for the review of standard business agreements and, for special assignments documentation, the Bank involves local and international law firms. Proper execution and completion of all legal contracts is ensured prior to committing funds to the transactions. All legal documents are reviewed on a periodic basis to ensure their ongoing enforceability, and are maintained under dual custody.

Basel III

The Central Bank of Bahrain issued detailed Basel III regulations with respect to capital adequacy calculations which became effective from 1 January 2015. UGB remains fully compliant with respect to CBB capital adequacy guidelines and follows a robust Internal Capital Adequacy Assessment Process (ICAAP) at the enterprise level.

Monitoring and Reporting

The monitoring and reporting of risk is conducted on a daily basis for market and liquidity risk, on a monthly basis for credit risk, and on a quarterly basis for operational risk. The regular forums in which risk-related issues are highlighted and discussed are Management meetings, Risk and Compliance Committee meetings, and Executive Committee meetings. The Board of Directors is also regularly apprised of pertinent risk issues, including the semi-annual investment reviews and the proposed corrective action.

Internal Capital Adequacy Assessment Process

The Internal Capital Adequacy Assessment Process (ICAAP) is a requirement of Pillar II norms of Basel III, and involves appropriate identification and measurement of risks, and maintenance of an appropriate level of internal capital in alignment with the Bank's overall risk profile and business plan. The objective of the Bank's ICAAP is to ensure that adequate capital is retained at all times to support the risks that UGB undertakes in the course of its business.

The Bank recognises that its earnings are the first line of defense against losses arising from business risks, and that capital is one of the tools to address such risks. Also important, are establishing and implementing documented procedures; defining and monitoring internal limits on the Bank's activities/ exposures; strong risk management, compliance and internal control processes; as well as adequate provisions for credit, market and operational losses. However, since capital is vital to ensure continued solvency, the Bank's objective is to maintain sufficient capital such that a buffer above regulatory capital adequacy requirement is available to meet risks arising from fluctuations in asset values, revenue streams, business cycles, and expansion and future requirements. UGB's ICAAP identifies risks that are material to the Bank's business, and the capital that is required to be set aside for such risks.

- The Bank seeks to achieve the following goals by implementing an effective capital management framework:
- Meet the regulatory capital adequacy requirement and maintain a prudent buffer
- Generate sufficient capital to support the overall business strategy
- Integrate capital allocation decisions with the strategic and financial planning process
- Enhance Board and Senior Management's ability to understand how much capital flexibility exists to support the overall business strategy
- Improve the Bank's understanding on capital requirements under different economic and stress scenarios
- Build and support the link between risks and capital and tie performance to both of them

Capital Sources

UGB's capital is primarily derived from common shareholders' equity and retained earnings. Other sources of capital include the Additional Tier 1 capital.

Capital Management

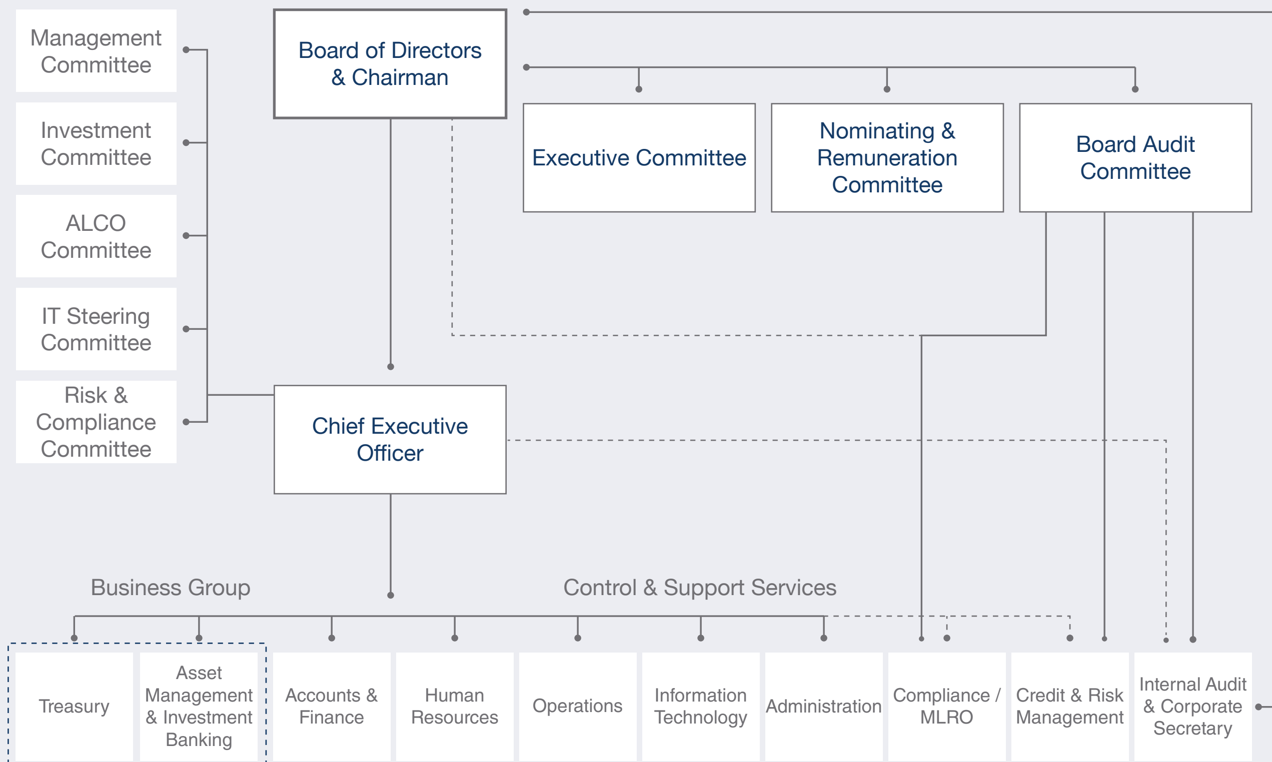
The Board of Directors of the Bank is responsible for ensuring that adequate levels of capital are maintained at all times. The Board also approves and oversees the processes adopted for capital management by the Bank.

CORPORATE GOVERNANCE REVIEW

UGB is committed to adopting the highest standards of corporate governance in line with global best practice. The Bank's Board of Directors and Management aspire to adopt a robust corporate governance framework that has integrity, accountability and transparency as its core values.

UGB is committed to adopting the highest standards of corporate governance in line with global best practice.

GOVERNANCE AND ORGANISATION STRUCTURE



Corporate Governance Framework

UGB has a well-established risk governance structure, with an active and engaged Board of Directors supported by an experienced senior management team; and a support services group that is independent of the business lines. Decision making is highly centralised through a number of Board and Management committees. The corporate governance framework of the Bank is a reflection of its culture, policies, stakeholder relationships, and commitment to corporate values. The Bank continues to review and develop this framework in light of changes in the external regulatory environment, its business requirements and best practice.

Key Developments in 2018

Throughout the year, UGB continued to take steps to ensure compliance with the Higher-Level Controls Module of the Rulebook of the Central Bank of Bahrain (CBB); regulations of the Bahrain Bourse; requirements of the Commercial Companies Law; and the Principles of the Code of Corporate Governance of the Kingdom of Bahrain (the Code). The main activities conducted in 2018 comprised:

- Completing the conversion of UGB to a closed Bahraini shareholding company.
- Managing the regulatory aspects pertaining to the transfer of certain core assets from UGB to UGH in line with the corporate restructuring plan.
- Implementing the newly developed RiskNucleus Corporate Governance system to act as a repository of all governance-related Board and Management Committee meetings. These include agendas, minutes, supporting documentation, Members' profiles and attendance records.

A detail Corporate Governance Report is available on the bank's website www.ugbbh.com

CORPORATE GOVERNANCE REVIEW

COMPLIANCE

In accordance with CBB requirements, UGB has a designated Chief Compliance Officer (CCO) with a dotted reporting line to the Board Audit Committee. The CCO acts as the central coordinator for all matters relating to regulatory reporting and other requirements. A framework of relevant policies and processes covering the areas of adherence to external regulations, code of conduct and conflicts of interest, are encapsulated in the Bank's Compliance Charter and Code of Conduct. These documents have been approved by the Board of Directors, and help define, clarify, assert and enforce the role of governance within UGB.

A Compliance Report for UGB and its main operating subsidiaries, is presented every quarter by the CCO to members of the Board Audit Committee, and the Risk and Compliance Committee. The Compliance function is also responsible for ensuring that all ad hoc requests for information from regulatory authorities are responded to immediately, and that corrective action is taken if required. The RiskNucleus Compliance system is used proactively by all departments as they receive automated e-mail alerts on forthcoming deadlines and activities.

Work carried out during the year ended 2018 included:

Conducting Annual Compliance Testing/Assessment of all requirements. The important objectives of identification, measurement and assessment of compliance risk, monitoring, testing and reporting; as well as adherence to the Compliance Programme; were confirmed as having been successfully achieved.

Developing / updating revised Compliance-related Policy & Procedures Manuals (PPMs)

UGB shares a strong rapport with its local regulators – the Central Bank of Bahrain, and the Ministry of Industry, Commerce and Tourism. There is proactive dialogue as and when warranted. In addition, the CBB conducts an annual Prudential Meeting with Senior Management of UGB in the presence of a Board Director. This forum involves the regulators receiving an overview of the Bank's performance; business model and strategic plan; market outlook; corporate governance and risk management; and capital adequacy framework. During the year, UGB provided constructive comments to a number of Consultation Papers issued by the CBB.

ANTI-MONEY LAUNDERING

UGB has a designated Money Laundering Reporting Officer (MLRO) and a Deputy MLRO (DMLRO) who are Controlled Persons approved by the CBB. The position of MLRO has been combined with that of the CCO. The Bank has implemented an anti-money laundering (AML) and counter terrorism financing (CFT) policy, which is reviewed annually and approved by the Board. UGB uses recent case studies on money laundering that are available in the public media domain, to train staff every year to raise awareness of identifying and reporting suspicious transactions. Employees receive an overview of the Bank's AML/CFT policy and procedures, and training slides; these are also available on the Intranet. UGB follows prudent practices related to Customer Due Diligence and Beneficial Ownership using the Thomson Reuters WorldCheck screening tool, and Know Your Customer (KYC) principles.

In accordance with regulatory requirements, the MLRO reviews the effectiveness of the AML/CFT procedures, systems and controls at least once a year. The Bank's anti-money laundering measures are audited annually by the independent external auditors for UGB and its main subsidiaries. Their separate assurance report is submitted to the Compliance Directorate of the CBB.

During 2018, the MLRO adopted the new in-house developed Customer Database to act as a repository of all customer data, with a special emphasis on capturing beneficial ownership of entities (including Treasury counterparties). The new system facilitates provision of timely information and reporting.

CODE OF CONDUCT

As required by the CBB, the Board of Directors has established corporate standards for all Directors and employees. These are enshrined in the Bank's Code of Conduct which reiterates the need to uphold sensitive and confidential information; avoiding and disclosing (wherever applicable) conflicts of interest; personal accountability; honesty; harmonious relationships with clients, subsidiaries, affiliates and regulators; non-solicitation of gifts; transparent and accurate external communications; expected standards of professionalism, fairness, behaviour and language; and accurate accounting, auditing and bookkeeping.

The Board and Senior Management view the Code of Conduct as an integral part of the way they exercise their responsibilities; and how they conduct themselves with clients, shareholders, staff, and the wider community. refresher sessions on the requirements of the Code of Conduct are conducted internally on annual basis. Board members and staff submit a written affirmation that they will abide by the tenets of the Code, and disclose any personal conflicts of interest. Any incidents of non-compliance with the Code, or lack of affirmation by any member of UGB, is escalated to the Board Audit Committee and the Board of Directors. The Code of Conduct is available on the Bank's website: www.ugbbh.com.

As part of its communications strategy, UGB's website (www.ugbbh.com) is the repository of financial information together with financial statements, relevant information on the Group/ Bank, key products and services, and press releases that are issued periodically to the media. As mandated by the CBB, the detailed risk management and capital adequacy calculations that relate to Basel III Pillar 3 have also been uploaded under 'Investor Relations / Public Disclosures'.

CORPORATE GOVERNANCE REVIEW

TRANSPARENCY AND DISCLOSURE

UGB is transparent and open with its regulators, shareholders, lenders and other stakeholders. The Board of Directors has approved a Disclosure and Transparency Policy which lays down the set of disclosure standards for the Bank. The objective of this policy is to facilitate understanding and compliance with the disclosure and transparency requirements for all material and non-material information with regard to the affairs of UGB. Adequate consideration is given to regulatory requirements to which the Bank is subject. The policy was also introduced to monitor the transparency adopted, and to enhance the Bank's image through accurate and timely disclosure of information.

As part of its communications strategy, UGB's website (www.ugbbh.com) is the repository of financial information together with financial statements, relevant information on the Group/ Bank, key products and services, and press releases that are issued periodically to the media. As mandated by the CBB, the detailed risk management and capital adequacy calculations that relate to Basel III have also been uploaded under 'Investor Relations'. The Bank's Corporate Governance Report, as well as incorporation documents, are also available on UGB's website.

PENALTIES

During the year ended 31 December 2018, a penalty of BD 2,000 was imposed and paid by the Bank for delays in submission of three monthly reports to the CBB, as information was not obtained from the Bank's subsidiaries and associates in time.

Other than the matter above, we confirm to the best of our knowledge and belief, that no violation of the Bahrain Commercial Companies Law, Central Bank of Bahrain and Financial Institutions Law and the Central Bank of Bahrain directives and the Memorandum and Articles of Association of the Bank has occurred during the year ended 31 December 2018. Accordingly, the Bank has complied with all the terms of its banking license.

INTERNAL AUDIT & QUALITY ASSURANCE

The independent Internal Audit department of UGB reports directly to the Board Audit Committee, and administratively to the Chief Executive Officer. Staffed by experienced and qualified professionals, the department is governed by a detailed Board-approved Audit Charter. Details of its responsibilities are documented in a Board-approved Policies & Procedures Manual in line with internal audit international best practice. Internal Audit has a close and direct working relationship with UGB's Executive Management and Committees; in addition to having unrestricted access to information, records, systems and personnel within the Bank.

Internal Audit carries out its responsibilities in line with a risk-based three-year strategic Audit Plan. This is designed to implement a systematic, disciplined audit review approach by utilising the available audit resources in the most efficient and effective manner. It examines the adequacy and effectiveness of processes, systems and procedures within the internal controls framework – comprising Compliance, Corporate Governance, Risk Management, IT Security, Financial Control and AML among others – and provides recommendations in order to enhance and strengthen their reliability. On a periodic basis, the department performs follow-ups on internal control recommendations and corrective actions that have been raised, and reports their updated status to the Board Audit Committee. The department also oversees the implementation of sound governance and internal control principles and practices at the level of UGB's subsidiaries and associate companies; and provides regular support to their respective Board Audit Committees and Internal Audit functions.

The Quality Assurance function adopts a consultative role in working with head office departments, and subsidiaries and associate companies, to facilitate continuous process improvements and review new initiatives. These include regular reviews of updates to the Bank's policies and procedures, organisation chart and job descriptions; and assessing the impact of new regulations. In addition, Quality Assurance conducts ad hoc special assignments at the request of the Board and Management to ensure continuous improvement.

CORPORATE SOCIAL RESPONSIBILITY REVIEW

The Bank has long been active in a wide range of socially-responsible activities including corporate philanthropy, employee involvement, and long-term strategic programmes in education. This is in line with its commitment to promote thought leadership within the industry, empower students through education and training, and contribute to the social well-being and economic prosperity of the Kingdom of Bahrain.

During 2018, UGB continued to implement its Corporate Social Responsibility (CSR) programme with a special emphasis on education and career development for young Bahrainis; development of the regional banking sector; and charitable and community-based activities. The Bank's CSR Policy is currently under review to assess conformance with new requirements of the Central Bank of Bahrain.

EDUCATION AND CAREER DEVELOPMENT FOR YOUNG BAHRAINIS

UGB supports the philosophy that education is the best source of empowerment. The Bank provides education and career development opportunities for young Bahraini students through the following activities:

- **University of Bahrain Student Internships**

  UGB is a founding member of this programme, which provides selected students with summer work experience and the opportunity of placement.

- **TradeQuest – The Trading Challenge**

  TradeQuest is a business-education partnership that was established 21 years ago. Conducted under the aegis of the Bahrain Bourse, it provides school students with an opportunity to participate in a simulated interschool trading competition by investing in shares listed on the New York Stock Exchange, NASDAQ and the Bahrain Bourse. UGB, who has supported this competition for the past 17 years by sponsoring one of the participating schools, became a Gold Sponsor in 2017. The UGB-supported school team won second place in the 2017-2018 competition.

- **UGB Mashare' Al Khair Scholarship Programme**

  This programme assists qualified UGB employees' dependants to study at accredited colleges, universities or other recognised academic institutions. The Bank also extends financial support to its staff to constantly enhance their academic and professional qualifications and fulfil their continuous professional development (CPD) commitments.

UGB has an enduring responsibility to support the well-being of communities in which it operates.

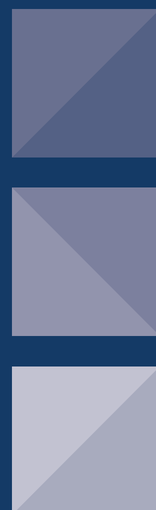
DEVELOPMENT OF THE REGIONAL BANKING SECTOR

UGB contributes to the growth and development of the regional banking and financial services sector in a number of different ways:

- The Bank supports a wide range of banking-related organisations including the Bahrain Association of Banks, Union of Arab Banks, Bahrain Institute of Banking and Finance (BIBF), and International Islamic Financial Market of Bahrain.
- UGB management and staff are members of professional institutions and associations.
- The Bank supports the CFA Society Bahrain in promoting and maintaining the highest standards of professional excellence and integrity in the financial and investment community.
- UGB management and staff are invited to speak at industry seminars, think tanks and conferences.

CHARITABLE AND COMMUNITY-BASED ACTIVITIES

Over the years, UGB has provided financial assistance for numerous charitable, cultural, social, medical, educational and child welfare organisations that work with orphans, needy families, and the underprivileged sections of society. In 2018, contributions were also made to entities that are committed to protecting the environment and raising awareness about women's cancer.



FINANCIAL REVIEW 2018

REPORT OF THE BOARD OF DIRECTORS

The Board of Directors is pleased to submit its report and the audited consolidated financial statements of United Gulf Bank B.S.C. (c) ("the Bank" or "UGB") for the year ended 31 December 2018.

Principal activities and review of business developments

The principal activities of the Bank and its subsidiaries (together the "Group") comprise of investment and commercial banking. Investment banking include asset portfolio management, corporate finance, advisory, investment in quoted and private equity / funds, real estate, capital markets, international banking and treasury functions. Commercial banking includes extending loans and other credit facilities, accepting deposits and current accounts from corporate and institutional customers.

Acquisition of Global Investment House

During September 2018, the Group (through its subsidiary KAMCO) acquired 71.18% effective equity interest of Global Investment House K.S.C. (Closed) ("GIH"), a Kuwaiti Shareholding Company, regulated by CMA as an investment company and CBK for financing activities. GIH is principally engaged in provision of asset management, investment banking and brokerage activities. The Group was able to control the investee and therefore, the entity became a subsidiary of the Group. Accordingly, GIH has been consolidated from 1 September 2018 being the date of exercise of control.

The Group carried out a Purchase Price Allocation exercise which resulted in a gain from business combination of US$ 23.9 million, since the fair value of the assets acquired and liabilities assumed exceeded the purchase consideration paid and related transaction expenses.

Results for the year

For the year ended 31 December 2018, the Bank earned a net profit of US$ 10.1 million (2017: net profit before reclassification adjustments of US$ 8.4 million) and total operating income of US$ 78.9 million (2017: US$ 50.3 million). Reclassification adjustments for the year ended 31 December 2017 included foreign currency losses of US$ 27.9 million and fair value losses of US$ 59.8 million that were reclassified to the consolidated statement of income as part of the Group's restructuring.

As of 31 December 2018, total assets of the Group were US$ 873.5 million (2017: US$ 680.1 million) with total equity of shareholders at US$ 187.0 million (2017: US$ 203.0 million).

Appropriations for the year

The Board of Directors' recommendation on the allocation of the net profit for the year is as follows:

- Transfer of US$ 1,009 thousand equivalent to 10% of the Company's net profit for the period to the Company's Statutory Reserves;
- Transfer of US$ 1,009 thousand equivalent to 10% of the Company's net profit for the period to the Company's General Reserves; and
- Retaining the remaining balance of net profit for the period as Retained Earnings for next year.

Auditors

Ernst & Young have expressed their willingness to continue in office and a resolution for their appointment as auditors of the Bank for the year ending 31 December 2019 has been put for approval by the Shareholders.

Signed on behalf of the Board of Directors

Masaud Hayat
Chairman

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF UNITED GULF BANK B.S.C. (c)

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

Opinion

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

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

Basis for opinion

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

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 auditors' report, we obtained the Report of the Board of Directors which forms 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 ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF UNITED GULF BANK B.S.C. (c) (CONTINUED)

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

- 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. 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 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.

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, 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.

Partner's registration no. 115
27 February 2019
Manama, Kingdom of Bahrain

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2018

	Note	2018 US$ 000	2017 US$ 000
ASSETS			
Demand and call deposits with banks		143,510	97,993
Placements with banks		108,529	68,577
Investments carried at fair value through statement of income	7	81,852	19,268
Non-trading investments	8	167,647	221,566
Held-to-maturity investments		494	-
Loans and receivables	9	25,191	4,216
Other assets	10	61,097	31,820
Investments in associates	11	71,513	77,512
Investment properties	12	107,629	105,093
Property and equipment	13	39,394	1,679
Goodwill and other intangible assets	14	66,634	52,390
TOTAL ASSETS		873,490	680,114
LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks and other financial institutions		220,879	250,211
Deposits from customers		32,608	31,018
Loans payable	16	67,033	98,658
Long term bonds	17	131,739	-
Other liabilities	18	106,375	37,358
TOTAL LIABILITIES		558,634	417,245
EQUITY			
Share capital	19	101,132	101,132
Share premium	19	5,687	5,687
Statutory reserve	19	50,890	49,881
General reserve	19	30,621	29,612
Fair value reserve	20	(10,121)	12,867
Foreign currency translation reserve	19	(4,534)	(3,871)
Retained earnings		13,318	7,659
CAPITAL AND RESERVES ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		186,993	202,967
Perpetual Tier 1 capital	21	33,000	33,000
Non-controlling interests in equity		94,863	26,902
TOTAL EQUITY		314,856	262,869
TOTAL LIABILITIES AND EQUITY		873,490	680,114

MASAUD HAYAT
Chairman

FAISAL AL AYYAR
Vice Chairman

HUSSAIN LALANI
Acting Chief Executive Officer

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2018

	Note	2018 US$ 000	2017 US$ 000
Continuing operations			
Interest income	22	6,363	4,431
Investment income - net	23	4,812	23,810
Gain on bargain purchase of a subsidiary	5	23,928	-
		35,103	28,241
Fees and commissions - net	24	42,965	25,391
Foreign currency gains (losses) - net		1,621	(409)
Share of results of associates - net	11,25	(764)	(2,922)
Total income		78,925	50,301
Interest expense	26	(14,732)	(15,232)
Operating income before expenses and provisions		64,193	35,069
Salaries and benefits		(30,310)	(15,862)
General and administrative expenses		(20,277)	(9,730)
Operating income before provisions and tax		13,606	9,477
Impairment loss on investments		-	(462)
Provision for losses against unfunded participation		(805)	-
Expected credit losses / provision	4	(2,306)	(2,895)
Taxation - net	15	95	(1,018)
Net profit for the year from continuing operations		10,590	5,102
Net profit from discontinued operations		524	3,268
Net profit before reclassification adjustments		11,114	8,370
Reclassification adjustments	19 (g)	-	(87,765)
Profit (loss) for the year		11,114	(79,395)
Net profit attributable to non-controlling interests		1,021	455
NET PROFIT (LOSS) ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT		10,093	(79,850)

MASAUD HAYAT
Chairman

FAISAL AL AYYAR
Vice Chairman

HUSSAIN LALANI
Acting Chief Executive Officer

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2018

	Note	2018 US$ 000	2017 US$ 000
Profit (loss) for the year		11,114	(79,395)
Other comprehensive income:			
Reclassification adjustments		-	87,765
		11,114	8,370
Other comprehensive (loss) income that may be reclassified to profit or loss in subsequent period			
Fair value reserve		(13,283)	4,950
Foreign currency translation reserve		(1,093)	6,029
Transfer to consolidated statement of income upon disposal		-	(1,880)
Cash flow hedges		180	256
		(14,196)	9,355
Other comprehensive loss that will not be reclassified to profit or loss in subsequent period			
Fair value reserve		(10,753)	-
Other comprehensive (loss) income for the year		(24,949)	97,120
TOTAL COMPREHENSIVE (LOSS) INCOME		(13,835)	17,725
Total comprehensive (loss) income attributable to:			
- shareholders of the parent		(11,405)	16,588
- non-controlling interests		(2,430)	1,137
		(13,835)	17,725

MASAUD HAYAT
Chairman

FAISAL AL AYYAR
Vice Chairman

HUSSAIN LALANI
Acting Chief Executive Officer

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2018

	Note	2018 US$ 000	2017 US$ 000
OPERATING ACTIVITIES			
Net profit (loss) for the year		11,114	(79,395)
Reclassification adjustments	19 (g)	-	87,765
Net profit from discontinued operations		(524)	(3,268)
Net profit for the year from continuing operations		10,590	5,102
Adjustments for non-cash items:			
Depreciation and amortisation		2,105	797
Share of results of associates - net	25	764	2,922
Expected credit losses / provision	9	2,306	2,895
Provision for losses against unfunded participation		805	-
Impairment loss on investments	8,11	-	462
(Gain) loss on investments carried at fair value through statement of income	23	852	(3,902)
Gain on fair valuation of investment properties	23	(124)	(2,732)
Gain on sale of an associate	23	523	(2,668)
Gain on sale of non-trading investments	23	-	(4,369)
Gain due to reclassification of investment	23	(31)	(2,971)
Gain on bargain purchase of a subsidiary	23	(23,928)	-
Interest income	22	(6,363)	(23,810)
Interest expense	26	14,732	15,232
Dividend income	23	(1,669)	(1,907)
Other non-cash items	14	298	(719)
Taxation		(95)	1,018
Operating profit (loss) before changes in operating assets and liabilities		765	(14,650)
Changes in operating assets and liabilities:			
Placements with banks with original maturities of more than ninety days		-	6,845
Investments carried at fair value through statement of income		142	29,812
Non-trading investments		51,804	187,165
Loans and receivables		(3,472)	1,178,460
Other assets		7,281	74,289
Due to banks and other financial institutions		(29,332)	(476,011)
Deposits from customers		1,590	(954,192)
Other liabilities		(4,642)	(13,924)
Net assets of disposal group classified as held for sale		524	3,268
Interest received		6,415	28,687
Interest paid		(14,010)	(26,279)
Dividends received	23	1,669	1,907
Donations		(200)	(200)
Directors' remuneration		-	(195)
Net cash from operating activities		18,534	24,982
INVESTING ACTIVITIES			
Investment in subsidiaries - net of cash acquired	5	(23,568)	-
Investments in associates - net		5,137	681,837
Investment properties - net		(241)	(1,035)
Property and equipment - net		(1,793)	29,641
Net cash (used in) from investing activities		(20,465)	710,443
FINANCING ACTIVITIES			
Share capital issued (Restructuring)		-	(277,775)
Repayment of loans		(31,625)	(553,467)
Interest payment on Tier 1 capital securities		(3,513)	(3,513)
Long term bonds		131,739	(50,000)
Net cash from (used in) financing activities		96,601	(884,755)
Foreign currency translation adjustments		663	33,605
Movement in non-controlling interests		(8,631)	(75,090)
NET CHANGE IN CASH AND CASH EQUIVALENTS		86,702	(190,815)
Cash and cash equivalents at 1 January		166,252	357,067
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	27	252,954	166,252

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2018

	Attributable to shareholders of the parent												
	Share capital US$ 000	Treasury shares US$ 000	Share premium US$ 000	Statutory reserve US$ 000	General reserve US$ 000	Treasury share reserve US$ 000	Fair value reserve US$ 000	Foreign currency translation reserve US$ 000	Retained earnings US$ 000	Total before non-controlling interests US$ 000	Perpetual Tier 1 capital US$ 000	Non-controlling interests US$ 000	Total equity US$ 000
Balance at 1 January 2018	101,132	-	5,687	49,881	29,612	-	12,867	(3,871)	7,659	202,967	33,000	26,902	262,869
Transition adjustment on adoption of IFRS 9 at 1 January 2018 (note 4)	-	-	-	-	-	-	3,037	-	(4,093)	(1,056)	-	465	(591)
	101,132	-	5,687	49,881	29,612	-	15,904	(3,871)	3,566	201,911	33,000	27,367	262,278
Profit for the year	-	-	-	-	-	-	-	-	10,093	10,093	-	1,021	11,114
Other comprehensive loss	-	-	-	-	-	-	(20,835)	(663)	-	(21,498)	-	(3,451)	(24,949)
Total comprehensive (loss) income for the year	-	-	-	-	-	-	(20,835)	(663)	10,093	(11,405)	-	(2,430)	(13,835)
Transfer upon disposal of non-trading investments	-	-	-	-	-	-	(5,190)	-	5,190	-	-	-	-
Interest payment on Tier 1 capital	-	-	-	-	-	-	-	-	(3,513)	(3,513)	-	-	(3,513)
Transfers during the year	-	-	-	1,009	1,009	-	-	-	(2,018)	-	-	-	-
Acquisition of a subsidiary (note 5)	-	-	-	-	-	-	-	-	-	-	-	78,557	78,557
Other movements in non-controlling interests	-	-	-	-	-	-	-	-	-	-	-	(8,631)	(8,631)
Balance at 31 December 2018	101,132	-	5,687	50,890	30,621	-	(10,121)	(4,534)	13,318	186,993	33,000	94,863	314,856
Balance at 1 January 2017	208,651	(18,131)	11,459	100,514	80,999	14,248	(49,966)	(37,476)	83,711	394,009	33,000	102,447	529,456
Net profit before reclassification adjustments	-	-	-	-	-	-	-	-	7,915	7,915	-	455	8,370
Reclassification adjustments (note 19 (g))	-	-	-	-	-	-	59,826	27,939	(87,765)	-	-	-	-
Other comprehensive income	-	-	-	-	-	-	3,007	5,666	-	8,673	-	682	9,355
Total comprehensive income (loss) for the year	-	-	-	-	-	-	62,833	33,605	(79,850)	16,588	-	1,137	17,725
Capital reduction	(107,519)	18,131	(5,772)	(50,633)	(36,387)	(14,248)	-	-	(7,689)	(204,117)	-	-	(204,117)
Transfers during the year	-	-	-	-	(15,000)	-	-	-	15,000	-	-	-	-
Interest payment on Tier 1 capital	-	-	-	-	-	-	-	-	(3,513)	(3,513)	-	-	(3,513)
Other movements in non-controlling interests	-	-	-	-	-	-	-	-	-	-	-	(76,682)	(76,682)
Balance at 31 December 2017	101,132	-	5,687	49,881	29,612	-	12,867	(3,871)	7,659	202,967	33,000	26,902	262,869

The attached explanatory notes 1 to 33 form part of these consolidated financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

1 INCORPORATION AND PRINCIPAL ACTIVITIES

Incorporation

United Gulf Bank B.S.C. (c) ("UGB" or "the Bank") is a closed joint stock company incorporated in the Kingdom of Bahrain in 1980, under Commercial Registration number 10550. The address of the Bank's registered office is UGB Tower, Diplomatic Area, P.O. Box 5964, Manama, Kingdom of Bahrain.

The Bank operates in the Kingdom of Bahrain under a Wholesale Banking License issued by the Central Bank of Bahrain ("the CBB").

Activities

The principal activities of the Bank and its subsidiaries (together the "Group") comprise of investment and commercial banking. Investment banking include asset portfolio management, corporate finance, advisory, investment in quoted and private equity / funds, real estate, capital markets, international banking and treasury functions. Commercial banking includes extending loans and other credit facilities, accepting deposits and current accounts from corporate and institutional customers.

The Bank's parent company is United Gulf Holding Company B.S.C. ("UGH") which owns 100% shares of the Bank and ultimate holding company is Kuwait Projects Company (Holding) K.S.C. ("KIPCO"). UGH is incorporated in the Kingdom of Bahrain as a joint stock company and is listed on the Bahrain Bourse. KIPCO is incorporated in the State of Kuwait and is listed on the Kuwait Stock Exchange (Boursa Kuwait).

These consolidated financial statements were authorised for issue by the Board of Directors on 27 February 2019.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and the relevant provisions of the Central Bank of Bahrain and Financial Institutions Law and the Bahrain Commercial Companies Law, and the CBB Rulebook (Volume 1 and applicable provisions of Volume 6) and CBB directives.

Basis of preparation

The consolidated financial statements have been prepared under the historical cost convention as modified by the remeasurement at fair value of investments carried at fair value through statement of income, non-trading investments, investment properties and derivative financial instruments.

Certain of the prior year figures have been reclassified to conform to the presentation adopted in the current year. Such reclassification did not affect the previously reported net loss or the total equity of the Group.

Presentation and functional currency

The consolidated financial statements have been presented in United States Dollar (US$) which is also the functional currency of the Group and are rounded to the nearest US$ thousands except when otherwise indicated.

New and amended standards and interpretations

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 9 Financial Instruments (IFRS 9)

IFRS 9 replaces IAS 39 Financial instruments: recognition and measurement (IAS 39) for annual periods on or after 1 January 2018 bringing together all three aspects of the accounting for financial instruments: classification and measurement; impairment; and hedge accounting.

The Group applied IFRS 9 prospectively, with an initial application date of 1 January 2018. The Group has not restated the comparative information, which continues to be reported under IAS 39. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings and other components of equity. The effect of adopting IFRS 9 as at 1 January 2018 is disclosed in note 4.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New and amended standards and interpretations (continued)

IFRS 9 Financial Instruments (IFRS 9) (continued)

Classification and measurement of financial assets

The nature of these adjustments are described below:

Under IFRS 9, the classification and measurement category of all financial assets, except equity instruments and derivatives, is assessed based on a combination of the entity's business model for managing the financial assets and its contractual cash flow characteristics.

The IAS 39 measurement categories of financial assets (fair value through profit or loss (FVTPL), available for sale (AFS), held-to-maturity (HTM) and amortised cost) have been replaced by:

- Debt instruments at amortised cost;
- Debt instruments at fair value through other comprehensive income (FVOCI), with gains or losses recycled to profit or loss on derecognition;
- Equity instruments at FVOCI, with no recycling of gains or losses to profit or loss on derecognition; and
- Financial assets at fair value through profit or loss (FVTPL).

The above designation of equity investments at FVOCI (i.e. election to present subsequent changes in fair value of an equity investment that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies in other comprehensive income) and debt investment that meets the amortised cost or FVOCI criteria as FVTPL (only if doing so eliminates or significantly reduces an accounting mismatch), through an irrevocable election / designation at initial recognition of a financial asset.

The Group's classification of its financial assets is explained in detail in note 6. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in note 4.

Classification and measurement of financial liabilities

Classification of financial liabilities remained largely unchanged for the Group. Financial liabilities continue to be measured at amortised cost.

Impairment of financial assets

IFRS 9 impairment requirements are based on expected credit loss (ECL) model as compared to the incurred loss model approach under IAS 39. Key changes to the Group's accounting policy for impairment of financial assets are listed below:

Under IFRS 9, the Group applies a three-stage approach to measuring ECL on all loans and debt type financial assets (including loan commitments and financial guarantee contracts) accounted for at amortised cost and FVOCI. Assets migrate through the following three stages based on the change in the credit quality since initial recognition:

i) Stage 1: 12 months ECL

   For exposures where there has not been a significant increase in credit risk (SICR) since initial recognition and that are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.

ii) Stage 2: Lifetime ECL - not credit impaired

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

iii) Stage 3: Lifetime ECL - credit impaired

   Financial assets are assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred. As this uses the same criteria as under IAS 39, the Group's methodology for specific provisions remains unchanged. For financial assets that have become credit impaired, a lifetime ECL is recognised and interest income is suspended and recognised on cash receipt basis.

For more details on the accounting policies, refer section summary of changes in significant accounting policies. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in note 4.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New and amended standards and interpretations (continued)

IFRS 7(revised) Financial instruments: Disclosures (IFRS 7R)

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial instruments: Disclosures was updated and the Group has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in note 4.

Reconciliations from opening to closing ECL allowances are presented in note 4.

IFRS 7R also requires additional and more detailed disclosures for hedge accounting. However, the adoption of IFRS 9 for hedge accounting did not have a material impact on the hedging activities / accounting of the Group.

IFRS 15 Revenue from contracts with customers (IFRS 15)

The Group adopted IFRS 15 Revenue from contracts with customers (IFRS 15) resulting in a change in the revenue recognition policy of the Group in relation to its contracts with customers.

IFRS 15 was issued in May 2014 and is effective for annual periods commencing on or after 1 January 2018. IFRS 15 outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue guidance, which is found currently across several standards and interpretations within IFRS. It established a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The adoption of this standard will result into change in accounting policies as discussed below:

The Group has opted for the modified retrospective application permitted by IFRS 15 upon adoption of the new standard. Modified retrospective application also requires the recognition of the cumulative impact of adoption of IFRS 15 on all contracts as at 1 January 2018 in equity. There were no adjustments to opening retained earnings and other account balances on the adoption of IFRS 15.

Several other amendments to standards and interpretations applied for the first time in 2018, however, they did not impact the consolidated financial statements of the Group.

Principles of consolidation

The consolidated financial statements include the financial statements of the Bank and its subsidiaries as at 31 December 2018. The reporting dates of the subsidiaries and the Bank are identical and the subsidiaries' accounting policies conform to those used by the Bank for like transactions and events in similar circumstances.

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. 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. Specifically, the Group controls an investee if and only if the Group has:

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

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Principles of consolidation (continued)

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

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

a) Derecognises the assets (including goodwill) and liabilities of the subsidiary;

b) Derecognises the carrying amount of any non-controlling interest;

c) Derecognises the cumulative transaction differences, recorded in equity;

d) Recognises the fair value of consideration received;

e) Recognises the fair value of any investment retained;

f) Recognises any surplus or deficit in the consolidated statement of income; and

g) Reclassifies the parent's share of a component previously recognised in OCI to consolidated statement of income or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities.

The principal subsidiaries of the Bank are as follows:

		Ownership at 31 December		
Name of the subsidiary	Country of incorporation	2018	2017	Year of incorporation
Held directly				
KAMCO Investment Company K.S.C.P. [KAMCO]	Kuwait	86%	86%	1998
United Gulf Financial Services Company-North Africa	Tunisia	83%	83%	2008
United Gulf Realty International, Ltd [UGRIL]	British Virgin Islands	100%	100%	2012
United Gulf Asset Company S.P.C.	Bahrain	100%	100%	2017

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Principles of consolidation (continued)

Name of the subsidiary	Country of incorporation	Ownership at 31 December 2018	2017	Year of incorporation
Held through KAMCO				
Al Dhiyafa United Real Estate Company W.L.L.	Kuwait	100%	100%	2007
Al Jazi Money Market Fund	Kuwait	51%	51%	2007
Al Tadamon United Holding Co	Kuwait	96%	96%	2017
Al Zad Real Estate W.L.L.	Kuwait	99%	99%	2007
Bukeye Power Project Advisory Co	U.S.A.	50%	50%	2017
Bukeye Power Project Manager Ltd	Jersey	100%	100%	2017
Carnation Advisory Company LLC	U.S.A.	75%	0%	2018
Carnation Manager limited	U.K.	100%	0%	2018
Flint Advisor Company Llc	Jersey	46%	46%	2017
Flint Manager Ltd	U.S.A.	100%	100%	2017
Global Investment House	Kuwait	71%	0%	1998
Kamco GCC Opportunistic Fund	Kuwait	100%	100%	2013
KAMCO Investment Company (DIFC) Limited	U.A.E.	100%	100%	2016
KAMCO Mena Plus Fixed Income Fund	Kuwait	38%	71%	2016
Kuwait Private Equity Opportunity Fund	Kuwait	73%	73%	2004
Nawasi United Holding Co	Kuwait	96%	96%	2017
North Africa Real Estate Co.	Kuwait	100%	100%	2014
S17POV Holding Ltd	UAE	100%	0%	2018

Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through the consolidated statement of income. It is then considered in the determination of goodwill.

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39 Financial Instruments: Recognition and Measurement, is measured at fair value with the changes in fair value recognised in the consolidated statement of income.

Goodwill and other Intangible assets

Goodwill

Goodwill represents the excess of the cost of acquisition over the Group's share of the fair value of the net identifiable assets of the acquired subsidiary or associate at the date of the acquisition. Goodwill arising on the acquisition of an associate is included in the carrying amount of the respective associate and, therefore, is not separately tested for impairment. Goodwill arising on the acquisition of a subsidiary is recognised as a separate asset in the consolidated statement of financial position.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Goodwill and other Intangible assets (continued)

Goodwill (continued)

Goodwill acquired in a business combination is initially measured at cost, being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interests, and any previous interest held, over the Bank's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired.

If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the re-assessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognised in the consolidated statement of income.

After initial recognition, goodwill is stated at cost less any accumulated impairment losses. Goodwill of subsidiaries is allocated to cash-generating units and is tested annually for impairment. If the recoverable amount of the cash generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's fair value less costs to sell, and its value in use. Any impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a part of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Other Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses.

The useful lives of intangible assets are assessed as either finite or infinite.

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the consolidated statement of income in the expense category that is consistent with the function of the intangible assets.

An intangible asset is derecognised upon disposal (i.e., at the date the recipient obtains control) or when no future economic benefits are expected from its use or disposal. Any gain or loss arising upon derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of income.

As at 31 December 2018, the Group did not have any intangible assets which had an infinite useful life.

Investments in associates

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

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

The Group's investments in its associates are accounted for using the equity method.

Under the equity method, the investment in an associate 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 since the acquisition date. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments in associates (continued)

The financial statements of associates are prepared for the same reporting period as that of 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 investments in its associates. At each reporting date, the Group determines whether there is objective evidence that an investment in an associate is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value, then recognises the loss as 'Share of results of associates' in the consolidated statement of income.

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

Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Date of recognition

Financial assets and liabilities, with the exception of loans and receivables, due to banks and other financial institutions and deposits from customers, are initially recognised on the trade date, i.e., the date that the Group becomes a party to the contractual provisions of the instrument. This includes regular way trades: 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. Loans and receivables are recognised when funds are transferred to the customers' accounts. The Group recognises due to banks and other financial institutions and deposits from customers when funds are transferred to the Group.

Initial measurement

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. At initial recognition, the Group measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at FVTPL, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees and commissions. Transaction costs of financial assets and financial liabilities carried at FVTPL are expensed in consolidated income. Immediately after initial recognition, an ECL is recognised for financial assets measured at amortised cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognised in the consolidated statement of income when an asset is newly originated.

When the fair value of financial assets and liabilities at initial recognition differs from the transaction price, the Group accounts for the Day 1 profit or loss as follows:

(a) When the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e. a Level 1 input) or based on a valuation technique that uses data only from observable markets, the difference is recognised as a day 1 gain or loss.

(b) In all other cases, the difference is deferred and the timing of recognition of deferred day 1 profit or loss is determined individually. It is either amortised over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or when the instrument is derecognised.

Measurement categories of financial assets and liabilities

From 1 January 2018, the Group classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost.
- Fair value through other comprehensive income (FVOCI); or
- Fair value through profit or loss (FVTPL);

The Group classifies and measures its derivative and trading portfolio at FVTPL. The Group may designate financial instruments at FVTPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial instruments (continued)

Measurement categories of financial assets and liabilities (continued)

Before 1 January 2018, the Group classified its financial assets as loans and receivables (amortised cost), FVTPL, available-for-sale or held-to-maturity (amortised cost), as explained in the annual consolidated financial statements for the year ended 31 December 2017.

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVTPL when they are derivative instruments.

Financial assets

Classification and subsequent measurement

The classification requirements for financial assets is as below:

Debt type Instrument: Classification and Subsequent measurement:

Classification and subsequent measurement of debt instruments depend on:

(i) the Group's business model for managing the asset; and

(ii) the cash flow characteristics of the asset i.e. solely payments of principal and interest (SPPI) test.

Based on these factors, the Group classifies its debt instruments into one of the following three measurement categories:

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent SPPI, and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any ECL allowance recognised and measured as described in note 4. Interest income from these financial assets is included in 'Interest income' using the EIR method.

- FVOCI: Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent SPPI, and that are not designated at FVTPL, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in consolidated statement of income. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to consolidated income and recognised in 'Investment income - net' as 'Gain on disposal of non-trading securities'. Interest income from these financial assets is included in 'Interest income' using the EIR method.

- FVTPL: Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at FVTPL and is not part of a hedging relationship is recognised in consolidated profit or loss and presented in the consolidated statement of income within 'Investment income - net' as 'Gain on trading securities' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Investment income - net' as 'Gain on disposal of non-trading securities'. Interest income from these financial assets is included in 'Interest income' using the EIR method.

Business model

The Group determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective. The business model reflects how the Group manages the assets in order to generate cash flows. That is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'held for trading' business model and measured at FVTPL. The business model assessment is not carried out on an instrument-by-instrument basis but at the aggregate portfolio level and is based on observable factors such as:

- 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, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of the assets;

- How the asset's and business model performance is evaluated and reported to key management personnel and Asset and Liability Committee (ALCO);

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial assets (continued)

- How risks are assessed and 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.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Group's original expectations, the Group does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

Financial assets that are held for trading 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.

SPPI test

As a second step of its classification process the Group assesses the contractual terms of financial assets to identify whether they meet the SPPI test.

Principal for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

Interest is the consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement.

In assessing whether the contractual cash flows are SPPI, 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:

- the currency in which the financial asset is denominated, and the period for which the interest rate is set;
- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms; and
- terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse asset arrangements).

Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at FVTPL.

The Group reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent.

Equity type instruments: classification and subsequent measurement

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets. Examples of equity instruments include basic ordinary shares.

Equity instruments at FVOCI

Upon initial recognition, the Group may elect to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of Equity under IAS 32 Financial Instruments: Presentation and are not held for trading. Such classification is determined on an instrument-by-instrument basis. Fair value gains and losses are recognised in other comprehensive income and are not subsequently reclassified to consolidated income, including on disposal. Equity investments at FVOCI are not subject to impairment assessment. Equity investments at FVOCI are included in non-trading investments in the statement of financial position. All other equity investments which the Group has not irrevocably elected at initial recognition or transition, to classify at FVOCI, are recognised at FVTPL.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial assets (continued)

Financial asset at FVTPL

The Group classifies financial assets at fair value through profit and loss when they have been purchased or issued primarily for short-term profit making through trading activities or form part of a portfolio of financial instruments that are managed together, for which there is evidence of a recent pattern of short-term profit taking. Held-for-trading assets are recorded and measured in the statement of financial position at fair value. 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. Changes in fair values gain and losses, financing income and dividends are recorded in consolidated statement of income according to the terms of the contract, or when the right to payment has been established.

Dividends are recognised in the consolidated statement of income as 'Investment income - net' when the Group's right to receive payments is established.

Impairment

The Group assesses on a forward-looking, basis the ECL associated with its debt instrument assets carried at amortised cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Group recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

To calculate ECL, the Group estimates the risk of a default occurring on the financial instrument during its expected life. ECLs are estimated based on the present value of all cash shortfalls over the remaining expected life of the financial asset, i.e., the difference between: the contractual cash flows that are due to the Group under the contract, and the cash flows that the Group expects to receive, discounted at the effective interest rate of the loan or an approximation thereof.

Measurement of ECL

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

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Group expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- undrawn loan commitments: estimates the expected portion of the loan commitment that are drawn down over the expected life of the loan commitment; and calculates the present value of cash shortfalls between the contractual cash flows that are due to the entity if the holder of the loan commitment draws down that expected portion of the loan and the cash flows that the entity expects to receive if that expected portion of the loan is drawn down; and
- financial guarantee contracts: estimates the ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the guarantor expects to receive from the holder, the debtor or any other party. If a loan is fully guaranteed, the ECL estimate for the financial guarantee contract would be the same as the estimated cash shortfall estimate for the loan subject to the guarantee.

For the purposes of calculation of ECL, the Group categorises its FVOCI debt securities, loans and receivable and loan commitments and financial guarantee contracts into Stage 1, Stage 2 and Stage 3, based on the applied impairment methodology, as described below:

- Stage 1 – Performing: when loans are first recognised, the Group recognises an allowance based upto 12-month ECL.
- Stage 2 – Significant increase in credit risk: when a loan shows a significant increase in credit risk, the Group records an allowance for the lifetime ECL.
- Stage 3 – Impaired: the Group recognises the lifetime ECL for these loans.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment (continued)

Measurement of ECL (continued)

For the purposes of categorisation into above stages, the Group has established a policy to perform an assessment at the end of each reporting period of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument.

The Group records impairment for FVOCI debt securities, depending on whether they are classified as Stage 1, 2, or 3, as explained above. However, the ECL does not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the asset were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss.

No impairment is recorded on equity investments.

Stage 1

The Group measures loss allowances at an amount up to 12-month ECL for Stage 1 customers. All financial assets are classified as Stage 1 on initial recognition date. Subsequently on each reporting date the Group classifies following as Stage 1:

- debt type assets that are determined to have low credit risk at the reporting date; and
- on which credit risk has not increased significantly since their initial recognition.

Stage 2

IFRS 9 requires financial assets to be classified in Stage 2 when their credit risk has increased significantly since their initial recognition. For these assets, a loss allowance needs to be recognised based on their lifetime ECLs.

The Group considers whether there has been a significant increase in credit risk of an asset by comparing the rating migration upon initial recognition of the asset against the risk of a default occurring on the asset as at the end of each reporting period. In each case, this assessment is based on forward-looking assessment that takes into account a number of economic scenarios, in order to recognise the probability of higher losses associated with more negative economic outlooks.

It is the Group's policy to evaluate additional available reasonable and supportive forward-looking information as further additional drivers.

Stage 3

Financial assets are included in Stage 3 when there is objective evidence that the loan is credit impaired. At each reporting date, the Group assesses whether financial assets carried at amortized cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have 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 reorganization; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a loan that is overdue for 90 days or more is considered impaired.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Group considers the following factors.

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

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment (continued)

Stage 3 (continued)

- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

Other than originated credit-impaired loans, loans are transferred from out of Stage 3 if they no longer meet the criteria of credit-impaired after a probation period of 12 months.

Forward looking information

The Group incorporates forward-looking information in the measurement of ECLs.

The Group considers forward-looking information such as macroeconomic factors (e.g., GDP growth, oil prices, country's equity indices and unemployment rates) and economic forecasts.

The Group uses internal information coming from internal economic experts, combined with published external information from government and private economic forecasting services. These forward looking assumptions undergo an internal governance process before they are applied for different scenarios.

Presentation of allowance for ECL in the statement of financial position

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

- financial assets measured at amortized cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: as a provision under other liabilities; and
- debt instruments measured at FVOCI: no loss allowance is recognised in the consolidated statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the cumulative changes in fair value reserve.

Limitation of estimation techniques

The models applied by the Group may not always capture all characteristics of the market at a point in time as they cannot be recalibrated at the same pace as changes in market conditions. Interim adjustments are expected to be made until the base models are updated. Although the Group uses data that is as current as possible, models used to calculate ECLs are based on data that is up to date except for certain factors for which the data is updated once it is available and adjustments are made for significant events occurring prior to the reporting date.

Experienced credit adjustment

The Group's ECL allowance methodology requires the Group to use its experienced credit judgement to incorporate the estimated impact of factors not captured in the modelled ECL results, in all reporting periods.

For more details on the impairment calculations and policy refer to note 4 to these consolidated financial statements.

Derivatives and hedging activities

A derivative is a financial instrument or other contract with all three of the following characteristics:

- Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract (i.e., the 'underlying').
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts expected to have a similar response to changes in market factors.
- It is settled at a future date.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Derivatives and hedging activities (continued)

The Group enters into derivative transactions with various counterparties. These include interest rate swaps and forward foreign exchange contracts. Derivatives are initially recognised at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated and qualifies as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

(a) Hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedges);

(b) Hedges of highly probable future cash flows attributable to a recognised asset or liability (cash flow hedges); or

(c) Hedges of a net investment in a foreign operation (net investment hedges).

The Group documents, at the inception of the hedge, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

(a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the consolidated statement of income, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to profit or loss over the period to maturity and recorded as net interest income.

(b) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the consolidated statement of income.

Amounts accumulated in equity are recycled to the consolidated statement of income in the periods when the hedged item affects income or loss. They are recorded in the income or expense lines in which the revenue or expense associated with the related hedged item is reported.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the periods when the hedged item affects income or loss. When a forecast transaction is no longer expected to occur (for example, the recognised hedged asset is disposed of), the cumulative gain or loss previously recognised in other comprehensive income is immediately reclassified to the consolidated statement of income.

(c) Net investment hedge

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised directly in other comprehensive income; the gain or loss relating to the ineffective portion is recognised immediately in the consolidated statement of income. Gains and losses accumulated in equity are included in the consolidated statement of income when the foreign operation is disposed of as part of the gain or loss on the disposal.

The Group did not have any impact on its retained earnings or profit or loss due to change in hedge accounting under IFRS 9.

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 loan, for an agreed period of time starting on a specified future date.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Derivative product types (Continued)

Swaps are contractual agreements between two parties to exchange interest or foreign currency amounts 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 cross-currency swaps, notional amounts are exchanged in different currencies. For cross-currency interest rate swaps, notional amounts and fixed and floating interest payments 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.

Derivative related credit risk

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Group. The majority of the Group's derivative contracts are entered into with other financial institutions and there is no significant concentration of credit risk in respect of contracts with positive fair value with any individual counterparty at the date of the statement of financial position.

Derivatives held or issued for trading purposes

Most of the Group's derivative trading activities relate to entering into forward contracts with external counterparties on behalf of UGH.

Derivatives held or issued for hedging purposes

The Group has adopted a comprehensive system 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. The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on an ongoing basis and hedging strategies used to ensure positions are maintained within established limits. The Board has established levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Interest rate gaps are reviewed on an ongoing basis and hedging strategies used to reduce the interest rate gaps to within the limits established by the Board of Directors.

As part of its asset and liability management the Group uses derivatives for hedging purposes in order to reduce its exposure to currency and interest rate risks. This is achieved by hedging specific financial instruments, forecasted transactions as well as strategic hedging against overall statement of financial position exposures. For interest rate risk this is carried out by monitoring the duration of assets and liabilities using simulations to estimate the level of interest rate risk and entering into interest rate swaps and futures to hedge a proportion of the interest rate exposure, where appropriate. Since strategic hedging does not qualify for special hedge accounting related derivatives are accounted for as trading instruments.

The Group uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks. In addition, the Group uses interest rate swaps to hedge against the interest rate risk arising from specifically identified loans and securities bearing fixed interest rates. In all such cases the hedging relationship and objective, including details of the hedged item and hedging instrument, are formally documented and the transactions are accounted for as hedges.

The Group applies hedge accounting in three separate hedging strategies, as follows:

Interest rate risk on fixed rate debt type instruments (fair value hedge)

The Group holds a portfolio of long-term variable and fixed rate loans / securities and therefore is exposed to changes in fair value due to movements in market interest rates. The Group manages this risk exposure by entering into pay fixed / receive floating interest rate swaps.

Only the interest rate risk element is hedged and therefore other risks, such as credit risk, are managed but not hedged by the Group. The interest rate risk component is determined as the change in fair value of the long-term variable / fixed rate loans and securities arising solely from changes in LIBOR (the benchmark rate of interest). Such changes are usually the largest component of the overall change in fair value. This strategy is designated as a fair value hedge and its effectiveness is assessed by comparing changes in the fair value of the loans attributable to changes in the benchmark rate of interest with changes in the fair value of the interest rate swaps.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Interest rate risk on fixed rate debt type instruments (fair value hedge) (continued)

The Group establishes the hedging ratio by matching the notional of the derivatives with the principal of the portfolio being hedged. Possible sources of ineffectiveness are as follows:

(i) differences between the expected and actual volume of prepayments, as the Group hedges to the expected repayment date taking into account expected prepayments based on past experience;

(ii) hedging derivatives with a non-zero fair value at the date of initial designation as a hedging instrument; and

(iii) counterparty credit risk which impacts the fair value of uncollateralised interest rate swaps but not the hedged items.

Net investment in foreign operation (net investment hedge)

The Group has investments in foreign operations which are consolidated in these financial statements. The foreign exchange rate exposure arising from this investment is hedged through the use of forward exchange contracts. These contracts are designated as net investment hedges to hedge the equity of the foreign operations. The Group establishes the hedging ratio by matching the contracts with the net assets of the foreign operations.

Hedge ineffectiveness

Hedge effectiveness is determined at the inception of the hedge relationship, and through periodic prospective effectiveness assessments to ensure that an economic relationship exists between the hedged item and hedging instrument. For hedges of exposures to fluctuations in foreign exchange rates, the Group enters into hedge relationships where the critical terms of the hedging instrument match exactly with the terms of the hedged item. The Group therefore performs a qualitative assessment of effectiveness.

In hedges of foreign currency exposures, ineffectiveness may arise if the timing of the cash flows changes from what was originally estimated, or if there are changes in the credit risk of the Bank or the derivative counterparty.

The Group enters into interest rate swaps that have similar critical terms as the hedged item, such as reference rate, reset dates, payment dates, maturities and notional amount. In cases, where the Group does not hedge 100% of its loans, the hedged item is identified as a proportion of the outstanding loans up to the notional amount of the swaps. As all critical terms matched during the year, the economic relationship was 100% effective.

Hedge ineffectiveness for interest rate swaps is assessed using the same principles as for hedges of foreign currency. It may occur due to the credit value/debit value adjustment on the interest rate swaps which is not matched by the loan, and differences in critical terms between the interest rate swaps and loans.

There was no ineffectiveness during 2018 or 2017 in relation to the interest rate swaps.

Interest income

Under both IFRS 9 and IAS 39, interest income is recorded using the effective interest rate (EIR) method for all financial instruments measured at amortised cost, financial instruments designated at FVTPL. Interest income on interest bearing financial assets measured at FVOCI under IFRS 9, similarly to interest bearing financial assets classified as available-for-sale or held to maturity under IAS 39 are also recorded by using the EIR method. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

Fair value measurement

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

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 economic best interest.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair value measurement (continued)

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

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

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

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

Level 2: valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable; and

Level 3: valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

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 asset or liability and the level of the fair value hierarchy as explained above.

The Group measures financial instruments, such as, derivatives, and non-financial assets such as investment properties, at fair value at each reporting date.

For financial instruments traded in an active market, fair value is determined by reference to quoted market bid prices for assets and quoted market offer prices for liabilities, without deduction for transaction costs. The fair value of investments in managed funds or similar investment vehicles, where available, are based on last published bid price.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indications that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For financial instruments where there is no active market, fair value is determined using appropriate valuation techniques. Such techniques may include the following:

- brokers' quotes
- recent arm's length market transactions
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics
- option pricing models
- other valuation methods (Note 32)

Financial instruments with no active market and where fair value can not be reliably determined are stated at cost less provision for any impairment.

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount payable on demand.

The fair value of forward foreign exchange contracts is determined using forward exchange rates at the statement of financial position date with the resulting value discounted back to present value.

The fair value of interest rate swaps is determined by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Derecognition

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

(a) the right to receive cash flows from the asset have expired;

(b) the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement; or

(c) the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

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

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. 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. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to consolidated statement of income.

Investment properties

All properties held for rental or for capital appreciation purposes, or both, are classified as investment properties. Where a property is partially occupied by the Group and the portions could be sold separately, the Group accounts for the portions separately either as an investment property or property and equipment, as appropriate. If the portions cannot be sold separately, the property is classified as an investment property only if an insignificant portion is held for own use.

The Group applies the fair value model of accounting for investment properties. All investment properties are initially recorded at cost, including acquisition expenses associated with the property.

Subsequent to initial recognition, all investment properties are remeasured at fair value and changes in fair value are recognised in the consolidated statement of income. The Group engages independent valuation specialists to determine the fair value of investment properties. Fair values are determined based on an annual evaluation performed by an accredited external independent valuer applying a valuation model recommended by the International Valuation Standards Committee.

Investment properties are derecognised either when they have been disposed of or when they are permanently withdrawn from use and no future economic benefit is expected from their disposal. The difference between the net disposal proceeds and the carrying amount of the asset is recognised in profit or loss in the period of derecognition.

Transfers are made to (or from) investment property only when there is a change in use. For a transfer from investment property to owner-occupied property, the deemed cost for subsequent accounting is the fair value at the date of change in use. If owner-occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under property, plant and equipment up to the date of change in use.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and impairment losses. When assets are sold or retired, their cost and accumulated depreciation are eliminated from the consolidated statement of financial position and any gain or loss resulting from disposal is included in the consolidated statement of income.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount, being the higher of their fair value less costs to sell and their value in use.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property and equipment (Continued)

Depreciation is provided on all property and equipment, except land and work in progress, at rates calculated to write off the cost of each asset on a straight line basis to their residual values over its expected useful life which is between 3 to 5 years for all property and equipment except for certain building fixtures and fittings which are depreciated over expected useful life of 10 years and building civil structure which is depreciated over its expected useful life of 20 years.

The assets' residual values, useful lives and methods of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate.

Financial liabilities

Financial liabilities comprise of due to banks and other financial institutions, deposits from customers, loans, bonds and subordinated debt and other liabilities. These are stated at amortised cost. Transaction costs are amortised over the period of the debt using the effective yield method. Deposits from customers include deposits from both external customers and other group companies.

Classification and subsequent measurement

The accounting for financial liabilities remains largely the same as it was under IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVTPL. Such movements are presented in OCI with no subsequent reclassification to the consolidated statement of income.

Treasury shares and treasury share reserve

Treasury shares are own equity instruments of the Bank which are reacquired by the Bank or any of its subsidiaries. These are stated at cost and deducted from equity. Any gain or loss arising on reissuance of treasury shares is taken directly to treasury share reserve in the consolidated statement of changes in equity.

Cash and cash equivalents

Cash and cash equivalents include cash, demand and call deposits, highly liquid investments that are readily convertible into cash and placements (excluding escrow balances) with original maturities up to ninety days from the date of acquisition.

Fiduciary assets

Assets held in a fiduciary capacity are not treated as assets of the Group in the consolidated statement of financial position.

Dividends on ordinary shares

The Bank recognises a liability to make cash or non-cash distributions to its equity holders when the distribution is authorised and the distribution is no longer at the discretion of the Bank. A distribution is authorised when it is approved by the shareholders. A corresponding amount is recognised directly in equity.

Non-cash distributions are measured at the fair value of the assets to be distributed with fair value re-measurement recognised directly in equity.

Upon distribution of non-cash assets, any difference between the carrying amount of the liability and the carrying amount of the assets distributed is recognised in the consolidated statement of income.

Dividends for the year that are approved after the statement of financial position date are disclosed as an event after the statement of financial position date.

Taxes

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on overseas subsidiaries is calculated on the basis of the tax rates applicable and prescribed according to the prevailing laws, regulations and instructions of the countries where these subsidiaries operate. Income tax payable on taxable profit ("current tax") is recognised as an expense in the period in which the profits arise in accordance with the fiscal regulations of the respective countries in which the Group operates.

Deferred Tax

Deferred tax is provided using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Taxes (continued)

Deferred tax assets are recognised for all deductible temporary differences, the carry forward of unused tax credits and any unused tax losses. Deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised, except when the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are re-assessed at each reporting date and are recognised to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

(a) When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

(b) In respect of taxable temporary differences associated with investments in subsidiaries and associates, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are measured using tax rates and applicable legislation at the reporting date.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

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 either settle on a net basis, or to realise the asset and settle the liability simultaneously.

Trade and settlement date accounting

All “regular way” purchases and sales of financial assets are recognised on the settlement date, i.e. the date the asset is delivered to the counterparty.

Employees benefits

The Group provides for end of service benefits to all its employees. Entitlement to these benefits is usually based upon the employees’ length of service and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment. National employees of the Bank are also covered by the Social Insurance Organisation scheme and the Bank’s obligations are limited to the amount contributed to the scheme.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and reliably measurable.

Foreign currencies

The consolidated financial statements have been presented in US Dollars being the functional and presentational currency of the Bank. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

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

Translation of foreign currency transactions and balances

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Exchange differences arising on the retranslation of monetary items, are included in consolidated statement of income for the year. Non-monetary items measured at fair value in a foreign currency are retranslated using the exchange rates at the date when the fair value was determined. Exchange differences arising on the retranslation of non-monetary investments carried at fair value through the statement of income are included in the consolidated statement of income for the year.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Foreign currencies (continued)

Translation of foreign currency transactions and balances (continued)

Exchange differences arising on the retranslation of available for sale equity investments, other than those which are carried at cost, are recognised directly in a fair value reserve in the consolidated statement of comprehensive income. Non–monetary items that are measured at historical cost in a foreign currency are translated using the spot exchange rates as at the date of recognition.

Translation of financial statements of foreign operations

Assets (including goodwill) and liabilities of foreign operations are translated at the exchange rates prevailing at the statement of financial position date. Income and expense items are translated at average exchange rates for the relevant period. All resulting exchange differences are taken directly to a foreign currency translation reserve in equity through consolidated OCI.

On disposal of a foreign operation, the component of consolidated OCI relating to that particular foreign operation is recognised in the consolidated statement of income.

Recognition of income and expenses

Interest income and related fees are recognised using the effective yield method, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Recognition of interest income is suspended when the related financial asset becomes impaired. Notional interest is recognised on impaired financial assets based on the rate used to discount future cash flows to their net present value.

Commission income and other fees are recognised when earned.

Performance-based fees

For revenue from performance-based fees for the provision of services over a period of time, the Group previously accrued revenue over that period. Under IFRS 15, performance-based fees will not be recognised until it is highly probable that a significant reversal in the amount of cumulative revenue will not occur. The recognition of performance-based fees will require significant judgement and are unlikely to be recognised in full until they have crystallised or are no longer subject to clawback.

Advisory income

For revenue from advisory fees for the provision of services over a period of time, the Group previously accrued revenue over that period. Under IFRS 15, the Group applied significant judgement to identify the performance obligations in an advisory service contract and whether each service is capable of being distinct in the context of contract. Revenue from these performance obligations are recognized either at a point in time or over time when the respective performance obligations in a contract are delivered to the customer.

Rental income on investment properties is recognised on a straight line basis.

Dividend income is recognised when the Group’s right to receive the dividend is established.

Contingent liabilities and contingent assets

Contingent liabilities are not recognised in the consolidated financial statements, but are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognised in the consolidated financial statements, but are disclosed when an inflow of economic benefits is probable.

Financial guarantee contracts and commitments

Financial guarantee contracts issued by the Group are those contracts that require a payment to be made to reimburse the holder for a loss it incurs because the specified debtor fails to make a payment when due in accordance with the terms of a debt instrument. Financial guarantee contracts are recognised initially as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the reporting date and the amount recognised less cumulative amortisation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial guarantee contracts and commitments (continued)

The premium received is recognised in the consolidated statement of profit or loss in other operating income on a straight line basis over the life of the guarantee.

Undrawn loan commitments, under which, over the duration of the commitment, the Group is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, under IAS 39, a provision was made if they were an onerous contract but, from 1 January 2018, these contracts are in the scope of the ECL requirements.

The nominal contractual value of financial guarantees and undrawn loan commitments, where the loan agreed to be provided is on market terms, are not recorded in the consolidated statement of financial position.

Significant assumptions, accounting judgements and estimates

In the process of applying the Group's accounting policies, management has made the following assumptions, judgements and estimates in determining the amounts recognised in the consolidated financial statements:

Measurement of the expected credit loss allowance (ECL)

The measurement of the ECL for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions, credit behaviour (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 judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Internal credit rating model, which assigns PDs to the individual ratings;
- Determining criteria for SICR;
- 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.

Classification of financial assets

Classification of financial assets in the appropriate category depends upon the business model and SPPI test. Determining the appropriate business model and assessing whether the cash flows generated by the financial asset meet the SPPI test is complex and requires significant judgements by management.

The Group applies judgement while carrying out SPPI test and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

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, management is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

Impairment of goodwill

The Group determines whether goodwill is impaired at each reporting date. This requires an estimation of the value in use of the cash generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Significant assumptions, accounting judgements and estimates (continued)

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of consolidated financial position cannot be derived from active markets, they are determined using valuation techniques including discounted cash flow models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Policies before adoption of IFRS 9

Investments carried at fair value through statement of income

Investments classified as carried at fair value through the statement of income comprise of two categories 'investments held for trading' and 'investments designated at fair value through statement of income'.

An investment is classified as 'held for trading' if it is acquired or incurred principally for the purpose of selling in the near term or if on initial recognition is part of a portfolio of identifiable financial investments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking. Derivatives which are not used as hedge are also categorised as held for trading.

Investments designated at fair value through statement of income are investments that are not classified as held for trading but are managed, and their performance is evaluated on a fair value basis in accordance with the Group's investment strategy.

These investments are initially recognised at fair value. Transaction costs are immediately expensed in the consolidated statement of income. Subsequent to initial recognition, investments designated at fair value through statement of income are remeasured at fair value and gains and losses arising from such remeasurement are included in the consolidated statement of income.

These are classified as follows:

- Held to maturity; and
- Available-for-sale

Investments which have fixed or determinable payments and fixed maturity and which are intended to be held to maturity are carried at amortised cost, less provision for impairment in value. Any gain or loss on such investments is recognised in the consolidated statement of income when the investment is derecognised or impaired.

Held to maturity

Investments with fixed or determinable payments and fixed maturities are classified as held to maturity when the Group has the positive intention and ability to hold these investments to maturity. These investments are initially recognised at fair value, including directly attributable transaction costs.

After initial recognition investments held to maturity are carried at amortised cost using the effective interest rate method. Any gain or loss on such investments is recognised in the consolidated statement of income when the investment is derecognised or impaired. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in 'interest income' in the consolidated statement of income. The losses, if any, arising from impairment of such investments are recognised in the consolidated statement of income.

Investments available-for-sale

Investments classified as available for sale are remeasured at fair value. Fair value of investments quoted in active markets is determined by reference to quoted bid prices. Fair value of investments listed on inactive markets and unlisted investments are determined using other generally accepted methods such as recent arm's length transaction, current fair value of another instruments that is substantially the same, the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics, and other valuation techniques. The fair value changes of investments available for sale are reported separately in equity in the fair value reserve until such investments are sold, realised or deemed to be impaired, at which time the realised gain or loss is included in the consolidated statement of income.

Investments available-for-sale include equity investments and debt securities. Investments available-for-sale are those non-derivative financial assets that are designated as available-for-sale or are not classified as investment at fair value through statement of income, investments held to maturity or loans and receivables.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Policies before adoption of IFRS 9 (continued)

Investments available-for-sale (continued)

These investments are initially recognised at fair value, including directly attributable transaction costs.

After initial recognition, available-for-sale investments are measured at fair value with gains and losses being recognised in the consolidated OCI until the investment is derecognised or determined to be impaired at which time the cumulative gains or losses previously reported in the consolidated OCI are recognised in the consolidated statement of income. Investments whose fair value cannot be reliably measured are carried at cost less impairment losses, if any.

Dividends are included in 'dividend income'. Interest income on available-for-sale investments is recorded in 'interest income' in the consolidated statement of income, using the effective interest yield method.

Loans and receivables

Loans and receivables are non-derivative financial assets originated or acquired by the Group with fixed or determinable payments that are not quoted in an active market.

Loans and receivables are recognised when cash is advanced to borrowers. They are derecognised when either borrower repays their obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred.

Loans and receivables are initially measured at cost, being the fair value of the consideration given.

Following initial recognition, loans and receivables are stated at cost less any amount written off and specific and collective provisions for impairment.

When a loan is uncollectible and there is no realistic prospect of recovery, it is written off against the related provision. Subsequent recoveries and reductions in provision are credited to provision for doubtful loans in the consolidated statement of income.

3 NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

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

IFRS 16 Leases

The IASB issued the new standard for accounting for leases - IFRS 16 Leases in January 2016. The new standard does not significantly change the accounting for leases for lessors. However, it does require lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right-of-use assets. Lessees must apply a single model for all recognised leases, but will have the option not to recognise 'short-term' leases and leases of 'low-value' assets. Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in the statement of profit or loss.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date. Lessees must adopt IFRS 16 using either a full retrospective or a modified retrospective approach.

The Group does not anticipate early adopting IFRS 16 and does not expect any material impact on the consolidated financial statements of the Group.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 and does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments.

The interpretation is effective for annual reporting periods beginning on or after 1 January 2019.

These amendments have no impact on the consolidated financial statements of the Group.

Amendments to IFRS 9: Prepayment Features with Negative Compensation

The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

3 NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

Amendments to IFRS 9: Prepayment Features with Negative Compensation (continued)

The amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted. These amendments have no impact on the consolidated financial statements of the Group.

Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely. The Group will apply these amendments when they become effective.

Amendments to IAS 19: Plan Amendment, Curtailment or Settlement

The amendments to IAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments apply to plan amendments, curtailments, or settlements occurring on or after the beginning of the first annual reporting period that begins on or after 1 January 2019, with early application permitted. These amendments are not applicable to the Group.

Amendments to IAS 28: Long-term interests in associates and joint ventures

The amendments clarify that an entity applies IFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). This clarification is relevant because it implies that the expected credit loss model in IFRS 9 applies to such long-term interests. The amendments also clarified that, in applying IFRS 9, an entity does not take account of any losses of the associate or joint venture, or any impairment losses on the net investment, recognised as adjustments to the net investment in the associate or joint venture that arise from applying IAS 28 Investments in Associates and Joint Ventures.

The amendments should be applied retrospectively and are effective from 1 January 2019, with early application permitted. Since the Group does not have such long-term interests in its associate and joint venture, the amendments will not have an impact on its consolidated financial statements.

Annual Improvements 2015-2017 Cycle

IFRS 3 Business Combinations

The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation. (effective from 1 January 2019, with earlier application permitted).

IFRS 11 Joint Arrangements

A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in IFRS 3. The amendments clarify that the previously held interests in that joint operation are not remeasured (the amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted).

IAS 12 Income Taxes

The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognises the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised those past transactions or events (the amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted).

IAS 23 Borrowing Costs

The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete (the amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted).

4 TRANSITION DISCLOSURES

(a) Remeasurement and reclassification

The Group performed a detailed analysis of its business models for managing financial assets and analysis of their cash flow characteristics.

The following table reconciles the carrying amounts of financial assets and financial liabilities, from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018:

Financial assets	IAS 39 carrying amount US$ '000	Re classification US$ '000	Re measurement US$ '000	IFRS 9 carrying amount US$ '000	Classification under IFRS 9
Demand and call deposits with banks	97,993	-	(1)	97,992	Amortised cost
Placements with banks	68,577	-	(204)	68,373	Amortised cost
Investments carried at fair value through statement of income	19,268	41,128	-	60,396	FVTPL
Non-trading investments	-	3,704	-	3,704	FVOCI
Non-trading investments	221,566	(72,828)	-	148,738	FVOCI
Loans and receivables	4,216	27,996	(1,005)	31,207	Amortised cost
Other assets	31,820	-	(157)	31,663	Amortised cost
Total assets	443,440	-	(1,367)	442,073	

The following explains how applying the new classification requirements of IFRS 9 led to changes in classification of certain financial assets held by the Group as shown in the table above:

(i) Debt instruments previously classified as available for sale

The Group holds a portfolio of debt instruments that were classified as available for sale under IAS 39. The Group has reassessed the debt instruments under IFRS 9. As a result, these instruments, which amounted to US$ 27,996 thousand were classified as amortised cost from the date of initial application.

During the year, based on certain amendments to an initial credit facility agreement, the repayment of the debt instrument will be made in kind with the issuance of fixed number of ordinary shares of the counter party at a fixed price at the date of maturity. The Group has reassessed the classification of the debt instrument and as at 31 December 2018 the Group reclassified its investment as an equity instruments measured at FVOCI, as permitted under IFRS 9.

(ii) Designation of equity instruments at FVOCI

The Group has elected to irrevocably designate investments of US$ 3,704 thousand that were previously classified as FVTPL, at FVOCI as permitted under IFRS 9. The changes in fair value of such securities will no longer be reclassified to profit or loss when they are disposed of.

(iii) Designation of equity instruments at FVTPL

The Group has elected to designate certain of its investments at a carrying value of US$ 44,832 thousand as FVTPL as permitted under IFRS 9 from the initial date of application. These investments were previously classified as available-for-sale. Any changes in fair value of these securities will be recognised in the statement of income.

Adoption of IFRS 9 did not result in any change in classification or measurement of financial liabilities.

4 TRANSITION DISCLOSURES (CONTINUED)

(b) Impact on retained earnings and other reserves

	Retained earnings US$ '000	Other reserves US$ '000
Closing balance under IAS 39 (31 December 2017)	7,659	12,867
Reclassifications and remeasurement of investments under IFRS 9	(2,726)	3,037
Recognition of expected credit losses under IFRS 9	(1,367)	-
Opening balance under IFRS 9 (1 January 2018)	3,566	15,904

(c) Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The following table reconciles the prior period's closing loan loss provisions measured in accordance with IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 ECL model at 1 January 2018:

Measurement category	Loan loss allowance under IAS 39 US$ '000	Remeasurement US$ '000	ECL under IFRS 9 US$ '000
Demand and call deposits with banks	-	1	1
Placements with banks	-	204	204
Loans and receivables	2,535	1,005	3,540
Other assets	-	157	157
Total	2,535	1,367	3,902

(d) Movement in ECL for the year

An analysis of movement in ECL allowances during the period is as follows:

	Stage 1 US$ 000	Stage 2 US$ 000	Stage 3 US$ 000	Total US$ 000
As at 1 January 2018	362	3,540	-	3,902
Net transfers between stage 1, 2 and 3	(298)	(1,276)	1,574	-
Amount written off	-	-	(1,574)	(1,574)
Acquisition of a subsidiary	176	-	10,650	10,826
Provided (reversed) during the year	3,206	(900)	-	2,306
Other movements	-	40	(116)	(76)
As at 31 December 2018	3,446	1,404	10,534	15,384

5 BUSINESS COMBINATION

During September 2018, the Group (through its subsidiary KAMCO) acquired 396,426,434 shares, representing 71.18% effective equity interest of Global Investment House K.S.C. (Closed) (“GIH”), a Kuwaiti Shareholding Company, regulated by CMA as an investment company and CBK for financing activities. GIH is principally engaged in provision of asset management, investment banking and brokerage activities. The Group was able to control the investee and therefore, the entity became a subsidiary of the Group. Accordingly, GIH has been consolidated from 1 September 2018 being the date of exercise of control. The acquisition has been accounted for in accordance with IFRS 3: Business combination (“IFRS 3”).

The consideration paid and the values of assets acquired and liabilities assumed, as well as the non-controlling interest at the proportionate share of the acquiree’s identifiable net assets, are summarized as follows:

	US$ 000
Assets	
Demand and call deposits with banks	108,739
Investments carried at fair value through statement of income	63,578
Non-trading investments	22,814
Amortised cost investments	494
Loans and receivables	19,809
Other assets	36,430
Investments in associates	425
Investment properties	2,171
Property and equipment	37,614
Intangible assets	14,955
	307,029
Liabilities	
Other liabilities	46,735
Total identifiable net assets at fair value	260,294
Non-controlling interests	4,982
	255,312
Group’s share of net assets acquired	181,737
Gain on bargain purchase	(23,928)
Total purchase consideration	157,809
Analysis of cash flows on business combination	
Cash consideration	(132,307)
Demand and call deposits with banks in subsidiary acquired	108,739
Net cash out flow on business combination	(23,568)
Deferred consideration payable	(25,502)

In accordance with requirements of IFRS 3, the Group has carried out a Purchase Price Allocation exercise which resulted in a gain from business combination, since the fair value of the assets acquired and liabilities assumed exceeded the purchase consideration paid and related transaction expenses. Non-controlling interest has been recognised at the proportionate share of GIH’s identifiable net assets.

Intangible assets of GIH represent Customer relationship and commercial license which has been assigned a provisional value. The Group is in the process of identification of other intangible assets and these are subject to change on the completion of Purchase Price Allocation (“PPA”) exercise. Fair valuation for GIH is based on an exercise performed by a valuation expert.

5 BUSINESS COMBINATION (CONTINUED)

Had the business combinations taken place at the beginning of the year, revenue of the Group and profit attributable to equity holders of the Group, would have been higher by US$ 35,391 thousand and US$ 11,193 thousand, respectively. From the date of acquisition, GIH contributed US$ 11,774 thousand of revenue and US$ 96 thousand net loss to the net profit from continuing operations of the Group.

At the time of acquisition, the Group was required to pay deferred consideration of US$ 8,264 thousand after 180 days of the acquisition and remaining amount of US$ 17,238 thousand was payable on completion of certain conditions, as per the arrangement terms agreed between the parties. As of 31 December 2018, only US$ 8,264 is remaining as payable with respect to the deferred consideration to the previous shareholders of GIH.

6 FINANCIAL ASSETS AND LIABILITIES

The table below summarises the accounting classification of the Group's financial assets and financial liabilities:

31 December 2018	Held for trading US$ 000	Designated at FVTPL US$ 000	Designated at FVOCI US$ 000	Amortised cost US$ 000	Total US$ 000
Demand and call deposits with banks	-	-	-	143,510	143,510
Placements with banks	-	-	-	108,529	108,529
Investments carried at fair value through statement of income	-	81,852	-	-	81,852
Non-trading investments	-	-	167,647	-	167,647
Held-to-maturity investments	-	-	-	494	494
Loans and receivables	-	-	-	25,191	25,191
Other assets	-	-	1,280	58,931	60,211
Total financial assets	-	81,852	168,927	336,655	587,434
Due to banks and other financial institutions	-	-	-	220,879	220,879
Deposits from customers	-	-	-	32,608	32,608
Loans payable	-	-	-	67,033	67,033
Long term bonds	-	-	-	131,739	131,739
Other liabilities	168	-	208	105,999	106,375
Total financial liabilities	168	-	208	558,258	558,634

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6 FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

31 December 2017	Held for trading US$ 000	Designated at FVTPL US$ 000	Available-for-sale US$ 000	Amortised cost / Loans and receivables US$ 000	Total US$ 000
Demand and call deposits with banks	-	-	-	97,993	97,993
Placements with banks	-	-	-	68,577	68,577
Investments carried at fair value through statement of income	17,983	1,285	-	-	19,268
Non-trading investments	-	-	221,566	-	221,566
Loans and receivables	-	-	-	4,216	4,216
Other assets	-	1,100	-	29,740	30,840
Total financial assets	17,983	2,385	221,566	200,526	442,460
Due to banks and other financial institutions	-	-	-	250,211	250,211
Deposits from customers	-	-	-	31,018	31,018
Loans payable	-	-	-	98,658	98,658
Other liabilities	115	-	-	37,243	37,358
Total financial liabilities	115	-	-	417,130	417,245

7 INVESTMENTS CARRIED AT FAIR VALUE THROUGH STATEMENT OF INCOME

	2018 US$ 000	2017 US$ 000
Quoted equities	12,278	6,305
Quoted debt securities	6,941	11,678
Unquoted equity	3,210	-
Managed funds	59,423	1,285
	81,852	19,268

Managed funds primarily represent funds invested through unlisted companies and limited partnership interests. The fund managers have created these legal structures for tax efficiency and to meet other investors' requirements. The underlying investments in these funds are primarily in quoted debt and equity instruments in Kuwait and other international markets.

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8 NON-TRADING INVESTMENTS

Below is an analysis of the Group's non-trading investments measured at FVOCI (2017: Available for sale):

	2018 US$ 000	]2017 US$ 000
Quoted		
Managed funds	33	-
Equities	45,219	42,081
Total quoted	45,252	42,081
Unquoted		
Equities	120,298	143,117
Other managed funds	1,950	36,074
Real estate managed funds	147	294
Total unquoted	122,395	179,485
Total non-trading investments	167,647	221,566

9 LOANS AND RECEIVABLES

	2018				2017
	Stage 1 US$ 000	Stage 2 US$ 000	Stage 3 US$ 000	Total US$ 000	US$ 000
Loans to customers	21,839	-	10,534	32,373	4,077
Staff loans	4,028	-	-	4,028	2,674
	25,867	-	10,534	36,401	6,751
Less: Expected credit losses	(676)	-	(10,534)	(11,210)	(2,535)
	25,191	-	-	25,191	4,216

The movement in the expected credit losses is as follows:

	Stage 1 US$ 000	Stage 2 US$ 000	Stage 3 US$ 000	Total US$ 000
As at 31 December 2017	-	2,535	-	2,535
Impact of adoption of IFRS 9	-	1,005	-	1,005
As at 1 January 2018	-	3,540	-	3,540
Acquisition of a subsidiary	176	-	10,650	10,826
Other movements	500	(3,540)	(116)	(3,156)
As at 31 December 2018	676	-	10,534	11,210

9 LOANS AND RECEIVABLES (CONTINUED)

An analysis of the allowance for impairment losses under IAS 39, for the year ended 31 December 2017 are as follows:

	2017		
	Specific US$ 000	Collective US$ 000	Total US$ 000
At 1 January	28,913	14,623	43,536
Provided (written-back) during the year - net	-	2,129	2,129
Written-off during the year	-	(2,107)	(2,107)
Other adjustments	(28,913)	(12,110)	(41,023)
Balance at 31 December	-	2,535	2,535

The table below shows the credit quality of loans and receivables:

	Neither past due nor impaired US$ 000	Past due and impaired US$ 000	Total US$ 000
31 December 2018			
Loans to customers	21,839	10,534	32,373
Staff loans	4,028	-	4,028
Total	25,867	10,534	36,401

	due Neither past nor impaired US$ 000	Past due and impaired US$ 000	Total US$ 000
31 December 2017			
Loans to customers	4,077	-	4,077
Staff loans	2,674	-	2,674
Total	6,751	-	6,751

No ECL is recognised against the Group's exposures to staff loans as these are fully collateralized.

10 OTHER ASSETS

	2018 US$ 000	2017 US$ 000
Due from customers	47,928	16,379
Accounts receivable	10,897	13,203
Prepayments	886	980
Interest receivable	106	158
Derivative assets (Note 30)	1,280	1,100
	61,097	31,820

Due from customers and accounts receivable are stated net of ECL of US$ 2,941 thousand (2017: provision of US$ 77 thousand). During the year, ECL of US$ 2,864 thousand was made against doubtful receivables (2017: provision reversed US$ 766 thousand).

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11 INVESTMENTS IN ASSOCIATES

		Activity	Carrying value 2018 US$ 000	Ownership 2018 %	Carrying value 2017 US$ 000	Ownership 2017 %
a)	Adhari Park Development Company	Real estate	188	20	-	-
b)	Arab Leadership Academy	Training institute	-	-	414	15
c)	FINA Corporation	Financial services	221	49	-	-
d)	Kamco Investment Fund	Fund	24,357	23	22,750	23
e)	KAMCO Real Estate Yield Fund	Fund	14,549	30	-	-
f)	Kuwait Education Fund	Fund	136	34	14,139	34
g)	Manafae Investment Company	Islamic investment	11,202	33	12,870	31
h)	N.S. 88	Real estate	11,570	20	12,280	20
i)	United Capital Transport Co K.S.C.C.	Transport	9,269	40	15,038	40
j)	United Real Estate Company - Syria	Real estate	21	20	21	20
			71,513		77,512	

The Group has no share of any contingent liabilities or capital commitments, as at 31 December 2018 and 2017 on behalf of its associates.

a) During the year, the Group had acquired GIH which holds 20% equity interest in Adhari Park Development Company B.S.C (c)situated in the Kingdom of Bahrain (2017: Nil).

b) Arab Leadership Academy is a training institute incorporated in the State of Kuwait in 2007. During the year, KAMCO has reclassified its ownership in Arab Leadership Academy from an associate to financial assets designated at FVOCI included under non-trading investments.

c) During the year, the Group had acquired GIH which holds 49% equity interest in FINA Corporation situated in Tunisia (2017: Nil).

d) The Group holds a 23% (2017: 23%) equity interest in KAMCO Investment Fund (“KIF”) through its subsidiary KAMCO.

e) During the year, the Group has reclassified its investment in KAMCO Real Estate Yield Fund from financial asset designated at FVTPL to investment in associates, since the ownership increased to 30%.

f) Kuwait Education Fund is a fund incorporated in the State of Kuwait in 2007. As of 31 December 2018, the Group owns 34% through its subsidiary KAMCO (2017: 34%).

g) The Group owns 33% of Manafae Investment Company through its subsidiary KAMCO (2017: 31%).

h) The Group owns 20% of N.S. 88 (formerly known as Savannah SPV) through its subsidiary KAMCO (2017: 20%).

i) United Capital Transport Company K.S.C.C. (UniCap) was incorporated in State of Kuwait in 2011. The Group owns a 40% equity interest through its subsidiary KAMCO (2017: 40%). UniCap is a dedicated leasing solutions provider to governments, international oil companies and varied construction, mining and industrial services businesses.

j) United Real Estate Company - Syria is a closed company incorporated in the Syrian Arab Republic. At 31 December 2018, the Bank directly owns 20% (2017: 20%) of its equity interest.

In accordance with IAS 36 Impairment of Assets, the Group’s recoverable amount of these associates (i.e. value in use) was in excess of their carrying values and accordingly no impairment was recognised against these investments during the year ended 31 December 2018 (2017: same).

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11 INVESTMENTS IN ASSOCIATES (CONTINUED)

Investments in associates that are not individually significant

As at 31 December 2018 and 2017, all of the Group's investments in associates were not individually significant. The aggregate summarised financial information of the Group's associates that are not individually significant are provided below:

	2018 US$ 000	2017 US$ 000
Summarised statement of financial position as of 31 December:		
Total assets	274,625	243,037
Total liabilities	(5,328)	(2,786)
Equity	269,297	240,251
Carrying amount of investments	71,513	77,512
Summarised statement of income for the year ended 31 December:		
Revenue	1,824	14,666
Loss for the year	(1,414)	(2,879)
Other comprehensive income for the year	-	-
Total comprehensive loss for the year	(1,414)	(2,879)
Group's share of loss for the year (note 25)	(764)	(2,922)

12 INVESTMENT PROPERTIES

	2018 US$ 000	2017 US$ 000
At 1 January	105,093	101,326
Acquired on acquisition of subsidiary (note 5)	2,171	-
Revaluation (note 23)	124	2,732
Foreign currency translation and other adjustments	241	1,035
At 31 December	107,629	105,093

Investment properties comprise of land and buildings owned by the Group. These are stated at fair values, determined based on independent valuations performed by external professional valuers at the year end.

Valuations of investment properties were conducted by independent appraisers with a recognised and relevant professional qualification and recent experience of the location and category of investment property being valued. The discounted future cash flow method or property market value method have been used as deemed appropriate considering the nature and usage of the properties. The Group's investment properties are categorised in level 3 of the fair value hierarchy as at 31 December 2018 and 2017.

Significant increases (decreases) in estimated rental value and rent growth per annum in isolation would result in a significantly higher (lower) fair value of the properties. Significant increases (decreases) in the long-term vacancy rate and discount rate (and exit yield) in isolation would result in a significantly lower (higher) fair value.

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13 PROPERTY AND EQUIPMENT

2018	Land US$ 000	Buildings US$ 000	Furniture and fixtures US$ 000	Computers and vehicles US$ 000	Total US$ 000
Cost					
Balance as at 1 January 2018	-	-	4,329	6,167	10,496
Acquired on acquisition of a subsidiary	15,852	55,627	14,265	10,645	96,389
Additions during the year	-	-	199	2,090	2,289
At 31 December 2018	15,852	55,627	18,793	18,902	109,174
Depreciation					
Balance as at 1 January 2018	-	-	(3,508)	(5,309)	(8,817)
Acquired on acquisition of a subsidiary	-	(35,040)	(14,002)	(9,733)	(58,775)
Charge for the year	-	(495)	(576)	(1,117)	(2,188)
At 31 December 2018	-	(35,535)	(18,086)	(16,159)	(69,780)
Net book value:					
At 31 December 2018	15,852	20,092	707	2,743	39,394
At 31 December 2017	-	-	821	858	1,679

14 GOODWILL AND OTHER INTANGIBLE ASSETS

2018	Goodwill US$ 000	Customer relationships US$ 000	Licenses with definite useful lives US$ 000	Total US$ 000
Cost				
Balance as at 1 January 2018	52,390	-	-	52,390
Acquired on acquisition of a subsidiary	-	11,328	3,627	14,955
Foreign currency translation adjustments	(298)	-	-	(298)
At 31 December 2018	52,092	11,328	3,627	67,047
Amortisation and impairment				
Balance as at 1 January 2018	-	-	-	-
Acquired on acquisition of a subsidiary	-	-	-	-
Amortisation	-	(413)	-	(413)
At 31 December 2018	-	(413)	-	(413)

14 GOODWILL AND OTHER INTANGIBLE ASSETS (CONTINUED)

2017	Goodwill US$ 000	Customer relationships US$ 000	Licenses with definite useful lives US$ 000	Total US$ 000
Cost				
Balance as at 1 January 2017	51,868	-	-	51,868
Transferred as part of restructuring	(197)	-	-	(197)
Foreign currency translation adjustments	719	-	-	719
At 31 December 2017	52,390	-	-	52,390
Amortisation and impairment				
Balance as at 1 January 2017 and				
At 31 December 2017	-	-	-	-
Net book value:				
At 31 December 2018	**52,092**	**10,915**	**3,627**	**66,634**
At 31 December 2017	52,390	-	-	52,390

Goodwill

The goodwill remaining as of 31 December relates to KAMCO (a subsidiary) and is allocated to the asset management and investment banking operating segment, a cash generating unit (a CGU). The recoverable amount of the CGU is determined based on a value in use calculation using cash flow projections from financial budgets approved by the Group's senior management covering a five year period. The key assumptions used in the value in use calculation include a perpetuity growth rate of 3% (2017: 3%) and discount factor of 9.6% (2017: 9.5%). There was no goodwill impairment identified in 2018 or 2017 as the recoverable amount of the CGU was higher than its net book value.

The calculation of value in use for the CGU is sensitive primarily to market risk premium, growth risk rate, risk free rate and country risk premium.

The sensitivity of the value in use calculation to changes in key assumptions used in the impairment assessment of goodwill is disclosed below:

	Impact of change	
	+10%	**-10%**
Key assumptions		
Growth rate	14,544	(13,284)
Discount factor	(36,551)	48,977

These changes do not result in impairment of goodwill.

Other intangible assets

Intangible assets of US$ 14,955 thousand were recognised as a result of a Purchase Price Allocation exercise done by KAMCO following its acquisition of GIH (note 5).

Customer relationships and licenses with finite useful lives have a useful economic life of 10 years each and are amortised on a straight line basis.

15 TAXATION

The Group's subsidiaries in the United States of America (2017: Malta, the United Kingdom, India, Chile and the United States of America) were subject to income tax in their respective jurisdictions. During 2017, all such subsidiaries, with the exception of UGRIL, were transferred to UGHC as part of the Group's restructuring.

a) Deferred tax liabilities

Deferred tax liabilities relate to the following:

	2018 US$ 000	2017 US$ 000
Excess of capital allowances over depreciation	-	390
Changes in fair value of financial instruments	2,666	2,859
	2,666	3,249

Reconciliation of deferred tax liabilities is as follows:

	Opening balance US$ 000	Recognised in consolidated statement of income US$ 000	Closing balance US$ 000
2018			
Excess of capital allowances over depreciation	390	(390)	-
Changes in fair value of financial instruments	2,859	(193)	2,666
	3,249	(583)	2,666
2017			
Excess of capital allowances over depreciation	403	(13)	390
Changes in fair value of financial instruments	1,799	1,060	2,859
	2,202	1,047	3,249

b) Income tax credit

The major components of income tax credit for the year ended 31 December are as follows:

	2018 US$ 000	2017 US$ 000
Consolidated statement of income		
Current income tax credit (charge)	678	(2,065)
Movement in deferred tax liabilities recognised in statement of income	(583)	1,047
Income tax credit (charge) reported in the consolidated statement of income - net	95	(1,018)

The Group offsets tax assets and liabilities if and only if it has a legally enforceable right to set off current tax assets and current tax liabilities and the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same tax authority.

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16 LOANS PAYABLE

31 December 2018	Currency*	Subsidiaries US$ 000	Total US$ 000
Maturing within one year			
1 month or less	KWD	6,994	6,994
3 months or less but over 1 month	KWD	16,326	16,326
1 year or less but over 3 months	KWD	16,467	16,467
		39,787	39,787
Maturing after one year			
More than 1 year & less than 2 years	KWD	16,467	16,467
More than 2 years	US$	10,779	10,779
		27,246	27,246
		67,033	67,033
31 December 2017			
Maturing within one year			
1 month or less	KWD	662	662
3 months or less but over 1 month	KWD	16,501	16,501
	GBP	2,419	2,419
1 year or less but over 3 months	US$	2,749	2,749
	GBP	3,534	3,534
	KWD	28,652	28,652
		54,517	54,517
Maturing after one year			
More than 1 year & less than 2 years	KWD	16,562	16,562
More than 2 years	KWD	16,562	16,562
	US$	11,017	11,017
		44,141	44,141
		98,658	98,658

* KWD represents Kuwaiti Dinar and GBP represents Pound Sterling.

17 LONG TERM BONDS

	2018 US$ 000	2017 US$ 000
Fixed interest rate of 6.00% per annum and maturing on 26 July 2023, (KWD 14.9 million)	49,073	-
Floating interest at CBK discount rate + 2.75% per annum (capped at 7% per annum) and maturing on 26 July 2023, (KWD 25.1 million)	82,666	-
	131,739	-

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18 OTHER LIABILITIES

	2018 US$ 000	2017 US$ 000
Staff related payables	35,812	20,019
Accrued expenses	13,767	3,002
Interest payable	1,045	322
Dividends payable	2,505	2,511
Deferred tax (Note 15)	2,666	3,249
Derivative financial liabilities (Note 30)	376	115
Provisions for legal liabilities under IFRS 3	9,899	-
Deferred consideration payable (note 5)	8,264	-
Deferred income	13,898	-
Other payables	18,143	8,140
	106,375	37,358

19 EQUITY

a) Share capital

The Bank's authorised share capital as of 31 December 2018 comprised 500 million shares of US$ 0.50 each (2017: 1 billion shares of US$ 0.25 each).

The issued and fully paid up share capital as of 31 December 2018 comprised 202,263,041 shares of US$ 0.50 each (2017: 404,526,082 shares of US$ 0.25 each).

b) Share premium

Share premium represents a non-distributable reserve arising from the exercise of the Bank's Employee Share Option Plan. The reserve is credited with the difference between the proceeds from the exercise of share options and the par value of the shares issued under the plan.

c) Statutory reserve

In accordance with the Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the profit for the year is transferred to a statutory reserve until such time as the reserve reaches 50% of the Bank's paid-up share capital. The reserve is not available for distribution, except in circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

d) General reserve

The Directors have approved a transfer of 10% (2017: nil) of the profit of the Group for the year to general reserve in accordance with the Bank's Articles of Association. During the previous year, the Group transferred US$ 15,000 thousand from general reserves to retained earnings.

e) Dividend paid

No dividend was announced or paid during the years ended 31 December 2018 or 2017.

f) Foreign currency translation reserve

The foreign currency translation reserve represents the net foreign exchange gain or loss arising from translating the financial statements of the Bank's foreign subsidiaries and associated companies from their functional currencies into United States Dollars.

g) Reclassification adjustment

As part of the Group's restructuring in 2017, foreign currency losses of US$ 27,939 thousand and fair value losses of US$ 59,826 thousand were transferred to the consolidated statement of income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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20 FAIR VALUE RESERVE

	Note	2018 US$ 000	2017 US$ 000
Non-trading investments			
Balance at 1 January		11,767	(50,811)
Transition adjustment on adoption of IFRS 9	4 (b)	3,037	-
Transferred to consolidated statement of income:			
- as part of restructuring	19 (g)	-	59,826
- sale of non-trading investments		(5,190)	(1,880)
Net movement in unrealised fair values during the year		(21,015)	4,632
Balance at 31 December		(11,401)	11,767
Cash flow hedges			
Balance at 1 January		1,100	844
Net movement in the fair values during the year		180	256
Balance at 31 December		1,280	1,100
		(10,121)	12,867

21 PERPETUAL TIER 1 CAPITAL

On 28 March 2016, the Bank issued Perpetual Additional Tier 1 Capital (the "AT1 Capital") amounting to US$ 33,000 thousand.

The AT1 Capital constitutes subordinated obligations of the Bank and is classified as equity in accordance with IAS 32: Financial Instruments – Classification. The AT1 Capital does not have a maturity date and bears interest on its nominal amount from the date of issue at a fixed annual rate.

The AT1 Capital is redeemable by the Bank at its sole discretion on or after 28 March 2021 or on any interest payment date thereafter subject to the prior consent of the Central Bank of Bahrain.

The Bank at its sole discretion may elect not to distribute interest and this is not considered an event of default. If the Bank does not pay interest on the AT1 Capital (for whatever reason), then the Bank must not make any other distribution on or with respect to its other shares that rank equally with or junior to the AT1 Capital.

22 INTEREST INCOME

	2018 US$ 000	2017 US$ 000
Loans and receivables	1,084	2,044
Investments carried at fair value through statement of income	595	743
Placements with banks	3,532	1,243
Demand and call deposits with banks	1,152	401
	6,363	4,431

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23 INVESTMENT INCOME - NET

	2018 US$ 000	2017 US$ 000
Dividend income	1,669	1,907
(Loss) gain on sale of associates	(523)	2,668
Rental income from investment properties	3,945	4,757
Gain on sale of non-trading investments	-	4,369
(Loss) gain on investments carried at fair value through statement of income	(794)	3,902
Unrealized gain on investment properties	124	2,732
Gain on sale due to reclassification of investment	31	2,971
Others	360	504
	4,812	23,810

24 FEES AND COMMISSIONS - NET

	2018 US$ 000	2017 US$ 000
Credit related fees, commissions and other income - net	21,381	2,266
Management fees from fiduciary activities	14,965	15,971
Advisory fees	6,619	7,154
	42,965	25,391

25 SHARE OF RESULTS OF ASSOCIATES - NET

	2018 US$ 000	2017 US$ 000
Al Sharq Financial Brokerage Co.	-	129
Kamco Investment Fund	1,737	(1,787)
KAMCO Real Estate Yield Fund	21	-
Kuwait Education Fund	237	1,055
Manafae Investment Company	(423)	(172)
N.S. 88	(392)	(2)
United Capital Transport Company	(1,944)	(2,145)
	(764)	(2,922)

26 INTEREST EXPENSE

	2018 US$ 000	2017 US$ 000
Loans payable	3,975	6,129
Long term bonds	3,353	-
Due to banks and other financial institutions	6,617	7,548
Deposits from customers	787	1,555
	14,732	15,232

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27 CASH AND CASH EQUIVALENTS

	2018 US$ 000	2017 US$ 000
Demand and call deposits with banks excluding mandatory reserves	143,192	97,675
Placements with original maturities of ninety days or less	109,762	68,577
Cash and cash equivalents gross of expected credit losses	252,954	166,252
Expected credit losses as per IFRS 9	(1,233)	-
Cash and cash equivalents net of expected credit losses	251,721	166,252

28 RELATED PARTY TRANSACTIONS

Related parties represent the parent, associates and joint ventures, directors and key management personnel and entities which are controlled, jointly controlled or significantly influenced by any of the above mentioned parties.

The income and expenses in respect of related parties transactions during the year and included in the consolidated financial statements are as follows:

	2018			
	Parent US$ 000	Associates US$ 000	Other related parties US$ 000	Total US$ 000
Gain on investments carried at fair value through statement of income	-	-	15	15
Fees and commissions - net*	6,800	3,290	9,499	19,589
Dividend income	-	-	836	836
Rental income	-	-	2,711	2,711
Interest income	-	-	2,272	2,272
Interest expense	(547)	-	(4,562)	(5,109)
Others	(12)	-	(1,243)	(1,255)

	2017			
	Parent US$ 000	Associates US$ 000	Other related parties US$ 000	Total US$ 000
Gain on investments carried at fair value through statement of income	-	-	48	48
Gain on sale of non-trading investments	-	-	(11)	(11)
Fees and commissions - net	1,476	2,224	7,044	10,744
Dividend income	-	-	503	503
Rental income	-	-	2,457	2,457
Interest income	-	-	2,746	2,746
Interest expense	-	-	(19,319)	(19,319)
Others	-	-	(1,023)	(1,023)

* The Bank and UGHC have entered into an arrangement for service sharing between the two group entities. In line with the arrangement the Bank will provide certain services and incur certain expenses on behalf of UGHC.

All related party transactions are on terms that are mutually agreed between the counterparties.

28 RELATED PARTY TRANSACTIONS (CONTINUED)

The year-end balances in respect of related parties included in the consolidated financial statements are as follows:

	2018			
	Parent US$ 000	Associates US$ 000	Other related parties US$ 000	Total US$ 000
Demand and call deposits with banks	-	-	21,120	21,120
Placements with banks	-	-	21,546	21,546
Non-trading investments	-	-	98,652	98,652
Loans and receivables	-	-	4,101	4,101
Other assets	102	1,716	9,083	10,901
Due to banks and other financial institutions	-	-	(135,908)	(135,908)
Deposits from customers	(14,365)	-	(7,074)	(21,439)
Other liabilities	-	-	(4,335)	(4,335)
Perpetual Tier 1 Capital	-	-	(10,000)	(10,000)
Off statement of financial position items:				
Letters of guarantee	-	-	150	150
Investment related commitments	-	-	3,194	3,194

	2017			
	Parent US$ 000	Associates US$ 000	Other related parties US$ 000	Total US$ 000
Demand and call deposits with banks	-	-	2,170	2,170
Placements with banks	-	-	22,777	22,777
Investments carried at fair value through statement of income	-	-	2,209	2,209
Non-trading investments	-	-	66,274	66,274
Loans and receivables	-	-	33,648	33,648
Other assets	2,357	-	7,212	9,569
Due to banks and other financial institutions	-	-	(134,689)	(134,689)
Deposits from customers	-	-	(18,902)	(18,902)
Loans payable	-	-	(14,078)	(14,078)
Other liabilities	-	-	(4,778)	(4,778)
Perpetual Tier 1 Capital	-	-	(10,000)	(10,000)
Off statement of financial position items:				
Letters of guarantee	-	-	150	150
Investment related commitments	-	-	4,000	4,000

All related party transactions are on terms that are mutually agreed between the counterparties. All related party exposures are performing.

28 RELATED PARTY TRANSACTIONS (CONTINUED)

The Parent has committed to acquire certain FVOCI investment of the Group at its carrying value of US$ 28 million.

Compensation of key management personnel was as follows:

	2018 US$ 000	2017 US$ 000
Short term employee benefits	5,991	3,943

29 COMMITMENTS AND CONTINGENCIES

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.

Letters of credit, guarantees (including standby letters of credit) and acceptances committed by the Group to make payments on behalf of customers if certain conditions are met under the terms of the contract.

The Group has the following credit and investment related commitments:

	2018 US$ 000	2017 US$ 000
Credit related		
Letters of guarantee	2,162	812
	2,162	812
Investment related commitments*	5,157	4,017
	7,319	4,829

* Investment related commitments represent commitments for capital calls of fund structures. These commitments can be called during the investment period of the fund which is normally 1 to 5 years.

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30 DERIVATIVES

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments.

The table below shows the positive and negative fair values of derivative financial instruments. The notional amount is that 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 and are not indicative of either market or credit risk.

			Notional amounts by term to maturity			
	Positive fair value	Negative fair value	Notional amount Total	Within 3 months	3 - 12 months	1 - 5 years
31 December 2018	US$ 000	US$ 000	US$ 000	US$ 000	US$ 000	US$ 000
*Derivatives held for trading **						
Forward foreign exchange contracts	1,171	(1,339)	767,694	420,762	327,311	19,621
Derivatives used as hedge of net investments in foreign operations						
Forward foreign exchange contracts	377	(585)	186,165	153,641	32,524	-
Derivatives used as cash flow hedges						
Interest rate swaps	1,280	-	75,000	-	-	75,000
31 December 2017						
*Derivatives held for trading **						
Forward foreign exchange contracts	774	(889)	427,968	274,505	153,463	-
Derivatives used as hedge of net investments in foreign operations						
Forward foreign exchange contracts	-	-	245,114	245,114	-	-
Derivatives used as cash flow hedges						
Interest rate swap	1,100	-	145,000	-	70,000	75,000

* The Group uses foreign currency denominated borrowings and forward currency contracts to manage some of its transaction exposures. These currency forward contracts are not designated as cash flow, fair value or net investment in foreign operations hedges and are entered into for periods consistent with currency transaction exposures.

Forward foreign exchange contracts are contractual agreements to either buy or sell a specified currency, at a specific price and date in the future, and are customised contracts transacted in the over-the-counter market.

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.

Hedge of net investments in foreign operations

The Bank has designated certain forward foreign exchange contracts to hedge against changes in the value of its investments in foreign operations for an amount of US$ 186 million (KWD 37.3 million and EUR 54.7 million) [2017: US$ 245 million (KWD 74 million)]. Gains or losses on the retranslation of these forward foreign exchange contracts are transferred to equity through other comprehensive income to offset any gains or losses on the translation of the net investments in foreign operations.

30 DERIVATIVES (CONTINUED)

Cash flow hedges

The Group is exposed to variability in interest cash flows on liabilities which bear interest at a variable rate. The Group uses interest rate swaps as cash flow hedges of these interest rate risks. A schedule indicating as at 31 December, the periods when the net cash flows are expected to occur and when they are expected to affect the consolidated statement of income is as follows:

	2018		2017	
	Within 1 year US$ 000	1-5 years US$ 000	Within 1 year US$ 000	1-5 years US$ 000
Net cash outflows (liabilities)	1,141	391	1,363	1,985
Other comprehensive income	1,280	-	1,100	-

31 RISK MANAGEMENT

a) Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is considered critical to the Group's continuing profitability.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Group's strategic planning process.

The major risks to which the Group is exposed while conducting its business and operations, and the means and organisational structure it employs to manage them strategically for building shareholder value, are outlined below.

Risk management structure

Each subsidiary within the Group is responsible for managing its own risks and has its own Board Committees, including Audit and Executive Committees in addition to other management committees such as Credit/ Investment Committee and Asset and Liability Committees (ALCO), or equivalent, with responsibilities generally the same as the Bank's committees.

The Board's role is to approve investment strategies of the Bank. However, it has delegated authority for the day-to-day decision making to the Executive Committee so that risk can be effectively managed within the Bank.

The Board of Directors has delegated the executive management of the Bank to the Acting Chief Executive Officer (who is not a Director) and has appointed several Board Committees to work with them and to form and define policies and approve procedures for all of the Bank's activities.

The Executive Management of the Bank is headed by the Acting Chief Executive Officer who is broadly responsible for the day to day conduct of the Bank's business in line with the Board's approved policies and procedures and complements and facilitates the Board in meeting its responsibility towards all stakeholders. He is assisted by the six members of the Bank's management team, each of whom is responsible for his or her respective department. Several management committees have been formed which are chaired by the Acting Chief Executive Officer.

Executive Committee

The Executive Committee comprises of four directors including the Chairman, Vice Chairman and two other directors. Board meetings are held through circulation to approve all proposals not within the Investment Committee's risk authority, as well as to act on all matters within the Board's remit.

Investment Committee

"The Investment Committee is mainly responsible for approving or recommending approval to the Executive Committee limits for individual exposures, investments and concentrations towards banks, countries, industries, risk rating classes, or other special risk asset categories. In addition, the Committee also monitors the overall risk profile of the Bank and recommends provision levels to the Executive Committee. The Investment Committee is constituted by a majority motion passed in the Executive Committee. Currently the Committee consists of four members.

31 RISK MANAGEMENT (CONTINUED)

a) Introduction (continued)

Risk management structure (continued)

Audit Committee

The Audit Committee is appointed by the Board and consists of four members who are Directors, including three independent Directors. The Audit Committee assists the Board in carrying out its responsibilities with respect to assessing (a) the quality and integrity of financial reporting, (b) the audit thereof, (c) the soundness of the internal controls of the Bank, (d) the risk assessment of the Bank's activities, and (e) the methods for monitoring compliance with laws, regulations and supervisory and internal policies.

Risk and Compliance Committee

The Risk and Compliance Committee is responsible for the monitoring and assessment of risks facing the Bank, the review of compliance with internal and external guidelines, the review and recommendation of provisioning requirements, the assessment of the impact on the Bank from new regulatory requirements, and review of Investment Committee decisions. The Committee comprises of six senior executives of the Bank including the Acting Chief Executive Officer. Additionally, the Head of Internal Audit and Quality Assurance participates in the Committee meetings in the capacity of an observer.

Asset and Liability Committee

The Asset and Liability Committee establishes policies and objectives for the asset and liability management of the Bank's statement of financial position in terms of structure, distribution, risk and return and its impact on profitability. It also monitors the cash flow, tenor and cost/yield profiles of assets and liabilities and evaluates the Bank's financial position both from interest rate sensitivity and liquidity points of view, making corrective adjustments based upon perceived trends and market conditions, monitoring liquidity, monitoring foreign exchange exposures and positions. The Committee comprises of six senior executives of the Bank including the Acting Chief Executive Officer.

Management Committee

The Management Committee acts as the steering committee of the Bank as well as a management forum to discuss any relevant issues. It meets on a weekly basis and consists of the Acting Chief Executive Officer and all Department Heads as well as Internal Audit. It also serves to follow up on a weekly basis on the daily conduct of the Bank's business activities. The Committee is headed by the Acting Chief Executive Officer.

Key Persons Committee

The Key Persons Committee comprises three members of senior management. The Committee is mainly responsible for the supervision of adequacy of compliance with the Central Bank of Bahrain and Bahrain Bourse guidelines on key persons trading (insider trading).

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected geographies and industry sectors. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Nominating and Remunerations Committee

The Nominating and Remuneration Committee (NRC) assists the Board in assessing the skills set of Board members and is responsible to oversee the preparation of appropriate nomination documents and notifications proposing candidates for directorships. It reviews the independence of directors on an annual basis, supervises the preparation of induction materials and orientation sessions, makes recommendations to the Board regarding the management structure and ensures that there is a succession plan in place. The NRC comprises of three members, all of whom are independent.

The NRC also recommends/ reviews the remuneration policies for the Board of Directors and senior management and submits recommendations for shareholders' approval.

31 RISK MANAGEMENT (CONTINUED)

a) Introduction (continued)

Risk mitigation

As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates and foreign currency transactions.

The risk profile is assessed before entering into hedge transactions, which are authorised by the appropriate level of seniority within the Group.

Where warranted, the Group enters into legally enforceable netting arrangements covering its money market and foreign exchange trading activities whereby the only net amounts may be settled at maturity. With regard to the credit risk in the off statement of financial statement exposures, third party guarantees are obtained wherever possible as a risk mitigation measure.

Concentration risk

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

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on country and counterparty limits and maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. Robust limit structures put in place by the Board ensures effective monitoring and control of concentration risk and any limit breaches are immediately rectified and reported to the Board.

b) Credit risk

Credit risk arises from the extension of credit facilities in the Group's banking and trading activities as well as in investment activities where there is a possibility that a counterparty may fail to honour its commitment whenever an investment may fail.

Credit risk is mitigated through:

(i) Establishing an appropriate credit risk environment;

(ii) Operating under a sound credit and investment approval process;

(iii) Maintaining appropriate credit administration, measurement and monitoring processes; and

(iv) Ensuring adequate controls over the credit risk management process.

The Group has well defined policies approved at the individual board level. These provide carefully documented guidelines for credit risk management. There is a two tier committee structure to approve and review credit and investment risk. The Investment Committee comprises of the Acting Chief Executive Officer, Head of Treasury and the Chief Financial Officer. The Head of Credit and Risk Management acts as a non-voting member to the Committee. Exposures beyond Investment Committee limits are approved by the Board's Executive Committee or by the Board of Directors.

31 RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

Maximum exposure to credit risk without taking account of any collateral or other credit enhancements

The table below shows the Group's maximum exposure to credit risk for the components of on and off statement of financial position exposure. The maximum exposure shown is gross before the effect of mitigation through the use of collateral arrangements, but after any expected credit losses.

	2018 US$ 000	2017 US$ 000
Demand and call deposits with banks	143,510	97,993
Placements with banks	108,529	68,577
Investments at FVTPL	6,941	11,678
Held-to-maturity investments	494	-
Loans and receivables	25,191	4,216
Other assets	58,931	29,740
Letters of guarantee	2,162	812
Derivative financial assets	1,280	1,100
	347,038	214,116

Risk concentrations of the maximum exposure to credit risk

Concentration of risk is managed by client/counterparty, by geographical region and by industry sector. The maximum credit exposure to any single client or counterparty as of 31 December 2018 was US$ 31.3 million (2017 US$ 72.1 million) before taking account of collateral or other credit enhancements.

An analysis of the Group's financial assets by geographical region, before taking into account collateral held or other credit enhancements, is as follows:

	G.C.C. US$ 000	Middle East and North Africa US$ 000	Europe US$ 000	Americas US$ 000	Others US$ 000	Total US$ 000
Demand and call deposits with banks	119,762	192	474	23,082	-	143,510
Placements with banks	85,267	23,262	-	-	-	108,529
Investments at FVTPL	6,941	-	-	-	-	6,941
Held-to-maturity investments	-	494	-	-	-	494
Loans and receivables	17,816	7,375	-	-	-	25,191
Other assets	51,061	6,735	2	1,133	-	58,931
Letters of guarantee	15	343	1,647	157	-	2,162
Derivative financial assets	1,280	-	-	-	-	1,280
31 December 2018	282,142	38,401	2,123	24,372	-	347,038
Demand and call deposits with banks	22,064	111	1,963	73,844	11	97,993
Placements with banks	45,800	22,777	-	-	-	68,577
Investments at FVTPL	11,678	-	-	-	-	11,678
Loans and receivables	3,834	382	-	-	-	4,216
Other assets	27,715	1,257	4	764	-	29,740
Letters of guarantee	662	150	-	-	-	812
Derivative financial assets	1,100	-	-	-	-	1,100
31 December 2017	112,853	24,677	1,967	74,608	11	214,116

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31 RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

Risk concentrations of the maximum exposure to credit risk (continued)

An industry sector analysis of the Group's financial assets, before taking into account collateral held or other credit enhancements, is as follows:

At 31 December 2018	Trading & Manufacturing US$ 000	Banks and other financial institutions US$ 000	Construction and real estate US$ 000	Individuals US$ 000	Others US$ 000	Total US$ 000
Demand and call deposits with banks	-	143,510	-	-	-	143,510
Placements with banks	-	108,529	-	-	-	108,529
Investments at FVTPL	-	6,941	-	-	-	6,941
Held-to-maturity investments	-	494	-	-	-	494
Loans and receivables	-	1,516	-	23,283	392	25,191
Other assets	-	53,485	-	10	5,436	58,931
Letters of guarantee	-	2,162	-	-	-	2,162
Derivative financial assets	-	1,280	-	-	-	1,280
	-	317,917	-	23,293	5,828	347,038
At 31 December 2017						
Demand and call deposits with banks	-	97,993	-	-	-	97,993
Placements with banks	-	68,577	-	-	-	68,577
Investments at FVTPL	-	11,678	-	-	-	11,678
Loans and receivables	-	-	1,873	1,670	673	4,216
Other assets	15,283	5,366	2,298	752	6,041	29,740
Letters of guarantee	662	150	-	-	-	812
Derivative financial assets	-	1,100	-	-	-	1,100
	15,945	184,864	4,171	2,422	6,714	214,116

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 for commercial lending include charges over real estate properties, inventory, trade receivables, trading securities and bank guarantees.

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

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

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31 RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

Credit risk exposure for each credit rating

At 31 December 2018	Investment grade US$ 000	Non-investment grade US$ 000	Unrated* US$ 000	Total US$ 000
Demand and call deposits with banks	143,071	318	121	143,510
Placements with banks	85,267	-	23,262	108,529
Investments at FVTPL	6,941	-	-	6,941
Held-to-maturity investments	-	-	494	494
Loans and receivables	-	-	25,191	25,191
Other assets	2,330	-	56,601	58,931
Letters of guarantee	-	-	2,162	2,162
Derivative financial assets	1,280	-	-	1,280
	238,889	318	107,831	347,038

* Includes exposures to counterparties not rated by credit rating agencies

At 31 December 2017	Investment grade US$ 000	Non-investment grade US$ 000	Unrated* US$ 000	Total US$ 000
Demand and call deposits with banks	97,498	318	177	97,993
Placements with banks	45,800	-	22,777	68,577
Investments at FVTPL	11,678	-	-	11,678
Loans and receivables	-	-	4,216	4,216
Other assets	1,406	34	28,300	29,740
Letters of guarantee	662	-	150	812
Derivative financial assets	1,100	-	-	1,100
	158,144	352	55,620	214,116

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risk and the comparison of credit exposures across all business lines, geographic regions and products. All externally rated credit risk exposures are rated by the relevant External Credit Assessment Institutions ("ECAIs").

Additionally, the internal risk ratings of the Group's externally unrated credit risk exposures which are largely subjective, are tailored to the various categories and are derived in accordance with the internal rating policy and practices. The attributable internal risk ratings are assessed and updated on a regular basis.

31 RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

Credit risk exposure for each credit rating (continued)

The table above reflects the risk ratings of the credit risk exposures rated by the relevant ECAIs. All of the externally unrated credit risk exposures have been classified under "Unrated" category.

Restructured 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, the loan is no longer considered past due. The Group has not restructured any loans as of 31 December 2018 (31 December 2017: Same).

Offsetting financial assets and financial liabilities

The disclosures set out in the table below include financial assets and financial liabilities that are offset in the Group's statement of financial position:

	Loans and receivables US$ 000	Customer deposits US$ 000
31 December 2018		
Gross amounts of recognised financial asset / liability	285,000	285,000
Gross amounts offset in the consolidated statement of financial position	(285,000)	(285,000)
Net amount of financial liability presented in the consolidated statement of financial position	-	-
31 December 2017		
Gross amounts of recognised financial asset / liability	305,700	305,700
Gross amounts offset in the consolidated statement of financial position	(305,700)	(305,700)
Net amount of financial liability presented in the consolidated statement of financial position	-	-

c) Market risk

Market risk is defined as the risk of losses in the value of on-or-off statement of financial position financial instruments caused by a change in market prices or rates, (including changes in interest rates and foreign exchange rates). The Group's policy guidelines for market risk have been vetted by the Board of Directors in compliance with the rules and guidelines provided by the Central Bank of Bahrain. The Central Bank of Bahrain guidelines introduced a risk measurement framework whereby all locally incorporated banks in Bahrain are required to measure and apply capital charges in respect of their market risk in addition to capital requirements for credit risk and operational risk.

The market risk subject to capital charge normally arises from changes in value due to market forces in the following exposures:

- Interest rate instruments and securities in the trading book; and
- Foreign exchange throughout the banking book.

The Group has entered into interest rate swaps and forward foreign exchange contracts for hedging purposes and does not actively trade in derivatives.

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31 RISK MANAGEMENT (continued)

c) Market risk (continued)

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's consolidated statement of income based on the consolidated statement of financial position as of 31 December:

Currency	Increase in basis points 2018	Sensitivity of net interest income 2018 US$ 000	Increase in basis points 2017	Sensitivity of net interest income 2017 US$ 000
Kuwaiti Dinar	+ 25	(260)	+ 25	(356)
United States Dollar	+ 25	(104)	+ 25	(147)
Euro	+ 25	(4)	+ 25	13
Pound Sterling	+ 25	-	+ 25	-
Others	+ 25	286	+ 25	32

The decrease in the basis points will have an opposite impact on the net interest income.

The sensitivity of the consolidated statement of income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate financial assets and financial liabilities held at 31 December 2018, including the effect of hedging instruments.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group considers the United States Dollar as its functional currency. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

The table below indicates the effect on profit before tax for the positions as at statement of financial position date as a result of change in the currency rate with all other variables held constant.

Currency	Change in currency rate in % 2018	Effect on profit before tax 2018 US$ 000	Effect on equity 2018 US$ 000	Change in currency rate in % 2017	Effect on profit before tax 2017 US$ 000	Effect on equity 2017 US$ 000
Kuwaiti Dinar	+2	(16,280)	19,615	+2	(6,174)	2,143
	-2	16,280	(19,615)	-2	6,174	(2,143)
Euro	+2	(1,425)	24,037	+2	(59)	3
	-2	1,425	(24,037)	-2	59	(3)
Pound Sterling	+2	17	-	+2	(121)	-
	-2	(17)	-	-2	121	-

31 RISK MANAGEMENT (CONTINUED)

c) Market risk (continued)

Equity price risk

Equity price risk arises from the change in fair values of equity investments. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

The geographical distribution of the Group's equity investments is as follows:

Geographical distribution

At 31 December 2018	Middle East/ North Africa US$ 000	Europe US$ 000	North America US$ 000	Others US$ 000	Total US$ 000
Investments carried at fair value through statement of income					
Quoted equities	10,584	879	783	32	12,278
Unquoted equities	280	-	2,930	-	3,210
Managed funds	42,706	9,916	6,801	-	59,423
	53,570	10,795	10,514	32	74,911
Non-trading investments					
Quoted equities	45,219	-	-	-	45,219
Unquoted equities	76,565	40,109	3,182	442	120,298
Managed funds	1,124	-	973	33	2,130
	122,908	40,109	4,155	475	167,647
Total	176,478	50,904	14,669	507	242,558

At 31 December 2017	Middle East/ North Africa US$ 000	Europe US$ 000	North America US$ 000	Others US$ 000	Total US$ 000
Investments carried at fair value through statement of income					
Quoted equities	6,303	-	1	1	6,305
Managed funds	956	263	66	-	1,285
	7,259	263	67	1	7,590
Non-trading investments					
Quoted equities	31,514	-	10,567	-	42,081
Unquoted equities	111,629	25,609	5,879	-	143,117
Managed funds	34,129	-	2,239	-	36,368
	177,272	25,609	18,685	-	221,566
Total	184,531	25,872	18,752	1	229,156

At the reporting date, the exposure to listed equity securities at fair value was US$ 57,497 thousand (2017: US$ 48,386 thousand). A decrease of 10% on the market indices of MENA stock exchanges could have an impact of approximately US$ 5,750 thousand (2017: US$ 4,839 thousand) on the income or equity attributable to the Group, depending on whether the decline is significant or prolonged. The majority of the equities in the MENA region are quoted on the Boursa Kuwait.

31 RISK MANAGEMENT (CONTINUED)

d) Liquidity risk

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2018 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

At 31 December 2018	On demand US$ 000	1 - 6 months US$ 000	6 - 12 months US$ 000	1 - 5 years US$ 000	Over 5 years US$ 000	Total US$ 000
Financial liabilities						
Due to banks and other financial institutions	120,879	-	100,000	-	-	220,879
Deposits from customers	31,145	1,463	-	-	-	32,608
Loans payable	-	23,320	16,467	27,246	-	67,033
Long term bonds	-	-	-	131,739	-	131,739
Other liabilities	-	63,601	-	42,774	-	106,375
Total non-derivative undiscounted financial liabilities	152,024	88,384	116,467	201,759	-	558,634
Derivatives						
Net cash outflows on interest rate swaps	-	571	571	390	-	1,532
Gross settled foreign currency derivatives	-	846,491	87,747	19,621	-	953,859
Off-statement of financial position items						
Letters of guarantee	-	-	2,162	-	-	2,162
Investment related commitments	-	-	-	5,157	-	5,157

The Group expects that not all of contingent items or commitments will be drawn before expiry of the commitments.

At 31 December 2017	On demand US$ 000	1 - 6 months US$ 000	6 - 12 months US$ 000	1 - 5 years US$ 000	Over 5 years US$ 000	Total US$ 000
Financial liabilities						
Due to banks and other financial institutions	133,661	16,757	101,423	-	-	251,841
Deposits from customers	62,395	6,323	-	-	-	68,718
Loans payable	663	40,270	14,746	49,224	-	104,903
Other liabilities	37,358	-	-	-	-	37,358
Total non-derivative undiscounted financial liabilities	234,077	63,350	116,169	49,224	-	462,820
Derivatives						
Net cash outflows on interest rate swaps	-	780	583	1,985	-	3,348
Gross settled foreign currency derivatives	-	673,082	-	-	-	673,082
Off statement of financial position items						
Letters of guarantee	-	-	812	-	-	812
Investment related commitments	-	-	-	4,017	-	4,017

The Group expects that not all of contingent items or commitments will be drawn before expiry of the commitments.

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At 31 December 2018

31 RISK MANAGEMENT (CONTINUED)

d) Liquidity risk (continued)

In order to ensure that the Group can meet its financial obligations as they fall due, there is a close monitoring of its assets / liabilities position. Besides other functions, the Asset-Liability Committee evaluates the statement of financial position both from a liquidity and an interest rate sensitivity point of view. The whole process is aimed at ensuring sufficient liquidity to fund its ongoing business activities and to meet its obligations as they fall due. A diversified funding base has evolved in deposits raised from the interbank market, deposits received from customers and medium term funds raised through syndicated and commodity based murabaha transactions. These, together with the strength of its equity and the asset quality, ensure that funds are made available on competitive rates.

The maturity analysis of assets and liabilities analysed according to when they are expected to be recovered or settled are as follows:

At 31 December 2018	Less than 12 months US$ 000	Over 12 months US$ 000	Total US$ 000
Demand and call deposits with banks	143,192	318	143,510
Placements with banks	108,529	-	108,529
Investments carried at fair value through statement of income	81,852	-	81,852
Non-trading investments	45,252	122,395	167,647
Held-to-maturity investment	-	494	494
Loans and receivables	21,169	4,022	25,191
Other assets	61,097	-	61,097
Investments in associates	-	71,513	71,513
Investment properties	-	107,629	107,629
Property and equipment	-	39,394	39,394
Goodwill and other intangible assets	-	66,634	66,634
Total assets	461,091	412,399	873,490
Due to banks and other financial institutions	220,879	-	220,879
Deposits from customers	32,608	-	32,608
Loans payable	39,787	27,246	67,033
Long term bonds	-	131,739	131,739
Other liabilities	63,601	42,774	106,375
Total liabilities	356,875	201,759	558,634
Net	104,216	210,640	314,856

31 RISK MANAGEMENT (CONTINUED)

d) Liquidity risk (continued)

At 31 December 2017	Less than 12 months US$ 000	Over 12 months US$ 000	Total US$ 000
Demand and call deposits with banks	97,675	318	97,993
Placements with banks	68,577	-	68,577
Investments carried at fair value through statement of income	19,268	-	19,268
Non-trading investments	42,081	179,485	221,566
Loans and receivables	1,564	2,652	4,216
Other assets	31,820	-	31,820
Investments in associates and joint venture	-	77,512	77,512
Investment properties	-	105,093	105,093
Property and equipment	-	1,679	1,679
Goodwill	-	52,390	52,390
Total assets	260,985	419,129	680,114
Due to banks and other financial institutions	250,211	-	250,211
Deposits from customers	31,018	-	31,018
Loans payable	54,517	44,141	98,658
Other liabilities	37,358	-	37,358
Total liabilities	373,104	44,141	417,245
Net	(112,119)	374,988	262,869

e) Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. When controls fail to perform operational risk can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group has established a board approved framework for operational risk management which comprehensively outlines operational risk appetite for the Bank and provides operational risk management procedures. The Framework is supported by a dedicated operational risk system covering Loss Data Collection, Risk and Control Self Assessment and Key Indicator modules which have been rolled out in the Bank. While, the Group cannot expect to eliminate all operational risks, but through dedicated operational risk framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

32 FAIR VALUE MEASUREMENT

The Group uses the hierarchy for determining and disclosing the fair value of financial instruments as disclosed in Note 2.

Management has assessed that financial assets comprising of demand and call deposits with banks, placements with banks, and loans and receivables maturing within one year, and financial liabilities comprising of on-demand customer deposits, amounts due to banks and loans payable falling due within one year approximate their carrying values largely due to the short term maturities of these instruments.

The following table provides the fair value measurement hierarchy of the Group's assets and liabilities.

Quantitative disclosures fair value measurement hierarchy for assets as at 31 December 2018:

	Fair value measurement using			
	Level 1 US$ 000	Level 2 US$ 000	Level 3 US$ 000	Total US$ 000
Assets measured at fair value				
Investments carried at fair value through statement of income				
Quoted equities	12,278	-	-	12,278
Quoted debt securities	6,941	-	-	6,941
Unquoted equities	-	-	3,210	3,210
Managed funds	-	43,516	15,907	59,423
Non-trading investments				
Equities - quoted	45,219	-	-	45,219
Equities - unquoted	-	69,025	51,273	120,298
Other managed funds	-	-	2,130	2,130
Derivatives				
Interest rate swaps	-	1,280	-	1,280
Investment properties	-	-	107,629	107,629
	64,438	113,821	180,149	358,408
Liabilities measured at fair value				
Derivatives				
Forward foreign exchange contracts	-	(376)	-	(376)
	-	(376)	-	(376)

32 FAIR VALUE MEASUREMENT (CONTINUED)

Quantitative disclosures fair value measurement hierarchy for assets as at 31 December 2017:

	Fair value measurement using			
	Level 1 US$ 000	Level 2 US$ 000	Level 3 US$ 000	Total US$ 000
Assets measured at fair value				
Investments carried at fair value through statement of income				
Quoted equities	6,305	-	-	6,305
Quoted debt securities	11,678	-	-	11,678
Managed funds	-	1,285	-	1,285
Non-trading investments				
Equities - quoted	42,081	-	-	42,081
Equities - unquoted	-	82,410	463	82,873
Other managed funds	-	25,011	10,342	35,353
Derivatives				
Interest rate swaps	-	1,100	-	1,100
Investment properties	-	-	105,093	105,093
	60,064	109,806	115,898	285,768
Liabilities measured at fair value				
Derivatives				
Forward foreign exchange contracts	-	(115)	-	(115)
	-	(115)	-	(115)

Transfers between Level 1, Level 2 and Level 3

During the year ended 31 December 2018 there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into or out of Level 3 fair value measurement.

Reconciliation of fair value measurement of investments in level 3 of the fair value hierarchy:

	Equities US$ 000	Other managed funds US$ 000	Investment properties US$ 000	Total US$ 000
As at 1 January 2017	474	15,581	101,326	117,381
Recognised in statement of income	-	-	3,767	3,767
Net purchases, sales and transfers and settlements	(11)	(5,024)	-	(5,035)
Remeasurement recognised in OCI	-	(215)	-	(215)
As at 1 January 2018	**463**	**10,342**	**105,093**	**115,898**
Recognised in statement of income	-	(652)	124	(528)
Net purchases, sales and transfers and settlements	64,052	8,347	2,171	74,570
Remeasurement recognised in OCI	(10,032)	-	-	(10,032)
Other adjustments	-	-	241	241
As at 31 December 2018	54,483	18,037	107,629	180,149

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At 31 December 2018

33 CAPITAL ADEQUACY

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") as adopted by the Central Bank of Bahrain.

Capital management

The primary objectives of the Group's capital management are to ensure that the Group complies with capital requirements of the Central Bank of Bahrain and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, or issue equity securities. No changes were made in the capital management objectives, policies and processes from previous years.

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

	2018 US$ 000	2017 US$ 000
Capital base:		
Tier 1	147,347	188,657
Tier 2	6,219	3,428
Total capital base (a)	153,566	192,085
Credit risk weighted exposure	944,533	750,074
Market risk weighted exposure	10,375	87,463
Operational risk weighted exposure	38,413	54,400
Total risk weighted exposure (b)	993,321	891,937
Capital adequacy (a/b * 100)	15.46%	21.54%
Minimum requirement	12.5%	12.5%

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, statutory reserve, general reserve, treasury share reserve, foreign currency reserve, retained earnings and non-controlling interests less goodwill. The other component of regulatory capital is Tier 2 capital, which includes subordinated long term debt and fair value reserves.

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