(Incorporated in Switzerland 1967)

Habib Bank AG Zurich

United Arab Emirates

Annual Report 2018

Habib Bank AG Zurich
UAE Branches

Financial statements
31 December 2018

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31 December 2018

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Independent Auditors' Report

To the Chief Executive Officer of Habib Bank AG Zurich – UAE Branches

Report on the Audit of Financial Statements

Opinion

We have audited the financial statements of Habib Bank AG Zurich – UAE Branches ("the Bank"), which comprise the statement of financial position as at 31 December 2018, the statement of profit or loss and other comprehensive income, changes in head office capital & reserves and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in the United Arab Emirates, 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.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Bank'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 management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 financial statements.

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

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's 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 Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance 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

Further, as required by Article (114) of the Decretal Federal Law No. (14) of 2018, we report that we have obtained all the information and explanations we considered necessary for the purposes of our audit.

KPMG Lower Gulf Limited

Emilio Pera
Registration Number: 1146
Dubai, United Arab Emirates
Date: 28 MAR 2019

Habib Bank AG Zurich – UAE Branches

Statement of financial position

as at 31 December

	Note	2018 AED 000	2017 AED 000
ASSETS			
Cash and balances with UAE Central Bank	6	**2,412,497**	2,685,446
Due from banks	7	**3,739,373**	3,932,281
Due from related parties	26	**130,546**	103,183
Loans and Islamic financing receivables	8	**3,458,343**	3,684,831
Investments	9	**1,097,127**	1,330,141
Property and equipment	10	**63,876**	56,220
Customers' indebtedness for acceptances		**42,542**	70,326
Deferred tax assets	11	**78,246**	41,067
Other assets	12	**117,366**	112,446
Total assets		**11,139,916**	12,015,941
LIABILITIES			
Deposits from customers	13	**9,387,053**	10,096,332
Due to banks	14	**50,836**	74,872
Due to related parties	26	**5,706**	49,190
Liabilities under acceptances		**42,542**	70,326
Other liabilities	15	**197,094**	250,492
Total liabilities		**9,683,231**	10,541,212
CAPITAL AND RESERVES			
Allocated capital	16	**100,000**	100,000
Legal reserve	17	**50,000**	50,000
Retained earnings		**1,319,446**	1,330,098
Revaluation Reserves		**(15,165)**	(5,369)
Impairment Reserves	5	**2,404**	-
Total capital and reserves		**1,456,685**	1,474,729
Total liabilities, capital and reserves		**11,139,916**	12,015,941
Contingent liabilities and other commitments	18	**637,634**	677,598

The notes on pages 8 to 75 form an integral part of these financial statements.

These financial statements were approved on 2 8 MAR 2019.

Chief Executive Officer

The independent auditors' report is set out on page 1 - 3.

Habib Bank AG Zurich – UAE Branches

Statement of profit or loss and other comprehensive income
for the year ended 31 December

	Note	**2018 AED 000**	2017 AED 000
Interest income and income from Islamic financing	*19*	**326,036**	280,621
Interest expense and distribution to Islamic depositors	*20*	**(31,094)**	(26,518)
Net interest income and income from Islamic financing		**294,942**	254,103
Fee and commission income (net)	*21*	**59,250**	66,347
Other income	*22*	**71,692**	62,088
Operating income		**425,884**	382,538
General and administrative expenses	*23*	**(246,789)**	(231,936)
Impairment allowance (net)	*8(c)*	**(24,522)**	(42,054)
Profit for the year before taxation		**154,573**	108,548
Taxation	*24*	**(35,135)**	(24,303)
Profit for the year after taxation		**119,438**	84,245
Other comprehensive income			
Items that may subsequently reclassified to profit or loss:			
FVOCI – net changes in fair value		**(17,120)**	(2,255)
Impairment allowance on FVOCI bonds		**7,324**	-
Other comprehensive loss for the year before tax		**(9,796)**	(2,255)
Total comprehensive income for the year		**109,642**	81,990

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The independent auditors' report is set out on page 1 - 3.

Habib Bank AG Zurich – UAE Branches

Statement of changes in Head Office capital and reserves
for the year ended 31 December

	Allocated Capital AED 000	Legal Reserve AED 000	Retained Earnings AED 000	Impairment Reserve AED 000	Fair Value Reserve AED 000	Total AED 000
As at 1 January 2017	100,000	50,000	1,245,853	-	(3,114)	**1,392,739**
Profit for the year	-	-	84,245	-	-	**84,245**
Other Comprehensive Income	-	-	-	-	(2,255)	**(2,255)**
As at 31 December 2017	**100,000**	**50,000**	**1,330,098**	-	**(5,369)**	**1,474,729**
Effects of adopting IFRS 9	-	-	(158,991)	-	-	**(158,991)**
IFRS 9 Adjustment – Related Deferred Tax Assets	-	-	31,305	-	-	**31,305**
Transfer to Impairment Reserve	-	-	(2,404)	2,404	-	**-**
As at 1 January 2018	**100,000**	**50,000**	**1,200,008**	**2,404**	**(5,369)**	**1,347,043**
Profit for the year	-	-	119,438	-	-	**119,438**
Other Comprehensive Income	-	-	-	-	(9,796)	**(9,796)**
As at 31 December 2018	**100,000**	**50,000**	**1,319,446**	**2,404**	**(15,165)**	**1,456,685**

Habib Bank AG Zurich – UAE Branches

Statement of cash flows
for the year ended 31 December

	Note	2018 AED 000	2017 AED 000
Operating activities			
Profit for the year before taxation		**154,573**	108,548
Adjustments for:			
Impairment allowance on loans and Islamic financing receivables (net)	*8(c)*	**14,292**	38,600
Impairment allowance on other assets (net)	*8(c)*	**5,712**	3,454
Impairment allowance on Investments	*8(c)*	**7,055**	-
Impairment reversal on due from bank	*8(c)*	**(2,537)**	-
Depreciation on property and equipment	*10*	**7,229**	5,319
(Gain)/loss on redemption/revaluation of Investments (net)		**3,299**	(535)
Discount / Premium on Investments (net)		**13,383**	11,992
Loss on disposal of property and equipment		**125**	153
Operating profit before changes in net operating assets		**203,131**	167,531
Change in UAE Central Bank certificates of deposit with maturity over three months		**(35,000)**	240,000
Change in statutory reserve with UAE Central Bank		**143,015**	(36,962)
Change in bank placements with maturity over three months		**(299,384)**	997,832
Change in loans and Islamic financing receivables		**66,428**	(80,334)
Change in other assets		**(14,158)**	(24,311)
Change in deposits from customers		**(709,279)**	(284,563)
Change in other liabilities		**(69,713)**	18,209
		(714,960)	997,402
Income tax paid		**(21,135)**	(20,759)
Net cash generated / (used) in operating activities		**(736,095)**	976,643
Investing activities			
Purchase of property and equipment	*10*	**(15,028)**	(10,124)
Sale proceeds from disposal of property and equipment		**18**	3
Net proceeds from redemption of investments		**372,789**	150,122
Purchase of investments	*9(a)*	**(174,070)**	(651,406)
Net cash used in investing activities		**183,709**	(511,405)
Balance at 1 January		**4,363,089**	3,897,851
Increase / (decrease) in cash and cash equivalents		**(552,386)**	465,238
Balance at 31 December	*31*	**3,810,703**	4,363,089

The notes on pages 8 to 75 form an integral part of these financial statements.

The independent auditors' report is set out on page 1 - 3.

1. Legal status and activities

Habib Bank AG Zurich, UAE Branches ("the Bank") operates in the Emirates of Abu Dhabi, Dubai and Sharjah under a full commercial banking license issued by the Central Bank of United Arab Emirates. The Head Office of the Bank is Habib Bank AG Zurich ("Head Office") incorporated in Switzerland. The registered address of the Bank is PO Box 3306, Dubai, United Arab Emirates.

These financial statements represent the combined financial position and results of the eight branches of the Bank in the United Arab Emirates.

The main activities of the Bank in the United Arab Emirates consist of providing retail, commercial and Islamic banking services.

2. Basis of preparation

2.1 Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and comply with relevant laws of the U.A.E.

From 1 January 2018, under Federal Decree-Law No. (8) of 2017, Value Added Tax (VAT) has been levied in United Arab Emirates. The Bank complies with the executive regulations and is required to file quarterly returns.

2.2 Functional and presentation currency

These financial statements are presented in United Arab Emirates Dirhams ("AED") which is the Bank's functional and presentation currency. Except as otherwise indicated, financial information presented in AED has been rounded to the nearest thousand.

2.3 Use of estimates and judgments

The preparation of the Bank's financial statements in conformity with IFRS requires management to make certain judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses. Such estimates are necessary based on assumptions about several factors involving varying degree of judgment and uncertainty and actual results may therefore differ, resulting in future changes in these estimates.

Estimates and judgments are continually evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances.

2. Basis of preparation (continued)

2.3 Use of estimates and judgments (continued)

Significant items where the use of estimates and judgments are required are outlined below:

(i) *Income taxes/ Deferred tax asset*

The Bank is subject to income taxes in each of the three Emirates in the UAE that it operates in. There are certain transactions and calculations for which ultimate tax determination is uncertain during the ordinary course of business. The Bank recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

(ii) *Contingent liability arising from litigations*

Due to nature of its operations the Bank may be involved in litigation arising in the ordinary course of business. Provision for contingent liabilities arising from litigation is based on the probability of outflow of economic resources and reliability of estimating such outflow. Such matters are subject to many uncertainties and the outcome of individual matters is not predictable with assurance.

Applicable from 1 January 2018:

(iii) *Financial asset classification*

Assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding.

(iv) *Significant increase in credit risk*

ECL are measured as an allowance equal to 12-month ECL for Stage 1 assets, or lifetime ECL for Stage 2 or Stage 3 assets. An asset moves to Stage 2 when its credit risk has increased significantly since initial recognition. IFRS 9 does not define what constitutes a significant increase in credit risk. In assessing whether the credit risk of an asset has significantly increased the Bank takes into account qualitative and quantitative reasonable and supportable forward looking information.

(v) *Models and assumptions used*

The Bank uses various models and assumptions in measuring fair value of financial assets as well as in estimating ECLs. Judgement is applied in identifying the most appropriate model for each type of asset, as well as for determining the assumptions used in these models, including assumptions that relate to key drivers of credit risk.

(vi) *Establishing groups of assets with similar credit risk characteristics*

When ECLs are measured on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics. The Bank monitors the appropriateness of the credit risk characteristics on an ongoing basis to assess whether they continue to be similar. This is required in order to ensure that should credit risk characteristics change there is an appropriate re-segmentation of the assets.

2. Basis of preparation (continued)

2.3 Use of estimates and judgments (continued)

(vi) *Establishing groups of assets with similar credit risk characteristics (continued)*

This may result in new portfolios being created or assets moving to an existing portfolio that better reflects the similar credit risk characteristics of that group of assets. Re-segmentation of portfolios and movement between portfolios is more common when there is a significant increase in credit risk (or when that significant increase reverses) and so assets move from 12-month to lifetime ECLs, or vice versa, but it can also occur within portfolios that continue to be measured on the same basis of 12-month or lifetime ECLs but the amount of ECL changes because the credit risk of the portfolios differ.

Applicable before 1 January 2018:

(i) *Impairment losses on loans and advances and Islamic financing*

The Bank reviews its loan portfolios to assess impairment at each reporting date. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio.

This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows (excluding future expected credit losses that have not yet been incurred). The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(ii) *Impairment of available-for-sale investments*

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment. In making this judgment, the Bank evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology or operational and financing cash flows.

2.4 Basis of measurement

The financial statements have been prepared on the historical cost basis except for the following:

- Derivative financial instruments are measured at fair value;
- Financial assets at fair value through other comprehensive income (applicable from 1 January 2018); and
- Financial assets at available-for-sale are measured at fair value (applicable before 1 January 2018)

3 Significant accounting policies

The accounting policies set out below have been applied consistently to all the years presented in these financial statements, except changes in accounting policies resulting from the adoption of IFRS 9 and IFRS 15 as described below.

Transition

The Bank initially applied IFRS 15 and IFRS 9 on 1 January 2018 retrospectively in accordance with IAS 8 without any practical expedients. The adoption of IFRS 15 did not materially impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Bank. Accordingly, the impact on the comparative information due to adoption of IFRS 15 is limited only to new disclosure requirements (refer note 3.11).

However, changes in accounting policies resulting from the adoption of IFRS 9 have been applied as follows:

- Comparative periods have not been restated and differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in the retained earnings as of 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and is therefore not comparable to the information presented for the period under IFRS 9; and
- The assessments for determination of the business model within which a financial asset is held has been made on the basis of the facts and circumstances that existed at the date of initial application.

IFRS 7 Financial Instruments – Disclosures

IFRS 7 Financial Instruments: Disclosures, which was updated to reflect the differences between IFRS 9 and IAS 39 was also adopted by the bank together with IFRS 9, for the year beginning 1 January 2018. Refer note 5 for the transition disclosures.

3.1 Financial instruments

(a) Recognition and initial measurement

A financial instrument is any contract that gives rise to both a financial asset for the Bank and a financial liability or equity instrument for another party or vice versa.

All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

Recognised financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at FVPL) are added to or deducted from the fair value of the financial assets or financial liabilities respectively, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVPL are recognised immediately in statement of profit or loss.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

(a) Recognition and initial measurement (continued)

If the transaction price differs from fair value at initial recognition, the bank will account for such difference as follows:

- if fair value is evidenced by a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only data from observable markets, then the difference is recognised in statement of profit or loss on initial recognition (i.e. day 1 profit or loss); and

- in all other cases, the fair value will be adjusted to bring it in line with the transaction price (i.e. day 1 profit or loss will be deferred by including it in the initial carrying amount of the asset or liability).

After initial recognition, the deferred gain or loss will be released to statement of profit or loss on a rational basis, only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

(b) Fair Value measurement

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 by the Bank.

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

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 Bank 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.

Fair value hierarchy

The fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the Bank determines fair values using other valuation techniques.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

(b) Fair Value measurement (continued)

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

- Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- Level 3: Inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The Bank recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist, and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark profit rates, credit spreads in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

For the purpose of fair value disclosures, the Bank 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 hierarchy used by the Bank is set out in note 29.

3.1.1 Financial assets

Applicable from 1 January 2018:

a) Classification

The Bank classifies financial assets on initial recognition in the following categories:

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

Business model assessment

The Bank makes an assessment of the objective of a business model in which a financial asset is held at portfolio level, because this reflects the way the business is managed and information is provided to the management. The assessment is not determined by a single factor or activity. Instead, the entity considers all relevant information available at the date of the assessment. The information considered includes:

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

a) Classification (continued)

- The stated policies and objectives for the business 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 realising cash flows through the sale of the assets;

- How the performance of the portfolio and the financial asset held within the portfolio is evaluated and reported to the management;

- The risks that affect the performance of the portfolio and, in particular, the way in which those risks are managed;

- How the managers of the business are compensated;

- 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 Bank's stated objective for managing the financial assets is achieved and how cash flows are realised; and

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

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

In assessing whether the contractual cash flows are solely payments of principal and interest (SPPI), the Bank considers the contractual terms of the instrument.

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

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 Bank considers:

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

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

a) Classification (continued)

The Bank holds a portfolio of long-term fixed-rate loans for which the Bank has the option to propose to revise the interest rate at periodic reset dates. These reset rights are limited to the market rate at the time of revision. The Bank has determined that the contractual cash flows of these loans are SPPI because the interest rate varies in a way that is consideration for the time value of money, credit risk, other basic lending risks and costs associated with the principal amount outstanding.

Non-recourse loans

In some cases, loans made by the Bank that are secured by collateral of the borrower limit the Bank's claim to cash flows of the underlying collateral (non-recourse loans). The Bank applies judgment in assessing whether the non-recourse loans meet the SPPI criterion. The Bank typically considers the following information when making this judgement:

- Whether the contractual arrangement specifically defines the amounts and dates of the cash payments of the loan;
- The fair value of the collateral relative to the amount of the secured financial asset;
- The ability and willingness of the borrower to make contractual payments, notwithstanding a decline in the value of collateral;
- Whether the borrower is an individual or a substantive operating entity or is a special-purpose entity;
- The Bank's risk of loss on the asset relative to a full-recourse loan;
- The extent to which the collateral represents all or a substantial portion of the borrower's assets; and
- Whether the Bank will benefit from any upside from the underlying assets.

(i) Financial assets at amortized cost

A debt instrument, including loans and advances and Islamic financing asset is classified as being measured at amortized cost if it meets both of the following conditions and is not designated as at FVPL:

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

(ii) Financial assets at fair value through other comprehensive income (FVOCI)

A debt instrument is classified as being measured at FVOCI if it meets the following two conditions and the debt instrument is not designated at FVPL:

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

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

a) Classification (continued)

The Bank measures all equity investments at fair value through profit or loss, except where the Bank's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. This election is made on an investment-by-investment basis.

(iii) Financial assets at fair value through profit or loss (FVPL)

Financial assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL.

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

Applicable before 1 January 2018

a) Classification

(i) Loans and Islamic financing receivables

Loans and Islamic financing receivables are non-derivative financial asset with fixed or determinable payments that are not quoted in the active market. They arise when the Bank provides money, goods or services directly to a debtor with no intention of trading the receivable.

Loans and Islamic financing receivables are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

Murabaha

A contract whereby the Bank (the "Seller") sells an asset to its customer (the "Purchaser"), on a deferred payment basis, after purchasing the asset and gaining possession thereof and title thereto, where the Seller has purchased and acquired that asset, based on a promise received from the Purchaser to buy the asset once purchased according to specific Murabaha terms and conditions. The Murabaha sale price comprises the cost of the asset and a pre-agreed profit amount. Murabaha profit is internally accounted for on a time-apportioned basis over the period of the contract based on the principal amount outstanding. The Murabaha sale price is paid by the Purchaser to the Seller on an instalment basis over the period of the Murabaha as stated in the contract.

(ii) Investments

Investment securities are initially measured at fair value plus, in case of investment securities not at fair value through profit or loss, incremental direct transaction costs, and subsequently accounted for depending on their classification as either held to maturity, or available-for-sale.

(a) Held-to-maturity ("HTM")

HTM assets are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity. These include certain debt instruments.

HTM investments are carried at amortised cost (less impairment, if any) using the effective interest method.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

a) Classification (continued)

(a) Held-to-maturity ("HTM") (continued)

Sale of HTM investments is allowed only under the following circumstances:

- The investment is close enough to maturity as to have no impact on fair value;
- The principal is substantially received;
- Isolated events beyond the Bank's control;
- Significant credit deterioration; and
- Major business combination or disposal.

(b) Available for sale ("AFS")

These assets are initially measured at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses and foreign currency differences on debt instruments, are recognised in other comprehensive income and accumulated in the fair value reserve. When these assets are derecognised, the gain or loss accumulated in equity is reclassified to profit or loss.

b) Subsequent measurement

Applicable from 1 January 2018

The Bank measures financial instruments, such as derivatives and investments in equity and certain fixed income instruments, at fair value at each reporting date.

Financial asset classified as at FVOCI or FVPL are subsequently measured at fair value. Financial assets not carried at fair value are subsequently measured at amortized cost using the effective interest method, less expected credit allowances.

Applicable before 1 January 2018

Financial assets are recognised when the Bank becomes a party to the contractual provisions of the instrument.

Financial assets are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in the statement of profit or loss and other comprehensive income.

c) Reclassifications

Applicable from 1 January 2018

Financial assets are not reclassified subsequent to their initial recognition except in the period after the Bank changes its business model for managing financial assets. If the business model under which the Bank holds financial assets changes, the financial assets affected are reclassified. The classification and measurement requirements related to the new category apply prospectively from the first day of the first reporting period following the change in business model that results in reclassifying the Bank's financial assets. During the current and previous financial year there was no change in the business model under which the Bank holds financial assets and therefore no reclassifications were made.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

c) Reclassifications (continued)

Applicable before 1 January 2018

In cases where available-for-sale investments with a fixed maturity are reclassified as held-to-maturity investments, the fair value gains or losses until the date of the reclassification are held in OCI and amortised over the remaining life of the held-to-maturity investments using the effective interest rate method.

d) Foreign exchange gains and losses

Foreign currency transactions are recorded at rates of exchange ruling at the value dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to UAE Dirhams at the exchange rates prevailing at the reporting date. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated to UAE Dirhams at the exchange rates prevailing at the date of transaction. Non-monetary items that are measured based on historical cost in a foreign currency are not translated. Gains or losses are taken to the statement of profit or loss and other comprehensive income. Forward exchange contracts are valued at market rates applicable to the respective maturity.

For equity instruments measured at FVOCI, exchange differences are recognised in OCI in the investments revaluation reserve.

e) Impairment

Applicable from 1 January 2018

The Bank recognises loss allowances for expected credit losses (ECLs) on the following financial instruments that are not measured at FVPL:

- Due from banks;
- Debt investment securities;
- Loans and advances, Islamic financing and other financial assets;
- Loan commitments; and
- Financial guarantee contracts.

No impairment loss is recognised on equity investments.

The Bank considers a debt investment security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Bank does not apply the low credit risk exemption to any other financial instruments.

IFRS 9 outlines a ‘three-stage’ model for impairment based on changes in credit quality since initial recognition as summarised below:

- ***Stage 1 – Performing Financial Assets***
  Stage 1 assets are assessed based on Bank’s existing Credit Risk Management standards for acceptable credit quality, in line with the credit policy. These are assets / exposures which have not increased significantly in credit risk since initial recognition.
- ***Stage 2 – Financial Assets with Significant Increase in Credit Risk (SICR)***
  These are financial assets whose credit quality has deteriorated significantly since origination.
- ***Stage 3 – Credit impaired Financial Assets***
  Assets classified under this category are obligors which are unlikely to repay their contractual obligations, on a timely basis and are considered as defaulted obligors.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

e) Impairment (continued)

ECL Measurement:
ECL is measured as a probability-weighted estimate of the present value of cash shortfalls (i.e., the weighted average of credit losses, with the respective risks of a default occurring in a given time period used as the weights). When measuring ECL, the following would be taken into account:

- The probability-weighted outcome;
- The time value of money so that ECLs are discounted to the reporting date; and
- Reasonable and supportable information (especially forward looking information) that is available without undue cost or effort.

ECL measurement will be undertaken by considering a range of macroeconomic scenarios (at least more than 2) for computation of unbiased ECL estimates.

The general model for computation of ECL will be based on the four components as follows:

- **Probability of Default (PD)** – This is an estimate of the likelihood of default over a given time horizon.
- **Exposure at Default (EAD) –** This is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities.
- **Loss Given Default (LGD) –** This is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from any collateral. It is usually expressed as a percentage of the EAD.
- **Discount Rate (DF)** – This is used to discount an expected loss to a present value at the reporting date using the effective interest rate (EIR) at initial recognition.

For term products, the Bank can estimate EIR by converting a facility’s contractual rate into its effective reducing rate. The contractual interest rate for a facility can be used as a substitute for the EIR when the bank is not able to reliably estimate cash flows or expected life.

For off balance sheet non funded exposures/ non term products, since, the expected cash flows do not exist, the swap rate of the currency of the contractual exposure plus the credit risk premium of the contractual exposure can be used as a substitute for EIR. Alternatively, Bank can also use the portfolio level yield as the discounting factor for ECL. If the counterparty has a term product with the Bank, then the contractual interest rate of that exposure can be used as a proxy for EIR for non-funded exposures.

Accordingly, the ECL will be computed as - Probability of default (PD) x Loss given default (LGD) x Exposure at default (EAD), discounted by the EIR under the different macroeconomic scenarios defined by the bank based on the macroeconomic forecasts and scenario probabilities and weights. The ECL numbers for stage 2 exposures will be computed over the lifetime of the facility based on residual maturity / tenor of the facility.

Provisioning based on business model classification:
For financial assets measured at amortized cost in the statement of financial position, the loss allowance will reduce the net carrying amount of the asset. While in the event of a ‘write-off’, the Bank will directly reduce the asset’s gross carrying amount. If the amount of loss on write-off is greater than the accumulated loss allowance, the difference will be provided as an additional impairment loss.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

e) Impairment (continued)

Provisioning based on business model classification (continued):

FVOCI business model assets are combination of both amortized cost and fair value measurement. As a result, impairment gains and losses will be determined using the same methodology that is applied to assets measured at amortized cost. Because such assets would be measured in the statement of financial position at fair value, accumulated impairment amount will be recognized in other comprehensive income.

Restructured financial assets:

A restructuring of a credit agreement generally is defined to be a breach of contract under the initially agreed terms and conditions. A change in the form of the credit facility - for example conversion from an overdraft facility to a trade-related facility – does not constitute a restructuring.

- Restructuring a credit facility, based on urgent request from the client, enables the client to continue servicing interest and amortization payments. Without restructuring the client would not be able anymore to meet the conditions of the contract. A restructuring therefore can be defined as the inability of the borrower to continue servicing the debt without any relief in the terms and conditions.
- Restructuring is not referring to a normal - business as usual – rescheduling request by the client to amend credit facilities according to the changing economic environment. This could be due to expansion of the business or reallocation of resources and therefore changing financing needs in view of a different expectation of the future economic environment.

Credit-impaired financial assets / Definition of default:

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt securities carried at FVOCI are credit-impaired.

Assets classified under this category are obligors which are unlikely to repay their contractual obligations, on a timely basis and are considered as defaulted obligors. The default definition used by the Bank is captured by the 'For Adjustment Purpose ("FAP")' tagging which in turn is triggered by the qualitative and quantitative criteria listed below:

- **Days Past Due (DPD):** Corporate / SME / Retail accounts is identified as default if the contractual payment is more than or equal to 90 days past due. For Investments & FI portfolios account is identified as default if the contractual coupon payment is more than 30 days past due. Additionally, for overdraft exposures, any excess over limit or forced debit will be treated similar to days past due i.e., an overdraft account showing excess over limit for 90 days will become a Stage 3 exposure. The days past due will be calculated and applied in line with the credit risk policy as applicable to the bank (and will be reflected in FAP tagging).
- **Non-Performing Loans ('For Adjustment Purpose (FAP)' Tagging):** The tagging of exposures to the Non-performing Loans ("NPL") category or Default FAP (2 or worse) based on the overdue status or qualitative information available with the Bank will trigger transfer of credit exposures to Stage 3.
- **Credit Rating Downgrade:** Under Investments & FI portfolios for Investment Grade ("IG") exposures, a downgrade of more than 2 notches from IG to Non-Investment Grade ("NIG") will trigger transfer to Stage 3. Whereas for exposures within the NIG, a 3 notch downgrade will trigger transfer to Stage 3.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

e) Impairment (continued)

Credit-impaired financial assets / Definition of default (continued):

- **Cross-Product Default:** For Corporate / SME or Retail portfolio whenever a credit exposure is marked NPL or Default FAP (2 or worse), all related exposures within the same entity / counterparty (all facilities and credit exposure from all product areas) are marked NPL or Overdue / Default FAP. The tagging of credit exposures as NPL or Default FAP (2 or worse) will trigger transfer to stage 3.

Purchased or originated credit-impaired (POCI) financial assets
The Bank, as a policy, does not purchase credit impaired assets. However, a significant modification of a financial asset can result in de-recognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a 'New' financial asset, assuming that the level of modification exceeds the internal thresholds set by the management.

The effective interest rate (EIR) for a POCI asset is estimated using expected cash-flows (i.e. its credit adjusted) rather than contractual cash-flows. For a POCI, interest accrual is not done on a gross basis, even if the credit quality of the asset improves. Since, the Bank utilizes the expected cash-flows to compute the credit adjusted EIR, these assets already incorporate life time expected credit losses and hence a separate loss allowance is not required. Any changes (whether a loss or a gain), however in the lifetime expected losses for these assets would require that a loss allowance is accrued to reflect the same.

Low Credit Risk
Under the general approach to impairment of IFRS 9, the bank is required to assess whether financial assets have experienced SICR since initial recognition. However, as an exception from the general requirements, IFRS 9 allows an entity to assume that the criterion for recognizing lifetime ECL is not met if the credit risk on the financial instrument is low at the reporting date. This means, the Bank could avoid assessing whether a financial instrument has experienced SICR if:

- The instrument has a low risk of default;
- The borrower has a strong capacity to meet its contractual obligations in the near term; and
- Adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability to fulfil its obligations.

Assets that have been deemed low credit risk will have to be monitored on an ongoing basis. In the event such assets stop being low risk, a full assessment of whether credit risk has increased significantly in accordance with the general approach is required.

All Investments within the 'Investment Grade' are considered having low credit risk for the purpose of assessment of SICR. On an on-going basis, the authority to recommend 'low credit risk' practical expedient to a credit exposure / facility lies with the Country Credit Function which will document the rationale for the override and subsequently seek approval from the Country Credit Management Committee ("CCMC"). Additionally, it is the responsibility of the CCMC to monitor exposures that have deemed low credit risk on an on-going basis.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

e) Impairment (continued)

Assessment of Significant Increase in Credit Risk:
The bank monitors all financial assets, issued loan commitments and financial guarantee contracts that are subject to the impairment requirements to assess whether there has been a significant increase in credit risk since initial recognition. If there has been a significant increase in credit risk, the bank will measure the loss allowance based on lifetime rather than 12-month ECL. The assessment is performed on monthly basis for each individual exposure.

The assessment of SICR and subsequent classification of the exposure / asset into Stage 2 and Stage 3 takes into account qualitative criteria and quantitative criteria which could include (but not limited to) the following:

- Days Past Due (DPD);
- Inability of the customer to service the contractual agreement which may result in covenant waivers / amendments (Restructuring);
- Significant increase in the credit risk of other financial instruments of the same customer (cross product/ facility);
- Transition (Downgrade) in the (internal / external) credit rating of obligor;
- Tagging of exposures as Watch List – Internal or External; and
- Tagging of exposures as ‘For Adjustment Purpose’ (FAP). The following early warning signals can trigger any of the above mentioned criteria and subsequently trigger classification of exposure into Stage 2 or Stage 3 based on the degree of severity of the signal and the judgment of the credit officer:
  - Significant changes in the terms of an existing financial instrument as on the reporting date compared to its terms at origination;
  - A borrower’s bank guarantee called upon by the counterparty;
  - The movement of an off balance sheet exposure of a customer to an on balance sheet;
  - A change in the financial position / operational efficiency of the borrowers, examples of which could include (but not limited to) the following:
    - Declining profitability;
    - Tightening liquidity or cash flow; and
    - Increasing leverage and / or weakening net worth;
    - Changes in Key Management Positions;
    - Weakened marketability and / or value of collateral;
    - A change in the industry in which the borrower operates; and
    - Stressed economic conditions may impact the performance of the borrower and impact the ability to pay.

As a backstop, for Corporate / SME and Retail portfolios significant increase in credit risk is presumed if a contract is more than 30 days past due in making a contractual payment. Whereas for Investments and FIs on which the contractual payments are more than or equal to 15 days past due will be regarded as having significantly increased in credit risk. The days past due will be calculated and applied in line with the credit risk policy as applicable to the bank.

Additionally, for overdraft exposures, any excess over limit or forced debit will be treated similar to days past due i.e., an overdraft account showing excess over limit for 30 days will be considered as significant increase in credit risk.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

e) Impairment (continued)

Improvement in credit risk profile:

Following a significant increase in credit risk on a credit exposure, the bank will need to monitor whether the exposure subsequently exhibits improvement in credit risk. The bank will need to assess whether there is sufficient evidence that credit risk has improved sufficiently such that the transfer criterion which resulted in the exposure being transferred to stage 2 or stage 3 is no longer present at the reporting date. However, the borrower must service the debt obligations for a minimum period before it can be transferred to Stage 2 and / or subsequently service its obligations for a minimum period in Stage 2 before being transferred to Stage 1.

Backward transition of any account can be triggered by Relationship Manager (RM) or Credit Management Function based on defined criteria. Additionally, the authority to override the curing period as identified above lies with the CCMC which will document the rationale for the override. The bank has defined below criteria in accordance with regulatory guidelines to assess any improvement in the credit risk profile which will result into upgrading of customers moving from Stage 3 to Stage 2 and from Stage 2 to Stage 1.

Stage 2 to 1: An exposure in Stage 2 is subject to a cooling period of 12 months given that credit risk has improved sufficiently such that the transfer criterion which resulted in the exposure being transferred to stage 2 is no longer present at the reporting date.

Stage 3 to 2: An exposure in Stage 3 is subject to a cooling period of 3 months / 3 instalments (whichever is longer) with exception of 12 months where instalments are on a longer frequency than quarterly, given that credit risk has improved sufficiently, such that the transfer criterion which resulted in the exposure being transferred to stage 3 is no longer present at the reporting date.

Incorporation of forward-looking information:

Exogenous macroeconomic parameters were used as independent variables to predict the dependent variable. Keeping in mind IFRS 9 requirements for obtaining reliable and supportable information, without undue cost or effort, macroeconomic information was aggregated from the following external sources:

- World Economic Outlook (WEO)
- Central Bank of UAE (CBUAE)

In order to ensure coverage of a wide spectrum of macroeconomic drivers, data was obtained for 48 variables, which broadly fall under the following categories:

- Gross Domestic Product
- Savings and Investment
- Inflation
- Trade Statistics
- Demographics
- Revenue and Expenditure
- Public Debt
- Real Estate
- Composite Indicators
- Oil Prices and Production

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

e) Impairment (continued)

Incorporation of forward-looking information (continued):
The bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro- economic variables and credit risk and credit losses.

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

- for financial assets measured at amortised cost: as a deduction from the gross carrying amount; and
- for debt instruments measured at FVOCI: as a credit to the fair value reserve of these assets;

Applicable before 1 January 2018

Identification and measurement of impairment
Financial assets (including loans and Islamic financing receivables, held to maturity investments, balances due from banks and financial institutions, and balances with central banks and other assets) that are measured at amortised cost are assessed for impairment at each reporting date. Financial assets measured at amortised cost are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial assets, the estimated future cash flows of the asset have been affected.

Objective evidence of impairment includes, but not limited to:

- significant financial difficulty of the issuer or counterparty;
- breach of contract, such as a default or delinquency in profit or principal payments;
- it becoming probable that the customer will enter bankruptcy or financial re-organisation; or
- the disappearance of an active market for that financial asset because of financial difficulties.

The amount of the impairment loss recognised is the difference between the asset's carrying amount and the present value of estimated future cash flows reflecting the amount of collateral and guarantee, calculated using the financial asset's original effective interest rate.

The carrying amount of the financial asset measured at amortised cost is reduced by the impairment loss directly for all financial assets. Subsequent recoveries of amounts previously written off are credited against the impairment allowance account. Changes in the carrying amount of the impairment allowance account are recognised in the statement of profit or loss and other comprehensive income.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the statement of profit or loss and other comprehensive income to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.1 Financial assets (continued)

e) Impairment (continued)

Write-off

Loans and advances and Islamic financing and debt securities are written-off when the Bank has no reasonable expectations of recovering the financial asset (either partially or in full). This is the case when the bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level. A write-off constitutes a derecognition event. The Bank may apply enforcement activities to financial assets written-off.

Recoveries of amounts previously written-off are included in 'recoveries' in the statement of profit or loss and statement of other comprehensive income.

f) Modification of financial assets

Restructuring a credit facility, based on urgent request from the client, enables the client to continue servicing interest and amortization payments. Without restructuring the client would not be able anymore to meet the conditions of the contract. A restructuring therefore can be defined as the inability of the borrower to continue servicing the debt without any relief in the terms and conditions.

Restructuring is not referring to a normal - business as usual – rescheduling request by the client to amend credit facilities according to the changing economic environment. This could be due to expansion of the business or reallocation of resources and therefore changing financing needs in view of a different expectation of the future economic environment.

In certain cases there might be a subtle line between the two above described cases. However, whenever all credit facilities of various banks need to be re-negotiated or a syndicated loan needs re-negotiation, this is most likely due to a breach of contract. If a private client is asking for re-negotiation, the Bank's judgment should be dependent on the financial flexibility of the client. An over-leveraged home loan where the Loan-to-value (LTV) is over 100% and the client asks for re-negotiation but has no additional financial resources (which he possibly could bring in) is also to be treated as a breach of contract.

Restructured cases need to be flagged as "restructured" from the start. This flagging is an additional earmark besides the classification. The ECL numbers for stage 2 exposures will be computed over the lifetime of the facility based on residual maturity / tenor of the facility.

g) Derecognition of financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expired, or when it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and the rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Bank is recognised as a separate asset or liability.

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

The Bank writes off loans and Islamic financing receivables when they are determined to be uncollectible.

Applicable from 1 January 2018: Any cumulative gain / loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in the statement of profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.2 Financial liabilities

a) Classification

The Bank classifies its financial liabilities in the following categories:

- Fair value through profit or loss; and
- Amortised cost.

(i) Financial liabilities at FVPL

Financial liabilities are classified as at FVPL when the financial liability is (i) held for trading, or (ii) it is designated as at FVPL. A financial liability is classified as held for trading if:

- It has been incurred principally for the purpose of repurchasing it in the near term; or
- On initial recognition it is part of a portfolio of identified financial instruments that the Bank manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and is effective as a hedging instrument.

A financial liability other than a financial liability held for trading or contingent consideration that may be paid by an acquirer as part of a business combination may be designated as at FVPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Bank's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IFRS 9 permits the entire hybrid (combined) contract to be designated as at FVPL.

Subsequent measurement

Financial liabilities at FVPL are stated at fair value, with any gains / losses arising on remeasurement recognised in profit or loss. The net gain / loss recognised in statement of profit or loss incorporates any interest paid on the financial liability.

Applicable from 1 January 2018: However, for non-derivative financial liabilities that are designated as at FVPL, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognised in OCI, unless the recognition of the effects of changes in the liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss.

The remaining amount of change in the fair value of liability is recognised in profit or loss. Changes in fair value attributable to a financial liability's credit risk that are recognised in OCI are not subsequently reclassified to statement of profit or loss; instead, they are transferred to retained earnings upon derecognition of the financial liability.

In making the determination of whether recognising changes in the liability's credit risk in OCI will create or enlarge an accounting mismatch in profit or loss, the Bank assesses whether it expects that the effects of changes in the liability's credit risk will be offset in profit or loss by a change in the fair value of another financial instrument measured at FVPL. This determination is made at initial recognition.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.2 Financial liabilities (continued)

a) Classification (continued)

Subsequent measurement (continued)

(ii) Financial liabilities at amortised cost

Other financial liabilities, including deposits and borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortised cost using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The EIR is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

b) Modification of financial liabilities

The Bank accounts for substantial modification of terms of an existing liability or part of it as an extinguishment of the original financial liability and the recognition of a new liability. It is assumed that the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective rate is materially different from the discounted present value of the remaining cash flows of the original financial liability.

In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and consideration paid is recognised in the statement of profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

Applicable from 1 January 2018: If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in the statement of profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification.

Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

c) Derecognition of financial liabilities

The Bank derecognises financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or have expired. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in the statement of profit or loss.

When the Bank exchanges with the existing lender one debt instrument into another one with substantially different terms, such exchange is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.3 Financial guarantee contracts

A financial guarantee contract is a contract that requires the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument.

Financial guarantee contracts issued by the Bank are initially measured at their fair values and, if not designated as at FVPL and not arising from a transfer of a financial asset, are subsequently measured at the higher of:

Applicable from 1 January 2018:
The amount of the loss allowance determined in accordance with IFRS 9 and the amount initially recognised less, where appropriate, the cumulative amount of income recognised in accordance with the Bank's revenue recognition policies.

Applicable before 1 January 2018:
The amount representing the initial fair value amortised over the life of the guarantee or the commitment and the present value of any expected payment to settle the liability when a payment under the contract has become probable.

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable).

3.1.4 Loan commitments

Loan commitments are firm commitments to provide credit under pre-specified terms and conditions. Commitments to provide a loan at a below-market interest rate are initially measured at their fair values and, if not designated as at FVPL, are subsequently measured as follows:

Applicable from 1 January 2018: At the higher of the amount of the loss allowance determined in accordance with IFRS 9 and the amount initially recognised less, where appropriate, the cumulative amount of income recognised in accordance with the Bank's revenue recognition policies.

Applicable before 1 January 2018: The Bank recognised a provision in accordance with IAS 37 if the contract was considered to be onerous. The Bank has not designated any commitments to provide a loan below market rate designated at FVPL.

3.2 Derivative financial instruments

The Bank enters into derivative instruments that comprise forward foreign exchange contracts and interest rate swaps. Derivatives are stated at fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the statement of financial position.

3 Significant accounting policies (continued)

3.3 Investment securities

The 'investment securities' caption in the statement of financial position includes:

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

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

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

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

The Bank elects to present in OCI changes in the fair value of certain investments in equity instruments that are not held for trading. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable.

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

Applicable before 1 January 2018:
Investment securities are initially measured at fair value plus, in case of investment securities not at fair value through profit or loss, incremental direct transaction costs, and subsequently accounted for depending on their classification as either held to maturity, or available-for-sale.

3.4 Property and equipment

Property and equipment are stated at cost less accumulated depreciation and impairment allowance, if any. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the profit or loss during the financial period in which they are incurred.

Depreciation is charged for all property and equipment items (except land) at rates calculated to write off the cost of each asset over its expected useful life. Where the carrying value of the asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount. Gains and losses on disposal are taken into account in determining net income.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date. The estimated useful lives for the various types of assets are as follows:

3 Significant accounting policies (continued)

3.4 Property and equipment (continued)

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date. The estimated useful lives for the various types of assets are as follows:

	Useful life
Building	25 years
Furniture and office equipment	4 to 7 years
Computer system	4 years
Motor vehicles	5 years

3.5 Impairment of non-financial assets

The carrying amount of the Bank's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any indication exists, then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable groups of assets that generates cash flows that largely are independent of the cash flows from other assets or groups of assets. Impairment losses are recognised in the statement of profit or loss and other comprehensive income.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

3.6 Customer deposits and Islamic customer deposits

Customer deposits are initially recognised at fair value, being the fair value of the consideration received.

After initial recognition, all deposits are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any transaction costs that are directly attributable to the acquisition or receipt of customer deposit.

The Islamic customer deposits are received by entering into following kinds of agreements:

Mudaraba
An agreement between the Bank and a third party whereby one party would provide a certain amount of funds (Rab ul Mal) which the other party (Mudarib) would then invest in a specific enterprise or activity against a specific share in the profit. The Mudarib would bear the loss in case of default, negligence or violation of any of the terms and conditions of the Mudaraba. In principle Mudaraba profit is distributed on declaration/distribution by the Mudarib.

Wakala
An agreement between Bank and third party whereby one party (Muwakil) provides certain amount of funds which the other party (Wakil) would invest according to the terms and conditions of Wakala in return for a certain fee. The Wakil is obliged to return the invested amount in case of default, negligence or violation of any of the terms and conditions of the Wakala. The Wakeel may be granted any excess over and above a certain pre-agreed rate of return as a performance incentive. In principle, wakala profit is distributed on declaration/distribution by the Wakil.

Islamic customer deposits are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective profit method.

3 Significant accounting policies (continued)

3.7 Staff terminal benefits

With respect to the Bank's national employees, the Bank contribute to the pension scheme for UAE nationals under the UAE pension and social security law in accordance with Federal Law No. 2 of 2000. This is a defined contribution pension plan and the Bank contributions are charged to the statement of profit or loss in the period to which they relate. In respect of this scheme, the Bank have an obligation to pay the fixed contributions as they fall due and no obligations exist to pay the future benefits.

The Bank provide for end of services benefits to other employees based on an estimation of the amount of future benefit that employees have earned in return for their service until their retirement, subject to completion of minimum services period. This calculation is performed based on a projected unit credit method.

3.8 Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the statement of profit or loss and other comprehensive income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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

Deferred tax is accounted for using the asset and liability method. Deferred tax assets and liabilities are recognised for the full tax consequences of all temporary differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases. Recognition of deferred tax assets are, however, restricted to the extent that it is probable that sufficient taxable profits will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured using tax rates that are expected to apply to the period in which the asset is expected to realise or the liability is expected to settle.

Deferred tax assets are reviewed at the end of each year to reduce the carrying amount by the extent to which it is no longer probable that sufficient taxable profits will be available to utilise the differences.

3.9 Offsetting

Financial assets and liabilities are set off and the net amount presented in the statement of financial position when, and only when, the Bank has a legally enforceable right to set off the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRSs, or for gains and losses arising from a group of similar transactions.

3.10 Cash and cash equivalents

Cash and cash equivalents consist of cash in hand and unrestricted cash balances with the UAE Central Bank, deposits and other balances due from/to banks, Head Office and other branches with original maturity of three months or less from the acquisition date, which are subject to insignificant credit risk, and are used by the Bank in the management of its short term commitments.

Cash and cash equivalents are carried at amortised cost.

3 Significant accounting policies (continued)

3.11 Revenue recognition

(i) ***Interest income and expense***

Applicable from 1 January 2018: Interest income and expense for all interest bearing financial instruments except at FVPL, are presented in 'interest income' and 'interest expense' in the statement of profit or loss on an accrual basis using the effective interest rates of the financial assets or financial liabilities to which they relate. Interest income and expense for financial instruments at FVPL is recognised as 'Net gains from investments at fair value through profit or loss'.

Applicable before 1 January 2018: Interest income and expense for financial instruments classified as held for trading or designated at FVPL is recognised as 'trading income'.

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- The gross carrying amount of the financial asset; or
- The amortised cost of the financial liability.

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not ECL. For purchased or originated credit-impaired financial assets, a credit- adjusted effective interest rate is calculated using estimated future cash flows including ECL.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Amortised cost and gross carrying amount
The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance (or 'impairment allowance' before 1 January 2018).

The 'gross carrying amount of a financial asset' is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

Calculation of interest income and expense

Applicable from 1 January 2018:
The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

3 Significant accounting policies (continued)

3.11 Revenue recognition (continued)

(i) Interest income and expense (continued)

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

Applicable before 1 January 2018:

The effective interest rate is the rate that discounts estimated future cash receipts and payments earned or paid on a financial asset or a liability through its expected life or, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

When calculating effective interest rates, the Bank estimates cash flows considering all contractual terms of the financial instruments, but not future credit losses. The calculation includes all amounts paid or received by the Bank that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

(ii) Income from Islamic financing and distributions to depositors

Income from Islamic financing is recognised in the statement of profit or loss using the effective profit method.

The calculation of the effective profit rate includes all fees paid or received, transaction costs, and discounts or premiums that are an integral part of the effective profit rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset.

Distribution to depositors (Islamic products) is calculated according to the Bank’s standard procedures and is approved by the Bank’s Sharia’s Supervisory Board.

(iii) Fees and commission

Fee income, which is not an integral part of the effective interest rate of a financial instrument, is earned from a diverse range of services provided by the Bank to its customers, and are accounted for in accordance with IFRS 15 ‘Revenue from Contracts with Customers’. Under the IFRS 15, fee income is measured by the Bank based on the consideration specified in a contract with a customer and excludes amounts collected on behalf of third parties. The Bank recognises revenue when it transfers control over a product or service to a customer.

A contract with a customer that results in a recognised financial instrument in the Bank's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

(iv) Fees for custodian services

The Bank provides custodian services to various clients. Fees for custodian services are calculated based on a fixed percentage of the value of assets managed and deducted from the customer's account balance on a monthly basis.

3 Significant accounting policies (continued)

3.12 Provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

3.13 Acceptances

Acceptances are recognised as financial liability in the statement of financial position with a contractual right of reimbursement from the customer as a financial asset. Therefore, commitments in respect of acceptances have been accounted for as financial assets and financial liabilities.

4 Application of new and revised international financial reporting standards "IFRS"

4.1 Relevant new and revised IFRS applied with no material effect on the financial statements

The following new and revised IFRS have been adopted in these financial statements. The application of these new and revised IFRS has not had any material impact on the amounts reported for the current and prior periods.

	Effective for annual beginning on or after
• Annual Improvements to IFRS Standards 2014 – 2016 Cycle amending IFRS 1 and IAS 28 to remove short-term exemptions and clarifying certain fair value measurements.	1 January 2018
• IFRIC 22 'Foreign Currency Transactions and Advance Consideration'	1 January 2018
• Amendments to IFRS 1 'First-time Adoption of International Financial Reporting Standards' deleting short-term exemptions for first-time adopters	1 January 2018
• Amendments to IFRS 7 'Financial Instruments' related to disclosures about the initial application of IFRS 9.	1 January 2018
• IFRS 15 'Revenue from Contracts with Customers'	1 January 2018

Other than the above, there are no other significant IFRSs and amendments that were effective for the first time for the financial year beginning on or after 1 January 2018.

4 Application of new and revised international financial reporting standards “IFRS” (continued)

4.2 Relevant new and revised IFRS issued but not yet effective

The Bank has not applied the following new and revised IFRSs, amendments and interpretations that have been issued but not yet effective:

	Effective for annual beginning on or after
• IFRS 16 Leases	1 January 2019
• Amendment to IAS 19 Employee Benefits	1 January 2019
• IFRIC 23 Uncertainty over Income Tax Treatments	1 January 2019
• Annual Improvements to IFRS Standards 2015 – 2017 Cycle amending IFRS 3, IFRS 11, IAS 12 and IAS 23	1 January 2019

Management anticipates that these IFRS and amendments will be adopted in the financial statements in the initial period when they become mandatorily effective. The management is currently assessing the impact of these standards and amendments.

5 Summary of impact analysis as per IFRS 9

The following table reconciles the original measurement categories and carrying amounts in accordance with IAS 39 and the new measurement categories with those under IFRS 9 for the bank's financial assets and financial liabilities with the impairment effect on opening retained earnings as at 1 January 2018.

	Original classification as per IAS 39	New classification as per IFRS 9	Original carrying amount	ECL under IFRS 9	New carrying amount
Financial assets			**AED'000**	**AED'000**	**AED'000**
Cash and deposits with UAE Central Bank	Amortised cost	Amortised cost	2,685,446	-	2,685,446
Due from banks	Amortised cost	Amortised cost	3,932,281	(12,496)	3,919,785
Due from Head Office and branches abroad	Amortised cost	Amortised cost	103,183	-	103,183
Securities	HTM / AFS	Amortised cost / FVOCI	1,330,141	(762)	1,329,379
Loans and advances	Loan and receivables	Amortised cost	3,684,831	(145,768)	3,539,063
Other assets	Amortised cost	Amortised cost	280,059	-	280,059
Total financial assets			**12,015,941**	**(159,026)**	**11,856,915**
Financial liabilities					
Deposits from customers	Amortised cost	Amortised cost	10,096,332	-	10,096,332
Due to banks	Amortised cost	Amortised cost	74,872	-	74,872
Due to Head Office and branches abroad	Amortised cost	Amortised cost	49,190	-	49,190
Other liabilities	Amortised cost	Amortised cost	320,818	-	320,818
Total financial liabilities			**10,541,212**	**-**	**10,541,212**

Pursuant to Guidance note to Banks and Financial Institutions on IFRS 9 Implementation issued by Central Bank of UAE, the bank has created a Specific Impairment Reserve amounting to AED 2,404 million (2017: nil).

Loans and advances include balances relating to off-balance sheet exposures and their related ECL impact.

6 Cash and balances with UAE Central Bank

	2018 AED 000	2017 AED 000
Cash in hand	**52,137**	69,973
Balances with UAE Central Bank:		
- Certificates of deposit	**895,000**	1,120,000
- Clearing account	**393,854**	300,952
- Statutory reserve	**886,506**	1,029,521
- Islamic commodity murabaha	**185,000**	165,000
	2,412,497	2,685,446

The statutory reserve represents mandatory interest free reserve deposits, which are not available to finance the Bank's day to day operations.

7 Due from banks

	2018 AED 000	2017 AED 000
Time	**3,471,081**	3,504,158
Demand	**278,251**	428,123
Allowance for impairment losses	**(9,959)**	-
	3,739,373	3,932,281

8 Loans and Islamic financing receivables

(a) The composition of the loans and Islamic financing receivables portfolio is as follows:

	2018			2017		
	UAE AED 000	**Others AED 000**	**Total AED 000**	UAE AED 000	Others AED 000	Total AED 000
Trade	**1,140,046**	**-**	**1,140,046**	1,043,573	-	1,043,573
Other commercial & business sector	**1,865,533**	**55,909**	**1,921,442**	1,890,520	41,227	1,931,747
Personal	**767,527**	**12,742**	**780,269**	919,447	14,933	934,380
Gross receivables – net of Interest in suspense	**3,773,106**	**68,651**	**3,841,757**	3,853,540	56,160	3,909,700
Allowance for impairment						
- Stage 3/ Specific			**(174,322)**			(112,742)
- Stage 1 and 2 / Collective			**(209,092)**			(112,127)
Net receivables			**3,458,343**			3,684,831

Loans and Islamic financing receivables include Murabaha financing activities amounting to AED 18.44 million (*2017: 010Mn*) provided through a Shari'a compliant Islamic window.

8 Loans and Islamic financing receivables (continued)

(b) An analysis of change in the gross carrying amount and the corresponding ECL allowance is as follows:

	Stage 1 AED '000	Stage 2 AED '000	Stage 3 AED '000	Total AED '000
Gross exposure at 1 January 2018	**2,419,728**	**1,105,026**	**388,083**	**3,912,837**
Net transfers between Stages	(235,833)	244,828	(8,995)	-
Net additions / (repayments)	153,067	(180,506)	(29,299)	**(56,738)**
Amounts written off	-	-	(1,514)	**(1,514)**
Gross exposure at 31 December 2018	**2,336,962**	**1,169,348**	**348,275**	**3,854,585**
Interest in suspense	-	-	(12,828)	**(12,828)**
Gross exposure – net of Interest in suspense	**2,336,962**	**1,169,348**	**335,447**	**3,841,757**

	Stage 1 AED '000	Stage 2 AED '000	Stage 3 AED '000	Total AED '000
ECL allowance at 1 January 2018	**26,224**	**177,594**	**166,818**	**370,636**
Net transfers between stages	457	378	(835)	-
Net (reversals) / impairment charge	(1,915)	6,354	9,853	**14,292**
Amounts written off	-	-	(1,514)	**(1,514)**
ECL allowance at 31 December 2018	**24,766**	**184,326**	**174,322**	**383,414**
Net loans and receivables	**2,312,196**	**985,022**	**161,125**	**3,458,343**

The movement in allowance for impairment on loans and Islamic financing receivables is as follows:

	2017 Specific AED 000	 Collective AED 000	 Total AED 000
As at 1 January	176,292	85,643	261,935
Amount written off	(75,666)	-	(75,666)
Charge/ (releases) during the year	12,116	26,484	38,600
Impairment allowance	112,742	112,127	224,869

8 Loans and Islamic financing receivables (continued)

(c) The charge to the statement of profit or loss and other comprehensive income for impairment allowance consists of the following:

	2018 AED 000	2017 AED 000
Reversal of impairment allowance on due from banks	**(2,537)**	-
Impairment allowance on loans and advances and Islamic financing	**14,292**	38,600
Impairment allowance on investment securities	**7,055**	-
Impairment allowance on other assets	**5,712**	3,454
Total charge for impairment for the year	**24,522**	42,054

9 Investments

	2018 AED 000	2017 AED 000
At fair value through OCI / Available for sale		
Investments in un-listed equities	**1,197**	1,197
Bond – Quoted (refer note 9a) *	**941,301**	1,105,511
At amortized cost / Held to maturity		
Bond – Quoted *	**155,122**	223,433
	1,097,620	**1,330,141**
Allowances for impairment losses on amortized cost bonds	**(493)**	-
Total investments	**1,097,127**	1,330,141

* The above investments include bonds guaranteed by the Government of Dubai, other corporates including international banks and financial institutions, denominated in USD and UAE Dirhams.

Income from investment taken to the statement of profit or loss and other comprehensive income is as follows:

	2018 AED 000	2017 AED 000
Interest income and income from Islamic financing (Note 19)	**34,552**	26,044
Other income		
Realised (loss) / gain on bonds designated at fair value through OCI	**(3,299)**	535

9 Investments (continued)

(a) FVOCI investments

The table below sets out the investment securities at their carrying and fair values:

Bond – Quoted

	2018 AED 000	2017 AED 000
Opening balance	**1,105,511**	642,998
Acquired during the year	**174,070**	605,735
Sold / redeemed during the year	**(306,677)**	(131,222)
Amortisation of premium	**(11,184)**	(9,745)
Realized losses	**(3,299)**	-
Fair Value movement	**(17,120)**	(2,255)
FVOCI Investments	**941,301**	1,105,511

An analysis of change in the gross carrying amount and the corresponding ECL allowance is as follows:

	Stage 1 AED '000	Stage 2 AED '000	Stage 3 AED '000	Total AED '000
Gross exposure at 1 January 2018	1,245,662	84,479	-	1,330,141
Net transfers between Stages	(57,350)	38,011	19,339	-
Net additions / (disposals)	(227,289)	(11,655)	6,423	(232,521)
At 31 December 2018	**961,023**	**110,835**	**25,762**	**1,097,620**

	Stage 1 AED '000	Stage 2 AED '000	Stage 3 AED '000	Total AED '000
ECL allowance at 1 January 2018	224	538	-	762
Net transfers between Stages	(50)	50	-	-
Net charge / (reversals)	632	(5)	6,428	7,055
Total ECL on investments	**806**	**583**	**6,428**	**7,817**
Less: ECL on FVOCI bonds	**(718)**	**(178)**	**(6,428)**	**(7,324)**
Closing Balance on 31 December 2018	**88**	**405**	**-**	**493**

10 Property and equipment

	Building	Furniture and office equipment	Computer system	Motor vehicles	Total
	AED '000	AED '000	AED '000	AED '000	AED '000
Cost					
At 1 January 2017	52,184	29,109	11,714	6,935	99,942
Additions	-	5,536	3,164	1,424	10,124
Disposals and write-offs	-	(1,353)	(164)	(626)	(2,143)
At 31 December 2017	**52,184**	**33,292**	**14,714**	**7,733**	**107,923**
At 1 January 2018	52,184	33,292	14,714	7,733	107,923
Additions	-	14,354	294	380	15,028
Disposals and write-offs	-	(7,079)	(1,022)	(352)	(8,453)
At 31 December 2018	**52,184**	**40,567**	**13,986**	**7,761**	**114,498**
Accumulated depreciation					
At 1 January 2017	10,624	21,549	11,407	4,791	48,371
Charge for the year	2,122	1,376	946	875	5,319
Disposals and write-offs	-	(1,198)	(163)	(626)	(1,987)
At 31 December 2017	**12,746**	**21,727**	**12,190**	**5,040**	**51,703**
At 1 January 2018	12,746	21,727	12,190	5,040	51,703
Charge for the year	2,117	3,229	941	942	7,229
Disposals and write-offs	-	(6,946)	(1,012)	(352)	(8,310)
At 31 December 2018	**14,863**	**18,010**	**12,119**	**5,630**	**50,622**
Net book value					
At 31 December 2018	**37,321**	**22,557**	**1,867**	**2,131**	**63,876**
At 31 December 2017	39,438	11,565	2,524	2,693	56,220

11 Deferred tax assets

Deferred tax assets are attributable to the following:

	2018	2017
	AED '000	AED '000
Allowances for impairment	**78,133**	41,067
Others	**113**	-
	78,246	41,067

Movements in temporary differences during the year are as follows:

	Opening Balance	**Recognised in statement of profit or loss and OCI**	**Recognised in equity**	**Closing balance**
	AED '000	**AED '000**	**AED '000**	**AED '000**
2018				
Allowances for impairment	**41,067**	**5,761**	**31,305**	**78,133**
Others	**-**	**113**	**-**	**113**
	41,067	**5,874**	**31,305**	**78,246**
2017				
Allowances for impairment	48,018	(6,951)	-	41,067
Others	154	(154)	-	-
	48,172	(7,105)	-	41,067

12 Other assets

	2018	2017
	AED 000	AED 000
Accrued interest / profit	**48,653**	34,770
Prepayments and deposits	**47,339**	47,010
Precious metal	**2,989**	3,387
Positive fair value of derivatives	**91**	-
Custodian collection	**16,085**	23,718
Others	**2,209**	3,561
	117,366	112,446

Prepayments include operating lease of AED 27.1 million (2017: AED 28.4 million) pertaining to the Zonal Head Office to be amortised over the remaining life of 21 years.

12 Other assets (continued)

Other assets consists of assets acquired in settlement of debt which have been fully impaired. The additional assets acquired in settlement of debt during 2018 amounted to AED 5.67 million. The total assets acquired in settlement of debt as at year ended 31 December 2018 were AED 22.58 million (2017: AED 16.91 million) and the impairment allowance on these was AED 22.58 million (2017: AED 16.91 million).

13 Deposits from customers

	2018	2017
	AED 000	AED 000
Business accounts		
Demand deposits	**3,181,327**	3,321,276
Time deposits	**874,356**	848,921
Call deposits	**567,060**	757,232
Savings deposits	**118,311**	147,286
Margin deposits	**121,239**	116,551
	4,862,293	5,191,266
Individual customers		
Demand deposits	**1,403,952**	1,557,399
Time deposits	**1,989,708**	2,131,308
Call deposits	**279,173**	293,230
Savings deposits	**844,228**	922,693
Margin deposits	**7,699**	436
	4,524,760	4,905,066
Total	**9,387,053**	10,096,332

Deposits from customers include Islamic customer deposits amounting to AED 201.0 million (*2017: 161.6Mn*) undertaken through a Sharia'a compliant Islamic window.

14 Due to banks

	2018	2017
	AED 000	AED 000
Demand deposits	**50,836**	74,872
	50,836	74,872

The average interest rate paid on the above was Nil (*2017: Nil*)

15 Other liabilities

	2018 AED 000	2017 AED 000
Accrued interest and Islamic profit payable	**26,383**	22,813
Staff terminal benefits	**33,526**	32,330
Accrued expenses payable	**4,178**	3,253
Tax payable	**36,902**	20,587
Bills payable	**42,487**	102,695
Negative fair value of derivatives	**42**	-
Others	**53,576**	68,814
	197,094	250,492

16 Allocated capital

The allocated capital represents the deposit of AED 100 million contributed by Head Office as assigned capital for the UAE branches.

17 Legal reserve

In accordance with article 239 of Federal Law No. 2 of 2015, 10% of the net profit for the year should be transferred to a non-distributable legal reserve, until such time as this reserve equals 50% of the allocated capital.

18 Contingent liabilities and other commitments

The contractual amounts of the Bank's off-balance sheet financial instruments that commit it to extend credit to customers are as follows:

	2018 AED 000	2017 AED 000
a) Direct credit substitutes including general guarantees of indebtedness and standby letters of credit serving as financial guarantees for loans and securities	**204,769**	210,233
b) Transaction-related contingencies including performance bonds, bid bonds and standby letters of credit related to particular transactions	**180,436**	199,365
c) Short-term self-liquidating trade-related contingencies arising from the movement of goods, such as documentary credits where the underlying shipment is used as security	**252,429**	268,000
	637,634	677,598

19 Interest income and Income from islamic Financing

	2018 AED 000	2017 AED 000
Loans and Islamic financing receivables	**202,605**	194,658
Certificates of Deposits with U.A.E. Central Bank	**19,855**	11,701
Due from related parties	**287**	538
Due from banks	**68,737**	47,680
Investment securities	**34,552**	26,044
	326,036	280,621

This includes income from Islamic activities amounting to AED 6.0 million (*2017: 2.3Mn*) for the year ended 31 December 2018.

20 Interest expense and distribution to Islamic depositors

	2018 AED 000	2017 AED 000
Due to banks	**75**	28
Deposits from customers	**30,712**	26,390
Due to related parties	**307**	100
	31,094	26,518

This includes distribution to Islamic depositors amounting to AED 0.339 million (*2017: 0.19* Mn) for the year ended 31 December 2018.

21 Fee and commission income (net)

	2018 AED 000	2017 AED 000
Fee and commission income	**61,824**	69,654
Fee and commission expense	**(2,574)**	(3,307)
	59,250	66,347

22 Other income

	2018 AED 000	2017 AED 000
Foreign exchange income	**31,096**	28,877
Telex charges recovery	**18,904**	18,134
Courier charges recovery	**5,510**	5,189
Insurance charges recovery	**576**	775
Other miscellaneous income	**16,493**	9,113
Commission expense	**(887)**	-
	71,692	62,088

23 General and administrative expenses

	2018 AED 000	2017 AED 000
Staff salaries and benefits	**106,539**	99,173
Depreciation	**7,229**	5,319
Telephone, telex and courier expenses	**7,037**	7,069
Head office charges	**20,382**	21,418
Office rent	**18,048**	15,973
Repairs and maintenance expenses	**5,570**	5,259
Printing and stationery	**1,304**	1,552
Insurance and travel	**3,490**	2,999
(Recovery) / charge for operational losses	**203**	(514)
Other miscellaneous expenses	**76,987**	73,688
	246,789	231,936

The total numbers of employees as at 31 December 2018 were 384 (2017: 336) of which 109 (2017: 122) were UAE Nationals.

24 Taxation

Provision is made for tax in the Emirates of Abu Dhabi, Dubai (except for Jebel Ali which is a tax free zone) and Sharjah in accordance with the respective tax legislation in these Emirates. Tax expense for the year comprises:

	2018 AED 000	2017 AED 000
Current tax expense	**40,461**	17,026
Additional tax paid for previous year	**548**	172
Deferred tax expense		
- (Reversal) / origination of temporary differences	**(5,874)**	7,105
Total tax expense for the year	**35,135**	24,303

The Bank recognises deferred tax asset/liability for all deductible temporary differences to the extent that it is probable that future taxable profit will be available against which the deductible temporary difference can be utilised.

Reconciliation of effective tax rate:

	2018 AED 000	2017 AED 000
Profit for the year before taxation	**154,573**	108,548
Tax calculated using UAE tax rates (20%)	**30,915**	21,710
Prior year tax	**548**	-
Tax exempt income - net	**(1,489)**	(1,470)
Non-deductible expenses	**5,161**	4,063
Total tax expense charged to profit or loss	**35,135**	24,303
Effective tax rate	**22.73%**	22.39%

25 Derivatives

Derivative product types

Forwards 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.

Derivative related credit risk

Credit risk in respect of derivative financial instruments arises from the potential for a counter party to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Bank.

26 Related party transactions

In the case of the Bank, related parties, as defined under the International Accounting Standard 24, include Head Office, branches abroad, subsidiaries and associates of Habib Bank AG Zurich outside the United Arab Emirates.

In the normal course of business, the Bank enters into various transactions with related parties. The Bank's management believes that all such transactions with related parties are carried out on mutually agreed terms.

Key management personnel are those persons, having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly.

The balances and income/expense arising from transactions with Head Office, branches abroad and subsidiaries are set out below:

	2018	2017
	AED 000	AED 000
Due from		
- Head office	**62,748**	23,827
- Branches (other than UAE)	**139**	-
- Subsidiaries of the Habib Group	**67,659**	79,356
	130,546	103,183
Due to		
- Head office	**305**	40,603
- Branches (other than UAE)	**1,195**	1,177
- Subsidiaries of the Habib Group	**4,206**	7,409
	5,706	49,190
Loan to HBZ Services LLC	**27,661**	29,102
Deposit from HBZ Services LLC	**12,897**	11,390

26 Related party transactions (continued)

Transactions with Related Parties

	2018 AED 000	2017 AED 000
Interest income (including on Loan to HBZ Services LLC)	**1,660**	1,866
Interest expense	**307**	100
Head Office charges	**20,382**	21,418
Expenses reimbursed to HBZ Services LLC (note 26.1)	**49,473**	56,077

Deposits from other related parties

	2018 AED 000	2017 AED 000
Deposits at 1 January	**141,880**	72,166
Deposits received and rolledover during the year	**169,782**	170,642
Deposits repaid during the year	**(165,379)**	(100,928)
Deposits at 31 December	**146,283**	141,880
Interest expense for the Bank during the year	**1,078**	927

Key management compensations

	2018 AED 000	2017 AED 000
Short term employment benefits	**4,600**	4,250
Post-employment benefits	**33**	116

26.1 Under an outsourcing agreement, HBZ Services LLC provides back office and support services to the Bank including transaction banking, information technology and internal audit.

27 Geographical concentration of assets and liabilities

31 December 2018	Loans	Debt securities	Total funded	Commitments	OTC derivatives	Other off-balance sheet exposures	Total non-funded	Total
	AED '000'							
UAE	3,391,248	67,783	8,425,539	-	5,566	550,012	555,578	**8,981,117**
GCC excluding UAE	11	-	54,117	-	-	-	-	**54,117**
Arab League (Excluding GCC)	-	-	379	-	-	-	-	**379**
Asia	25,724	434,147	1,166,976	-	-	53,173	53,173	**1,220,149**
Africa	225	-	7,492	-	-	1,244	1,244	**8,736**
North America	1,293	335,715	365,232	-	-	-	-	**365,232**
South America	-	-	-	-	-	-	-	**-**
Caribbean	-	-	-	-	-	-	-	**-**
Europe	39,842	259,482	1,114,459	-	-	33,122	33,122	**1,147,581**
Australia	-	-	5,722	-	-	83	83	**5,805**
Others	-	-	-	-	-	-	-	**-**
Total	**3,458,343**	**1,097,127**	**11,129,916**	**-**	**5,566**	**637,634**	**643,200**	**11,783,116**

27 Geographical concentration of assets and liabilities (continued)

31 December 2017	Loans	Debt securities	Total funded	Commitments	OTC derivatives	Other off-balance sheet exposures	Total non-funded	Total
	AED '000							
UAE	3,629,269	207,876	9,226,405	-	21,305	591,719	613,024	9,839,429
GCC excluding UAE	552	-	66,923	-	-	-	-	66,923
Arab League (Excluding GCC)	-	-	972	-	-	-	-	972
Asia	17,948	504,562	1,070,920	-	400	29,951	30,351	1,101,271
Africa	625	-	17,840	-	-	7,024	7,024	24,864
North America	-	315,185	548,695	-	-	-	-	548,695
South America	-	-	-	-	-	-	-	-
Caribbean	-	-	-	-	-	-	-	-
Europe	36,437	302,518	1,072,624	-	-	50,821	50,821	1,123,445
Australia	-	-	11,562	-	-	83	83	11,645
Others	-	-	-	-	-	-	-	-
Total	**3,684,831**	**1,330,141**	**12,015,941**	**-**	**21,705**	**679,598**	**701,303**	**12,717,244**

28 Financial assets and liabilities

The table below set out the Bank's classification of financial assets and liabilities and the carrying and fair value as at 31 December:

	Fair value through profit or loss AED 000	Fair value through other comprehensive income AED 000	Amortised cost AED 000	Carrying amount AED 000	Total fair value AED 000
At 31 December 2018					
Assets					
Cash and balances with UAE Central Bank	-	-	2,412,497	2,412,497	2,412,497
Due from banks	-	-	3,739,373	3,739,373	3,739,373
Due from Head office, Branches abroad and associates	-	-	130,546	130,546	130,546
Loans and receivables	-	-	3,458,343	3,458,343	3,458,343
Customers' indebtedness for acceptances	-	-	42,542	42,542	42,542
Investments	-	942,498	155,122	1,097,620	1,095,240
Other assets	91	-	71,758	71,849	71,849
	91	**942,498**	**10,010,181**	**10,952,770**	**10,950,390**
Liabilities, capital and reserves					
Deposits from customers	-	-	9,387,053	9,387,053	9,387,053
Due to banks	-	-	50,836	50,836	50,836
Due to Head office, Branches abroad and associates	-	-	5,706	5,706	5,706
Liabilities under acceptances			42,542	42,542	42,542
Other liabilities	42	-	197,052	197,094	197,094
	42	**-**	**9,683,189**	**9,683,231**	**9,683,231**

28 Financial assets and liabilities (continued)

At 31 December 2017	Designated at fair value AED 000	Available for sale	Held to maturity AED 000	Loans and advances AED 000	Other amortised cost AED 000	Total carrying amount AED 000	Fair value AED 000
Assets							
Cash and balances with UAE Central Bank	-		-	-	2,685,446	2,685,446	2,685,446
Due from banks	-		-	-	3,932,281	3,932,281	3,932,281
Due from Head office, Branches abroad and associates	-		-	-	103,183	103,183	103,183
Loans and receivables	-		-	-	3,684,831	3,684,831	3,684,831
Customers' indebtedness for acceptances					70,326	70,326	70,326
Investments		1,106,708	223,433	-	-	1,330,141	1,329,071
Other assets	-		-	-	67,330	67,330	67,330
	-	**1,106,708**	**223,433**	**-**	**10,543,397**	**11,873,538**	**11,872,468**
Liabilities, capital and reserves							
Deposits from customers	-	-	-	-	10,096,332	10,096,332	10,096,332
Due to banks	-	-	-	-	74,872	74,872	74,872
Due to Head office, Branches abroad and associates	-	-	-	-	49,190	49,190	49,190
Liabilities under acceptances	-	-	-	-	70,326	70,326	70,326
Other liabilities	-	-	-	-	250,492	250,492	250,492
	-	**-**	**-**	**-**	**10,541,212**	**10,541,212**	**10,541,212**

29 Fair Value hierarchy

Fair value hierarchy

The table below analyses financial instruments, measured at fair value at the end of reporting period, by level into fair value hierarchy into which the fair value measurement is categorised:

	Level 1 AED 000	**Level 2 AED 000**	**Level 3 AED 000**	**Total AED 000**
At 31 December 2018				
Financial assets				
Investments	**941,301**	**-**	**1,197**	**942,498**
Forward foreign Exchange contracts	**-**	**91**	**-**	**91**
	941,301	**91**	**1,197**	**942,589**
Financial liabilities				
Forward foreign	**-**	**42**	**-**	**42**
Exchange contracts	**-**	**-**	**-**	**-**
	-	**42**	**-**	**42**

	Level 1 AED 000	**Level 2 AED 000**	**Level 3 AED 000**	**Total AED 000**
At 31 December 2017				
Financial assets				
Investments	1,105,511	-	1,197	1,106,708
Forward foreign Exchange contracts	-	-	-	-
	1,105,511	**-**	**1,197**	**1,106,708**
Financial liabilities				
Forward foreign Exchange contracts	-	-	-	-
	-	**-**	**-**	**-**

29 Fair Value hierarchy (continued)

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorised.

At 31 December 2018	**Level 1 AED'000**	**Level 2 AED'000**	**Level 3 AED'000**	**Fair value AED'000**	**Carrying amount AED'000**
Financial assets					
Cash and balances with UAE Central Bank	-	2,412,497	-	2,412,497	2,412,497
Due from banks	-	3,739,373	-	3,739,373	3,739,373
Due from related parties	-	-	130,546	130,546	130,546
Loans and Islamic financing receivables	-	-	3,458,343	3,458,343	3,458,343
Investments	152,742	-	-	152,742	155,122
Customers' indebtedness for acceptances	-	-	42,542	42,542	42,542
Other assets	-	-	71,849	71,849	71,849
	152,742	**6,151,870**	**3,703,280**	**10,007,892**	**10,010,272**
Financial liabilities					
Deposits from customers	-	-	9,387,053	9,387,053	9,387,053
Due to banks	-	50,836	-	50,836	50,836
Due to related parties	-	-	5,706	5,706	5,706
Customers' liabilities under acceptances	-	-	42,542	42,542	42,542
Other liabilities	-	-	197,094	197,094	197,094
	-	**50,836**	**9,632,395**	**9,683,231**	**9,683,231**

At 31 December 2017	**Level 1 AED'000**	**Level 2 AED'000**	**Level 3 AED'000**	**Fair value AED'000**	**Carrying amount AED'000**
Financial assets					
Cash and balances with UAE Central Bank	-	2,685,446	-	2,685,446	2,685,446
Due from banks	-	3,932,281	-	3,932,281	3,932,281
Due from related parties	-	-	103,183	103,183	103,183
Loans and Islamic financing receivables	-	-	3,684,831	3,684,831	3,684,831
Investments	222,361	-	-	222,361	223,433
Customers' indebtedness for acceptances	-	-	70,326	70,326	70,326
Other assets	-	-	67,330	67,330	67,330
	222,361	6,617,727	3,925,670	10,765,758	10,766,830
Financial liabilities					
Deposits from customers	-	-	10,096,332	10,096,332	10,096,332
Due to banks	-	74,872	-	74,872	74,872
Due to related parties	-	-	49,190	49,190	49,190
Customers' liabilities under acceptances	-	-	70,326	70,326	70,326
Other liabilities	-	-	250,492	250,492	250,492
	-	74,872	10,466,340	10,541,212	10,541,212

29 Fair Value hierarchy (continued)

- In respect of those financial assets and financial liabilities measured at amortised cost, which are of short term nature (up to 1 year), management believes that carrying amount is equivalent to its fair value.

- Financing to customers are fair valued based on DCF which takes into account original underlying cash borrower credit grading and expected prepayments. These features are used to estimate expected cash flows and discounted at risk-adjusted rates. However, this technique is subject to inherent limitations, such as estimation of the appropriate risk-adjusted discount rate, and different assumptions and inputs would yield different results.

- Fair values of customer deposits and due to banks is estimated using discounted cash flow techniques, applying the rates that are offered for deposits of similar maturities and terms. The fair value of deposits payable on demand is the amount payable at the reporting date.

30 Risk management

The Bank is exposed to the following risks from its use of financial instruments:

- Credit risk
- Market risk
- Liquidity risk
- Operational risk

The core business of the Bank is long established, with risk levels easily identifiable and well known to the management. Comprehensive limits are established which are changed from time to time by Board resolutions. The overall risk position is evaluated at Head Office from the standard monthly reporting of the branches and compliance with Bank limits monitored on a regular basis. Measurement is based on compliance with limits and/ or by means of risk weightage as defined for capital adequacy purpose by the Central Bank of UAE and the Bank for International Settlement ('BIS').

The Bank engages in new, large-scale business operations only where limits for such transactions have been approved by the Board of Directors ('the Board'). This approval will only be given after submission of a report by the management setting out the purpose and composition of the proposed product or transaction, together with a clear analysis of the anticipated profitability, resources required and the risks involved. Limits are set taking into account the BIS risk weightage and the guidelines of the Central Bank of UAE. The Board has also set discretionary limits for management below which level minor, non-recurring transactions may be made, or new products tested on a limited basis, without referral to the Board.

(a) Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's lending and investing activities and in cases where it acts as an intermediary on behalf of customers or other third parties or issues guarantees.

30 Risk management (continued)

(a) Credit risk

The Bank's primary exposure to credit risk arises through its loans and Islamic Financing receivables to customers. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the statement of financial position. In addition, the Bank is exposed to off-balance sheet credit risk through commitments to extend credit and guarantees issued.

The Bank is further exposed to credit risk on various other financial assets, including derivative instruments and debt investments. The current credit exposure in respect of these instruments is equal to the carrying amount of these assets in the statement of financial position. Investment securities are those guaranteed by investment grade banks in order to keep credit risks to a minimum. Should an investment fall outside this category prior to maturity, an immediate report is made to General Management at Head Office with proposals for rectifying the situation.

The responsibility for management of credit risk lies with Zonal Credit Committee, Branch Credit committee and Credit Risk Management department. The Credit risk management department is responsible for the following:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures and compliance with regulatory and statutory requirements;
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to various credit committees. Larger facilities require approval by management as appropriate;
- Reviewing and assessing credit risk: Credit Risk Management department assesses all credit exposure in excess of designated limits, prior to facilities being committed to customers. Renewals and reviews of facilities are subject to the same review process;
- Limiting concentration of exposure to counterparties, geographies and industries
- Developing and maintaining the risk grading in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risk; the risk grading system is used in determining where impairment provisions may be required against specific credit exposures. Risk grades are subject to regular reviews; and
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types.

Transaction and position limits by instrument and/or by counterparty are set by General Management based in Head Office, within the overall limits set by the Board. These limits are subject to annual review. Comprehensive reporting is to be made to the Board at Head office prior to such review.

Credit risk of individual counterparties or issuers are checked and monitored by management in accordance with internal rules.

Regular audits of business units and credit processes are undertaken by Internal Audit.

30 Risk management (continued)

(a) Credit risk (continued)

Exposure to credit risk

The bank measures its exposure to credit risk by reference to gross carrying amount of financial assets less interest suspended and expected credit allowances, if any.

	Stage 1	Stage 2	Stage 3	Total
Due from banks	**AED'000**	**AED'000**	**AED'000**	**AED'000**
Performing	3,407,358	341,974	-	3,749,332
Allowance for impairment losses	(8,808)	(1,151)	-	(9,959)
Net carrying amount	**3,398,550**	**340,823**	**-**	**3,739,373**

	Stage 1	Stage 2	Stage 3	Total
Loans and advances	**AED'000**	**AED'000**	**AED'000**	**AED'000**
Performing	2,336,962	1,169,348	-	3,506,310
Non-performing	-	-	335,447	335,447
Allowance for impairment losses	(24,766)	(184,326)	(174,322)	(383,414)
Net carrying amount	**2,312,196**	**985,022**	**161,125**	**3,458,343**

	Stage 1	Stage 2	Stage 3	Total
Debt securities	**AED'000**	**AED'000**	**AED'000**	**AED'000**
Performing	961,023	110,835	-	1,071,858
Non-performing	-	-	25,762	25,762
Allowance for impairment losses*	(88)	(405)	-	(493)
Net carrying amount	**960,935**	**110,430**	**25,762**	**1,097,127**

**Allowance for impairment losses on FVOCI bonds is netted from the fair value reserve.*

30 Risk management (continued)

(a) Credit risk (continued)

Exposure to credit risk (continued):

The credit quality of the financial assets is managed by the Bank using internal credit ratings. The table below shows the credit quality by class of financial assets based on the Bank's credit rating system:

	Loans and Islamic financing receivables 2017 AED 000	Due from banks 2017 AED 000	Investments 2017 AED 000
Individually Impaired			
Substandard	95,291	-	1,197
Doubtful	207,748	-	-
Loss	100	-	-
Gross amount	303,139	-	1,197
Interest in suspense	(3,137)	-	-
Specific allowance for impairment	(112,742)	-	-
Carrying Amount	187,260	-	1,197
Past due but not impaired			
Watch list – overdue by less than 90 days	127,779	-	-
Interest suspended	-	-	-
Specific allowance for impairment	-	-	-
Carrying Amount	127,779	-	-
Neither past due nor impaired			
Low / fair risk	3,481,919	3,932,281	1,328,944
Collective allowance for impairment	(112,127)	-	-
Carrying amount	3,684,831	3,932,281	1,330,141

Credit risk exposure of the Bank's investment portfolio as per the external risk rating is as follows:

	S&P equivalent rating	2018 AED'000	2017 AED'000
Low risk	AAA to A-	**372,647**	543,192
Fair risk	BBB+ to B-	**723,776**	785,752
High risk	CCC+ to D	**-**	-
	Unrated	**1,197**	1,197
		1,097,620	1,330,141

30 Risk management (continued)

(a) Credit risk (continued)

Impairment reserve under the Central Bank of UAE (CBUAE) guidance
The CBUAE has issued its IFRS 9 guidance addressing various implementation challenges and practical implications for Banks adopting IFRS 9 in the UAE ("the guidance").

Since stage 1 and stage 2 ECL held by the bank is higher than the general provision as per the requirements of CBUAE, hence no general impairment reserve is created. Whereas, based on individual comparison of stage 3 ECL as per IFRS 9 and specific provision as required by the CBUAE, the Bank has created specific impairment reserve amounting to AED 2,404 million.

Impairment assessment
The asset portfolio is reviewed at least quarterly at a minimum or as often as necessitated. The accrual or non-accrual status of the asset is re-assessed and appropriately risk graded as per the credit policy on risk grades. Impaired assets are classified as such through approvals on a credit memorandum and reported at least on quarterly intervals to the Board sub committees.

Corporate loans: The Bank determines the impairment appropriate for each individually significant loan or advance on an individual basis in line with Central Bank of the UAE and IFRS requirements. The Bank classifies those accounts where recovery is considered doubtful and ensures provisions are made accordingly. The impairment losses are evaluated on an ongoing basis. Credit exposures are classified by exercising mature judgment in line with Central Bank of the UAE regulations and IFRS requirements. Specific impairment is assessed when it shows a significant perceived decline in the credit quality or when an obligation is past due or over-limit for more than 90 days. Delinquent accounts are broadly classified as Substandard, Doubtful or Loss. The following general guidelines are followed for account classification into non-impaired and impaired:

- Loans and advances which bear normal banking risk, whereby information available to the bank assures repayment as agreed are classified as normal loans; Loans and advances which show some weaknesses in the borrower's financial condition and credit worthiness, requiring more than normal attention but not allocation of provisions are classified as Watch list loans;
- Those accounts where adverse factors may hinder repayment or weaken security or lead to some loss are classified as "Substandard accounts". In general these are credit exposures where agreed payments of principal and/or interest are more than 90 consecutive days in arrears;
- Those accounts where full recovery of interest and principal seems doubtful on the basis of information available, leading generally to a loss of part of these loans are classified as "Doubtful accounts"; and
- Those accounts where the bank has exhausted all courses of action available but failed to recover anything or where there is a possibility that nothing shall be recovered are classified as "Loss accounts".

All accounts classified as "Sub Standard", "Doubtful" and "Loss" constitute "Non- Performing Accounts"

During IFRS 9 implementation, the Bank formed a Steering Committee comprising of the appropriate Bank representatives to oversee the process of IFRS 9 implementation.

Post implementation of IFRS 9, the Bank established principles for ongoing IFRS 9 governance to ensure effective oversight of IFRS 9 processes. An effective IFRS 9 governance structure incorporates Credit, Risk and Finance departments as central support functions for each component of IFRS 9, defines clear process owners and reviewing functions and utilizes the three lines of defense to ensure an effective framework.

30 Risk management (continued)

(a) Credit risk (continued)

Under the IFRS 9 Governance Structure of the Bank, below are the three lines of defense for the key IFRS 9 processes i.e. classification and measurement, staging, impairment and disclosures:

- The process owners i.e. Credit, Financial Control and Treasury form the first line of defense;
- The reviewing/approving functions i.e. Chief Executive Officer, Head of Financial Control, Country Credit Management Committee and Country Asset and Liability Committee form the second line of defense; and
- The independent review functions i.e. Internal Audit and the Audit Committee of the BOD form the third line of defense.

To develop an effective governance framework, roles and responsibilities of the relevant stakeholders are defined to ensure appropriate segregation of duties and accountability.

The CCMC and Head of Credit will be responsible for review of the directive. The directive is subject to amendments if necessary as the Bank's business practice changes, the IFRS 9 standard evolves, market practices develop and regulatory directives are updated / introduced. The roles and responsibilities are updated in the appropriate committee charters and policies of the Bank.

<u>Write offs</u>
Corporate: Facilities where partial loss of principal is expected and full recovery of interest and fees is not expected or which are overdue for 180 days or more are transferred on a case-by-case basis to the Specialised Loans Bank for specialised remedial management and, where appropriate, written off as approved by the Management.

Consumer: Consumer loans are written off in the event of a compromise settlement agreed between the Bank and the customer.

The Bank generally waits until all legal and other remedies are exhausted before writing-off fully provisioned loans.

<u>Collateral Management</u>
Credit risk assessment identifies the primary sources of repayment which are the obligor's normal business cash flows and/ or normal personal income. Where credit facilities are secured by collateral, the Bank seeks to ensure the enforceability of the collateral.

Acceptable collateral includes deposits marked with lien, mortgages over land and property, movable assets including inventory, securities, investment grade bonds, gold and guarantees. The maximum lending value and the valuation frequencies are documented in the credit policy.

Collaterals are revalued as a general rule as per the Bank's credit policy. However, adhoc valuations are also carried out depending on the nature of collateral and general economic condition. This enables the Bank to assess the fair market value of the collateral and ensure that risks are appropriately covered.

Collaterals and guarantees are effectively used as mitigating tools by the Bank. The quality of collateral is continuously monitored and assessed.

30 Risk management (continued)
(a) Credit risk (continued)

Analysis by economic activity:
The Bank monitors concentrations of credit risk by economic activity sector. The analysis on significant credit risk by economic activity is as follows:

	2018			**2017**		
	Loans and Receivables AED 000	**Banks & Investment AED 000**	**Other Off-Balance Sheet exposures**	Loans and receivables AED 000	Banks & Investment AED 000	Other Off-Balance Sheet exposures
Manufacturing	**722,453**	**-**	**161,604**	636,490	-	228,336
Construction & Real Estate	**1,025,262**	**-**	**35,755**	1,043,219	-	42,593
Trade	**1,140,475**	**-**	**230,836**	1,043,920	-	246,444
Transport and communication	**30,238**	**-**	**9,419**	46,556	-	9,728
Services	**110,315**	**-**	**47,632**	156,225	-	51,580
Sovereign	**18,358**	**49,834**	**-**	-	225,583	-
Personal	**802,258**	**-**	**12,578**	980,525	-	6,155
Banks & other financial	**5,226**	**4,474,339**	**-**	5,902	4,663,724	-
Others	**-**	**322,779**	**139,810**	-	373,115	94,762
Total gross assets	**3,854,585**	**4,846,952**	**637,634**	3,912,837	5,262,422	679,598

30 Risk management (continued)

(a) Credit risk (continued)

Impairment

The Bank's past due loans and advances by industry segment and geographical location at 31 December 2018, as defined by the Central Bank of the UAE are as follows:

	Past due but not impaired AED 000	Individually impaired AED 000	Total AED 000	ECL and IIS AED 000	Net Impaired assets AED 000
As at 31 December 2018					
Industry Segment					
Manufacturing	**10,576**	**39,648**	**50,224**	**(37,291)**	**12,933**
Construction & Real Estate	**66,681**	**70,779**	**137,460**	**(44,319)**	**93,141**
Trade	**2,533**	**64,824**	**67,357**	**(51,122)**	**16,235**
Transport and communication	**8**	**932**	**940**	**(742)**	**198**
Services	**-**	**428**	**428**	**(312)**	**116**
Sovereign	**-**	**-**	**-**	**-**	-
Personal	**26,002**	**166,742**	**192,744**	**(50,008)**	**142,736**
Financial institutions	**-**	**4,922**	**4,922**	**(3,356)**	**1,566**
Others	-	-	-	-	-
Total	**105,800**	**348,275**	**454,075**	**(187,150)**	**266,925**
Concentration by Geography					
United Arab Emirates	**105,800**	**344,369**	**450,169**	**(186,715)**	**263,454**
Others	**-**	**3,906**	**3,906**	**(1,556)**	**2,350**
Total	**105,800**	**348,275**	**454,075**	**(187,150)**	**266,925**
As at 31 December 2017	127,779	303,139	430,918	(115,879)	315,039

30 Risk management (continued)

(a) Credit risk (continued)

Collateral

The Bank holds collateral against loans and Islamic financing receivables in the form of cash, guarantees, mortgages and liens over properties or other securities over assets. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and are subsequently monitored on a periodic basis.

Analysis of the collateral type is presented in the following table:

	2018 AED'000	2017 AED'000
Pledged deposits	**716,630**	611,596
Debt / Equity securities	**50,244**	75,216
Property	**1,549,637**	1,726,268
Vehicles	**94,246**	153,116
Bank guarantees	**382**	369
Total	**2,411,139**	2,566,565

The above represents values restricted to the lower of loan balance or collateral value, and includes AED 174.4 million (2017: AED 172.7 million) collateral held against impaired loans and financing receivables.

Analysis of the Bank's exposure at 31 December 2018 based on BASEL III standardised approach is as follows:

	On & Off balance Sheet	**Credit risk mitigation ("CRM")**			**Risk weighted assets**
Assets classes	**Gross outstanding AED 000**	**Exposure before CRM AED 000**	**CRM AED 000**	**Exposure after CRM AED 000**	**Total AED 000**
31 December 2018					
Claims on sovereign	**2,397,137**	**2,392,546**	**-**	**2,392,546**	**32,185**
Claims on (PSEs)	**31,415**	**31,415**	**-**	**31,415**	**-**
Claims on banks	**4,651,367**	**4,651,367**	**-**	**4,605,932**	**1,837,130**
Claims on corporate	**3,075,470**	**3,073,633**	**(530,629)**	**2,330,446**	**1,762,160**
Claims included in retail portfolio	**606,504**	**604,223**	**(186,383)**	**564,331**	**339,601**
Claims secured by residential property	**609,065**	**609,065**	**-**	**609,065**	**374,837**
Claims secured by commercial real estate	**639,458**	**639,458**	**-**	**639,458**	**639,458**
Past due loans	**458,561**	**269,007**	**-**	**267,402**	**268,192**
Other assets	**334,118**	**311,534**	**-**	**311,534**	**364,965**
Total	**12,803,095**	**12,582,248**	**(717,012)**	**11,752,129**	**5,618,528**

30 Risk management (continued)

(a) Credit risk (continued)

Analysis of the Bank's exposure at 31 December 2018 based on BASEL III standardised approach is as follows:

31 December 2017					
Claims on sovereign	2,782,308	2,782,308	-	2,782,308	9,669
Claims on (PSEs)	58,747	58,747	-	58,747	-
Claims on banks	4,801,151	4,801,151	-	4,773,265	1,831,730
Claims on corporate	2,744,763	2,741,176	(374,205)	1,995,847	1,558,606
Claims included in retail portfolio	934,203	919,689	(237,760)	872,354	560,520
Claims secured by residential property	767,203	767,084	-	767,084	474,893
Claims secured by commercial real estate	684,253	684,253	-	684,253	684,253
Past due loans	436,550	315,155	-	312,889	384,808
Other assets	296,614	279,708	-	279,708	206,347
Total	13,505,792	13,349,271	(611,965)	12,526,455	5,710,826

Risk weighted capital requirement

The Bank has adopted the standardised approach for credit risk, market risk and operational risk for regulatory reporting purposes. The Bank's risk weighted capital requirement for credit, market and operation risk are given below:

Risk weights for credit risk

The Bank has a diversified funded and unfunded credit portfolio. The exposures are classified as per the Standard Portfolio approach mentioned under the Central Bank of UAE Basel III Capital Adequacy Framework covering the standardised approach for credit risk. The descriptions of the counterparty classes along with the risk weights used to derive the risk weighted assets are as follows:

Funded exposure

Claims on sovereigns

These pertain to exposures to governments and their central banks. Claims on central banks and sovereigns are risk weighted in accordance with their ratings from acceptable External Credit Assessment Institutions ('ECAIs'), except that, for all Gulf Cooperation Council ('GCC') sovereigns a 0% weight has been applied.

Claims on non-commercial public sector entities (PSEs)

Domestic currency claims on GCC non-commercial PSE were treated as claims on GCC sovereign if their Central Bank or monetary authority treats them as such. Foreign currency claims on GCC PSE were treated one grade less favourable than its sovereign i.e. 20% risk weight were applied. Claims on other foreign non-commercial PSE were treated one grade less favourable than its sovereign.

Claims on multilateral development banks (MDBs)

All MDBs are risk weighted in accordance with each bank's credit rating except for those members listed in the World Bank Group which are risk weighted at 0%.

30 Risk management (continued)

(a) Credit risk (continued)

Risk weighted capital requirement (continued)

Claims on banks
Claims on banks are risk weighted based on the ratings assigned to them by external rating agencies, however, short term claims denominated in local currency were assigned more favourable risk weighting.

No claim on an unrated bank would receive a risk weight lower than that applied to claims on its sovereign of incorporation.

Claims on corporate portfolio and government related entities portfolio
Claims on corporate and government related entities portfolio (entities with greater than 50% government ownership) are risk weighted in accordance with ratings from acceptable ECAIs. Risk weightings for unrated corporate and government related entities' claims are assigned at 100%.

Claims on regulatory retail exposures
Retail claims that are included in the regulatory retail portfolio are assigned risk weights of 75% (except for past due loans), if they meets the criteria mentioned in the Central Bank of UAE BASEL-III guidelines.

Claims secured by residential property
A preferential risk weight of 35% was applied on claims that did not exceed AED 10 million to a single borrower and the claim was secured by residential property with LTV of up to 85%. Other claims secured on residential property were risk weighted 100%.

Claims secured by commercial property
100% risk weight was applied on claims secured by commercial property.

Past due exposures
The unsecured portion of any loan (other than a qualifying residential mortgage loan) that is past due for more than 90 days, net of specific provisions (including partial write-offs), is risk weighted as follows :

- 150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan; and
- 100% risk weight when specific provisions are greater than 20% of the outstanding amount of the loan.

Other exposures
These are risk weighted at 100%.

<u>Unfunded exposure</u>
For credit-related contingent items, the nominal value is converted to an exposure through the application of Credit Conversions Factors (CCF). The CCF is at 20%, 50% or 100% depending on the type of contingent item, and is used to convert off balance sheet notional amounts into an equivalent on balance sheet exposure.

Undrawn commitments to extend credit represent commitments that have not been drawn down or utilised at the reporting date. The nominal amount provides the calculation base to which the CCF is applied for calculating the exposure. CCF range between 20% and 50% for commitment with original maturity of up to one year and over one year respectively and 0% CCF is applicable for commitments which can be unconditionally cancelled at any time.

30 Risk management (continued)

(a) Credit risk (continued)

The Bank's exposure and credit risk mitigation at 31 December 2018 is summarised as follows:

	2018 **AED 000**	2017 AED 000
Gross exposure prior to credit risk mitigation – after CCF	**12,469,141**	13,349,271
Less: exposure covered by eligible financial collateral	**716,630**	611,596
Less: exposure covered by guarantees	**382**	369
Net exposure after credit risk mitigation	**11,752,129**	12,737,306
Risk Weighted Assets	**5,618,528**	5,710,826

(b) Market risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's/ issuer's credit standing) will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk. The prohibition on speculative trading on the Bank's own behalf is designed to ensure that such risks are kept to a minimum.

Market risks are managed on a continuing basis by Area Management based on limits set by the Board and General Management at Head Office. Aggregation at the total Bank level is carried out on a monthly basis as part of the normal month-end reporting procedures.

Foreign currency risk

The Bank is exposed to currency risk through transactions in foreign currencies. The Bank's transactional exposure gives rise to foreign currency gains and losses that are recognised in the statement of profit or loss and other comprehensive income. These exposures comprise the monetary assets and monetary liabilities of the Bank that are not denominated in the measurement currency of the Bank. The Bank ensures that its foreign currency exposure is kept at an acceptable level by buying and selling foreign currencies at spot rates when appropriate.

30 Risk management (continued)

(b) Market risk (continued)

Foreign currency risk (continued)

The table below summarises the Bank's exposure towards various currencies:

At 31 December 2018	AED AED 000	USD AED 000	GBP AED 000	Others AED 000	Total AED 000
Assets					
Cash and balances with UAE Central Bank	**2,121,753**	**290,744**	**-**	**-**	**2,412,497**
Due from banks	**2,268,288**	**855,702**	**303,831**	**311,552**	**3,739,373**
Due from related parties	**254**	**9,482**	**6,993**	**113,817**	**130,546**
Loans and Islamic financing receivables	**3,248,689**	**202,992**	**1,526**	**5,136**	**3,458,343**
Investments	**1,197**	**1,075,069**	**-**	**20,861**	**1,097,127**
Property and equipment	**63,876**	**-**	**-**	**-**	**63,876**
Customers' indebtedness for acceptances	**1,969**	**37,497**	**-**	**3,076**	**42,542**
Deferred tax assets	**78,246**	**-**	**-**	**-**	**78,246**
Other assets	**95,713**	**11,623**	**305**	**9,725**	**117,366**
Total assets	**7,879,985**	**2,483,109**	**312,655**	**464,167**	**11,139,916**
Liabilities, capital and reserves					
Deposits from customers	**6,237,195**	**2,389,959**	**306,505**	**453,394**	**9,387,053**
Due to banks	**2,865**	**42,701**	**5,270**	**-**	**50,836**
Due to related parties	**5,633**	**73**	**-**	**-**	**5,706**
Liabilities under acceptances	**1,969**	**37,497**	**-**	**3,076**	**42,542**
Other liabilities	**184,539**	**7,830**	**866**	**3,859**	**197,094**
Capital and reserves	**1,456,685**	**-**	**-**	**-**	**1,456,685**
Total liabilities, capital and reserves	**7,888,886**	**2,478,060**	**312,641**	**460,329**	**11,139,916**
Net position	**(8,901)**	**5,049**	**14**	**3,838**	**-**
At 31 December 2017					
Total assets	8,527,323	2,825,898	303,445	359,275	12,015,941
Total liabilities, capital and reserves	8,547,635	2,809,117	304,858	354,331	12,015,941
Net position	(20,312)	16,781	(1,413)	4,944	-

30 Risk management (continued)

(b) Market risk (continued)

Foreign currency risk (continued)

The Bank's functional currency is the UAE Dirham. The Bank is exposed to currency risk through transactions in spot and forward contracts. Forward transactions are done to accommodate customer requirements and not for any speculative purposes. At 31 December, the Bank had the following net exposures denominated in foreign currencies.

Currency	**Net spot position 2018 AED 000**	**Forward position 2018 AED 000**	**Net exposure 2018 AED 000**	Net exposure 2017 AED 000
US Dollar	**5,049**	**2,807**	**7,856**	(2,966)
GBP	**14**	**-**	**14**	(549)
Others	**3,838**	**(48)**	**3,790**	5,062
	======	======	======	======

Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or reprice at different times or in different amounts. In the case of floating rate assets and liabilities, the Bank is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices. Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with Bank's business strategies. The interest sensitivity of the Bank can be illustrated as follows:

Shift in yield curve	**2018 AED 000**	2017 AED 000
+200 b.p.	**97,746**	104,060
-200 b.p.	**(97,746)**	(104,060)
	======	======

A substantial portion of the Bank's assets and liabilities are re-priced within one year. Accordingly there is limited exposure to interest rate risk. The interest rate sensitivities set out above are illustrative only and employ simplified scenarios. They are based on AED 9.8 billion of monthly average interest bearing assets and AED 5.0 billion of monthly average interest bearing liabilities (31 Dec 2017: AED 11 billion average interest bearing assets and AED 5.4 billion average interest bearing liabilities.) The sensitivity does not incorporate actions that could be taken by the management to mitigate the effect of interest rate movements.

30 Risk management (continued)

(b) Market risk (continued)

Interest rate risk

A summary of the Bank's interest rate gap position on non-trading portfolios is as follows:

As at 31 December 2018	Up to 3 months AED 000	3 – 12 months AED 000	1 – 5 year AED 000	Over 5 years AED 000	Non interest bearing AED 000	Carrying amount AED 000
Assets						
Cash and balances with UAE Central Bank	**560,000**	**520,000**	**-**	**-**	**1,332,497**	**2,412,497**
Due from banks	**2,452,457**	**1,008,665**	**-**	**-**	**278,251**	**3,739,373**
Due from related parties	**5,134**	**-**	**-**	**-**	**125,412**	**130,546**
Loans and Islamic financing receivables	**3,244,133**	**43,157**	**114,657**	**24,922**	**31,474**	**3,458,343**
Investments	**17,830**	**204,497**	**717,923**	**156,877**	**-**	**1,097,127**
Property and equipment	**-**	**-**	**-**	**-**	**63,876**	**63,876**
Customers' indebtedness for acceptances	**-**	**-**	**-**	**-**	**42,542**	**42,542**
Deferred tax assets					**78,246**	**78,246**
Other assets	**-**	**-**	**-**	**-**	**117,366**	**117,366**
Total assets	**6,279,554**	**1,776,319**	**832,580**	**181,799**	**2,069,664**	**11,139,916**
Liabilities, capital and reserves						
Deposits from customers	**2,219,941**	**1,297,290**	**339,148**	**-**	**5,530,674**	**9,387,053**
Due to banks	**-**	**-**	**-**	**-**	**50,836**	**50,836**
Due to related parties	**956**	**-**	**-**	**-**	**4,750**	**5,706**
Liabilities under acceptances	**-**	**-**	**-**	**-**	**42,542**	**42,542**
Other liabilities	**-**	**-**	**-**	**-**	**197,094**	**197,094**
Capital and reserves	**-**	**-**	**-**	**-**	**1,456,685**	**1,456,685**
Total liabilities and capital and reserves	**2,220,897**	**1,297,290**	**339,148**	**-**	**7,282,581**	**11,139,916**
Interest rate sensitivity gap						
2018	**4,058,657**	**479,029**	**493,432**	**181,799**	**(5,212,917)**	**-**
2017	4,614,306	175,423	780,222	154,322	(5,724,273)	-
Cumulative interest rate sensitivity gap						
2018	**4,058,657**	**4,537,686**	**5,031,118**	**5,212,917**	**-**	**-**
2017	4,614,306	4,789,729	5,569,951	5,724,273	-	-

Repricing of assets and liabilities has been determined on the basis of contractual pricing or maturity dates, whichever is earlier.

30 Risk management (continued)

(c) Liquidity risk

Liquidity risk is the risk that a bank will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset at close to its fair value.

The Asset Liability Committee of the Bank meets regularly and monitors the liquidity requirements. The Bank's liquidity management policies are designed to ensure that even under adverse conditions the Bank should be in a position to meet its obligations. The Bank's conservative lending policy and risk averse approach to funding has resulted in a significant mitigation of the Liquidity Risk on the Bank's books, thereby justifying enough liquidity and Capital Adequacy.

Daily liquidity management is carried out through comprehensive reporting by Finance Department and Treasury Department that gives relevant information to the Bank's Management regarding liquidity risk. Excess funds after meeting customer advances and other requirements are placed with Central Bank of the UAE and other good quality internationally rated banks to maintain an optimal short and medium term liquidity position.

The following table shows the undiscounted cash flows on the Bank's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity.

	Carrying amount AED 000	Inflow / (Outflow) AED 000	0 – 3 months AED 000	3 months to 1 year AED 000	1 year to 5 years AED 000
<u>At 31 December 2018</u>					
Financial Liabilities					
Deposits from customers	**9,387,053**	**(9,413,527)**	**(7,768,590)**	**(1,302,935)**	**(342,002)**
Due to banks	**50,836**	**(50,849)**	**(50,849)**	**-**	**-**
Due to related parties	**5,706**	**(5,733)**	**(5,733)**	**-**	**-**
	9,443,595	**(9,470,109)**	**(7,825,172)**	**(1,302,935)**	**(342,002)**
Unrecognised loan commitments	**637,634**	**637,634**	**374,391**	**201,376**	**61,867**
<u>At 31 December 2017</u>					
Financial Liabilities					
Deposits from customers	10,096,332	(10,126,664)	(8,544,060)	(1,268,661)	(313,943)
Due to banks	74,872	(74,878)	(74,878)	-	-
Due to related parties	49,190	(49,192)	(49,192)	-	-
	10,220,394	(10,250,734)	(8,668,130)	(1,268,661)	(313,943)
Unrecognised loan commitments	677,598	677,598	433,969	181,961	61,668

30 Risk management (continued)

(c) Liquidity risk (continued)

The Bank's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance; and unrecognised loan commitments are not all expected to be drawn down immediately.

The table below summarises the maturity profile of the Bank's assets and liabilities analysed according to when they are expected to be recovered or settled.

As at 31 December 2018	Up to 3 months AED 000	3 – 12 months AED 000	1 – 5 year AED 000	Over 5 years AED 000	On demand AED 000	Total amount AED 000
Assets						
Cash and balances with UAE Central Bank	**560,000**	**520,000**	**-**	**-**	**1,332,497**	**2,412,497**
Due from banks	**2,452,547**	**1,008,665**	**-**	**-**	**278,251**	**3,739,373**
Due from related parties	**5,134**	**-**	**-**	**-**	**125,412**	**130,546**
Loans and Islamic financing receivables	**1,092,222**	**983,547**	**998,706**	**24,922**	**358,946**	**3,458,343**
Investments	**17,829**	**160,304**	**762,116**	**156,878**	**-**	**1,097,127**
Property and equipment	**-**	**-**	**-**	**-**	**63,876**	**63,876**
Customers' indebtedness for acceptances	**29,612**	**12,930**	**-**	**-**	**-**	**42,542**
Deferred tax assets	**-**	**-**	**-**	**-**	**78,246**	**78,246**
Other assets	**-**	**-**	**-**	**-**	**117,366**	**117,366**
Total Assets	**4,157,344**	**2,685,446**	**1,760,822**	**181,800**	**2,354,594**	**11,139,916**
Liabilities, capital and reserves						
Deposits from customers	**2,202,797**	**1,297,290**	**339,148**	**-**	**5,547,818**	**9,387,053**
Due to banks	**-**	**-**	**-**	**-**	**50,836**	**50,836**
Due to related parties	**956**	**-**	**-**	**-**	**4,750**	**5,706**
Liabilities under acceptances	**29,612**	**12,930**	**-**	**-**	**-**	**42,542**
Other liabilities	**-**	**-**	**-**	**-**	**197,094**	**197,094**
Capital and reserves	**-**	**-**	**-**	**-**	**1,456,685**	**1,456,685**
Total liabilities and capital and reserves	**2,233,365**	**1,310,220**	**339,148**	**-**	**7,257,183**	**11,139,916**
Maturity gap						
2018	**1,923,979**	**1,375,226**	**1,421,674**	**181,800**	**(4,902,589)**	**-**
2017	2,271,369	613,753	2,284,874	169,455	(5,339,451)	-

30 Risk management (continued)

(d) Operational Risk

Operational Risk is defined as the risk of loss resulting from inadequate or failed internal processes, people or systems or from external events. This definition comprises legal risk including regulatory fines and settlements, but excludes strategic and reputation risk.

The Bank has an Independent Department in charge of the management of operational risks. This function is responsible for the development of strategies for the identification, assessment, monitoring, control and mitigation of operational risks. The function is also responsible for the development and implementation of a method to assess and report operational risks and systematically collecting the operational risk data relevant for the Bank's operations.

The operational risk department is an integral part of the overall risk management strategy of the Bank. The Bank has sound documentation of all the standard procedures, policies and standardised approaches for all the generic and key processes. Majority of the coverage as to the Management of Operational Risk at the Bank is also effected through system controls.

(e) Capital risk management

Capital allocation

The Bank's lead regulator, the Central Bank of the UAE, sets and monitors regulatory capital requirements.

The Bank's objectives when managing capital are as follows:

- Safeguarding the Bank's ability to continue as a going concern and increase return for shareholders; and
- Comply with regulatory capital set by Central Bank of UAE.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank also assesses its capital requirements internally taking into consideration growth requirements and business plans, and quantifies its Regulatory and Risk/ Economic Capital requirements within its integrated Internal Capital Adequacy Process ("ICAAP") Framework.

30 Risk management (continued)

(e) Capital risk management (continued)

Risks such as Interest Rate Risk in the Banking Book, Concentration Risk, Strategic Risk, Legal and Compliance Risk, Stress Risk, Insurance Risk and Reputational Risk are all part of the ICAAP.

Effective from 2017, the capital is computed using the Basel III framework of the Basel Committee on Banking Supervision (‘Basel Committee’), after applying the amendments advised by the CBUAE, within national discretion. The Basel III framework, like Basel II, is structured around three ‘pillars’: minimum capital requirements, supervisory review process and market discipline.

The Bank’s regulatory capital is analysed into two tiers:

- CET1 capital is the highest quality form of capital, comprising share capital, legal, statutory and other reserves, fair value reserve, retained earnings, after deductions for intangibles and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes under ‘CBUAE’ guidelines.
- Tier 2 capital comprises of collective provision which shall not exceed 1.25% of total credit risk weighted assets.

The CBUAE issued Basel III capital regulations, which came into effect from 1 February 2017 introducing minimum capital requirements at three levels, namely Common Equity Tier 1 (‘CET1’), Additional Tier 1 (‘AT1’) and Total Capital. The minimum capital adequacy requirements as set out by the Central Bank are as follows:

- Minimum common equity tier 1 (CET 1) ratio of 7% of risk weighted assets (RWAs).
- Minimum tier 1 ratio of 8.5% of RWAs.
- Total capital adequacy ratio of 10.5% of RWAs.

Additional capital buffers (Capital Conservation Buffer (CCB) and Countercyclical Capital Buffer (CCyB) - maximum up to 2.5% for each buffer) introduced over and above the minimum CET1 requirement of 7%.

For 2018, CCB is effective in transition arrangement and is required to be kept at 1.88% of the Capital base and from 2019 it will be required to be kept at 2.5% of the Capital base. CCyB is not in effect and is not required to be kept for 2018.

The Bank has complied with all the externally imposed capital requirements.

30 Risk management (continued)

(e) Capital risk management (continued)

As at 31 December 2018, the Bank's regulatory capital position is as follows:

	2018	2017
	AED 000	AED 000
Common Equity Tier 1 (CET 1) CAPITAL		
Share capital	**100,000**	100,000
Legal reserves	**50,000**	50,000
Retained earnings*	**1,179,445**	1,330,098
Fair value reserve	**(22,489)**	(5,369)
Total CET 1 capital	**1,306,956**	1,474,729
Regulatory adjustments	-	-
Total tier 1 capital	**1,306,956**	1,474,729
TIER 2 CAPITAL		
General provisions	**70,232**	71,341
Total tier 2 capital	**70,232**	71,341
Total regulatory capital (Sum of tier 1 and 2 capital)	**1,377,188**	1,546,070
RISK WEIGHTED ASSETS		
Credit risk	**5,618,528**	5,710,826
Market risk	**3,711**	4,063
Operational risk	**725,333**	753,793
Total risk weighted assets (RWA)	**6,347,572**	6,468,682
Total CET 1 capital expressed as % of RWA	**20.59%**	22.80%
Total tier 1 capital expressed as % of RWA	**20.59%**	22.80%
Total regulatory capital expressed as % of RWA	**21.70%**	23.90%

*Habib Bank AG Zurich Head Office has proposed the Bank for profit repatriation of AED 140 million on 12 November 2018. This amount is excluded from the retained earnings as at 31 December 2018 for calculation of CET 1 capital.

30 Risk management (continued)

(e) Capital risk management (continued)

Risk weights for market risk

Capital requirement for market risk is calculated using standardised approach. The capital requirement for market risk is analysed into capital requirement for interest rate risk, equity risk, foreign exchange risk and option risk.

Risk weight for operation risk

Capital requirement for operation risk is calculated using basic indicator approach. This capital change was computed using basic indicator approach by multiplying the three years' average gross income by a predefined beta factor.

31 Cash and cash equivalents

Analysis of the balances of cash and cash equivalent items:

	2018	2017	Change in year
	AED 000	AED 000	AED 000
Cash and deposits with UAE Central Bank	**2,412,497**	2,685,446	(272,949)
Less: Certificates of deposit with maturity of over 3 months from original maturity	**(520,000)**	(485,000)	(35,000)
Less: Statutory reserve	**(886,506)**	(1,029,521)	143,015
Due from banks	**3,739,373**	3,932,281	(192,908)
Less: Bank placements with maturity of over 3 months from original maturity	**(1,008,665)**	(719,238)	(289,427)
Due from related parties	**130,546**	103,183	27,363
Due to banks	**(50,836)**	(74,872)	24,036
Due to related parties	**(5,706)**	(49,190)	43,484
	3,810,703	4,363,089	(552,386)

32 Custody accounts

The Bank provides custody, trustee and administration services to third parties in relation to a wide range of financial instruments. Those assets that are held in a fiduciary capacity are not included in these financial statements. At the reporting date, the Bank has investment custody accounts aggregating to approximately AED 1,058 million (2017: AED 1,298 million).

33 Comparative figures

Certain comparative figures have been reclassified to conform to the presentation adopted in these financial statements.