NATIONAL BANK OF KUWAIT (LEBANON) SAL

FINANCIAL STATEMENTS

31 DECEMBER 2018

Building a better
working world

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF NATIONAL BANK OF KUWAIT (LEBANON) SAL

Qualified Opinion

We have audited the financial statements of National Bank of Kuwait (Lebanon) SAL (the "Bank"), which comprise the statement of financial position as at 31 December 2018, and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the "Basis for Qualified Opinion" section of our report, 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 (IFRSs).

Basis for Qualified Opinion

As disclosed in note 22 to the financial statements, due to regulatory requirements enacted since 2016, the Bank carried excess provisions of LL million 1,670 as at 31 December 2017. Since "Provisions for risks and charges" were overstated and "Equity" was understated by LL million 1,670 as at 31 December 2017, our opinion on the financial statements for the year ended 31 December 2017 was modified accordingly. Our opinion on the current year's financial statements is also modified due to effect of this matter on the comparability of the current year's financial statements and the corresponding prior year.

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' 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 Lebanon, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Key audit matters

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

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

Key audit matters (continued)
Refer to note 2 of the financial statements for a description of the accounting policy and note 34.2 for analysis of credit risk.

Due to the inherently judgmental nature of the computation of expected credit losses ("ECL") for financial assets, there is a risk that the amount of ECL may be misstated. On adoption, the Bank has applied the requirements of IFRS9 retrospectively without restating the comparatives.

The key areas of judgement include:
1. The identification of exposure with a significant deterioration in credit quality.
2. Assumptions used in the ECL model such as financial condition of counterparty, expected future cash flows, forward looking macroeconomic factors etc.
3. The need to apply additional overlays to reflect current or future external factors that might not be captured by the expected credit loss model.

How the matter was addressed during our audit:
We performed the following procedures:

1. We assessed the modelling techniques and methodology against the requirements of IFRS 9.
2. We tested the data, both current and historical, used in determining the ECL.
3. We tested the expected credit loss models including build, validation and governance of models.
4. We tested the material modelling assumptions in addition to any overlays.
5. We examined a sample of exposures and performed procedures to determine whether significant increase in credit risk had been identified on a timely basis.
6. We re-performed the ECL computation for sample of credit facilities.
7. We assessed the adequacy of disclosures in the financial statements.

Responsibilities of Management and the Audit Committee 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.

The Audit Committee is responsible for overseeing the Bank's financial reporting process.

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

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

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

The partner in charge of the audit resulting in this independent auditors' report is Ramzi Ackawi.

Ernst & Young

12 April 2019
Beirut, Lebanon

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2018

	Notes	*2018* *LL million*	*2017* *LL million*
Interest and similar income	3	**19,740**	15,507
Interest and similar expense	4	**(3,486)**	(1,823)
Net interest income		**16,254**	13,684
Fee and commission income		**1,941**	2,168
Fee and commission expenses		**(305)**	(255)
Net fee and commission income	5	**1,636**	1,913
Net gain from foreign exchange	6	**788**	748
Other operating income	7	**595**	494
Total operating income		**19,273**	16,839
Net impairment loss on financial assets	30	**-**	(41)
Net operating income		**19,273**	16,798
Personnel expenses	8	**(8,350)**	(8,330)
Administrative and other operating expenses	9	**(3,978)**	(4,433)
Depreciation of property and equipment	16	**(700)**	(660)
Total operating expenses		**(13,028)**	(13,423)
Profit before tax		**6,245**	3,375
Income tax expense	10	**(1,516)**	(274)
Net profit for the year		**4,729**	3,101
Other comprehensive income for the year		**-**	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**4,729**	3,101

The attached notes 1 to 35 form part of these financial statements.

STATEMENT OF FINANCIAL POSITION

At 31 December 2018

	Notes	*2018* *LL million*	*2017* *LL million*
Assets			
Cash and balances with the Central Bank	11	**118,801**	107,375
Due from banks and financial institutions	12	**77,764**	29,682
Due from head office, branches and affiliates	13	**6,826**	5,634
Loans and advances to customers at amortized cost	14	**107,199**	113,330
Loans and advances to related parties at amortized cost	27	**822**	941
Financial assets at amortized cost	15	**136,995**	162,582
Property and equipment	16	**11,567**	11,670
Derivative financial instruments	19	**-**	303
Other assets	18	**1,254**	1,253
Total assets		**461,228**	432,770
Liabilities and shareholders' equity			
Liabilities			
Due to banks and financial institutions		**-**	6
Due to head office, branches and affiliates	13	**37,904**	22,620
Derivative financial instruments	19	**567**	-
Customers' deposits at amortized cost	20	**318,370**	311,041
Related parties' deposits at amortized cost	27	**1,822**	673
Other liabilities	21	**8,449**	7,631
Provisions for risks and charges	22	**5,023**	6,645
Total liabilities		**372,135**	348,616
Shareholders' equity			
Share capital – common shares	23	**40,020**	40,020
Non-distributable reserves (legal and obligatory)	24	**15,413**	15,103
Distributable reserves	25	**31,845**	31,945
Accumulated losses		**(2,914)**	(6,015)
Net results of the financial year – profit		**4,729**	3,101
Total shareholders' equity		**89,093**	84,154
Total liabilities and shareholders' equity		**461,228**	432,770

The financial statements were authorized for issue in accordance with a resolution of the Board of Directors on 12 April 2019.

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2018

			Non-distributable reserves (legal and obligatory)				Distributable free reserve			
	Share capital – common shares LL million	*Statutory reserve LL million*	*Reserve for capital increase LL million*	*Reserve for general banking risks LL million*	*General reserve LL million*	*Total LL million*	*General reserve LL million*	*Accumulated losses LL million*	*Results of the financial year - profit LL million*	*Total LL million*
Balance at 1 January 2018	40,020	4,989	3,419	6,695	-	15,103	31,945	(6,015)	3,101	84,154
Impact of adopting IFRS 9 at 1 January	-	-	-	-	-	-	-	(1,030)	-	(1,030)
Transfer from reserve for general banking risks	-	-	-	(1,030)	-	(1,030)	-	1,030	-	-
Restated balance at 1 January 2018	40,020	4,989	3,419	5,665	-	14,073	31,945	(6,015)	3,101	83,124
Results of the financial year – profit	-	-	-	-	-	-	-	-	4,729	4,729
Total comprehensive income for the year	-	-	-	-	-	-	-	-	4,729	4,729
Transfer to accumulated losses	-	-	-	-	-	-	-	3,101	(3,101)	-
Transfer to non-distributable general reserve (notes 22 & 24)	-	-	-	(5,665)	7,005	1,340	(100)	-	-	1,240
Balance at 31 December 2018	**40,020**	**4,989**	**3,419**	-	7,005	**15,413**	**31,845**	**(2,914)**	**4,729**	**89,093**
Balance at 1 January 2017	40,020	4,989	3,419	6,667	-	15,075	31,973	-	(6,015)	81,053
Results of the financial year – profit	-	-	-	-	-	-	-	-	3,101	3,101
Total comprehensive income for the year	-	-	-	-	-	-	-	-	3,101	3,101
Transfer to accumulated losses	-	-	-	-	-	-	-	(6,015)	6,015	-
Appropriation from general reserve (note 24)	-	-	-	28	-	28	(28)	-	-	-
Balance at 31 December 2017	40,020	4,989	3,419	6,695	-	15,103	31,945	(6,015)	3,101	84,154

The attached notes 1 to 35 form part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2018

	Notes	*2018* *LL million*	*2017* *LL million*
OPERATING ACTIVITIES			
Net profit before income tax		**5,788**	3,154
Adjustments for:			
Depreciation of property and equipment	16	**700**	660
Provision for retirement benefits obligation	22	**80**	15
Net provision for risks and charges	22	**177**	449
Net impairment loss on financial assets	30	**-**	41
Gain on sale of property and equipment		**-**	(17)
Gain on sale of non-current asset held for sale	7	**(105)**	-
		6,640	4,302
Working capital changes:			
Cash and balances with the Central Bank – Maturities of more than 3 months		**-**	(15,000)
Loans and advances to customers at amortized cost		**5,851**	(12,961)
Loans and advances to related parties at amortized cost		**110**	152
Other assets		**(1)**	(65)
Customers' deposits at amortized cost		**7,329**	23,583
Related parties' deposits at amortized cost		**1,149**	(173)
Other liabilities		**(147)**	2,634
Cash from operations		**20,931**	2,472
Provisions for risks and charges paid	22	**(215)**	(4,175)
Taxes paid	10	**(53)**	-
Net cash from (used in) operating activities		**20,663**	(1,703)
INVESTING ACTIVITIES			
Purchase of financial assets at amortized cost		**(75,800)**	(129,434)
Purchase of property and equipment	16	**(597)**	(237)
Proceeds from redemption of financial assets at amortized cost		**101,365**	101,003
Proceeds from sale of non-current assets held for sale	17	**105**	-
Proceeds from sale of property and equipment		**-**	63
Net cash from (used in) investing activities		**25,073**	(28,605)
FINANCING ACTIVITIES			
Due to head office, branches and affiliated – maturities of more than 3 months		**15,244**	22,612
Net cash from financing activities		**15,244**	22,612
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**60,980**	(7,696)
Cash and cash equivalents at 1 January		**97,527**	105,223
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	26	**158,507**	97,527
OPERATING CASH FLOWS			
Interest received		**19,311**	13,897
Interest paid		**3,695**	1,251

The attached notes 1 to 35 form part of these financial statements.

1 CORPORATE INFORMATION

The Bank is a shareholding company registered in Beirut, Lebanon. It was registered during 1963 under the name of RIF Bank SAL under commercial registration number 13188 and number 73 on the list of banks published by the Central Bank of Lebanon. In 1996, the name of the Bank was changed to National Bank of Kuwait (Lebanon) SAL. The Bank provides a full range of commercial banking activities. Its main branch is at Sanayeh and it operates through three branches.

National Bank of Kuwait S.A.K. owns directly and indirectly 72.66% of the Bank's shares. The main address of National Bank of Kuwait S.A.K. is P.O.Box 95 Safat 13001, Kuwait.

2 SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

The financial statements are prepared under the historical cost convention as modified for the measurement at fair value of derivative financial instruments.

The financial statements have been presented in millions of Lebanese Lira (LL million).

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Standards Board (IASB), and the regulations of the Central Bank of Lebanon and the Banking Control Commission ("BCC").

Presentation of financial statements

The Bank presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the statement of financial position date (current) and more than 12 months after the statement of financial position date (non-current) is presented in the risk management note.

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liability simultaneously. Income and expense are not offset in the statement of comprehensive income unless required or permitted by any accounting standard or interpretation, as specifically disclosed in the accounting policies of the Bank.

2.2 New and Amended Standards and Interpretations

The Bank applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2018. The nature and the impact of each amendment is described below:

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments and all previous versions of IFRS 9 (2009, 2010 and 2013). The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. The new version, IFRS 9 (2014) is effective for annual periods beginning on or after 1 January 2018. The Bank adopted the new standard on the required effective date, along with the provisions of the Central Bank of Lebanon basic circular No. 143 and the Banking Control Commission circular No. 293.

The Bank has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9 (2014). Therefore, the comparative information for 2017 is reported under IFRS 9 (2009, 2010 and 2013) and IAS 39 impairment requirements and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 (2014) have been recognised directly in retained earnings or reserves (as applicable) as of 1 January 2018 and are disclosed in V below.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 New and Amended Standards and Interpretations (continued)

IFRS 9 Financial Instruments **(continued)**

I. Classification and measurement

The Bank has early adopted classification and measurement requirements as issued in IFRS 9 (2009) and IFRS 9 (2010). In the July 2014 publication of IFRS 9, the new measurement category fair value though other comprehensive income was introduced for financial assets that satisfy the contractual cash flow characteristics (SPPI test). This category is aimed at portfolio of debt instruments for which amortised cost information, as well as fair value information is relevant and useful. A debt financial asset is measured at fair value through OCI if:

- it is held in a business model whose objective is achieved by both holding assets to collect contractual cash flows and selling the assets, and
- it satisfies the contractual cash flow characteristics (SPPI test).

At the date of application of IFRS 9 (2014), the Bank reassessed the classification and measurement category for all financial assets debt instruments that satisfy the contractual cash flow characteristics (SPPI test) and classified them within the category that is consistent with the business model for managing these financial assets on the basis of facts and circumstances that existed at that date.

The classification and measurement requirements for financial assets that are equity instruments or debt instruments that do not meet the contractual cash flow characteristics (SPPI test) and financial liabilities remain unchanged from previous versions of IFRS 9.

The Bank's classification of its financial assets and liabilities is explained in Note 2.4. The impact on the classification of the Bank's financial assets and their carrying values and equity is discussed in V below.

II. Expected Credit Losses

The adoption of IFRS 9 has fundamentally changed the Bank's accounting for loan loss impairments by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Bank to record an allowance for ECLs for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset.

The impact of the adoption of IFRS 9 impairment provisions on the Bank's financial assets and their carrying values and equity is discussed in V below.

III. IFRS 7 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. Changes include transition disclosures as shown in V below, detailed qualitative and quantitative information about the ECL calculations. The assumptions and inputs used are set out in Note 2.4.

Reconciliations from opening to closing ECL allowances are presented in the notes to the financial statements.

IV. Hedge accounting

The Bank has early adopted hedge accounting requirements as issued in IFRS 9 (2013). These requirements were first published in November 2013 and remain unchanged in the July 2014 publication of IFRS 9, except to reflect the addition of the FVOCI measurement category to IFRS 9.

There is no impact on the financial statements as the Bank does not have hedged items measured at FVOCI.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 New and Amended Standards and Interpretations (continued)

***IFRS 9 Financial Instruments* (continued)**

V. Transition

In accordance with the transition provisions of IFRS 9 (2014), the Bank applied this standard retrospectively. The following tables set out the impact of adopting IFRS 9 (2014) on the statement of financial position, and retained earnings including the effect of replacing IAS 39's incurred credit loss calculations with IFRS 9's ECLs.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 New and Amended Standards and Interpretations (continued)

IFRS 9 Financial Instruments (continued)

Impact of change in classification and measurement
Expect for the financial statement captions listed in the below table, there have been no changes in the carrying amounts of assets and liabilities on application of IFRS 9 (2014) as at 1 January 2018.

	Classification under IFRS 9 (2010) (31 December 2017) Category LL million	*Amount LL million*	*Re-measurement ECL LL million*	*Classification under IFRS 9 (2014) (1 January 2018) Category LL million*	*Amount LL million*
Financial assets					
Cash and balances with the central banks	**Amortized cost**	**107,375**	**349**	**Amortized cost**	**107,026**
Loans and advances to customers at amortised cost	**Amortized cost**	**113,330**	**84**	**Amortized cost**	**113,414**
Loans and advances to related parties at amortized cost	**Amortized cost**	**941**	**9**	**Amortized cost**	**932**
Financial assets at amortised cost	**Amortized cost**	**162,582**	**1,329**	**Amortized cost**	**161,253**
			1,771		
Non financial liabilities					
Provision for ECL on financial guarantees and other commitments			**11**		
Total impact of adoption of IFRS 9 (2014)			**1,782**		
Less: amount covered by excess provisions available on 1 January 2018			**(752)**		
Net impact on equity			**(1,030)**		

The increase in impairment allowances when measured in accordance with IFRS 9 expected credit losses model compared to IAS 39 incurred loss model amounts to LL million 1,782, and was covered partly by the Company's excess provision disclosed under "provision for risks and charges" amounting to LL million 752. Accordingly, the impact on the Bank's equity from adoption of the IFRS 9 impairment requirements amounted to LL million 1,030 as at 1 January 2018.

Total adjustments related to classification and measurements other than impairment will not have any impact on the opening retained earnings and other components of equity.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 New and Amended Standards and Interpretations (continued)

IFRS 9 Financial Instruments (continued)

Impact of change in classification and measurement (continued)

The following table reconciles the aggregate opening loan loss provision allowances under IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 *Provision Contingent Liabilities and Contingent Assets* to the ECL allowance under IFRS 9.

	Impairment allowance under IAS 39/IAS 37 at 31 December 2017 LL million	*Re-measurement LL million*	*ECLs under IFRS 9 at 1 January 2018 LL million*
Impairment allowance for			
Cash and balances with the Central Bank	-	**349**	**349**
Loans and advances to customers at amortised cost	**1,156**	**84**	**1,240**
Loans and advances to related parties at amortized cost	-	**9**	**9**
Financial assets at amortised cost	-	**1,329**	**1,329**
	1,156	**1,771**	**2,927**
Financial guarantees and other commitments	-	**11**	**11**
	1,156	**1,782**	**2,938**

IFRS 15 *Revenue from contracts with customers*

IFRS 15 supersedes IAS 11 Construction Contracts, IAS 18 Revenue and related Interpretations and it applies to all revenue arising from contracts with customers, unless those contracts are in the scope of other standards. The new standard establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The standard requires entities to exercise judgement, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract. The Bank assessed that the impact of IFRS 15 is not material on the financial statements of the Bank.

Amendments to IFRS 2 *Classification and Measurement of Share-based Payment Transactions*

The IASB issued amendments to IFRS 2 Share-based Payment that address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled. On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and other criteria are met. If applicable, the Bank's accounting policy for cash-settled share based payments is consistent with the approach clarified in the amendments. In addition, the Bank has no share-based payment transaction with net settlement features for withholding tax obligations and had not made any modifications to the terms and conditions of its share-based payment transaction. These amendments do not have any impact on the Bank's financial statements.

IFRIC Interpretation 22 *Foreign Currency Transactions and Advance Considerations*

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine a date of transaction for each payment or receipt of advance consideration. This Interpretation does not have any impact on the Bank's financial statements.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 Standards Issued but not Yet Effective

Certain new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2018, with the Bank not opting for early adoption. These have therefore not been applied in preparing these consolidated financial statements.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 *Operating Leases-Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16, which is effective for annual periods beginning on or after 1 January 2019, requires lessees and lessors to make more extensive disclosures than under IAS 17.

Transition to IFRS 16

The Bank plans to adopt IFRS 16 by applying the modified retrospective approach, i.e. comparative figures for the preceding year will not be adjusted. The Bank will elect to apply the standard to contracts that were previously identified as leases applying IAS 17 and IFRIC 4. The Bank will therefore not apply the standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

The Bank is currently assessing further impacts of adopting IFRS 16 on the financial statements. It is intended to use most of the simplifications available under IFRS 16.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 Standards Issued but not Yet Effective

Other standards issued but not yet effective include the following. The Bank is currently assessing the impact of adopting these changes as it plans to adopt the new standards on the required effective dates.

Standard	Description	Effective date
IFRIC Interpretation 23 "Uncertainty over Income Tax Treatment"	The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 and does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses the following: • Whether an entity considers uncertain tax treatments separately. • The assumptions an entity makes about the examination of tax treatments by taxation authorities. • How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates. • How an entity considers changes in facts and circumstances. An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. Since the Bank operates in a complex multinational tax environment, applying the Interpretation may affect its financial statements and the required disclosures. In addition, the Bank may need to establish processes and procedures to obtain information that is necessary to apply the Interpretation on a timely basis.	1 January 2019
Amendments to IFRS 10 and IAS 28: "Sale or Contribution of Assets between an Investor and its Associate or Joint Venture:	The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely, but an entity that early adopts the amendments must apply them prospectively.	Indefinite

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 Standards Issued but not Yet Effective (continued)

Standard	Description	Effective date
Amendments to IAS 19: Plan Amendment, Curtailment or Settlement	The amendments address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments specify that when a plan amendment, curtailment or settlement occurs during the annual reporting period, an entity is required to: • Determine current service cost for the remainder of the period after the plan amendment, curtailment or settlement, using the actuarial assumptions used to remeasure the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event. • Determine net interest for the remainder of the period after the plan amendment, curtailment or settlement using: the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event; and the discount rate used to remeasure that net defined benefit liability (asset). The amendments also clarify that an entity first determines any past service cost, or a gain or loss on settlement, without considering the effect of the asset ceiling. This amount is recognised in profit or loss. An entity then determines the effect of the asset ceiling after the plan amendment, curtailment or settlement. Any change in that effect, excluding amounts included in the net interest, is recognised in other comprehensive income. These amendments will apply only to any future plan amendments, curtailments, or settlements of the Bank.	1 January 2019
Amendments to IFRS 9: Prepayment Features with Negative Compensation	Under IFRS 9, a debt instrument can be measured at amortised cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.	1 January 2019
Amendments to IAS 28: Long-term interests in associates and joint ventures	The amendments clarify that an entity applies IFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). This clarification is relevant because it implies that the expected credit loss model in IFRS 9 applies to such long-term interests. The amendments also clarified that, in applying IFRS 9, an entity does not take account of any losses of the associate or joint venture, or any impairment losses on the net investment, recognised as adjustments to the net investment in the associate or joint venture that arise from applying IAS 28 Investments in Associates and Joint Ventures.	1 January 2019

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 Standards Issued but not Yet Effective (continued)

Annual Improvements 2015-2017 Cycle (issued in December 2017)	These improvements include: • ***IFRS 3 Business Combinations*** The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation. • ***IFRS 11 Joint Arrangements*** A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in IFRS 3. The amendments clarify that the previously held interests in that joint operation are not remeasured. • ***IAS 12 Income Taxes*** The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognises the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised those past transactions or events. • ***IAS 23 Borrowing Costs*** The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete.	1 January 2019

2.4 Summary of significant accounting policies

Foreign currency translation

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

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange at the statement of financial position date. All differences are taken to "Net gain (loss) from financial instruments at fair value through profit or loss" in the income statement.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Financial instruments – Initial recognition

(i) Date of recognition

All financial assets and liabilities are initially recognized on the trade date, i.e. the date that the Bank becomes a party to the contractual provisions of the instrument. This includes purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

(ii) Initial measurement of financial instruments

Financial instruments are initially measured at their fair value, plus or minus, in the case of a financial instrument not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial instrument. In the cases of financial instrument is measured at fair value, with the change in fair value being recognised in profit or loss, the transaction costs are recognised as revenue or expense when the instrument is initially recognised.

When the fair value of financial instruments at initial recognition differs from the transaction price, the Bank accounts for the Day 1 profit or loss, as described below.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Financial instruments – Initial recognition (continued)

(iii) Day 1 Profit or Loss

When the transaction price differs from the fair value at origination and the fair value is based on a valuation technique using only observable inputs in market transactions, the Bank immediately recognises the difference between the transaction price and fair value (a "Day 1" profit or loss) in the income statement. In cases where fair value is based on models for which some of the inputs are not observable, the difference between the transaction price and the fair value is deferred and is only recognised in the income statement when the inputs become observable, or when the instrument is derecognised.

Classification and measurement

On initial recognition, a financial asset is classified as measured at: amortised cost, fair value through other comprehensive income or fair value through profit or loss.

A debt instrument is measured at amortised cost if it meets both of the following conditions:

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

A debt instrument is measured at fair value through other comprehensive income only if it meets both of the following conditions:

- 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 instrument give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

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

All other financial assets are classified as measured at fair value through profit or loss.

An entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases. An entity is required to disclose such financial assets separately from those mandatorily measured at fair value.

Business Model

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected)
- The expected frequency, value and timing of sales are also important aspects of the Bank's assessment

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Classification and measurement (continued)

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

In making an assessment whether a business model's objective is to hold assets in order to collect contractual cash flows, the Bank considers at which level of its business activities such assessment should be made. Generally, a business model is a matter of fact which can be evidenced by the way business is managed and the information provided to Management. However, in some circumstances, it may not be clear whether a particular activity involves one business model with some infrequent asset sales or whether the anticipated sales indicate that there are two different business models. Thus, an entity's business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur. However, if more than an infrequent number of sales are made out of a portfolio, the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows. If the objective of the entity's business model for managing those financial assets changes, the entity is required to reclassify financial assets. Gains and losses arising from the derecognition of financial assets measured at amortised cost are reflected under "net gain on sale of financial assets at amortised cost" in the income statement.

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.

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

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

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at fair value though profit and loss.

Financial Assets at Amortised Cost
Balances with the Central Bank, Due from Banks and Financial Institutions, Due to Banks and Financial Institutions, and Loans and Advances to Customers and Related Parties – at Amortised Cost
These financial assets are initially recognised at cost, being the fair value of the consideration paid for the acquisition of the investment. All transaction costs directly attributed to the acquisition are also included in the cost of investment. After initial measurement, these are subsequently measured at amortised cost using the EIR, less expected credit losses. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The amortisation is included in "interest and similar income" in the income statement. The losses arising from impairment are recognised in the income statement in "net impairment losses on financial assets".

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

The SPPI Test (continued)

Financial Assets at Fair Value through Profit or Loss
Included in this category are those debt instruments that do not meet the conditions in "Debt instruments at amortized cost" above, and debt instruments designated at fair value through profit or loss upon initial recognition.

Management only designates a financial asset at fair value through profit and loss upon initial recognition when the designation eliminates, significantly reduces, the inconsistent treatment that would otherwise arise from measuring assets or recognising gains and losses on them on a different basis.

Financial Liabilities (other than financial guarantees, documentary credits and undrawn credit lines) – Classification and Measurement

Liabilities are initially measured at fair value plus, in the case of a financial liability not at fair value through profit or loss, particular transaction costs. Liabilities are subsequently measured at amortised cost or fair value.

The Bank classifies all financial liabilities as subsequently measured at amortised cost using the effective interest rate method, except for:
- Financial liabilities at fair value through profit or loss (including derivatives);
- Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies;

Due to banks and financial institutions, customers' deposits and related parties deposits
After initial measurement, due to banks and financial institutions, customers' and related parties' deposits are measured at amortized cost less amounts repaid using the effective interest rate method. Amortized cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate method.

Derivatives recorded at fair value through profit or loss
The Bank uses derivatives such as interest rate swaps and forward foreign exchange contracts.

Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. The notional amount and fair value of such derivatives are disclosed separately in the notes. Changes in the fair value of derivatives are recognized in "net gain on financial assets at fair value through profit and loss" in the income statement.

Embedded Derivatives
An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract. A derivative that is attached to a financial instrument, but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

An embedded derivative is separated from the host and accounted for as a derivative if, and only if:
(a) the hybrid contract contains a host that is not an asset within the scope of IFRS 9
(b) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host
(c) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
(d) the hybrid contract is not measured at fair value with changes in fair value recognized in profit or loss

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Financial Guarantees, Documentary Credits and Undrawn Credit Lines
The Bank issues financial guarantees, documentary credits and undrawn credit lines.

Financial guarantees are initially recognised in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and an ECL provision. The premium received is recognised in the income statement in "Net fee and commission income" on a straight line basis over the life of the guarantee.

Undrawn credit lines and documentary credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, these contracts are in the scope of ECL requirements.

The nominal contractual value of financial guarantees, documentary credits and undrawn credit lines, where the loan agreed to be provided is on market terms, are not recorded on in the statement of financial position. The nominal values of these instruments together with the corresponding ECLs are disclosed in the notes.

Reclassification of financial assets
The Bank reclassifies financial assets if the objective of the business model for managing those financial assets changes. Such changes are expected to be very infrequent. Such changes are determined by the Bank's senior management as a result of external or internal changes when significant to the Bank's operations and demonstrable to external parties.

If financial assets are reclassified, the reclassification is applied prospectively from the reclassification date, which is the first day of the first reporting period following the change in business model that results in the reclassification of financial assets. Any previously recognized gains, losses or interest are not restated.

If a financial asset is reclassified so that it is measured at fair value, its fair value is determined at the reclassification date. Any gain or loss arising from a difference between the previous carrying amount and fair value is recognized in profit or loss. If a financial asset is reclassified so that it is measured at amortized cost, its fair value at the reclassification date becomes its new carrying amount.

De-recognition of Financial Assets and Financial Liabilities

Financial Assets

(i) Derecognition due to substantial modification of terms and conditions

If the terms of a financial asset are modified, then the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:

- fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- other fees are included in profit or loss as part of the gain or loss on derecognition.

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place (see below).

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

De-recognition of Financial Assets and Financial Liabilities (continued)

Financial Assets (continued)

(i) Derecognition due to substantial modification of terms and conditions (continued)

If the modification of a financial asset measured at amortised cost or fair value through other comprehensive income does not result in derecognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. For floating-rate financial assets, 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 or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest rate method.

(ii) Derecognition other than for substantial modification

A financial asset (or where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when the rights to receive cash flows from the financial asset have expired. The Bank also derecognises the financial asset if it has both transferred the financial asset and the transfer qualifies for derecognition.

The Bank has transferred the financial asset if, and only if, either:

- The Bank has transferred its contractual rights to receive cash flows from the financial asset; or
- The Bank retains the rights to the cash flows, but has assumed an obligation to pay the received cash flows in full without material delay to a third party under a "pass-through" arrangement.

Pass-through arrangements are transactions whereby the Bank retains the contractual rights to receive the cash flows of a financial asset (the 'original asset'), but assumes a contractual obligation to pay those cash flows to one or more entities (the 'eventual recipients'), when all of the following three conditions are met:

- The Bank has no obligation to pay amounts to the eventual recipients unless it has collected equivalent amounts from the original asset, excluding short-term advances with the right to full recovery of the amount lent plus accrued interest at market rates;
- The Bank cannot sell or pledge the original asset other than as security to the eventual recipients;
- The Bank has to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the Bank is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents including interest earned, during the period between the collection date and the date of required remittance to the eventual recipients

A transfer only qualifies for derecognition if either:

- The Bank has transferred substantially all the risks and rewards of the asset; or
- The Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset

The Bank considers control to be transferred if and only if, the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer.

When the Bank has neither transferred nor retained substantially all the risks and rewards and has retained control of the asset, the asset continues to be recognised only to the extent of the Bank's continuing involvement, in which case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Derecognition of Financial Assets and Financial Liabilities (continued)

Financial Assets (continued)

(ii) Derecognition other than for substantial modification (continued)
Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration the Bank could be required to pay.

If continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the continuing involvement is measured at the value the Bank would be required to pay upon repurchase. In the case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities
A financial liability is de-recognized when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognized in the income statement.

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 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.

Impairment of Financial Assets (Policy applicable from 1 January 2018)

(i) Overview of the ECL Principles
As described in Note 2.3, the adoption of IFRS 9 has fundamentally changed the Bank's loan loss impairment method by replacing IAS 39's incurred loss approach with a forward-looking ECL approach. From 1 January 2018, the Bank has been recording the allowance for expected credit losses for all loans and other financial assets not held at FVPL, together with loan commitments and financial guarantee contracts, in this section all referred to as 'financial instruments'. Equity instruments are not subject to impairment under IFRS 9.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss), unless there has been no significant increase in credit risk since origination, or the debt instrument is determined to have low credit risk at the reporting date, in which cases, the allowance is based on the 12 months' expected credit loss (12mECL).

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Impairment of Financial Assets (Policy applicable from 1 January 2018) (continued)

(i) Overview of the ECL Principles (continued)

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. The Bank's policies for determining if there has been a significant increase in credit risk are set out in the risk management notes.

The 12mECL is the portion of lifetime ECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Both lifetime ECLs and 12mECLs are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments. The Bank's policy for grouping financial assets measured on a collective basis is explained in the risk management notes.

The Bank has established a policy to perform an assessment, on a quarterly basis, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. This is further explained in the risk management notes.

Based on the above process, the Bank groups its financial instruments into Stage 1, Stage 2 and Stage 3 as described below:

Stage 1
When loans are first recognised, the Bank recognises an allowance based on 12mECLs. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.

Stage 2
When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the Lifetime ECLs. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.

Stage 3
Loans considered credit-impaired (as outlined in the risk management notes). The Bank records an allowance for the Lifetime ECLs.

For financial assets for which the Bank has no reasonable expectations of recovering either the entire outstanding amount, or a proportion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) derecognition of the financial asset.

(ii) The calculation of ECLs

The Bank calculates ECLs based on a three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Impairment of Financial Assets (Policy applicable from 1 January 2018) (continued)

(ii) The calculation of ECLs (continued)

The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

- PD: The Probability of Default is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio. The concept of PDs is further explained in the risk management notes.
- EAD: The Exposure at Default 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, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments. The EAD is further explained in the risk management notes.
- LGD: The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD. The LGD is further explained in the risk management notes.

When estimating the ECLs, the Bank considers three scenarios (a base case, an upside, and a downside). Each of these is associated with different PDs, EADs and LGDs. When relevant, the assessment of multiple scenarios also incorporates how defaulted loans are expected to be recovered, including the probability that the loans will cure and the value of collateral or the amount that might be received for selling the asset.

With the exception of credit cards and other revolving facilities the maximum period for which the credit losses are determined is the contractual life of a financial instrument unless the Bank has the legal right to call it earlier.

Impairment losses and releases are accounted for and disclosed separately from modification losses or gains that are accounted for as an adjustment of the financial asset's gross carrying value.

Provisions for ECLs for undrawn loan commitments are assessed as set out in the notes. The calculation of ECLs (including the ECLs related to the undrawn element) of revolving facilities such as credit cards is explained below.

The mechanics of the ECL method are summarised below:

<u>Stage 1</u>

The 12mECL is calculated as the portion of lifetime ECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The Group calculates the 12mECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12-month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by an approximation to the original EIR. This calculation is made for each of the three scenarios, as explained above.

<u>Stage 2</u>

When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the lifetime ECLs. The mechanics are similar to those explained above, including the use of multiple scenarios, but PDs and LGDs are estimated over the lifetime of the instrument. The expected cash shortfalls are discounted by an approximation to the original EIR.

<u>Stage 3</u>

For loans considered credit-impaired (as defined in the risk management notes), the Bank recognises the lifetime expected credit losses for these loans. The method is similar to that for Stage 2 assets, with the PD set at 100%.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Impairment of Financial Assets (Policy applicable from 1 January 2018) (continued)

(ii) The calculation of ECLs (continued)

Loan Commitments and Letters of Credit

When estimating lifetime ECLs for undrawn loan commitments, the Bank estimates the expected portion of the loan commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the loan is drawn down, based on a probability-weighting of the three scenarios. The expected cash shortfalls are discounted at an approximation to the expected EIR on the loan.

For credit cards and revolving facilities that include both a loan and an undrawn commitment, ECLs are calculated and presented together with the loan. For loan commitments and letters of credit, the ECL is recognised within "Provisions for risks and charges".

Financial Guarantees

The Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and the ECL provision. For this purpose, the Bank estimates ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs. The shortfalls are discounted by the risk-adjusted interest rate relevant to the exposure. The calculation is made using a probability-weighting of the three scenarios. The ECLs related to financial guarantee contracts are recognised within "Provisions for risks and charges".

(iii) Credit cards and other revolving facilities

The Bank's product offering includes a variety of corporate and retail overdraft and credit cards facilities, in which the Bank has the right to cancel and/or reduce the facilities with one day's notice. The Bank does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over a period that reflects the Bank's expectations of the customer behaviour, its likelihood of default and the Bank's future risk mitigation procedures, which could include reducing or cancelling the facilities. Based on past experience and the Bank's expectations, the period over which the Bank calculates ECLs for these products, is five years for corporate and seven years for retail products.

The ongoing assessment of whether a significant increase in credit risk has occurred for revolving facilities is similar to other lending products. This is based on shifts in the customer's internal credit grade but greater emphasis is also given to qualitative factors such as changes in usage.

The interest rate used to discount the ECLs for credit cards is based on the average effective interest rate that is expected to be charged over the expected period of exposure to the facilities. This estimation takes into account that many facilities are repaid in full each month and are consequently charged no interest.

The calculation of ECLs, including the estimation of the expected period of exposure and discount rate is made, on an individual basis for corporate and on a collective basis for retail products. The collective assessments are made separately for portfolios of facilities with similar credit risk characteristics.

(iv) Forward Looking Information

The Bank incorporates forward-looking information in to both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. The Bank has performed historical analysis and identified the key economic variables impacting credit risk and ECL. Relevant macro-economic adjustments are applied to capture variations from economic scenarios. These reflect reasonable and supportable forecasts of future macro-economic conditions that are not captured within the base ECL calculations. Macro-economic factors taken in to consideration include, but are not limited to gross domestic product, and unemployment rates and require an evaluation of both the current and forecast direction of the macro-economic cycle. Incorporating forward-looking information increases the degree of judgement required as to how changes in these macro-economic factors will affect ECLs. The methodologies and assumptions including any forecasts of future economic conditions are reviewed regularly.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Impairment of Financial Assets (Policy applicable from 1 January 2018) (continued)

Collateral valuation
To mitigate its credit risks on financial assets, the Bank seeks to use collateral, where possible. The collateral comes in various forms, such as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. The Bank's accounting policy for collateral assigned to it through its lending arrangements under IFRS 9 is the same as it was under IAS 39. Collateral, unless repossessed, is not recorded on the Bank's statement of financial position. However, the fair value of collateral affects the calculation of ECLs. It is generally assessed, at a minimum, at inception and re-assessed on a quarterly basis. However, some collateral, for example, cash or securities relating to margining requirements, is valued daily. Details of the impact of the Bank's various credit enhancements are disclosed in the risk management notes.

To the extent possible, the Bank uses active market data for valuing financial assets held as collateral. Other financial assets which do not have readily determinable market values are valued using models. Non-financial collateral, such as real estate, is valued based on data provided by third parties such as mortgage brokers, or based on housing price indices.

Collateral repossessed
The Bank's accounting policy under IFRS 9 remains the same as it was under IAS 39. The Bank occasionally acquires properties in settlement of loans and advances. Upon initial recognition, those assets are measured at fair value as approved by the regulatory authorities. Subsequently, these properties are measured at the lower of carrying value or net realisable value.

Upon sale of repossessed assets, any gain or loss realised is recognised in the income statement under "other operating income" or "other operating expenses". Gains resulting from the sale of repossessed assets are transferred to "reserves appropriated for capital increase" in the following financial year.

Write Offs
The Bank's accounting policy under IFRS 9 remains the same as it was under IAS 39. Financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to "Net impairment losses on financial assets".

Forborne and modified loans
The Bank sometimes makes concessions or modifications to the original terms of loans as a response to the borrower's financial difficulties, rather than taking possession or to otherwise enforce collection of collateral. The Bank considers a loan forborne when such concessions or modifications are provided as a result of the borrower's present or expected financial difficulties and the Bank would not have agreed to them if the borrower had been financially healthy. Indicators of financial difficulties include defaults on covenants, or significant concerns raised by the Credit Risk Department. Forbearance may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms. It is the Bank's policy to monitor forborne loans to help ensure that future payments continue to be likely to occur. Derecognition decisions and classification between Stage 2 and Stage 3 are determined on a case-by-case basis. If these procedures identify a loss in relation to a loan, it is disclosed and managed as an impaired Stage 3 forborne asset until it is collected or written off.

From 1 January 2018, when the loan has been renegotiated or modified but not derecognised, it will be tagged as default and therefore reclassified under stage 3. Once an asset has been classified as forborne, it will remain forborne for a minimum 12-month moratorium period. In order for the loan to be reclassified out of the forborne category, the customer has to meet the moratorium period and meet the scheduled payments (all on current basis) for at least 1 year, as determined by the Bank.

If modifications are substantial, the loan is derecognised, as explained above.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Impairment of Financial Assets (Policy applicable before 1 January 2018)

The Bank assesses at each statement of financial position date whether there is any objective evidence that financial asset or a group of financial assets is impaired. A financial asset or a group of financial asset is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

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

(i) Financial assets carried at amortized cost
For financial assets carried at amortized cost (such as amounts due from banks, loans and advances to customers and financial assets measured at amortized cost), the Bank first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the income statement. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the 'Credit loss expense' in the income statement.
The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate (EIR).

If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR. If the Bank has reclassified trading assets to loans and advances, the discount rate for measuring any impairment loss is the new EIR determined at the reclassification date. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system, that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Impairment of Financial Assets (Policy applicable before 1 January 2018) (continued)

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

Fair Value Measurement
The Bank measures financial instruments, such as derivatives, at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortised cost are disclosed in the notes.

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

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.

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

- Level 1 – Quoted (unadjusted) market prices in active markets for identical assets or liabilities.
- Level 2 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.
- Level 3 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

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

Management determines the policies and procedures for both recurring and non-recurring fair value measurement. At each reporting date, Management analyses the movements in the values of assets and liabilities which are required to be re-measured or re-assessed as per the Bank's accounting policies. For this analysis, Management verifies the major inputs applied in the latest valuation by agreeing the information in the valuation computation to contracts and other relevant documents.

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

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

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

In relation to effective fair value hedges any gain or loss from remeasuring the hedging instrument to fair value, as well as related changes in fair value of the item being hedged, are recognised immediately in the income statement.

In relation to cash flow hedges, the gain or loss on the hedging instrument is recognised initially in equity to the extent that the hedge is effective and either transferred to the income statement in the period in which the hedged transaction impacts the income statement, or included as part of the cost of the related asset or liability.

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

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. For fair value hedges of financial instruments with fixed maturities any adjustment arising from hedge accounting is amortized over the remaining term to maturity. For cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in shareholders' equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in shareholders' equity is transferred to the income statement.

Offsetting
Financial assets and financial liabilities are only offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognized amounts and the Bank intends to either settle on a net basis, or to realize the asset and settle the liability simultaneously.

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

(i) Interest and Similar Income and Expense

The effective interest rate
Interest income and expense are recognized in the income statement applying the EIR method for all financial instruments measured at amortised cost.

The EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. When calculating the EIR for financial instruments other than purchased or originated credit impaired, an entity shall take into account all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses. For purchased or originated credit impaired financial assets, a credit adjusted effective interest rate is calculated using estimated future cash flows and expected credit losses.

The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Revenue Recognition (continued)

(i) Interest and Similar Income and Expense (Continued)

Interest income and interest expense

The effective interest rate of a financial asset or a financial liability is calculated on initial recognition of the financial asset or financial liability. In determining interest income and expense, the EIR is applied to the gross carrying amount of the financial asset (unless the asset is credit-impaired) or the amortized cost of a financial 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. The effective interest rate is also revised for fair value hedge adjustments at the date amortisation of the hedge adjustment begins.

The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts, unless the financial instrument is measured at fair value, with the change in fair value being recognised in profit or loss. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised.

When a financial asset becomes credit-impaired after initial recognition, interest income is determined by applying EIR to the net amortized cost of the instrument. If the financial asset cures and is no longer credit-impaired, the Bank reverts back to calculating interest income on a gross basis. Furthermore, for financial assets that were credit-impaired on initial recognition, interest is determined by applying a credit-adjusted EIR to the amortized cost of the instrument. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

Presentation

Interest income calculated using the effective interest method presented in the statement of profit or loss includes interest on financial assets at amortised cost.

Interest expense presented in the statement of profit or loss includes financial liabilities measured at amortised cost.

Interest income or expense on financial instruments measured at amortized cost are presented in the income statement under "Interest and similar income.

(ii) Fee and Commission Income

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

Fee Income Earned from Services That Are Provided over a Certain Period of Time

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

Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the EIR on the loan. When it is unlikely that a loan be drawn down, the loan commitment fees are recognised as revenues on expiry.

Cash and cash equivalents

Cash and cash equivalents comprise of those balances whose original maturities are three months or less from the date of acquisition: cash and balances with the Central Bank, due from banks and other financial institutions, deposits with head office, branches and affiliates, deposits due to banks and other financial institutions, deposits due to head office, branches and affiliates, and treasury bills.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Property and equipment
Property and equipment are stated at cost. Depreciation is calculated on a straight line basis to write down the cost of property and equipment to their residual values over their estimated useful lives. Freehold land is not depreciated. The estimated useful lives are as follows:

Buildings	50 years
Furniture, fixtures and equipments	From 4 to 12.5 years
Leasehold improvements and decorations	5 years
Vehicles	4 years
Computer equipment	5 years

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

Expenditure incurred to replace a component of an item of property and equipment that is accounted for separately is capitalised and the carrying amount of the component that is replaced is written off. Other subsequent expenditure is capitalised only when it increases future economic benefits of the related item of property and equipment. All other expenditure is recognised in the income statement as the expense is incurred.

Fixed assets taken in recovery of debt
The Bank occasionally acquires real estate in settlement of certain loans and advances. Such real estate is stated at the lower of the amount of the related loans and advances and the current fair value of such assets based on the instructions of the Control Authorities. Gains or losses on disposal, and revaluation losses, are recognized in the income statement for the year.

Customers' deposits
All customer deposits are carried at the fair value of the consideration received, less amounts repaid.

Taxation

(i) Current tax
Taxation is provided for in accordance with the fiscal regulations in Lebanon.

Current tax assets and liabilities for the current and prior years are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the statement of financial position date.

(ii) Deferred tax
Deferred tax is provided using the liability method on temporary differences at the statement of financial position date between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the statement of financial position date.

Current tax and deferred tax relating to items recognized directly in equity are also recognized in equity and not in the income statement.

The carrying amount of deferred tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each statement of financial position date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

Provisions
Provisions are recognized when the Bank has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and can be reliably measured.

Retirement benefits obligations
The retirement benefits obligations are provided for based on 8.5% of the employees' salaries. The benefits are calculated upon completion of 20 years of services, or when the employee reaches retirement age, or resigns permanently, on the basis of the last salary multiplied by years of service. The Bank is obliged to pay the difference between the paid contribution (calculated at 8% basis) and the provisions for retirements benefits payable to the National Social Security Fund. The Bank provides for employees' retirement benefit obligations on this basis.

Fiduciary assets
Assets held in a fiduciary capacity are not treated as assets of the Bank and are recorded as off financial position items.

2.5 Significant accounting judgments and estimates
In the process of applying the Bank's accounting policies, management has exercised judgment and estimates in determining the amounts recognized in the financial statements. The most significant uses of judgment and estimates are as follows:

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

Fair value of financial instruments
Where the fair values of financial assets and financial liabilities recorded on the statement of financial position, cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data are not available, judgment is required to establish fair values. The valuation of financial instruments is described in more detail in note 32.

Impairment Losses on Financial Instruments (Applicable after 1 January 2018)
The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:
- The Bank's internal credit grading model, which assigns PDs to the individual grades;
- The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a lifetime ECL basis and the qualitative assessment;
- The segmentation of financial assets when their ECL is assessed on a collective basis;
- Development of ECL models, including the various formulas and the choice of inputs;
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs; and
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

It has been the Bank's policy to regularly review its models in the context of actual loss experience and adjust when necessary.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 Significant accounting judgments and estimates (continued)

Impairment losses on loans and advances (Applicable before 1 January 2018)
The Bank reviews its individually significant loans and advances at each statement of financial position date to assess whether an impairment loss should be recorded in the income statement. In particular, management judgment is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as levels of arrears, credit utilization, loan to collateral ratios, etc.) and judgments to the effect of concentrations of risks and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups).

The impairment loss on loans and advances is disclosed in more detail in note 14.

Impairment of non-financial assets
The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use. Where the carrying amount of an asset or cash-generating unit exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing the 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. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded subsidiaries or other available fair value indicators.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Bank estimates the asset's or cash-generating unit's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceeds the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the income statement. Impairment losses relating to goodwill cannot be reversed in future periods.

Deferred tax assets
Deferred tax assets are recognized in respect of tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits, together with future tax planning strategies.

Business model
In determining whether its business model for managing financial assets is to hold assets in order to collect contractual cash flows the Bank considers:
- management's stated policies and objectives for the portfolio and the operation of those policies in practice;
- how management evaluates the performance of the portfolio;
- whether management's strategy focuses on earning contractual interest revenues;
- the degree of frequency of any expected asset sales;
- the reason for any asset sales; and
- whether assets that are sold are held for an extended period of time relative to their contractual maturity.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 Significant accounting judgments and estimates (continued)

Impairment of non-financial assets (continued)

Contractual cash flows of financial assets

The Bank exercises judgment in determining whether the contractual terms of financial assets it originates or acquires give rise on specific dates to cash flows that are solely payments of principal and interest on the principal outstanding and so may qualify for amortized cost measurement. In making the assessment the Bank considers all contractual terms, including any prepayment terms or provisions to extend the maturity of the assets, terms that change the amount and timing of cash flows and whether the contractual terms contain leverage.

3 INTEREST AND SIMILAR INCOME

	2018 *LL million*	*2017* *LL million*
Deposits and similar accounts with banks and financial institutions	**4,233**	2,034
Deposits with head office, branches and affiliates	**155**	22
Loans and advances to customers at amortized cost	**6,204**	5,727
Loans and advances to related parties at amortized cost	**184**	55
Financial assets at amortized cost	**8,964**	7,669
	19,740	15,507

4 INTEREST AND SIMILAR EXPENSE

	2018 *LL million*	*2017* *LL million*
Deposits from customers and other credit balances at amortized cost	**2,566**	1,755
Deposits from related parties at amortized cost	**2**	4
Term loan from a related party	**918**	64
	3,486	1,823

5 NET FEE AND COMMISSION INCOME

	2018 *LL million*	*2017* *LL million*
Commission income		
Letters of credit, guarantees and acceptances	**31**	216
Loans and advances to customers	**108**	156
Credit cards	**205**	180
Commissions on real estate	**85**	76
Special banking services	**6**	1
Other services	**1,506**	1,539
	1,941	2,168
Commission expenses		
Commission of clearance room and accounts management	**(247)**	(200)
Credit cards	**(53)**	(29)
Commissions and other fees	**(5)**	(26)
	(305)	(255)
Net commission income	**1,636**	1,913

6 NET GAIN FROM FOREIGN EXCHANGE

This account represents the profit generated from exchange operations that are mainly in Euros, Kuwaiti Dinars and US Dollars.

7 OTHER OPERATING INCOME

	2018 *LL million*	*2017* *LL million*
Write back of provisions	**140**	110
Gain on sale of non-current asset held for sale (note 17)	**105**	-
Net gain on sale of property and equipment	**-**	17
Income recognized from operating leases	**-**	231
Other income	**350**	136
	595	494

8 PERSONNEL EXPENSES

	2018 *LL million*	*2017* *LL million*
Salaries and wages	**5,614**	5,378
Social security contribution	**744**	684
Contractual employees' salaries	**466**	825
Provision for retirement benefits obligations (note 22)	**80**	15
Other employees' benefits	**1,446**	1,428
	8,350	8,330

9 ADMINISTRATIVE AND OTHER OPERATING EXPENSES

	2018 *LL million*	*2017* *LL million*
Expenses and computer services	**779**	773
Taxes and fees	**714**	802
Maintenance and repairs	**370**	376
Professional fees	**368**	457
Electricity, fuel and telecommunication expenses	**366**	326
Cleaning	**218**	215
Guarding fees	**191**	181
Guarantee of deposits fee	**176**	176
Subscriptions	**89**	82
Insurance fees	**87**	96
Rent	**86**	85
Office supplies	**81**	68
Building expenses	**76**	108
Travel, transport and similar expenses	**55**	80
Net provision for risks and charges (note 22)	**177**	449
Other expenses	**145**	159
	3,978	4,433

10 INCOME TAX EXPENSE

	2018	2017
	LL million	LL million
Profit before tax	**6,245**	3,375
7% tax on interest income received from banks	**(457)**	(221)
Balance at 31 December	**5,788**	3,154

The relationship between income tax expense and the accounting profit is as follows:

	2018	2017
	LL million	LL million
Net profit before income tax	**5,788**	3,154
Non-deductible expenses and non-taxable income in determining taxable profit:		
Net provision for risks and charges non deductible	**42**	75
Provision for retirement benefits obligations non deductible	**-**	271
Other non deductible taxes	**(257)**	53
Additional general provisions	**150**	578
Other expenses non- tax deductible	**104**	192
Write-back of provisions previously taxable	**(112)**	(110)
7% / 5% tax on interest income received from banks*	**-**	178
	441	4,391
Loss available for carry forward	**-**	(2,971)
Taxable income (loss)	**6,229**	1,420
Effective income tax rate*	**17%**	16.26%
Income tax expense	**1,059**	231
5% tax on interest income received from banks	**-**	(178)
	1,059	53

* Effective October 2017, the applicable tax rate increased from 15% to 17%. Furthermore tax on interest increased from 5% to 7% and is no longer allowed as a tax credit. Instead it became a deductible for the purpose of calculation of taxable profit.

The movement of income tax expense is as follows:

	2018	2017
	LL million	LL million
Balance at 1 January	**88**	35
Tax paid during the year	**(56)**	-
Provisions for the year	**1,059**	53
Balance at 31 December	**1,091**	88

11 CASH AND BALANCES WITH THE CENTRAL BANK

	2018	2017
	LL million	*LL million*
Cash on hand	**8,166**	6,932
Current accounts	**35,290**	36,372
Time deposits	**75,667**	64,071
	119,123	107,375
Less: Allowance for expected credit losses (note 30)	**(322)**	-
	118,801	107,375

Current accounts at the Central Bank include an amount of LL million 11,216 (2017: LL million 9,627) to cover the monetary regulatory reserve requirement on Lebanese Lira deposits, according to Lebanese banking laws and regulations.

Time deposits at the Central Bank include two placements of US$ 13 million and US$ 20 million (2017: US$ 8 million and US$ 20 million) with interest rates of 2.365% and 3.489% respectively (2017: 1.344% and 2.292% respectively) to cover the regulatory reserve of 15% on foreign currency deposits and amounting to LL million 45,262 (2017: LL million 38,589). The placements mature on 28 January 2019 and on 8 February 2019 respectively (2017: 29 January 2018 and 4 February 2018 respectively).

12 DUE FROM BANKS AND FINANCIAL INSTITUTIONS

	2018	2017
	LL million	*LL million*
Current accounts	**11,415**	11,590
Time deposits	**66,349**	18,092
	77,764	29,682

13 HEAD OFFICE, BRANCHES AND AFFILIATES

	2018	2017
	LL million	*LL million*
Due from head office, branches and affiliates		
Current accounts	**6,826**	5,634
Due to head office, branches and affiliates		
Term loan	**37,856**	22,612
Current accounts	**48**	8
	37,904	22,620

14 LOANS AND ADVANCES TO CUSTOMERS AT AMORTIZED COST

	2018 ***LL million***	*2017* *LL million*
Gross commercial loans	**64,188**	75,073
Gross consumer loans	**44,379**	39,413
	108,567	114,486
Less: Allowance for expected credit losses / Impairment allowance (note 30)	**(1,368)**	(1,156)
	107,199	113,330

According to the Central bank instructions, the Bank transferred to off-financial position all bad debts satisfying certain criteria and their related provision and interest in suspense. The gross balance of these loans amounted to LL million 266 as of 31 December 2018 (2017: the same).

15 FINANCIAL ASSETS AT AMORTIZED COST

	2018 ***LL million***	*2017* *LL million*
Lebanese sovereign		
Lebanese eurobonds - quoted	**91,198**	91,429
Lebanese treasury bills - unqoted	**43,248**	68,576
	134,446	160,005
Other sovereign		
US treasury bills - quoted	**2,893**	2,880
Effect of hedging interest rate risk (note 31)	**567**	(303)
	137,906	162,582
Less: Allowance for expected credit losses (note 30)	**(911)**	-
	136,995	162,582

16 PROPERTY AND EQUIPMENT

	Advances on purchase of fixed assets *LL million*	*Land* *LL million*	*Buildings* *LL million*	*Furniture, fixtures and equipment* *LL million*	*Leasehold improvements and decorations* *LL million*	*Vehicles* *LL million*	*Computer equipment* *LL million*	*Total* *LL million*
Cost:								
At 1 January 2018	-	1,478	15,394	2,576	900	210	2,603	23,161
Additions	351	-	-	226	7	-	13	597
Write-offs	-	-	-	(32)	-	-	(63)	(95)
At 31 December 2018	351	1,478	15,394	2,770	907	210	2,553	23,663
Depreciation:								
At 1 January 2018	-	-	6,152	2,436	781	94	2,028	11,491
Charge for the year	-	-	308	96	42	46	208	700
Relating to write-offs	-	-	-	(32)	-	-	(63)	(95)
At 31 December 2018	-	-	6,460	2,500	823	140	2,173	12,096
Net carrying amount:								
At 31 December 2018	**351**	**1,478**	**8,934**	**270**	**84**	**70**	**380**	**11,567**

16 PROPERTY AND EQUIPMENT (continued)

	Advances on purchase of fixed assets LL million	*Land LL million*	*Buildings LL million*	*Furniture, fixtures and equipment LL million*	*Leasehold improvements and decorations LL million*	*Vehicles LL million*	*Computer equipment LL million*	*Total LL million*
Cost:								
At 1 January 2017	8	1,478	15,394	2,674	1,542	409	2,512	24,017
Additions	-	-	-	42	14	-	181	237
Write-offs	-	-	-	(126)	(656)	-	(90)	(872)
Disposals	(8)	-	-	(14)	-	(199)	-	(221)
At 31 December 2017	-	1,478	15,394	2,576	900	210	2,603	23,161
Depreciation:								
At 1 January 2017	-	-	5,844	2,519	1,382	219	1,914	11,878
Charge for the year	-	-	308	50	48	50	204	660
Relating to write-offs	-	-	-	(133)	(649)	-	(90)	(872)
Relating to disposals	-	-	-	-	-	(175)	-	(175)
At 31 December 2017	-	-	6,152	2,436	781	94	2,028	11,491
Net carrying amount:								
At 31 December 2017	-	1,478	9,242	140	119	116	575	11,670

17 NON CURRENT ASSETS HELD FOR SALE

	2018 LL million	*2017 LL million*
Cost	-	121
Provision for impairment	-	(121)
	-	-

During the year ended 31 December 2018, the Bank sold the section 32 of the plot number 1931 in the Dekerman area for the amount of LL million 105 to a third party (note 7).

18 OTHER ASSETS

	2018 LL million	*2017 LL million*
Deferred expenses	**411**	302
Prepaid expenses	**284**	298
Staff receivables	**216**	228
Sundry debtors	**253**	341
Exchange difference on structural foreign exchange position*	**74**	74
Stamps	**16**	10
	1,254	1,253

*The Bank has accounted for an amount of LL million 17,345 in prior years as structural foreign exchange position with the approval of the Banking Control Commission. The exchange difference arising on this position amounting to LL million 74 was recorded in the income statement, in prior years.

19 DERIVATIVE FINANCIAL INSTRUMENTS

	2018 LL million	*2017 LL million*
(Negative) positive fair value on swap contracts (note 31)	**(567)**	303

20 CUSTOMERS' DEPOSITS AT AMORTIZED COST

	2018 *LL million*	*2017* *LL million*
Current accounts	**217,458**	224,414
Time deposits	**11,726**	7,064
Saving accounts	**88,460**	79,046
Accrued interest payable	**726**	517
	318,370	311,041

Customers' deposit accounts include blocked accounts amounting to LL million 11,413 (2017: LL million 6,750) representing cash collateral pledged in favor of the Bank as a guarantee for the credit facilities and guarantees issued in favor of the customers.

21 OTHER LIABILITIES

	2018 *LL million*	*2017* *LL million*
Sundry creditors	**5,666**	5,815
Accrued expenses	**1,433**	1,432
Income tax liability	**1,091**	88
National Social Security Fund	**87**	89
Other taxes	**172**	207
	8,449	7,631

22 PROVISIONS FOR RISKS AND CHARGES

	2018 *LL million*	*2017* *LL million*
Retirement benefits obligation	**3,176**	3,140
Provision for risks and charges	**1,841**	3,505
Provision for ECL on financial guarantees and commitments	**6**	-
	5,023	6,645

The movement in the provision of retirement benefits obligation included in the statement of financial position is as follows:

	2018 *LL million*	*2017* *LL million*
Provision at 1 January	**3,140**	7,300
Provided during the year (note 8)	**80**	15
Provision paid during the year (a)	**(44)**	(4,175)
Provision at 31 December	**3,176**	3,140

22 PROVISIONS FOR RISKS AND CHARGES (continued)

The movement of the provisions for risks and charges during the year was as follows:

	2018 ***LL million***	*2017* *LL million*
Balance at 1 January	**3,505**	3,056
Additional provisions during the year (note 9)	**177**	449
Provision used for allowance ECL on 1 January 2018 (b)	**(752)**	-
Transfer of provision for allowance ECL (b) (note 30)	**322**	-
Transfer of excess ECL provisions to non-distributable general reserves (b)	**(1,240)**	-
Provision paid during the year	**(171)**	-
Balance at 31 December	**1,841**	3,505

(a) The Board of Directors decided on 19 February 2016 to close 4 branches (Achrafieh, Jounieh, Dora and Shiah). Accordingly, a number of employees became redundant. During the year ended 31 December 2016, the Bank provided for the amount of LL million 4,362 as final settlements for those employees. During the year ended 31 December 2017, the Bank settled part of the provision for the amount of LL million 3,851. No settlements were made during the year 2018.

(b) During 2016, the Central Bank of Lebanon issued Intermediate Circular number 439 dated 8 November 2016 requesting banks operating in Lebanon to book a 2% provision on risk-weighted loans in preparation for the implementation of the impairment of International Financial Reporting Standards (IFRS 9) effective 1 January 2018. In order to comply with the regulatory requirement, the Bank recorded excess provisions under "provisions for risks and charges" amounting to LL million 1,670 as at 31 December 2016. During the year ended 31 December 2018, as discussed in note 2.2, the Bank used part of this provision amounting to LL million 752 to cover the impact of first-time adoption of IFRS 9 Expected Credit Losses (ECL) model on 1 January 2018. Furthermore, the Bank transferred an amount of LL million 322 resulting from subsequent adoption of ECL model as at 31 December 2018. The remaining excess provision amounting to LL million 1,240 was transferred to non-distributable general reserves complying with the Intermediate Circular number 143 dated 7 October 2017 issued by the Central Bank of Lebanon.

23 SHARE CAPITAL – COMMON SHARES

The authorized, issued and fully paid share capital as of 31 December 2018 comprised of 5,800,000 shares of nominal value LL 6,900 per share (2017: the same).

24 NON DISTRIBUTABLE RESERVES

1. Statutory reserve

As required by Article 132 of the Lebanese Code of Money and Credit, 10% of the net profit after tax should be transferred to a statutory reserve. This reserve is not distributable. The Bank did not appropriate any amount from prior year net profit to this reserve during the current year (2017: the same).

2. Reserve for capital increase

In compliance with circular 167 issued by the Banking Control Commission which states the requirement to transfer the recovery of provisions for doubtful debts to a special free reserve for capital increase limited by the net income. The Bank did not appropriate any amount from prior year net profit to this reserve during the current year (2017: the same).

3. Reserve for general banking risks (before 1 January 2018)

In compliance with main circular no. 50 issued by the Central Bank, the Bank should transfer from net profit for the year a minimum amount of 2 per thousand and a maximum of 3 per thousand from the total risk weighted assets and off financial position items based on rates specified by the Central Bank as a reserve for general banking risks. The accumulated balance of this reserve should not be less than 1.25% of the total risks at the end of the financial year ten (year 2017) and 2% at the end of the financial year twenty (year 2027). In accordance with the resolution of the ordinary general assembly of shareholders dated 9 June 2017, the Bank appropriated LL million 28 to this reserve from the general reserves during the year ended 31 December 2017.

24 NON DISTRIBUTABLE RESERVES (continued)

4. General Reserves

According to the Central Bank of Lebanon Main Circular 143, Banks in Lebanon are required to transfer to General Reserves, the balance of Reserves for General Banking Risks and General Reserves for Loans and Advances previously appropriated in line with the requirements of decision 7129 and decision 7776 respectively. This reserve is part of the Bank's equity and is not available for distribution. During the year ended 31 December 2018, the Bank transferred to this reserve the balance of Reserves previously mentioned amounting to LL million 5,665 and LL million 100 respectively.

25 DISTRIBUTALBE RESERVES

General reserve

After all the transfers to non-distributable reserves, the remaining balance can be distributed.

26 CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the statement of cash flows consist of the following:

	2018	*2017*
	LL million	*LL million*
Cash and balances with the Central Bank	**73,965**	62,225
Due from banks and financial institutions	**77,764**	29,682
Due to banks and financial institutions	**-**	(6)
Due from head office, branches and affiliates	**6,826**	5,634
Due to head office, branches and affiliates	**(48)**	(8)
	158,507	97,527

27 RELATED PARTY TRANSACTIONS

Related parties of the Bank include subsidiaries, key management personnel and their close family members, as well as entities controlled or jointly controlled by them.

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly, including the Directors and Officers of the Bank.

Entities under common directorship are defined as those entities over which the Bank's key management personnel have similar authority and responsibility to those they have in the Bank.

Terms and conditions of transactions with related parties

The Bank enters into transactions with related parties in the ordinary course of business at commercial interest and commission rates.

27 RELATED PARTY TRANSACTIONS (continued)

The following table provides the total amount of transactions and the amount of outstanding balances (including commitments) with related parties for the relevant financial year.

	2018	
	Outstanding balance LL million	***Interest income (expense) LL million***
Key Management Personnel and their Family members		
Net loans and advances*	**822**	**29**
Deposits	**158**	**2**
Banks under common directorships		
Debit balances	**4,051**	**129**
Term loan	**37,856**	**918**
Credit balances	**48**	**-**
Shareholders		
Debit balances	**2,775**	**26**
Deposits	**857**	**-**
Guarantees received	**13,532**	**-**
Other related parties		
Deposits	**698**	**-**
Board Members		
Deposits	**109**	**-**

*Included in net loans and advances allowance for expected credit losses amounting to LL million 9 as at 31 December 2018 (2017: nil) (note 30).

	2017	
	Outstanding balance LL million	*Interest income (expense) LL million*
Key Management Personnel and their Family members		
Net loans and advances	941	33
Deposits	185	4
Banks under common directorships		
Debit balances	2,596	19
Credit balances	8	-
Term loan	22,612	64
Shareholders		
Debit balances	3,038	3
Deposits	227	-
Guarantees received	24,184	-
Other related parties		
Deposits	138	-
Board Members		
Deposits	123	-

The Bank entered into swap deals with NBK Kuwait, and as result the Bank paid the received fixed interest and earned the floating interest amounting to LL million 3,745 and LL million 3,542 respectively for year ended 31 December 2018 (2017: LL million 1,864 and LL million 1,475 respectively). The notional amount for the interest rate swap with National Bank of Kuwait SAK as at 31 December 2018 amounted to LL million 55,778 (2017: the same).

28 COMMITMENTS AND CONTINGENT LIABILITIES

Credit-related commitments

To meet the financial needs of customers, the Bank enters into various irrevocable commitments, guarantees and other contingent liabilities, which are mainly credit-related instruments including both financial and non-financial guarantees and commitments to extend credit. The letters of credit and guarantees (including the enhanced credits) and acceptances commit the Bank payments on behalf of customers if the customer fails to meet its obligations in accordance with the terms of the contract. Even though these obligations may not be recognized on the statement of financial position, they do contain credit risk and are therefore part of the overall risk of the Bank.

Nominal principal amounts represent the amount at risk should the contracts be fully drawn upon and clients default. As a significant portion of guarantees and commitments is expected to expire without being withdrawn, the total of the nominal principal amount is not indicative of future liquidity requirements.

The table below discloses the nominal principal amounts of credit-related commitments and contingent liabilities.

	2018	*2017*
	Customers	*Customers*
	LL million	*LL million*
Guarantees and contingent liabilities		
Financial guarantees	**4,873**	8,658
Commitments		
Undrawn credit lines (revocable)	**25,603**	15,691
Other commitments	**30**	30
	25,633	15,721
	30,506	24,379

Guarantees

Guarantees are given as security to support the performance of a customer to third parties. The main types of guarantees provided are:

- Financial guarantees given to banks and financial institutions on behalf of customers to secure loans, overdrafts, and other banking facilities; and
- Non financial guarantees provided include mainly performance guarantees and retention guarantees.

Undrawn credit lines

Undrawn credit lines are agreements to lend a customer in the future, subject to certain conditions. Such commitments are either made for a fixed period, or have no specific maturity but are cancellable by the lender subject to notice requirements.

Legal claims

Litigation is a common occurrence in the banking industry due to the nature of the business undertaken. The Bank has formal controls and policies for managing legal claims. Based on advice from legal counsel, management believes that legal claims will not result in any financial loss to the Bank.

Claims resulting from Judicial disputes are detailed as follows:

	2018	*2017*
	LL million	*LL million*
Claims' value raised against the Bank	**294**	5,725

28 COMMITMENTS AND CONTINGENT LIABILITIES (continued)

Lease arrangements

Future minimum lease payments are as follows:

	2018 *LL million*	*2017* *LL million*
Within one year	**86**	85
After one year but not more than five years	**11**	37
	97	122

Other contingencies

The Bank's books are still subject to review by the Department of Income Tax for the years 2014 to 2018 (inclusive).

The Bank's books are still subject to review by the National Social Security Fund for the years 2002 to 2018 (inclusive).

Management believes that the ultimate outcome of any such review will not have a material effect on the financial statements.

29 ASSETS UNDER MANAGEMENT

The Bank has fiduciary assets as follows:

	2018 *LL million*	*2017* *LL million*
Lebanese treasury bills denominated in LL	**4,647**	5,349
Lebanese eurobonds	**10,478**	10,478
Financial notes	**5,743**	7,277
	20,868	23,104

The above Lebanese treasury bills, eurobonds and financial notes are stated at nominal value.

30 EXPECTED CREDIT LOSSES

	2018					
	Cash and balances with the Central Bank LL million	*Loans and advances to customers at amortised cost LL million*	*Loans and advances to related parties at amortised cost LL million*	*Financial assets at amortised cost LL million*	*Financial guarantees and other commitments LL million*	*Total LL million*
Balance as of 1 January	-	1,156	-	-	-	1,156
Effect of IFRS 9 adoption	349	84	9	1,329	11	1,782
Amended balance as of 1 January	349	1,240	9	1,329	11	2,938
Impairment loss for the year*	-	128	-	-	-	128
Recoveries for the year*	(27)	-	-	(418)	(5)	(450)
Balance as at 31 December	322	1,368	9	911	6	2,616

30 EXPECTED CREDIT LOSSES (continued)

	2017					
	Cash and balances with the Central Bank LL million	*Loans and advances to customers at amortised cost LL million*	*Loans and advances to related parties at amortised cost LL million*	*Financial assets at amortised cost LL million*	*Financial guarantees and other commitments LL million*	*Total LL million*
Balance at 1 January	-	1,115	-	-	-	1,115
Add:						
Charges for the year	-	41	-	-	-	41
Balance as at 31 December	-	1,156	-	-	-	1,156

*Net recoveries of provision for allowance ECL amounting to LL million 322 are accounted for under "Provisions for risks and charges" for the year ended 31 December 2018 (note 22).

31 DERIVATIVES

The table below shows the positive and negative fair values of derivative financial instruments, which are equivalent to the market values, together with the notional amounts analyzed by the term to maturity. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured.

	2018			*2017*		
	Positive fair values LL million	***Negative fair value LL million***	***Total Notional amount LL million***	*Positive fair values LL million*	*Negative fair value LL million*	*Total Notional amount LL million*
Derivatives used for hedging purposes:						
Interest rate swaps	-	**567**	**55,778**	303	-	55,778

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

The Bank has entered into the above interest rate swaps to hedge the treasury bills in US Dollars (Eurobonds) at amortized cost and revalued at fair value to hedge interest rate risk. These hedges are effective fair value hedges, accordingly losses that resulted from the change of the fair value of the interest rate swaps have been directly charged to the income statement.

Derivative Financial Instruments Held for Hedging Purposes
The Bank uses derivatives for hedging purposes in order to reduce its exposure to credit and market risks. This is achieved by hedging specific financial instruments, portfolios of fixed rate financial instruments and forecast transaction, as well as strategic hedging against overall financial position exposures.

32 FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair values in this note are stated at a specific date and may be different from the amounts which will actually be paid on the maturity or settlement dates of the instrument. In many cases, it would not be possible to realize immediately the estimated fair values given the size of the portfolios measured. Accordingly, these fair values do not represent the value of these instruments to the Bank as a going concern. Financial assets and liabilities are classified according to a hierarchy that reflects the significance of observable market inputs. The three levels of the fair value hierarchy are defined below.

Quoted market prices – Level 1
Financial instruments are classified as Level 1 if their value is observable in an active market. Such instruments are valued by reference to unadjusted quoted prices for identical assets or liabilities in active markets where the quoted price is readily available, and the price represents actual and regularly occurring market transactions on an arm's length basis. An active market is one in which transactions occur with sufficient volume and frequency to provide pricing information on an ongoing basis.

32 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Valuation technique using observable inputs – Level 2
Financial instruments classified as Level 2 have been valued using models whose most significant inputs are derived directly or indirectly from observable market data. Such inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical instruments in inactive markets and observable inputs other than quoted prices such as interest rates and yield curves, implied volatilities, and credit spreads.

Valuation technique using significant unobservable inputs – Level 3
Financial instruments are classified as Level 3 if their valuation incorporates significant inputs that are not based on observable market data (unobservable inputs).

32.1 FAIR VALUE OF FINANCIAL INSTRUMENTS CARRIED AT FAIR VALUE

Fair value measurement hierarchy of the Bank's financial assets and liabilities carried at fair value:

	2018	*2017*
	Level 2	*Level 2*
Financial liabilities	*LL million*	*LL million*
Derivative financial instruments		
Interest rate swaps	**567**	(303)

No transfers between levels were made during the years 2018 and 2017.

Valuation techniques used for material classes of financial assets and liabilities categorized within Level 2:

Derivatives
Derivative products are valued using valuation techniques with market observable inputs. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

Comparison of Carrying and Fair Values for Financial Assets and Liabilities not Held at Fair Value:
The fair values included in the table below were calculated for disclosure purposes only. The fair valuation techniques and assumptions described below relate only to the fair value of the Bank financial instruments not measured at fair value. Other institutions may use different methods and assumptions for their fair value estimations, and therefore such fair value disclosures cannot necessarily be compared from one institution to another.

32.2 FAIR VALUE OF FINANCIAL INSTRUMENTS NOT HELD AT FAIR VALUE

Fair value measurement hierarchy of the Bank's financial assets and liabilities for which fair value is disclosed:

31 December 2018

	Nominal Amount	*Fair Value*			
		Level 1	*Level 2*	*Level 3*	*Total*
	LL million	*LL million*	*LL million*	*LL million*	*LL million*
Financial Assets					
Cash and balances with the Central Bank	118,801	8,166	110,635	-	118,801
Due from banks and financial institutions	77,764	-	77,764	-	77,764
Due from head office, branches and affiliates	6,826	-	6,826	-	6,826
Loans & advances to customers at amortized cost	107,199	-	-	100,098	100,098
Loans & advances to related parties at amortized cost	822	-	-	725	725
Financial assets at amortized cost	136,995	3,671	125,597	-	129,268
	448,407	11,837	320,822	100,823	433,482
Financial liabilities					
Due to head offices, branches and affiliates	37,904	-	37,904	-	37,904
Customers' deposits at amortized cost	318,370	-	317,633	-	317,633
Related parties deposits at amortized cost	1,822	-	1,822	-	1,822
	358,096	-	357,359	-	357,359

32 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

32.2 FAIR VALUE OF FINANCIAL INSTRUMENTS NOT HELD AT FAIR VALUE (continued)

Fair value measurement hierarchy of the Bank's financial assets and liabilities for which fair value is disclosed: (continued)

31 December 2017

	Nominal Amount	*Fair Value*			
		Level 1	*Level 2*	*Level 3*	*Total*
	LL million	*LL million*	*LL million*	*LL million*	*LL million*
Financial Assets					
Cash and balances with the Central Bank	107,375	6,933	100,442	-	107,375
Due from banks and financial institutions	29,682	-	29,682	-	29,682
Due from head office, branches and affiliates	5,634	-	5,634	-	5,634
Loans & advances to customers at amortized cost	113,330	-	-	108,706	108,706
Loans & advances to related parties at amortized cost	941	-	-	844	844
Financial assets at amortized cost	162,582	3,897	158,775	-	162,672
	419,544	10,830	294,533	109,550	414,913
Financial liabilities					
Due to banks and financial institutions	6	-	6	-	6
Due to head offices, branches and affiliates	22,620	-	22,620	-	22,620
Customers' deposits at amortized cost	311,041	-	311,237	-	311,237
Related parties deposits at amortized cost	673	-	673	-	673
	334,340	-	334,536	-	334,536

Valuation techniques used for material classes of financial assets and liabilities categorized within Level 2 and Level 3:

Deposits with banks, the Central Bank, and with the Head office, branches and affiliates
For the purpose of this disclosure there is minimal difference between fair value and carrying amount of these financial assets as they are short-term in nature or have interest rates that re-price frequently. The fair value of deposits with longer maturities are estimated using discounted cash flows applying market rates for counterparties with similar credit quality.

Government bonds, certificates of deposits and other debt securities
The Bank values these unquoted debt securities using discounted cash flow valuation models where the lowest level input that is significant to the entire measurement is observable in an active market. These inputs include assumptions regarding current rates of interest, implied volatilities and credit spreads.

Loans and advances to customers
For the purpose of this disclosure, fair value of loans and advances to customers is estimated using discounted cash flows by applying current rates for new loans granted during 2018 with similar remaining maturities and to counterparties with similar credit quality.

Deposits from banks and customers
In many cases, the fair value disclosed approximates carrying value because these financial liabilities are short-term in nature or have interest rates that re-price frequently. The fair value for deposits with long-term maturities, such as time deposits, are estimated using discounted cash flows, applying either market rates or current rates for deposits of similar remaining maturities.

33 MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below summarizes the maturity profile of the Bank's assets and liabilities based on contractual arrangements. The contractual maturities of the effective maturities relating to current customer deposits accounts amounting to LL 219,513 (2017: LL million 225,253) could differ.

31 December 2018

	Less than One year LL million	*More than One year LL million*	*Total LL million*
ASSETS			
Cash and balances with the Central Bank	**103,557**	**15,244**	**118,801**
Due from banks and financial institutions	**77,764**	-	**77,764**
Due from head office, branches and affiliates	**6,826**	-	**6,826**
Loans and advances to customers at amortized cost	**66,299**	**40,900**	**107,199**
Loans and advances to related parties at amortized cost	-	**822**	**822**
Financial assets at amortized cost	**52,060**	**84,935**	**136,995**
Property and equipment	-	**11,567**	**11,567**
Other assets	**1,254**	-	**1,254**
TOTAL ASSETS	**307,760**	**153,468**	**461,228**
LIABILITIES			
Due to head office, branches and affiliates	**48**	**37,856**	**37,904**
Customers' deposits at amortized cost	**317,616**	**754**	**318,370**
Related parties' deposits at amortized cost	**1,822**	-	**1,822**
Other liabilities	**8,449**	-	**8,449**
Provisions for risks and charges	**5,023**	-	**5,023**
TOTAL LIABILITIES	**332,958**	**38,610**	**371,568**
NET	**(25,198)**	**114,858**	**89,660**

31 December 2017

	Less than One year LL million	*More than One year LL million*	*Total LL million*
ASSETS			
Cash and balances with the Central Bank	61,867	45,508	107,375
Due from banks and financial institutions	29,682	-	29,682
Due from head office, branches and affiliates	5,634	-	5,634
Loans and advances to customers at amortized cost	82,500	30,830	113,330
Loans and advances to related parties at amortized cost	70	871	941
Financial assets at amortized cost	51,866	110,716	162,582
Property and equipment	-	11,670	11,670
Derivative financial Instruments	303	-	303
Other assets	1,253	-	1,253
TOTAL ASSETS	233,175	199,595	432,770
LIABILITIES			
Due to banks and financial institutions	6	-	6
Due to head office, branches and affiliates	72	22,548	22,620
Customers' deposits at amortized cost	310,755	286	311,041
Related parties' deposits at amortized cost	673	-	673
Other liabilities	7,631	-	7,631
Provisions for risks and charges	6,645	-	6,645
TOTAL LIABILITIES	325,782	22,834	348,616
NET	(92,607)	176,761	84,154

34 RISK MANAGEMENT

34.1 INTRODUCTION

The Bank manages its business activities within risk management guidelines as set by the board of directors. The Bank recognizes the role of the board of directors and executive management in the risk management process as set out in the Banking Control Commission circular 242. In particular, it is recognized that the ultimate responsibility for establishment of an effective risk management culture and practices lies within the Board of Directors as does the setting up of Bank's risk appetite and tolerance levels. The Board of Directors delegates through its risk management committee the day–to–day responsibility for establishment and monitoring of risk management process across the Bank to the head of risk management, who is directly appointed by the board of directors, in coordination with executive management at the Bank.

The Bank is exposed to credit risk, liquidity risk, market risk and operating risks.

The risk management committee has the mission to periodically (1) review and assess the risk management function of the Bank, (2) review the adequacy of the Bank's capital and its allocation and (3) review risk limits and reports and make recommendations to the board of directors.

The risk management committee undertakes its responsibilities and helps executive management in controlling and actively managing the Bank overall risk. The department mainly ensures that:

- Risk policies and methodologies are consistent with Bank's risk appetite.
- Limits and risk across banking activities are monitored throughout the Bank.

Through a comprehensive risk management framework, transactions and outstanding risk exposures are quantified and compared against authorized limits, whereas non-quantifiable risks are monitored against policy guidelines as set by the Bank "Risk Management Policy". Any discrepancies, breaches or deviations are escalated to executive management in a timely manner for appropriate action.

In respect of Basel 2 capital adequacy ratio calculations, risk management started, since December 2004, to issue internal reports to executive management and the board revealing multiple scenarios of capital adequacy calculations for credit and market risks under the standardized approaches and for operational risk under the basic indicator approach.

34.2 CREDIT RISK

Credit risk is the risk that the Bank will incur a loss because its customers or counterparties fail to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits. In addition, the Bank obtains securities where appropriate.

Credit risk is monitored by the credit risk department of the Bank's independent Risk Controlling Unit. It is their responsibility to review and manage credit risk, including environmental and social risk for all types of counterparties. Credit risk consists of line credit risk managers who are responsible for their business lines and manage specific portfolios and experts who support both the line credit risk manager, as well as the business with tools like credit risk systems, policies, models and reporting.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process aims to allow the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective actions.

The Bank has also established authorization structure for the approval and renewal of credit facilities. Credit officers and credit committees are responsible for the approval of facilities up to the limit assigned to them, which depends on the size of the exposure and the obligor's creditworthiness as measured by his internal rating. Once approved, facilities are disbursed when all the requirements set by the respective approval authority are met and documents intended as security are obtained and verified by the Credit Administration function.

34 RISK MANAGEMENT (continued)

34.2 CREDIT RISK (continued)

Derivative financial instruments
Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded on the statement of financial position. With gross–settled derivatives, the Bank is also exposed to a settlement risk, being the risk that the Bank honors its obligation but the counterparty fails to deliver the counter–value.

Credit–related commitments and financial guarantee risks
The Bank makes available to its customers guarantees which may require that the Bank makes payments on their behalf and enters into commitments to extend credit lines to secure their liquidity needs. Such commitments expose the Bank to similar risks as loans and are mitigated by the same assessment processes and policies.

Impairment assessment
The references below show where the Bank's impairment assessment and measurement approach is set out in this report. It should be read in conjunction with the *Summary of significant accounting policies.*

34.2.1 Definition of default and cure
The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations when:

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held); or
- the borrower is more than 90 days past due on any material credit obligation to the Bank. Overdrafts are considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than the current amount outstanding.

Any credit impaired or stressed facility that has been restructured would also be considered in default.

In assessing whether a borrower is in default, the Bank considers indicators that are:

- qualitative: e.g. breaches of covenant;
- quantitative: e.g. overdue status and non-payment on another obligation of the same issuer to the Bank; and
- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

The definition of default largely aligns with that applied by the Bank for regulatory capital purposes.

As a part of a qualitative assessment of whether a customer is in default, the Bank carefully considers whether the events listed above should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate.

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

34.2.2 The Bank's internal rating and PD estimation process
In managing its portfolio, the Bank utilises ratings and other measures and techniques which seek to take account of all aspects of perceived risk. The Bank uses industry-standard rating tools. The tool provides the ability to analyze a business and produce risk ratings. The analysis supports the usage of financial factors as well as non-financial subjective factors. The Bank also uses external ratings by recognised rating agencies for externally-rated portfolios.

The standard requires the use of separate PD for a 12-month duration and lifetime duration depending on the stage allocation of the obligor. A PD used for IFRS 9 should reflect the Bank's estimate of the future asset quality. The through the cycle (TTC) PDs are generated from the rating tool based on the internal/external credit ratings. The Bank converts the TTC PDs to a point-in-time (PIT) PD term structures using appropriate models and techniques.

34 RISK MANAGEMENT (continued)

34.2 CREDIT RISK (continued)

Impairment assessment (continued)

34.2.2 The Bank's internal rating and PD estimation process (continued)
With respect to the retail portfolio, and in view of low historical defaults and low transition in flow rates for this portfolio, Probability of Default (PD) and Loss Given Default (LGD) have not been assessed separately, and a single loss rate has been assessed through a normalized non-seasonal weighted average provision index with ECL calculated for each facility.

34.2.3 Exposure at default
Exposure at default (EAD) represents the amount which the obligor will owe to the Bank at the time of default. The Bank considers variable exposures that may increase the EAD in addition to the drawn credit line. These exposures arise from undrawn limits and contingent liabilities. Therefore, the exposure will contain both on and off balance sheet values. EAD is estimated taking into consideration the contractual terms such as coupon rates, frequency, reference curves, maturity, pre-payment options, amortization schedule, credit conversion factors, etc. EAD for retail loans incorporate repayment assumptions whereas for credit portfolio, credit conversion factors are applied to estimate the future drawdowns.

34.2.4 Loss given default
LGD is the magnitude of the likely loss if there is a default. The LGD assessment is based on the history of recovery rates of claims against defaulted counterparties. It considers the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For portfolios in respect of which the Bank has limited historical data, external benchmark information is used to supplement the internally available data.

34.2.5 Significant increase in credit risk
The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12 months ECL or life time ECL, the Bank assesses as whether there has been a significant increase in credit risk since initial recognition. The quantitative criteria used to determine a significant increase in credit risk is a series of relative and absolute thresholds. All financial assets that are 30 days past due are deemed to have significant increase in credit risk since initial recognition and migrated to stage 2 even if other criteria do not indicate a significant increase in credit risk. Retail facilities however, migrate to stage 2 based on days pat due movement and the IFRS 9 presumption of 30 days past due is rebuttable but not rebutted. The Bank considers a financial instrument with an external rating of "investment grade" as at the reporting date to have low credit risk. In addition to the above quantitative criteria, the Bank applies qualitative criteria for the assessment of significant increase in credit risk based on monitoring of certain early warning signals.

Incorporation of forward-looking information
The Bank considers key economic variables that are expected to have an impact on the credit risk and the ECL in order to incorporate forward looking information into the ECL models. Key economic variables include, but not limited to gross domestic product and unemployment rate. These primarily reflect reasonable and supportable forecasts of the future macro-economic conditions. The consideration of such factors increases the degree of judgment in determination of ECL. The Bank employs statistical models to incorporate macro-economic factors on historical default rates. The Bank considers 3 scenarios (baseline, upside and downside) of forecasts of macro-economic data separately for each geographical segments and appropriate probability weights are applied to these scenarios to derive a probability weighted outcome of expected credit loss. The ECL estimates have been assessed for sensitivity to changes to forecasts of macro-variables and also together with changes to the weights assigned to the scenarios. The impact of ECL is not material. The management reviews the methodologies and assumptions including any forecasts of future economic conditions on a regular basis.

34 RISK MANAGEMENT (continued)

34.2 CREDIT RISK (continued)

Impairment assessment (continued)

Geographical location analysis

The Bank controls credit risk by maintaining close monitoring credit of its assets exposures by geographic location. The distribution of assets, liabilities and off-financial position items by geographic region and industry sector as of 31 December was as follows:

	2018		*2017*	
	Assets LL million	***Liabilities LL million***	*Assets LL million*	*Liabilities LL million*
Geographic region:				
Domestic (Lebanon)	**407,987**	**221,050**	374,668	201,370
Middle East countries	**13,432**	**139,095**	18,616	133,786
Europe	**19,805**	**3,126**	19,486	2,998
North America	**20,004**	**7,386**	20,000	5,766
Other	**-**	**1,478**	-	4,696
	461,228	**372,135**	432,770	348,616
Industry sector:				
Trading and manufacturing	**59,445**	**44,573**	54,986	39,599
Banks and financial institutions	**203,391**	**38,471**	142,691	35,646
Construction and real estate	**8,085**	**39,589**	8,989	24,574
Other	**190,307**	**249,502**	226,104	248,797
	461,228	**372,135**	432,770	348,616

Analysis of risk concentrations

Credit Quality and Maximum Exposure to Credit Risk Analysis

In managing its portfolio, the Bank utilizes rating and other measures and techniques which seek to take account of all aspects of perceived risk. Credit exposures classified as "High" quality are those where the ultimate risk of financial loss from the obligor's failure to discharge its obligation is assessed to be low. These include facilities to corporate entities with financial condition, risk indicators and capacity to repay which are considered to be good to excellent. Credit exposures classified as "Standard" quality comprise all other facilities whose payment performance is fully compliant with contractual conditions and which are not "impaired". The ultimate risk of possible financial loss on "Standard" quality is assessed to be higher than that for the exposures classified within the "High" quality range.

34 RISK MANAGEMENT (continued)

34.2 CREDIT RISK (continued)

Analysis of risk concentrations (continued)

Credit Quality and Maximum Exposure to Credit Risk Analysis (continued)

The table below shows the credit quality and the maximum exposure to credit risk based on the Bank's internal credit rating system and year-end stage classification. The amounts presented are gross of impairment allowances.

	2018				2017
	Stage 1	Stage 2	Stage 3	Total	Total
	LL Million	LL Million	LL Million	LL Million	LL Million
Balances with the Central Bank	**110,957**	-	-	**110,957**	100,443
Standard grade	*110,957*	-	-	*110,957*	*100,443*
Due from banks and financial institutions	**77,764**	-	-	**77,764**	29,682
High grade	*64,517*	-	-	*64,517*	*28,758*
Standard grade	*13,247*	-	-	*13,247*	*924*
Due from head office, branches and affiliates	**6,826**	-	-	**6,826**	5,634
High grade	*6,826*	-	-	*6,826*	*5,634*
Financial assets at amortised cost	**137,906**	-	-	**137,906**	162,582
Lebanese sovereign					
Standard grade	*135,013*	-	-	*135,013*	*159,702*
Other sovereign					
High grade	*2,893*	-	-	*2,893*	*2,880*
Loans and advances to customers at amortised cost	**56,365**	**51,429**	**773**	**108,567**	113,379
Commercial					
Standard grade	*19,929*	*44,259*	-	*64,188*	*72,239*
Consumer					
Standard grade	*36,436*	*7,170*	-	*43,606*	*40,230*
Individually impaired	-	-	*773*	*773*	*910*
Loans and advances to related parties at amortised cost	**831**	-	-	**831**	941
Standard grade	*831*	-	-	*831*	*941*
Financial guarantees and other commitments	**25,797**	**4,709**	-	**30,506**	24,650
Financial guarantees					
Standard grade	*164*	*4,709*	-	*4,873*	*8,658*
Undrawn credit lines					
Standard grade	*25,603*	-	-	*25,603*	*15,962*
Other commitments					
Standard grade	*30*	-	-	*30*	*30*
Total	**416,446**	**56,138**	**773**	**473,357**	437,311

34 RISK MANAGEMENT (continued)

34.2 CREDIT RISK (continued)

Financial Assets and ECLs by stage

The tables below presents an analysis of financial assets at amortised cost by gross exposure and impairment allowance by stage allocation as at 31 December 2018. The Bank does not hold any material purchased or originated credit-impaired assets as at year-end.

	Gross exposure				Impairment allowance				
31 December 2018	*Stage 1 LL Million*	*Stage 2 LL Million*	*Stage 3 LL Million*	*Total LL Million*	*Stage 1 LL Million*	*Stage 2 LL Million*	*Stage 3 LL Million*	*Total LL Million*	*Net exposure LL Million*
Balances with the Central Bank	110,957	-	-	110,957	322	-	-	322	110,635
Due from banks and financial institutions	77,764	-	-	77,764	-	-	-	-	77,764
Due from head office, banks and affiliates	6,826	-	-	6,826	-	-	-	-	6,826
Loans and advances to customers at amortized cost	56,365	51,429	773	108,567	432	174	762	1,368	107,199
Commercial	*19,929*	*44,259*	-	*64,188*	*74*	*84*	-	*158*	*64,030*
Consumer	*36,436*	*7,170*	*773*	*44,379*	*358*	*90*	*762*	*1,210*	*43,169*
Loans and advances to related parties at amortized cost	831	-	-	831	9	-	-	9	822
Financial assets at amortized cost	137,906	-	-	137,906	911	-	-	911	136,995
Financial guarantees and other commitments	25,797	4,709	-	30,506	6	-	-	6	30,500
Total	416,446	56,138	773	473,357	1,680	174	762	2,616	470,741

Collateral and other credit enhancements

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

Management monitors the market value of collateral in order to request additional collateral in case of a decline in market value and to estimate the recoverable amount during its review of the adequacy of the allowance for impairment losses.

The main types of collateral obtained are as follows:

Letters of credit / guarantees:

The Bank holds in some cases guarantees, letters of credit and similar instruments from banks and financial institutions which enable it to claim settlement in the event of default on the part of the counterparty. The balances shown represent the notional amount of these types of guarantees held by the Bank.

Real estate

The Bank holds in some cases a first degree mortgage over residential property (for housing loans) and commercial property (for commercial loans). The value shown above reflects the fair value of the property limited to the related mortgaged amount.

34 RISK MANAGEMENT (continued)

34.2 CREDIT RISK (continued)

Analysis of maximum exposure to credit risk and collateral and other credit enhancements

The following table shows maximum exposure to credit risk by class of financial asset. It further shows the total fair value of collateral, capped to the maximum exposure to which it relates and the net exposure to credit risk.

	2018						
	Maximum exposure LL million	*Cash collateral and margins LL million*	*Letters of guarantees LL million*	*Real estate guarantees LL million*	*Personal guarantees LL million*	*Other guarantees LL million*	*Net credit exposure LL million*
Balances with the Central Bank	118,801	-	-	-	-	-	118,801
Due from banks and financial institutions	77,764	-	-	-	-	-	77,764
Due from head office, branches and affiliates	6,826	-	-	-	-	-	6,826
Loans and advances to customers at amortized cost:	107,199	7,173	5,891	32,387	13,902	10,806	37,040
Commercial loans	64,030	27	5,573	3,272	12,693	7,010	35,455
Consumer loans	43,169	7,146	318	29,115	1,209	3,796	1,585
Loans and advances to related parties at amortized cost	822	-	-	393	-	57	372
Financial assets at amortized cost	136,995	-	-	-	-	-	136,995
Financial guarantees	4,873	-	-	-	-	-	4,873
Undrawn credit lines	25,603	-	-	-	-	-	25,603
Other commitments	30	-	-	-	-	-	30
Total	478,913	7,173	5,891	32,780	13,902	10,863	408,304
Utilized collateral		7,173	5,891	32,780	13,902	10,863	70,606
Surplus of collateral before undrawn credit lines		1,565	2,710	12,897	27,984	13,419	58,575
Total collateral		8,805	11,311	45,790	47,087	24,282	129,181

	2017						
	Maximum exposure LL million	*Cash collateral and margins LL million*	*Letters of guarantees LL million*	*Real estate guarantees LL million*	*Personal guarantees LL million*	*Other guarantees LL million*	*Net credit exposure LL million*
Balances with the central banks	107,376	-	-	-	-	-	107,376
Due from banks and financial institutions	29,682	-	-	-	-		29,682
Due from head office, branches and affiliates	5,634	-	-	-	-		5,634
Loans and advances to customers at amortized cost:	113,330	2,891	8,844	32,126	12,195	24,687	32,587
Commercial loans	74,039	29	7,560	2,825	9,101	22,657	31,867
Consumer loans	39,291	2,862	1,284	29,301	3,094	2,030	720
Loans and advances to related parties at amortized cost	941	13	-	695	-	75	158
Financial assets at amortized cost	162,647	-	-	-	-	-	162,647
Financial guarantees	8,658	716	-	-	-	-	7,942
Documentary credits	-	-	-	-	-	-	-
Undrawn credit lines	15,962	-	-	-	-	-	15,962
Other commitments	30	-	-	-	-	-	30
Total	444,260	3,620	8,844	32,821	12,195	24,762	362,018
Utilized collateral		3,620	8,844	32,821	12,195	24,762	82,242
Surplus of collateral before undrawn credit lines		3,130	16,153	16,701	129,074	61,731	226,789
Total collateral		6,750	24,997	49,522	141,269	86,493	309,031

The surplus of collateral mentioned above is presented before offsetting additional credit commitments given to customers amounting to LL million 25,603 as of 31 December 2018 (2017: LL million 15,962).

34 RISK MANAGEMENT (continued)

34.3 LIQUIDITY RISK

Liquidity risk is defined as the risk that the Bank will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk arises because of the possibility that the Bank might be unable to meet its payment obligations when they fall due under both normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, and adopted a policy of managing assets with liquidity in mind and of monitoring future cash flows and liquidity on a regular basis. The Bank has developed internal control processes and contingency plans for managing liquidity risk. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

As per Lebanese banking regulations, the Bank must retain obligatory reserves with the Central Bank of Lebanon calculated on the basis of 25% of the sight deposits and 15% of term deposits denominated in Lebanese Pounds, in addition to interest bearing placements equivalent to 15% of all deposits in foreign currencies regardless of their nature.

The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank. The Bank maintains a solid ratio of highly liquid net assets in foreign currencies to deposits and commitments in foreign currencies taking market conditions into consideration. In accordance with the Central Bank of Lebanon circulars, the ratio of net liquid assets to deposits in foreign currencies should not be less than 10% and the ratio of liquid assets to net tier 1 Capital and in Lebanese Lira should not be less than 40%. The liquid assets consist of cash and balances with the Central Bank of Lebanon, due from banks and financial institutions, due from Head Office, affiliates and branches, Certificates of deposits issued by the Central Bank of Lebanon and treasury bills less due from banks and financial institutions and due from Head Office, affiliates and branches that mature within one year. Deposits and commitments comprise of total customer deposits in addition to acceptances and loans that mature within one year.

34.3.1 Analysis of financial assets and liabilities by remaining contractual maturities

The table below summarizes the maturity profile of the Bank's financial assets and liabilities based on contractual undiscounted repayment obligations. As the special commission payments up to contractual maturity are included in the table, totals do not match with the statement of financial position. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period at the statement of financial position date to the contractual maturity date and do not take into account the effective expected maturities.

Repayments which are subject to notice are treated as if notice were being given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

	2018					
	Up to 1 month LL million	*1 to 3 months LL million*	*3 to 12 months LL million*	*1 to 5 years LL million*	*Over 5 years LL million*	*Total LL million*
Financial assets						
Cash and balances with the Central bank	53,834	368	31,697	20,789	-	106,688
Due from banks and financial institutions	77,764	-	-	-	-	77,764
Due from head office, branches, and affiliates	6,825	-	-	-	-	6,825
Loans and advances to customers at amortized cost	57,855	4,175	14,256	23,862	17,577	117,725
Loans and advances to related parties at amortized cost	77	25	74	387	301	864
Financial assets at amortized cost	10,676	6,750	39,924	91,057	3,839	152,246
Other assets	1,254	-	-	-	-	1,254
Total undiscounted financial assets	208,285	11,318	85,951	136,095	21,717	463,366
Financial liabilities						
Due to head office, branches and affiliates	118	224	1,046	39,327	-	40,715
Customer's deposits at amortized cost	287,022	13,160	18,054	776	-	319,012
Related parties' deposits at amortized cost	1,822	-	-	-	-	1,822
Total undiscounted financial liabilities	288,962	13,384	19,100	40,103	-	361,549

34 RISK MANAGEMENT (continued)

34.3 LIQUIDITY RISK (continued)

34.3.1 Analysis of financial assets and liabilities by remaining contractual maturities (continued)

	2017					
	Up to 1 month LL million	*1 to 3 months LL million*	*3 to 12 months LL million*	*1 to 5 years LL million*	*Over 5 years LL million*	*Total LL million*
Financial assets						
Cash and balances with the Central bank	61,867	161	1,612	36,430	16,124	116,194
Due from banks and financial institutions	29,682	-	-	-	-	29,682
Due from head office, branches, and affiliates	5,634	-	-	-	-	5,634
Loans and advances to customers at amortized cost	58,045	5,546	25,793	19,792	12,993	122,169
Loans and advances to related parties at amortized cost	114	18	74	387	400	993
Financial assets at amortized cost	11,427	12,607	33,536	118,302	4,617	180,489
Other assets	1,253	-	-	-	-	1,253
Total undiscounted financial assets	168,022	18,332	61,015	174,911	34,134	456,414
Financial liabilities						
Due to banks and financial institutions	6	-	-	-	-	6
Due to head office, branches and affiliates	8	137	411	23,709	-	24,265
Customer's deposits at amortized cost	265,814	15,940	29,719	307	-	311,780
Related parties' deposits at amortized cost	673	-	-	-	-	673
Total undiscounted financial liabilities	266,501	16,077	30,130	24,016	-	336,724

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments:

	2018						
	On demand LL million	***Up to 1 month LL million***	***1 to 3 months LL million***	***3 to 12 months LL million***	***1 to 5 years LL million***	***Over 5 years LL million***	***Total LL million***
Financing commitments given to banks and financial institutions	-	-	-	-	-	-	-
Guarantees given to customers	**429**	**23**	**24**	**4,367**	**30**	-	**4,873**
Foreign currencies to deliver	-	**980**	-	-	-	-	**980**
Undrawn credit lines	**25,603**	-	-	-	-	-	**25,603**
Total	**26,032**	**1,003**	**24**	**4,367**	**30**	-	**31,456**

	2017						
	On demand LL million	*Up to 1 month LL million*	*1 to 3 months LL million*	*3 to 12 months LL million*	*1 to 5 years LL million*	*Over 5 years LL million*	*Total LL million*
Financing commitments given to banks and financial institutions	-	-	-	-	-	-	-
Guarantees given to customers	61	25	917	7,617	38	-	8,658
Foreign currencies to deliver	-	530	-	-	-	-	530
Undrawn credit lines	15,961	-	-	-	-	-	15,961
Total	16,022	555	917	7,617	38	-	25,149

The Bank expects that not all of the contingent liabilities or commitments will be demanded before maturity.

34.4 MARKET RISK

Market risk arises from fluctuations in interest rates, foreign exchanges rates and equity prices. The board of directors has set limits on the value of risk that may be accepted. This is monitored on a monthly basis by the Assets and Liabilities Committee in Kuwait.

34.5 INTEREST RATE RISK

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches of interest rate re-pricing of assets, liabilities and financial instruments presented as off-financial position items. The Bank has established levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods.

The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is a historical rate for a fixed rate instrument carried at amortized cost and a current market rate for a floating rate instrument or an instrument carried at fair value.

34 RISK MANAGEMENT (continued)

34.5 INTEREST RATE RISK (continued)

The fluctuation of 10 basis points with all other variables held constant has the following effect on the income statement:

Currency	*Changes in basis points*	*2018 Net (loss) profit LL million*	*2017 Net (loss) profit LL million*
Lebanese Lira	+10	22	(3)
US Dollars	+10	(85)	(53)

The table below analyses the Bank's interest rate risk exposure on non-trading financial assets and liabilities. The Bank's assets and liabilities are included at carrying amount and categorized by the earlier of contractual re-pricing maturity dates.

31 December 2018

	Up to 3 months LL million	*3 to 6 Months LL million*	*6 months to 1 year LL million*	*1 to 3 years LL million*	*Over 3 years LL million*	*Non interest bearing items LL million*	*Total LL million*
ASSETS							
Cash and balances with the Central Bank	53,867	-	30,308	-	15,244	19,382	118,801
Due from banks and financial institutions	66,350	-	-	-	-	11,414	77,764
Due from head office, branches and affiliates	6,826	-	-	-	-	-	6,826
Loans and advances to customers at amortized cost	36,091	11,633	31,846	6,797	20,832	-	107,199
Loans and advances to related parties at amortized cost	-	-	-	60	762	-	822
Financial assets at amortized cost	15,931	14,267	21,862	51,351	33,584	-	136,995
Property and equipment	-	-	-	-	-	11,567	11,567
Other assets	-	-	-	-	-	1,254	1,254
TOTAL	179,065	25,900	84,016	58,208	70,422	43,617	461,228
LIABILITIES							
Due to head office, branches and affiliates	-	-	-	37,856	-	48	37,904
Derivative financial instruments	-	-	-	-	-	567	567
Customers' deposits at amortized cost	79,085	13,480	17,650	754	-	207,401	318,370
Related parties' deposits at amortized cost	158	-	-	-	-	1,664	1,822
Engagements by acceptances	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	-	8,449	8,449
Provisions for risks and charges	-	-	-	-	-	5,023	5,023
Equity	-	-	-	-	-	89,093	89,093
TOTAL	79,243	13,480	17,650	38,610	-	312,245	461,228
Total interest rate sensitivity gap	99,822	12,420	66,366	19,598	70,422	(268,628)	-
Accumulated total interest rate sensitivity gap	99,822	112,242	178,608	198,206	268,628	-	

31 December 2017

	Up to 3 months LL million	*3 to 6 Months LL million*	*6 months to 1 year LL million*	*1 to 3 years LL million*	*Over 3 years LL million*	*Non interest bearing items LL million*	*Total LL million*
ASSETS							
Cash and balances with the Central Bank	28,748	-	-	30,254	15,241	33,132	107,375
Due from banks and financial institutions	18,092	-	-	-	-	11,590	29,682
Due from head office, branches and affiliates	1,018	-	-	-	-	4,616	5,634
Loans and advances to customers at amortized cost	37,285	40,344	2,928	4,495	28,278	-	113,330
Loans and advances to related parties at amortized cost	-	-	1	112	828	-	941
Financial assets at amortized cost	22,793	15,386	14,053	75,031	34,672	647	162,582
Property and equipment	-	-	-	-	-	11,670	11,670
Derivative financial instruments	-	-	-	-	-	303	303
Other assets	-	-	-	-	-	1,253	1,253
TOTAL	107,936	55,730	16,982	109,892	79,019	63,211	432,770
LIABILITIES							
Due to banks and financial institutions	-	-	-	-	-	6	6
Due to head office, branches and affiliates	-	-	-	22,549	-	71	22,620
Customers' deposits at amortized cost	48,243	13,322	16,352	286	-	232,838	311,041
Related parties' deposits at amortized cost	286	-	-	-	-	387	673
Other liabilities	-	-	-	-	-	7,631	7,631
Provisions for risks and charges	-	-	-	-	-	6,645	6,645
Equity	-	-	-	-	-	84,154	84,154
TOTAL	48,529	13,322	16,352	22,835	-	331,732	432,770
Total interest rate sensitivity gap	59,407	42,408	630	87,057	79,019	(268,521)	-
Accumulated total interest rate sensitivity gap	59,407	101,815	102,445	189,502	268,521	-	

34 RISK MANAGEMENT (continued)

34.6 CURRENCY RISK

Foreign exchange risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Banks are allowed to maintain a net trading position, debit or credit, of less than 1% of shareholders' equity provided that the total foreign currencies position should not exceed 40% of the equity (Central Bank of Lebanon main circular 32).

The Bank views itself as a Lebanese entity with the Lebanese Lira as its functional currency.

The table below analyses the effect of a reasonably possible movement of the currency rate against the Lebanese Lira, with all other variables held constant on the income statement and equity.

A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase:

	Change in currency rate in %	***2018 Effect on statement of comprehensive income LL million***	*2017 Effect on statement of comprehensive income LL million*
Currency			
US Dollars	**5%**	**(1)**	717
Euros	**5%**	**1**	1

The following statement of financial position as of 31 December 2018 is detailed in Lebanese Lira (LL) and foreign currencies (mainly in US dollars):

	Lebanese Lira	***Foreign currencies***		
	LL million	***In US Dollars (000)***	***Equivalent to LL million***	***Total in LL million***
ASSETS				
Cash and balances with the Central Bank	**38,967**	**52,958**	**79,834**	**118,801**
Due from banks and financial institutions	**12,065**	**43,581**	**65,699**	**77,764**
Due from head office, branches and affiliates	**-**	**4,528**	**6,826**	**6,826**
Loans and advances to customers at amortized cost	**6,367**	**66,887**	**100,832**	**107,199**
Loans and advances to related parties at amortized cost	**-**	**545**	**822**	**822**
Financial assets at amortized cost	**42,963**	**62,376**	**94,032**	**136,995**
Property and equipment	**11,567**	**-**	**-**	**11,567**
Other assets	**1,035**	**145**	**219**	**1,254**
TOTAL ASSETS	**112,964**	**231,020**	**348,264**	**461,228**
LIABILITIES AND SHAREHOLDERS' EQUITY				
Due to head office, branches and affiliates	**-**	**25,144**	**37,904**	**37,904**
Derivative financial instruments	**-**	**382**	**567**	**567**
Customers' deposits at amortized cost	**40,360**	**184,418**	**278,010**	**318,370**
Related parties' deposits at amortized cost	**100**	**1,142**	**1,722**	**1,822**
Engagements by acceptances	**-**	**-**	**-**	**-**
Other liabilities	**2,952**	**3,646**	**5,497**	**8,449**
Provisions for risks and charges	**3,673**	**896**	**1,350**	**5,023**
Share capital – common shares	**40,020**	**-**	**-**	**40,020**
Non-distributable reserves (legal and obligatory)	**10,305**	**3,388**	**5,108**	**15,413**
Distributable reserves	**31,845**	**-**	**-**	**31,845**
Accumulated losses	**(2,914)**	**-**	**-**	**(2,914)**
Results of the financial year - profit	**4,729**	**-**	**-**	**4,729**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**131,070**	**2,19,016**	**330,158**	**461,228**

34 RISK MANAGEMENT (continued)

34.6 CURRENCY RISK (continued)

The following statement of financial position as of 31 December 2017 is detailed in Lebanese Lira (LL) and foreign currencies (mainly in US dollars):

	Lebanese Lira	*Foreign currencies*		
	LL million	*In US Dollars (000)*	*Equivalent to LL million*	*Total in LL million*
ASSETS				
Cash and balances with the Central Bank	36,463	47,039	70,912	107,375
Due from banks and financial institutions	-	19,690	29,682	29,682
Due from head office, branches and affiliates	-	3,737	5,634	5634
Loans and advances to customers at amortized cost	687	74,722	112,643	113,330
Loans and advances to related parties at amortized cost	-	624	941	941
Financial assets at amortized cost	68,511	62,402	94,071	162,582
Property and equipment	11,549	80	121	11,670
Derivative financial instruments	-	201	303	303
Other assets	956	197	297	1,253
TOTAL ASSETS	118,166	208,692	314,604	432,770
LIABILITIES AND SHAREHOLDERS' EQUITY				
Due to banks and financial institutions	-	4	6	6
Due to head office, branches and affiliates	-	15,048	22,620	22,620
Customers' deposits at amortized cost	50,768	172,652	260,273	311,041
Related parties' deposits at amortized cost	97	382	576	673
Other liabilities	1,812	3,860	5,819	7,631
Provisions for risks and charges	5,322	878	1,323	6,645
Share capital – common shares	40,020	-	-	40,020
Non-distributable reserves (legal and obligatory)	9,183	3,927	5,920	15,103
Distributable reserves	31,945	-	-	31,945
Accumulated losses	(6,015)	-	-	(6,015)
Results of the financial year - profit	3,101	-	-	3,101
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	136,233	196,751	296,537	432,770

34.7 PREPAYMENT RISK

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier than expected, such as fixed rate housing loans when interest rate falls. The fixed rate assets of the Bank are not significant compared to the total assets. Moreover, other market conditions causing prepayment is not significant in the markets in which the Bank operates. Therefore, the Bank considers the effect of prepayment on net interest income is not material after taking into account the effect of any prepayment penalties.

34.8 OPERATIONAL RISK

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes.

35 CAPITAL MANAGEMENT

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

The primary objectives of the Bank's capital management policy are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholder value.

The following table shows the applicable regulatory capital ratios:

	Common Tier 1 capital ratio	*Tier 1 capital ratio*	*Total capital ratio*
For the year ended 31 December 2018*	**10**	**13**	**15**
For the year ended 31 December 2017*	**9**	**12**	**14.5**
For the year ended 31 December 2016*	**8.5**	**11**	**14**

(*) Include Capital Conversion Buffer (CCB). This CCB, which will reach 4.5% of risk –weighted assets by end of 2018, must be met through Common Equity Tier 1 capital.

At 31 December 2018 and 2017, the capital consists of only Common Equity Tier 1 as follows:

	2018 ***LL million***	*2017* *LL million*
Total capital	**84,364**	81,054

	2018 ***LL million***	*2017* *LL million*
Risk weighted assets		
Credit risk	**253,173**	238,115
Market risk	**243**	211
Operational risk	**31,097**	29,488
Total risk weighted assets	**284,513**	267,814

The capital adequacy ratio as of 31 December is as follows:

	2018	*2017*
Capital adequacy ratio – Common Tier 1	**29.65%**	30,27%
Capital adequacy ratio – Tier 1	**29.65%**	30,27%
Capital adequacy ratio – Total capital	**29.65%**	30,27%

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes during the years ended 31 December 2018 and 2017.