

National Bank of Kuwait (International) PLC

Annual Reports and Financial Statements

31 December 2018

Company registration: 02773743
FCA registration 171532

Chairman

Nasser Musaed Abdullah Al Sayer

Vice Chairman

Isam Jassim Al Sager

Directors

Ghassan Ahmed Saoud Al Khaled

Hamad Abdul Aziz Al Sagar

Shaikha Al Bahar

Georges Richani

Hamish Cameron Galbraith Marr

Lesley Jane Titcomb

Fawzi Adnan Dajani

Andrew Simon Richardson

Secretaries

Stephen George Byrne

Dagmar Moravkova (appointed: 27 July 2018)

Andrew Simon Richardson (resigned: 27 July 2018)

Auditors

Ernst & Young LLP

25 Churchill Place

London E14 5EY

Registered Office

NBK House

13 George Street

London W1U 3QJ

Registered number 02773743

FCA registration number 171532

Strategic report

31 December 2018

The directors present their strategic report for the year ended 31 December 2018.

Principal activities

The company is an authorised bank carrying out international commercial banking, financial and related services from its London headquarters.

Throughout this Report and Financial Statements the company is referred to as “the Bank”.

During the year, the branch of the Bank located in Paris was converted into a direct subsidiary of the group company National Bank of Kuwait SAKP as at 31 December 2018. The Bank holds 19.68% of the share capital of NBK France S.A. In the Strategic Report, the 2017 comparatives have been adjusted to include London operation only.

Key financial highlights

	2018	2017
		(London only)
	<u>US\$000</u>	<u>US\$000</u>
<u>Profit or Loss Account:</u>		
Operating income before credit impairment gain / (losses) & expected credit losses (ECL) write back	53,703	40,226
Profit before tax	28,789	4,626
Profit after tax	22,780	3,759
<u>Balance Sheet:</u>		
Loans to customers	1,224,519	1,148,448
Customer deposits	1,167,190	1,137,355
Shareholders' equity	312,440	297,816
<u>Key ratios:</u>		
Return on shareholders' equity	7.3%	1.3%
Cost income ratio	47.2%	51.5%
Return on assets	0.90%	0.13%

Net operating income was up on last year by US\$ 13.5 million (33.5%) as a result of higher interest income in the Treasury business and new loan business booked in Commercial Real Estate. Costs were up year on year reflecting investment in the risk and control framework, however the overall cost income ratio improved to 47.2%. Return on shareholder's equity has increased as a result of the higher operating revenues.

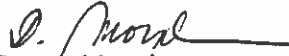
Loans to customers increased 6.6% to US\$ 1.23 billion compared to US\$ 1.15 billion last year. Customer deposits increased 2.6% to US\$ 1.17 billion compared to US\$ 1.14 billion last year.

The Bank's funding and liquidity positions are satisfactory and the capital position is comfortably above minimum regulatory requirement.

Principal risks and uncertainties

Details of the financial risk management objectives and policies of the Bank and exposure of the Bank to market risk, interest rate risk, foreign exchange risk, credit risk and liquidity risk are given in the notes to the financial statements.

By order of the Board



Dagmar Moravkova
Secretary

21 March 2019

Directors' report

31 December 2018

The directors have pleasure in submitting their twenty fifth annual report together with the audited financial statements for the year ended 31 December 2018.

Directors

The names of the present directors are listed on page two.

Significant change during the year and subsequently is as follows:

- Sir David William Brewer KG CMG CVO resigned as a director on 31 January 2018.

According to the register of directors' interests, no director holding office as at 31 December 2018 had any beneficial interest in the shares of the Bank during the year or at year end.

Financial risk management

The Bank is primarily exposed to various types of risk such as credit risk, liquidity risk, market risk and operational risk. The management of risk is detailed in the note 26 to the financial statements together with an explanation of various risks.

Results and dividends

The Bank has made a profit after tax of US\$ 22,780 thousand (2017 – profit of US \$4,887 thousand). This is a significant performance for the Bank in 2018. Underlying this performance is solid revenue generation from all business areas and in particular Treasury and Commercial Real Estate lending. The directors proposed no dividend for the year ending 31 December 2018 (2017 – Nil).

Discontinued operations

On the 31 December 2018, the Board has established a separate entity in France and has transferred all the assets and liabilities of Paris branch to the newly established company, NBK France S.A. The new company is a direct subsidiary of National Bank of Kuwait SAKP ("NBK SAKP"). The Bank holds 19.68% of the share capital of NBK France S.A.

Future developments

The directors aim to continue to maintain the management policies which have resulted in a successful performance to date. After the creation of NBK France SA, the Bank will act as the UK and non-EU Europe arm for NBK SAKP. The Bank's presence in London will continue to be seen as a strategically important location both for the optimisation of client services and market participation. In addition, the Bank is well-placed to benefit from the growth in Middle Eastern economies, especially through trade finance business and the structuring and execution of transactions in conjunction with the wider NBK Group.

Going concern

The 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 of any material uncertainties that may cast significant doubt upon the ability of the Bank to continue as a going concern. The directors concur with the management's assessment and therefore the financial statements continue to be prepared on a going concern basis.

Charitable donations

The Bank made charitable donations of US\$ 978 (2017 – US\$ 1,008) during the year.

Employees

It is the Bank's policy to attract, retain and develop the best qualified employees to enable it to achieve its overall business objectives. Accordingly, all vacant positions are filled with the best qualified people, either from internal candidates where that is appropriate or from external recruitment. Equal treatment is offered to all applicants internally and externally with no discrimination on the grounds of race, colour, sex, nationality, marital status or disability, the criteria for selection being suitability and competence to do the job.

The Bank is committed to providing high quality training to its employees using formal courses in addition to on the job training. This is to ensure that employees have the required knowledge and skills to perform effectively in their present and future positions within the Bank.

Supplier's payment policy

It is the Bank's policy in every case to comply with the terms of payment expected by suppliers. In this respect, the Bank's creditor payment practice is to pay within the agreed period from the date of the invoice.

Disclosure of information to the auditors

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors, each director has taken all the steps that he/she is obliged to take as a director in order to make himself/herself aware of any relevant audit information and to establish that the auditor is aware of that information.

Auditors

The auditors, Ernst & Young LLP, have expressed their willingness to continue in office. Pursuant to section 489 of the Companies Act 2006, a resolution for the re-appointment of Ernst & Young LLP will be proposed at the forthcoming annual general meeting of the Company.

By order of the Board



Dagmar Moravkova
Secretary

21 March 2019

Statement of directors' responsibilities

The directors are responsible for preparing the Strategic Report, Directors' report and the Financial Statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with UK Financial Reporting Standard 101 – Reduced Disclosure Framework. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Bank and of the profit or loss of the Bank for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Financial Reporting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Bank and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NATIONAL BANK OF KUWAIT (INTERNATIONAL) PLC

Opinion

We have audited the financial statements of National Bank of Kuwait (International) Plc (the 'Bank') for the year ended 31 December 2018 which comprise the Statement of Income, Statement of Comprehensive Income, Statement of Financial Position, the Statement of Changes in Equity and the related notes 1 to 27 (except for note 27 which is marked as unaudited), including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including FRS 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the Bank's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Bank's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Overview of our audit approach

Key audit matters	<ul style="list-style-type: none"> • Risk of material misstatement in the valuation and completeness of impairment provisions. • Risk of fraud in the recognition of revenue using the Effective Interest Rate (EIR) method. • Risk of material misstatement in the valuation of shares acquired in NBK France S.A.
Materiality	<ul style="list-style-type: none"> • Overall materiality of USD 1.65 million which represents 5% of adjusted pre-tax income.

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 current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p>Risk of material misstatement in the valuation and completeness of impairment provisions</p> <p>Loans and advances to customers USD 1,227 million (2017: USD 1,399 million)</p> <p>Loan loss allowance: USD 2.1 million (2017: USD 15.2 million)</p> <p>Refer to transition disclosure and accounting policies (Note 2) and Notes 14 and 26.1 of the Financial Statements.</p> <p>The provision for impairment of loans and advances to customers is a significant balance and carries a high degree of estimation uncertainty derived from the assumptions and judgments used to estimate provisions.</p> <p>The application of IFRS 9, effective for the year ended 31 December 2018, results in fundamental changes to how impairment provisions are determined as IFRS 9 requires a forward-looking assessment of expected loss, as opposed to the incurred loss model used under IAS 39.</p> <p>Considering the level of estimation uncertainty and uncertainty in the UK economy as a result of Brexit, the valuation and completeness of credit impairment provisions is a key audit matter.</p> <p>The inherent ability of management to override internal controls in relation to credit</p>	<p>We understood and evaluated the design effectiveness of key controls relevant to the impairment, and validated the operating effectiveness of the controls that we placed reliance upon.</p> <p>We performed testing over the completeness and accuracy of the data inputs into the IFRS 9 expected credit loss (ECL) model.</p> <p>We performed a test on the accuracy of internal credit ratings.</p> <p>We performed credit file reviews for a sample of loans and advances to customers allocated to stages 1, 2 and 3 to test the appropriateness of stage allocation and to consider the reasonableness of the ECL estimate, including engaging our real estate valuation specialists to independently value a sample of collateral valuations.</p> <p>We engaged our credit risk modelling specialists to carry out a review of the Bank's IFRS 9 model which included a reperformance of the calculation of the ECL, benchmarking analysis and a review of methodology and assumptions.</p> <p>We performed subsequent event procedures to identify adjusting post balance sheet developments in the loan portfolio which would materially affect the year end provisioning value.</p>	<p>We concluded to the Audit Committee that the provision levels held by the Bank in relation to credit impairment were reasonably estimated and in line with the new requirements of IFRS 9.</p> <p>We highlighted the following matters:</p> <ul style="list-style-type: none"> • Based on our testing of the reasonableness ECL provisions across the stages, and our specialist review of the IFRS 9 model, we concluded that the ECL provision is within a reasonable range, and towards a conservative end of this range. • Following our assessment of stage 3 provisions, including the independent valuation of collateral, we concluded that Management's estimates were reasonable and the collateral held was appropriately valued. • Based on our validation of the transitional impact of IFRS 9, we concluded that the opening balance sheet position is materially correct.

<p>impairment provisions also represents a risk of fraud.</p>		
<p>Risk of fraud in the recognition of revenue using the Effective Interest Rate (EIR) method</p> <p>Interest income USD 41 million (2017: USD 32 million)</p> <p>Refer to Accounting policies (Note 2) and Note 3 of the Financial Statements.</p> <p>There is a risk that certain fees and commissions are inappropriately included or excluded from the EIR calculation or that the method of EIR calculation is not applied correctly. This could result in the misstatement of net interest income and net fee and commission income for the period.</p>	<p>We understood and evaluated the design effectiveness of key controls over the income recognition process, and validated the operating effectiveness of the controls that we placed reliance upon.</p> <p>We compared the Bank's policy and application of the EIR method to the requirements of IFRS 9, and tested the relevant inputs used for completeness and accuracy.</p> <p>We tested that the fees and commissions were appropriately included in the effective interest rate calculations in accordance with accounting standards.</p> <p>We tested the appropriateness of the Bank's EIR calculation methodology using the work of our internal valuation specialists, and checked that this methodology had not changed in 2018.</p> <p>We tested a sample of the fees and commissions recorded under EIR and compared with the Bank's internal calculation. We extrapolated the difference arising across the loan book.</p> <p>We tested the existence and measurement for a sample of new fees and commissions recognised in 2018.</p> <p>We tested amortisation of the fees and commissions received during 2018 on a sample basis and reconciled them with the underlying agreements.</p>	<p>We communicated to the Audit Committee that no material issues were identified when executing the audit procedures over revenue recognition on loans and advances calculated using the Effective Interest Rate (EIR) method.</p> <p>We highlighted that the resulting difference between the methodology adopted by the Bank and our independent calculations using the EIR method was immaterial.</p>
<p>Risk of material misstatement in the valuation of shares acquired in NBK France S.A.</p> <p>Investment in group entity USD 49.2 million (2017: USD Nil)</p> <p>Refer to accounting policies (Note 2) and Note 16.</p> <p>There is a risk that underlying assumptions of the discount rate and future cash-flows may not have been appropriately considered, which could result in the incorrect valuation of the investment acquired in NBK France S.A.</p>	<p>We engaged our valuation specialists to carry out an independent assessment of the Bank's valuation model. This included testing the appropriateness of the key assumptions used, including valuation methodology adopted, reasonableness of growth rates projected to determine the future cash flows and discount rate used.</p> <p>We tested the mathematical accuracy of the valuation model.</p> <p>We performed subsequent event procedures to identify indicators of impairment that could affect the fair value.</p>	<p>We communicated to the Audit Committee that the fair value of the investment in NBK France S.A. was within a reasonable range.</p>

<p>The inherent ability of management to override internal controls in relation to fair value estimation also represents a risk of fraud.</p> <p>This is newly identified risk in 2018 due to the transaction occurring on 31 December 2018.</p>		
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An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Bank. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Bank and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the audit engagement team.

Our application of materiality

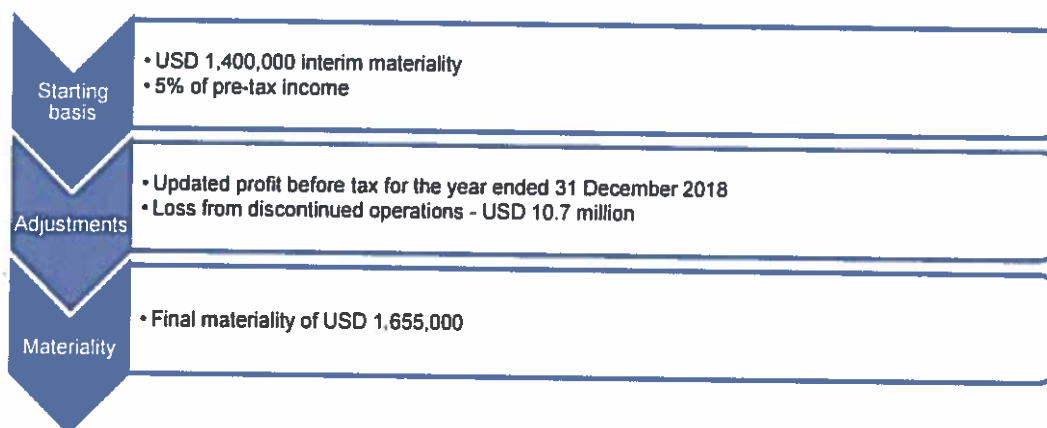
We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Bank to be USD 1,655,000 (2017: USD 959,000), which is 5% of adjusted pre-tax income (2017: 5% of normalised earnings on a three year average pre-tax income). We believe that pre-tax income to be the most appropriate measurement basis for determining our materiality. The primary stakeholders of the financial statements are the parent company, National Bank of Kuwait S.A.K.P., and the Prudential Regulation Authority who regard the operating performance, particularly profit before tax, as the most relevant measure as this reflects profits available for distribution to shareholders or to be retained as retained earnings for forming part of the Bank's equity.

During the course of the audit we identified a material one-off event, being the discontinued operations in relation to the sale of the Paris Branch on which a net loss of USD 10.7 million was recognised. We reassessed planning materiality and concluded it reasonable to recalculate our materiality level excluding this one-off transaction.



Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Bank's overall control environment, our judgement was that performance materiality was 50% (2017: 50%) of our planning materiality, namely USD 825,000 (2017: USD 479,000). We have set performance materiality at this percentage due to our expectations about the likelihood of misstatements, primarily based on prior year experience.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of USD 82,000 (2017: USD 47,000), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We evaluate any uncorrected misstatements against both the qualitative measures of materiality discussed above and in the light of other relevant qualitative considerations in forming our opinion.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and directors' report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Bank and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or directors' report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 7, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view and for such internal control as the directors determine 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, the directors are 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 the directors either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) 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.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

National Bank of Kuwait (International) PLC

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Bank and determined that the most significant are the Companies Act 2006, Financial Services and Markets Act 2000 ('FSMA'), Financial Services Act 2012 and other relevant Financial Conduct Authority ('FCA') and Prudential Regulation Authority ('PRA') regulations;
- We understood how the Bank is complying with these legal and regulatory frameworks and made enquiries of management and those responsible for legal and compliance matters. We also reviewed correspondence between the Bank and UK regulatory bodies; reviewed minutes of the Board and Audit & Risk Committee; and gained an understanding of the Bank's approach to governance, demonstrated by the Board's approval of the Bank's governance framework and the Board's review of the Bank's risk management framework and the Board's review of the Bank's risk management framework and internal controls processes;
- We assessed the susceptibility of the Bank's financial statements to material misstatements, including how fraud might occur, by considering the controls that the Bank has established to address risks identified by the Bank, or that otherwise seek to prevent, deter or detect fraud. We also considered performance and incentive plan targets that their potential to influence management to manage earnings or influence the perceptions of investors;
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved enquiries with the internal legal counsel and senior management, and focused testing, as referred to in the Key Audit Matters section above; and
- The Bank operates in the banking industry which is a highly regulated environment. As such, the senior statutory auditor reviewed the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of EY experts where appropriate.

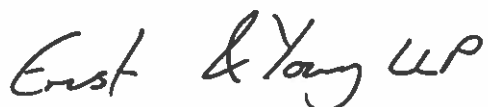
A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

Other matters we are required to address

- We were first appointed by the Bank to audit the financial statements for the year-ending 31 December 1992 and have audited all subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments is 27 years, covering the years ending 31 December 1992 to 31 December 2018;
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Bank and we remain independent of the Bank in conducting the audit; and
- The audit opinion is consistent with the additional report to the audit committee.

Use of our report

This report is made solely to the Bank's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Bank's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

Handwritten signature of Stephen Littler in black ink, reading "Ernst & Young LLP".

Stephen Littler (Senior statutory auditor)

for and on behalf of Ernst & Young LLP, Statutory Auditor

London

21 March 2019

Statement of Income

For the year ended 31 December 2018

	<i>Notes</i>	<i>2018</i> <i>US\$000</i>	<i>2017</i> <i>US\$000</i>
Interest and similar income	3	80,005	55,463
Interest and similar expense	4	(31,805)	(16,116)
Net interest and similar income		48,200	39,347
Net fees and commissions income	5	4,287	6,099
Net gains from dealing in foreign currencies	6	1,210	1,307
Other operating income		6	15
Net operating income before credit impairment and ECL		53,703	46,768
Credit impairment gain / (losses)	14	-	(14,881)
Expected credit losses write back	26.1	415	-
Net operating income after credit impairment and ECL		54,118	31,887
Administrative expenses	7	(24,721)	(25,533)
Depreciation		(608)	(481)
Operating expenses		(25,329)	(26,014)
Profit for the year before taxation	8	28,789	5,873
Taxation	9	(6,009)	(986)
Profit from continuing operations		22,780	4,887
Discontinued operation			
(Loss) on investment in Paris	21	(10,791)	-
Profit from discontinued operations - Paris	21	4,302	-
Profit for the year		16,291	4,887

Notes 1 to 27 are an integral part of the financial statement.

Statement of Comprehensive Income

For the year ended 31 December 2018

	<i>2018</i> <i>US\$000</i>	<i>2017</i> <i>US\$000</i>
Profit for the year	16,291	4,887
Other comprehensive income:		
Change in fair value of available for sale investment	-	427
Change in fair value of debt securities measured at FVOCI (net of tax)	(715)	-
Items that will be reclassified subsequently to profit or loss when specific conditions are met	(715)	427
Change in fair value of equity instruments measured at FVOCI (net of tax)	66	-
Items that will not be reclassified subsequently to profit or loss	66	-
Other comprehensive income / (expense) for the year	(649)	427
Total comprehensive income for the year	15,642	5,314

Notes 1 to 27 are an integral part of the financial statement.

Statement of Financial Position

31 December 2018

	<i>Notes</i>	<i>2018</i> <i>US\$000</i>	<i>2017</i> <i>US\$000</i>
Assets			
Cash and cash equivalents	11	223,793	366,212
Deposits with banks	12	830,523	982,433
Loans and advances to banks	13	17,404	17,500
Loans and advances to customers	14	1,224,519	1,383,302
Investment securities	15	174,204	260,417
Investment in group entity	16	49,209	-
Fixed assets		2,794	1,682
Other assets	17	34,973	13,499
Total assets		2,557,419	3,025,045
Liabilities			
Due to banks and other financial institutions		1,007,787	1,356,327
Customer deposits		1,167,190	1,303,904
Certificates of deposit issued		20,000	15,000
Other liabilities	18	50,002	49,195
Total liabilities		2,244,979	2,724,426
Equity			
Share capital	19	150,083	150,083
Retained earnings		160,052	147,582
Cumulative changes in fair values		2,305	2,954
Total equity		312,440	300,619
Total equity and liabilities		2,557,419	3,025,045

The financial statements were approved by the board of directors and authorised for issue on 21 March 2019

Nasser Al Sayer
Chairman of the Board of Directors
21 March 2019

Notes 1 to 27 are an integral part of the financial statement.

Statement of Changes in Equity

31 December 2018

	<i>Share capital US\$000</i>	<i>Retained earnings US\$000</i>	<i>Cumulative changes in fair values US\$000</i>	<i>Total US\$000</i>
Balances as at 31 December 2016	150,083	144,195	2,527	296,805
Dividend paid	-	(1,500)	-	(1,500)
Profit for the year	-	4,887	-	4,887
Other comprehensive income for the year	-	-	427	427
Total comprehensive income for the year	-	3,387	427	3,814
Balances as at 31 December 2017	150,083	147,582	2,954	300,619
Impact on transition to IFRS 9 (see note 2E)	-	(3,821)	-	(3,821)
Restated balance at 1 January 2018	150,083	143,761	2,954	296,798
Profit for the year – continuing operations	-	22,780	-	22,780
Profit for the year – discontinued operations	-	(6,489)	-	(6,489)
Other comprehensive income / (loss) for the year	-	-	(649)	(649)
Total comprehensive income / (loss) for the year	-	16,291	(649)	15,642
Balances as at 31 December 2018	150,083	160,052	2,305	312,440

Notes 1 to 27 are an integral part of the financial statement.

Notes to the financial statements

31 December 2018

1. INCORPORATION AND REGISTRATION

The financial statements of National Bank of Kuwait (International) PLC (the “Bank”) were approved by the Board of Directors on 21 March 2019. The Bank is incorporated in United Kingdom and is principally engaged in banking activities, primarily in United Kingdom. The address of registered office is NBK House, 13 George Street, London W1U 3QJ.

The Bank is a wholly-owned subsidiary of National Bank of Kuwait SAKP, Kuwait. Copies of the Group financial statements of National Bank of Kuwait SAKP may be obtained from: NBK House, 13 George Street, London, W1U 3QJ. National Bank of Kuwait SAKP is the ultimate parent company.

The Bank is a public company limited by shares registered in England.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

The financial statements have been prepared in accordance with the provisions of the Companies Act 2006 relating to banking companies and UK Financial Reporting Standard 101 ‘Reduced Disclosure Framework’. The Bank has taken advantage of the following exemptions under FRS 101:

- a) IAS 1 Presentation of Financial Statements, paragraph 38, to present comparative information in respect of IAS 16 Property, Plant and Equipment, paragraph 73(e).
- b) IAS 1, paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D and 111.
- c) The requirements of IAS 7 Statement of Cash Flows.
- d) IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, paragraphs 30 and 31.
- e) IAS 24 Related Party Disclosures, paragraph 17.
- f) The requirements in IAS 24 Related Party Disclosures to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member.
- g) Not applying equity accounting for holding in NBK France S.A.

The financial statements are prepared under the historical cost convention except for the measurement at fair value of derivatives and investments at fair value through other comprehensive income. In addition and as more fully described below, assets and liabilities that are hedged in fair value hedging relationships are carried at fair value to the extent of the risk being hedged.

Interest income and interest expenses on derivatives are shown net to improve presentation of interest yield and cost of funds. Deferred tax assets and deferred tax liabilities have been netted in other liabilities.

The financial statements have been prepared on a going concern basis in accordance with UK Financial Reporting Standard 101.

2.2 Changes in accounting policies

IFRS 9: Financial Instruments

The Bank has adopted IFRS 9 as issued by IASB in July 2014 with a date of transition of 1 January 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognised in the financial statements. The bank did not adopt any of IFRS 9 in previous periods. This standard replaces IAS 39. For further detail on IAS 39, see 2017 financial statements.

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

As permitted by the transitional provisions of IFRS 9, the bank elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognised in the opening retained earnings and other reserves of the current period.

Consequently, for notes disclosures, the consequential amendments to IFRS 7 disclosures have also only been applied to the current period. The comparative period notes disclosures repeat those disclosures made in the prior year.

The adoption of IFRS 9 has resulted in changes in accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments such as IFRS 7 'Financial Instruments: Disclosures'.

Set out below are disclosures relating to the impact of the adoption of IFRS 9 on the Bank.

A. Classification and measurement of financial assets and liabilities

a. Financial assets

From 1 January 2018, the Bank has applied IFRS 9 and classifies its financial assets in the following measurement categories:

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

The classification requirements for debt and equity instruments are described below:

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds and trade receivables purchased from clients in factoring arrangements without recourse.

Classification and subsequent measurement of debt instruments depend on:

- A. the Bank's business model for managing the asset; and
- B. the cash flow characteristics of the asset.

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

- **Amortised cost:** Financial assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described in note 26.1.2. Interest income from these financial assets is included in 'interest and similar income' using the effective interest rate method.
- **Fair value through other comprehensive income:** Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that not designated at FVPL, are measured at fair value through other comprehensive income (FVOCI). Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and loss on the instrument's amortised cost which are recognized in profit or loss. When the financial asset is derecognized, the cumulative gain or loss previously recognized in OCI is reclassified from equity to profit or loss and recognized in 'Net investment income'. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

- **Fair value through profit or loss:** Financial Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognized in profit or loss and presented in the profit or loss statement within 'Net trading income' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Net investment income'. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.

Business model: the business model reflects how the Bank manages the assets in order to generate cash flows. That is, whether the Bank's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g., financial assets are held for trading purposes), then the financial assets are classified as part of the "other" business model and measured at FVPL. Factors considered by the Bank in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

SPPI (solely payments of principal and interest): Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Bank assesses whether the financial instruments' cash flows represent SPPI. In making this assessment, the Bank considers whether the contractual cash flows are consistent with a basic lending arrangement i.e., interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

The Bank reclassifies debt instruments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

Equity instruments

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

Equity instruments are measured at FVPL. However, the Bank management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Bank's policy is to designate equity investments as FVOCI when those investments are held for purposes other than to generate investment returns. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal. Impairment losses (and reversal of impairment losses) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as dividend income when the Bank's right to receive payments is established.

The adoption of this standard did not have a significant impact on the classification and measurement of Bank's financial assets and financial liabilities. These are compared at 1 January 2018 as follows:

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

	IAS 39		IFRS 9	
	Measurement category	Carrying amount US\$000	Measurement category	Carrying amount US\$000
Financial assets				
Cash and cash equivalents	Amortised cost	366,212	Amortised cost	365,783
Deposits with banks	Amortised cost	982,433	Amortised cost	982,079
Loans and advances to banks	Amortised cost	17,500	Amortised cost	17,413
Loans and advances to customers measured at amortised cost	Amortised cost	1,323,221	Amortised cost	1,321,129
Loans and advances to customers measured at FVOCI	Hedged loans - FVOCI	60,081	Hedged loans - FVOCI	60,050
Investment securities	Treasury Bonds – AFS	259,859	Treasury Bonds – FVOCI	259,849
	Equity – AFS	558	Equity – FVOCI	558
Other assets (derivative)	IRS – FVPL	797	IRS – FVPL	797
	Forward FX – FVPL	942	Forward FX – FVPL	942
	Other assets – cost	11,760	Other assets – cost	12,654
Financial liabilities				
Other liabilities (derivative)	IRS – FVPL	11,981	IRS – FVPL	11,981
	Forward FX – FVPL	20,779	Forward FX – FVPL	20,779
	Other liabilities – cost	16,435	Other liabilities – cost	17,975

There are no other changes to the classification and measurement of remaining financial liabilities

* On sale of equity investments, the gain / loss shall not be reclassified to profit and loss account. Also, equity assets are not required to be tested for impairment as per IFRS 9.

B. Reconciliation of statement of financial position balances from IAS 39 to IFRS 9

The Bank performed a detailed analysis of its business model for managing financial assets and financial liabilities including an analysis of their cash flow characteristics. Please refer to note above (section A) for more detailed information regarding the new classification requirements of IFRS 9.

The following table reconciles the carrying amounts of financial assets and liabilities from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018 (i.e., including the Expected Credit Loss (ECL) impact):

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

	<i>IAS 39 carrying amount 31 December 2017 US\$000</i>	<i>Reclassifications (Deferred tax) US\$000</i>	<i>Remeasurements US\$000</i>	<i>IFRS 9 carrying amount 1 January 2018 US\$000</i>
<i>Financial assets</i>				
<u>Cash and cash equivalents</u>				
Opening balance under IAS 39	366,212			
Reclassification		-		
Remeasurement: ECL allowance			(429)	
Closing balance under IFRS 9				365,783
<u>Deposits with banks</u>				
Opening balance under IAS 39	982,433			
Reclassification		-		
Remeasurement: ECL allowance			(354)	
Closing balance under IFRS 9				982,079
<u>Loans and advances to banks</u>				
Opening balance under IAS 39	17,500			
Reclassification		-		
Remeasurement: ECL allowance			(87)	
Closing balance under IFRS 9				17,413
<u>Loans and advances to customers measured at amortised cost</u>				
Opening balance under IAS 39	1,323,221			
Reclassification		-		
Remeasurement: ECL allowance			(2,092)	
Closing balance under IFRS 9				1,321,129
<u>Loans and advances to customers measured at FVOCI</u>				
Opening balance under IAS 39	60,081			
Reclassification		-		
Remeasurement: ECL allowance			(31)	
Closing balance under IFRS 9				60,050
<u>Investment securities</u>				
Opening balance under IAS 39	259,859			
Reclassification		-		
Remeasurement: ECL allowance			(10)	
Closing balance under IFRS 9				259,849
<u>Other assets</u>				
Opening balance under IAS 39	11,760			
Reclassification		894		
Remeasurement: ECL allowance			-	
Closing balance under IFRS 9				12,654

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

	<i>IAS 39 carrying amount 31 December 2017 US\$000</i>	<i>Reclassifications (Deferred tax) US\$000</i>	<i>Remeasurements US\$000</i>	<i>IFRS 9 carrying amount 1 January 2018 US\$000</i>
<u>Other liabilities</u>				
Opening balance under IAS 39	16,435			
Reclassification		(172)		
Remeasurement: ECL allowance			1,712	
Closing balance under IFRS 9				17,975
Transition adjustment (note 2E)			(4,715)	

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

a) Investment in debt securities designated at FVOCI

The Bank holds an investment of \$259,859,551 in a portfolio of debt securities which had previously been classified as available for sale. The Bank has classified the investment at FVOCI. The changes in fair value of these securities will be reclassified to profit or loss when they are disposed of.

b) Hedged loans at FVOCI

The Bank has a portfolio of loans which is hedged using interest rate swaps. The portfolio meets two conditions under IFRS9 i.e., business model test and cash flow characteristics test and therefore is measured at FVOCI.

c) Designation of equity instruments at FVOCI

The Bank has elected to irrevocable designate strategic investment of \$557,689 of equity securities at FVOCI under IFRS 9. These securities were previously classified as available for sale. The changes in fair value of this security will no longer be reclassified to profit or loss when they are disposed of.

d) Financial liabilities

In both the current and prior period, financial liabilities are classified as subsequently measured at amortised cost, except for:

Financial liabilities at FVPL: this classification is applied to derivatives, financial liabilities held for trading and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (change in fair value attributable to credit risk) and partially profit or loss. If such presentation would create an accounting mismatch then the gain and loss attributable to change in credit risk of the liability is also presented in profit or loss;

A financial liability arising from the transfer of financial assets which did not qualify for derecognition whereby a financial liability is recognised for the consideration received for the transfer.

C. Financial guarantee contracts and loan commitments

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial guarantees contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the loss allowance; and
- The premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

For loan commitments and financial guarantees contracts, the loss allowance is recognised as a provision. However, for contracts that include both a loan and an undrawn commitment and the Bank cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognised together with the loss allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognised as a provision.

D. Impairment of financial assets

The impairment requirements apply to financial assets measured at amortised cost, fair value through other comprehensive income, lease receivables and certain loan commitments and financial guarantee contracts. The IFRS 9 expected credit loss (ECL) model replaces the current “incurred loss” model of IAS 39.

The ECL model contains a three stage approach which is based on the change in credit quality of financial assets since initial recognition. Under Stage 1, where there has not been a significant increase in credit risk since initial recognition, an amount equal to 12 months ECL will be recorded. Under Stage 2, where there has been a significant increase in credit risk since initial recognition but the financial instruments are not considered credit impaired, an amount equal to the default probability weighted lifetime ECL will be recorded. Under the Stage 3, where there is objective evidence of impairment at the reporting date these financial instruments will be classified as credit impaired and an amount equal to the lifetime ECL will be recorded for the financial assets.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment are intended to be more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile.

E. Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The Bank has determined the impact of the expected provision for credit losses in accordance with IFRS 9 as of 1 January 2018, the transition adjustment with regard to ECL is USD 5.0m (before tax) which is be a transitional adjustment to equity.

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

	<i>Loan loss allowance under IAS 39</i>	<i>Remeasurements</i>	<i>Loan loss allowance under IFRS 9</i>
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>
<i>On Balance Sheet:</i>			
Cash and cash equivalents	-	429	429
Deposits with banks	-	354	354

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

	<i>Loan loss allowance under IAS 39</i> <i>US\$000</i>	<i>Remeasurements</i> <i>US\$000</i>	<i>Loan loss allowance under IFRS 9</i> <i>US\$000</i>
<i>On Balance Sheet:</i>			
Loans and advances to banks	-	87	87
Loans and advances to customers measured at amortised cost	251	2,092	2,343
Loans and advances to customers measured at FVOCI	-	31	31
Investment securities	-	10	10
Subtotal (note 26.1.3)	251	3,003	3,254
<i>Off Balance Sheet:</i>			
Loan commitments: Loans and advances to customers	-	776	776
Financial guarantees	-	936	936
Subtotal (note 26.1.3)	-	1,712	1,712
	251	4,715	4,966
Deferred tax on transition adjustment	-	(894)	(894)
	251	3,821	4,072

The bank has recognised an adjustment of USD \$3,821k to opening retained earnings comprising of \$4,715k provisions for expected credit losses and a corresponding \$894k increase in deferred tax assets. The deferred tax asset reverses either in the current period or spread over a ten year period dependent upon the taxable nature of the asset class the impairment arises on.

Further information on the measurement of the impairment allowance under IFRS 9 can be found in note 26.1.2.

F. Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks. The Bank continued using the hedge accounting as per IAS 39; as this option is permissible under IFRS9 and does not have any significant impact on its financial position.

G. Financial instruments: disclosures (IFRS 7)

IFRS 7 Financial Instruments: Disclosures has been amended to include more extensive qualitative and quantitative disclosure relating to IFRS 9 such as new classification categories, three stage impairment model, new hedge accounting requirements and transition provisions.

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

IFRS 15: Revenue from Contracts with customers

IFRS 15 was issued by IASB on 28 May 2014, effective for annual periods beginning on or after 1 January 2018. IFRS 15 supersedes IAS 11 Construction Contracts and IAS 18 Revenue along with related IFRIC 13, IFRIC 15, IFRIC 18 and SIC 31 from the effective date. This new standard removes inconsistencies and weaknesses in previous revenue recognition requirements, provides a more robust framework for addressing revenue issues and improves comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets.

Revenue under IFRS 15 is recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard also specifies a comprehensive set of disclosure requirements regarding the nature, extent and timing as well as any uncertainty of revenue and corresponding cashflows with customers. The Bank has assessed the impact of IFRS 15. Based on the assessment, adoption of IFRS 15 does not have any material effect on the Bank's financial statements.

Standards issued but not yet effective

IFRS 16: Leases

In January 2016, the IASB issued IFRS 16 'Leases' with an effective date of annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognise a 'right of use' asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in IAS 17.

The objective of the disclosures is for lessees to disclose information in the notes that together with the information provided in the statement of financial position and in statement of profit or loss gives a basis for users of financial statements to assess the effect that leases have on the financial position and financial performance. The Bank has completed an initial assessment of the potential impact on its financial statements. The actual impact of applying IFRS 16 on the financial statements will depend on the future economic conditions, borrowing rate at 1 January 2019 and on the portfolio. The implementation is expected to increase the net assets by \$0.3million.

The most significant impact identified is that the Bank will recognise "right of use" asset and lease liability on its balance sheet for its operating leases.

The other accounting policies applied are consistent with those used in the previous year. Amendments to IFRSs which are effective for annual accounting period starting from 1 January 2018 did not have any material impact on the accounting policies, financial position or performance of the Bank.

2.3 Foreign currencies

The Bank has a multi-currency share capital comprising two classes of ordinary shares: GB pounds sterling and US dollars. The functional and presentation currency of the Bank is US dollars and reserves are also held in US dollars.

Translation of foreign currency transactions

Transactions in foreign currencies are initially recorded in the functional currency rate of exchange ruling at the date of the transaction. Monetary assets and monetary liabilities in foreign currencies are translated into functional currency at rates of exchange prevailing at the reporting date. Any gains or losses are taken to the statement of income. Non-monetary items in foreign currencies that are measured in terms of historical cost are translated using the rate of exchange at the date of the transaction.

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Interest income and expenses

Interest income and expense for all interest-bearing financial instruments are recognised within 'interest income' and 'interest expense' in the statement of income using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period.

The effective interest rate (EIR) is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the gross carrying amount of the financial asset or financial liability. Fees which are considered an integral part of the effective yield of a financial asset are recognised using the effective interest method. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

The interest differential between the currencies involved in forward exchange contracts is included in the interest income and expenses.

2.5 Fees and commissions income

Fees that are an integral part of the effective interest rate (EIR) of loans are treated as an adjustment to the effective interest rate of the loans. Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument. Fees can be recognised on a Straight Line Method (SLM), where the difference between amortising fees using EIR and SLM is not material. Fee and commission income that are not considered an integral part of the interest rate of the loan should be accounted for in accordance with IFRS 15. Fees and transaction costs on financial instruments measured at fair value through profit or loss should not be included in EIR calculation and charged to Statement of Income as and when accrued/incurred.

Fee income under IFRS 15 is recognized as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard also specifies a comprehensive set of disclosure requirements regarding the nature, extent and timing as well as any uncertainty of revenue and corresponding cash flows with customers

As per IFRS 15, the Company applies a 5 step model to determine when to recognize revenue and at what amount. Depending on whether certain criteria are met, revenue is recognised:

- i) Over the life of the contract if the service is provided over the contract length
- ii) At a point in time, when the performance obligation towards the customer is fulfilled.

2.6 Dividend income

Dividend income is recognised when the right to receive payment is established.

2.7 Assets held for sale and discontinued operations

A non-current assets (or disposal group) are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use and the sale is considered to be highly probable.

A sale is considered to be highly probable if the appropriate level of management is committed to a plan to sell the asset (or disposal group), and the sale is expected to qualify for recognition as a completed sale within one year from the date that it is classified as held for sale.

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

A non-current asset (or disposal group) and discontinued operations held for sale are measured at the lower of carrying amount and fair value less cost to sell. Assets and liabilities of disposal group classified as held for sale and non-current assets classified as held for sale are shown separately on the face of the balance sheet.

The results of discontinued operations comprising the post-tax profit or loss account of discontinued operations and the post-tax gains or loss recognised either on measurement to fair value less costs to sell or on the disposal of the discontinued operations are shown as a single amount on the face of the income statement.

A discontinued operation is a cash generating unit or group of cash generating units that has either been disposed of, or is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical assets of operations or (c) is a subsidiary acquired exclusively with a view to resale.

2.8 Pensions

The Bank operates a defined contribution pension schemes for employees in the UK. The costs of providing retirement benefits are charged to the statement of income in the period in which they are incurred.

2.9 Taxation

Current income tax assets and liabilities for the current year 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 amounts are those that are enacted or substantively enacted, at the reporting date in the countries where the Bank operates and generates taxable income. Deferred tax assets are recognised for deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent it is probable that taxable profit will be available to utilise these.

Deferred tax liabilities are recognised for taxable temporary differences. Deferred tax assets and liabilities are measured using tax rates and applicable legislation enacted at the reporting date.

2.10 Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, in the most advantageous market to which the Bank has access at that date.

When available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

If an asset or liability measured at fair value has a bid price and an ask price, then the Bank measures assets at a bid price and liabilities at an ask price.

The Bank determines whether transfers have occurred between levels in the hierarchy by reassessing 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.

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

2.11 Offsetting of financial assets and liabilities

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

2.12 Derecognition of financial assets and financial liabilities

Financial assets

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

- the rights to receive cash flows from the asset have expired, or
- the Bank retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement, or
- the Bank has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

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

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expired. 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.

2.13 Derivative financial instruments

The Bank continued using the hedge accounting as per IAS 39; as this option is permissible under IFRS9 and does not have any significant impact on its financial position. We have not provided comparative information for the periods before the date of initial application of IFRS 9 for the new disclosure introduced by IFRS 9 as a consequential amendment to IFRS 7 as permitted by IFRS 7 paragraph 44Z.

The Bank deals in interest rate swaps to manage interest rate risk on interest bearing assets and liabilities. Similarly the Bank deals in forward foreign exchange contracts for customers and to manage its foreign currency positions and cash flows. All derivative financial instruments of the Bank are recorded in the statement of financial position at fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models.

Positive and negative fair values are reported as assets and liabilities respectively and are offset when there is both an intention to settle net and a legal right to offset exists.

For the purposes of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability and (b) cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised financial asset or liability or a highly probable forecast transaction. In relation to fair value hedges which meet the conditions for hedge accounting, any gain or loss from re-measuring the hedging instrument is recognised immediately in the statement of income. The hedged items are adjusted for fair value changes relating to the risk being hedged and the difference is recognised in the statement of income.

Notes to the financial statements

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2. SIGNIFICANT ACCOUNTING POLICIES (continued)

In relation to cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised initially in equity and any ineffective portion is recognised in the statement of income. The gains or losses on cash flow hedges recognised initially in equity are transferred to the statement of income in the period in which the hedged transaction impacts the statement of income. Where the hedged transaction results in the recognition of an asset or liability, the associated gains or losses that had initially been recognised in equity are included in the initial measurement of the cost of the related asset or liability. For hedges that do not qualify for hedge accounting, any gains or losses arising from changes in fair value of the hedging instrument are taken directly to the statement of income.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, no longer qualifies for hedge accounting or is revoked by the Bank. For cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the forecast transaction occurs. In the case of fair value hedges of interest bearing financial instruments, any adjustment relating to the hedge is amortised over the remaining term to maturity. Where the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the statement of income.

2.14 Trade and settlement date accounting

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

2.15 Investment in group undertaking

The Bank has an investment in a newly set up entity NBK France S.A, a subsidiary owned by National Bank of Kuwait SAKP. Currently, this is measured at FVPL.

2.16 Fixed assets

Fixed assets are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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

Depreciation is provided on the depreciable amount of other items of premises and equipment on a straight line basis over their estimated useful life. The depreciable amount is the gross carrying value, less the estimated residual value at the end of its useful life. The estimated useful life of premises and equipment are as follows:

Leasehold improvements : term of lease
Other tangible fixed assets : 3-5 years

Residual values and useful lives of assets are reviewed, and adjusted if appropriate, at each reporting date. The carrying values of tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These are included in the statement of income.

Notes to the financial statements

31 December 2018

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

2.17 Due to Banks and Financial Institutions, Customer deposits & Certificate of deposit issued

Due to Banks and Financial Institutions, Customer Deposits & Certificate of deposit issued are stated at amortised cost using the effective interest method.

2.18 Significant accounting judgements and estimates

The preparation of financial statements requires the use of accounting estimates which, by definition, will seldom equal the actual results. Management also needs to exercise judgement in applying the Bank's accounting policies.

This note provides an overview of the areas that involve a higher degree of judgement or complexity, and major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment within the next financial year. Detailed information about each of these estimates and judgements is included in the related notes together with information about the basis of calculation for each affected line item in the financial statements.

Measurement of the expected credit loss allowance

The measurement of the expected credit loss allowance for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behavior (e.g., the likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in note 26.1.2.3, which also sets out key sensitivities of the ECL to changes in these elements.

A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product / market and the associated ECL; and
- Establishing groups of similar financial assets for the purposes of measuring ECL.

Detailed information about the judgements and estimates made by the Bank in the above area is set out in note 26.1.2.

3. INTEREST AND SIMILAR INCOME

	2018 US\$000	2017 US\$000
Deposits with banks	33,721	19,387
Loans and advances	41,115	32,192
Debt investment securities	5,165	3,528
Other	4	356
	<u>80,005</u>	<u>55,463</u>

4. INTEREST AND SIMILAR EXPENSES

	2018 US\$000	2017 US\$000
Due to banks and other financial institutions	24,251	13,124
Customer deposits	4,827	2,620
Other	2,727	372
	<u>31,805</u>	<u>16,116</u>

Notes to the financial statements

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5. NET FEES AND COMMISSIONS INCOME

	2018 US\$000	2017 US\$000
<i>Fees and commission income:</i>		
Lending related fees	69	423
Retail banking customer fees	1,915	1,958
Financial guarantee contract & letter of credit fees	1,686	3,166
Other	840	792
	<u>4,510</u>	<u>6,339</u>
<i>Fees and commission related expenses</i>		
Net fees and commissions income	<u>(223)</u>	<u>(240)</u>
	<u>4,287</u>	<u>6,099</u>

6. NET GAINS FROM DEALING IN FOREIGN CURRENCIES

Net gains from dealing in foreign currencies mainly consist of dealing profits generated from foreign currency related transactions.

7. ADMINISTRATIVE EXPENSES

	2018 US\$000	2017 US\$000
<i>Staff costs:</i>		
Wages and salaries	11,733	10,897
Social security costs	1,239	2,153
Pension costs	1,166	987
	<u>14,138</u>	<u>14,037</u>
Other administrative expenses	10,583	11,496
	<u>24,721</u>	<u>25,533</u>

The average number of employees, all engaged in banking activities during the year was 134 (2017 – 132) in continued operations and on the same basis there were 20 people employed in discontinued operations. Other administrative expenses include occupancy, computer expenses, professional fees and various other overheads.

The Bank operates one defined contribution pension scheme. The UK scheme assets are in the form of units in a life fund.

8. PROFIT FOR THE YEAR BEFORE TAX

<i>This is stated after charging:</i>		2018 US\$000	2017 US\$000
Auditors' remuneration –	audit service	596	511
Operating lease rentals –	land and buildings	1,414	1,774

Notes to the financial statements

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9. TAXATION

(a) The tax charge is made up as follows:	<i>2018</i>	<i>2017</i>
	<i>US\$000</i>	<i>US\$000</i>
<i>Current tax:</i>		
UK corporation tax on the profit for the year	5,829	706
UK double tax relief	(533)	(124)
Foreign tax	560	257
Adjustment in respect of prior years	(304)	673
Total current tax	<u>5,552</u>	<u>1,512</u>
<i>Deferred tax charge/(income) (Note c)</i>		
Adjustment in respect of prior years	53	(609)
Related to the current year	384	83
Effect of changes in tax rates	20	-
Total deferred tax	<u>457</u>	<u>(526)</u>
Tax per income statement (Note b)	<u>6,009</u>	<u>986</u>
<i>Other comprehensive income – deferred tax (credit)</i>	<u><i>(129)</i></u>	<u><i>-</i></u>
(b) Factors affecting tax charge for the year	<i>2018</i>	<i>2017</i>
	<i>US\$000</i>	<i>US\$000</i>
Profit on ordinary activities before tax	<u>22,300</u>	<u>5,873</u>
Profit taxed at UK corporation tax		
Average standard rate of 19% (2017 – 19.25%)	4,237	1,130
<i>Effects of:</i>		
Disallowed expenses	2,087	6
Disallowed income	(1)	-
Foreign tax net of double tax relief	-	133
Depreciation net of capital allowances	-	34
Adjustment in respect of prior years	(252)	64
Effects of overseas tax rates	27	-
Tax rate changes	20	-
Amounts not recognised	(157)	-
Others	48	(381)
Total tax charge	<u>6,009</u>	<u>986</u>
(c) Disclosed in statement of financial position	<i>2018</i>	<i>2017</i>
	<i>US\$000</i>	<i>US\$000</i>
Current tax liabilities		
Corporation tax	2,117	(28)
Other tax provision	634	634
Overseas tax	560	-
	<u>3,311</u>	<u>606</u>

Notes to the financial statements

31 December 2018

9. TAXATION (continue)

Deferred tax (assets) / liabilities		
Provision at the start of period	(722)	755
Adjustment in respect of prior years	53	(609)
Deferred tax charge to income statement for the period	404	83
Deferred tax charge in equity for the period	-	(894)
Deferred tax charge in OCI for the period	(129)	(57)
	(394)	(722)
Net temporary differences		
Fixed assets	45	124
Provisions	(17)	(20)
Fair value change in debt securities	1,787	2,521
Fair value of hedging instruments	(1,362)	(1,967)
Fair value movement on AFS assets	30	56
Change in basis adjustment trading	(379)	(459)
Change in basis adjustment trading – 2018	(498)	(894)
Other adjustments	-	(83)
	(394)	(722)

Deferred tax is computed at the rate expected to apply when the underlying temporary differences eventually reverse. Based on the announced changes in the corporation tax rates coming into effect in future years, the corporation tax rate of 19% will reduce to 17% with effect from 1 April 2020.

10. EMOLUMENTS OF DIRECTORS

	2018	2017
	US\$000	US\$000
Fees and other emoluments	848	746
Pension contributions in respect of defined contribution schemes	68	57
Highest paid director	434	425

11. CASH AND CASH EQUIVALENTS MEASURED AT AMORTISED COST

	2018	2017
	US\$000	US\$000
Cash on hand	1,968	2,722
Balances with central banks	221,827	363,490
Less: ECL	(2)	-
	223,793	366,212

Notes to the financial statements

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12. DEPOSIT WITH BANKS MEASURED AT AMORTISED COST	2018 US\$000	2017 US\$000
On demand and short notice	277,741	307,362
Less: ECL	(8)	-
Credit institutions	552,851	675,071
Less: ECL	(61)	-
	<u>830,523</u>	<u>982,433</u>
13. LOANS AND ADVANCES TO BANKS MEASURED AT AMORTISED COST	2018 US\$000	2017 US\$000
Loans and advances to banks measured at amortised cost	17,500	17,500
Less: ECL	(96)	-
	<u>17,404</u>	<u>17,500</u>
14. LOANS AND ADVANCES TO CUSTOMERS	2018 US\$000	2017 US\$000
Loans and advances to customers measured at amortised cost	1,204,122	1,338,488
Less: ECL	(2,126)	-
Loans and advances to customers measured at FVOCI	22,544	60,081
Less: ECL	(21)	-
Specific provision (IAS 39)	-	(15,016)
Collective provision (IAS 39)	-	(251)
	<u>1,224,519</u>	<u>1,383,302</u>

During the year the Bank repossessed collateral of \$11.4m from three of its customers.

15. INVESTMENT SECURITIES	2018 US\$000	2017 US\$000
<i>Investments:</i>		
Equities measured at FVOCI	623	558
Debt securities measured at FVPL	6,024	-
Debt securities measured at FVOCI	167,566	259,859
Less: ECL	(9)	-
	<u>174,204</u>	<u>260,417</u>

Debt securities are held on a yield-to-maturity basis, for portfolio management purposes. See note 25 for details on valuation of investment securities.

16. INVESTMENT IN GROUP UNDERTAKING	2018 US\$000	2017 US\$000
Investment in NBK France S.A.	<u>49,209</u>	-

Notes to the financial statements

31 December 2018

The group has sold its Paris branch on 31 December 2018 to a newly set up company, NBK France S.A. registered at 90 Avenue des Champs-Elysees, 75008 Paris, France. NBKI Plc has 19.68% investment in the newly set up company which is a subsidiary owned by National Bank of Kuwait SAKP.

17. OTHER ASSETS	2018 US\$000	2017 US\$000
Accrued interest receivable	15,404	7,875
Sundry debtors and prepayments	899	1,296
Deferred Tax Assets (note 9)	394	-
Derivative assets (note 23)	14,702	1,739
Others	3,574	2,589
	<u>34,973</u>	<u>13,499</u>

18. OTHER LIABILITIES	2018 US\$000	2017 US\$000
Interest payable	20,509	5,320
Deferred income	5,516	6,636
Derivative liabilities (note 23)	19,410	32,760
Tax payable (note 9)	3,311	606
Deferred tax liabilities	-	172
Others	739	3,701
ECL on guarantees and letters of credit (note 24)	517	-
	<u>50,002</u>	<u>49,195</u>

19. SHARE CAPITAL

There are two classes of ordinary share capital issued, being in pounds sterling and US dollars:

Ordinary share capital

Authorised at 31 December 2017 and 2018

	£1 each	US\$1 each
Nominal value	50,000	182,910,000
Number of shares		

Allotted, called up and fully paid at 31 December 2017 and 2018:

	£000	US\$000	Total US\$000
Currency amounts at 31 December 2017 and 2018	<u>50</u>	<u>150,000</u>	
US dollar equivalent at 31 December 2017 and 2018	83	150,000	<u>150,083</u>

On 29 January 2019, the EGM has passed a resolution to increase the authorised share capital and the issued share capital of the Bank subject to regulatory approval in Kuwait and in the U.K. Both the authorised share capital and the issued share capital are expected to increase to £50,000 and US\$185,000,000 by 31 March 2019.

Notes to the financial statements

31 December 2018

20. ORDINARY DIVIDENDS

The directors proposed no dividend for the year ending 31 December 2018 (2017 – Nil).

21. DISCONTINUED OPERATIONS AND ASSETS AND LIABILITIES OF DISPOSAL GROUP

The group has sold its Paris branch on 31 December 2018 to a newly set up company, NBK France S.A. This entity is a direct subsidiary of the Group and NBKI Plc has 19.68% investment in this for a total consideration of \$49.2 million (note 16). See section (c) for further details in relation to sale proceeds. Consequently, all the assets and liabilities of Paris branch have been transferred to NBK France S.A. on 31 December 2018.

(a) Profit or Loss from Paris Branch

	2018	2017
	US\$000	US\$000
Net interest income	5,521	4,616
Other income	2,228	1,926
Total income	7,749	6,542
Operating expenses	(5,158)	(5,296)
Profit before impairment losses	2,591	1,246
Expected credit loss – write back	1,711	-
Operating profit before tax	4,302	1,246
Tax	(560)	(252)
Profit after tax	3,742	994

(b) Assets and liabilities of Paris Branch

	2017
	US\$000
Assets:	
Cash and balances at central banks	363,757
Loans and advances to banks (including NBKI London: \$63,138)	68,308
Loans and advances to customers	234,855
Debt securities and equity shares	2
Other assets	1,904
	668,826
Liabilities:	
Deposits by banks (including NBKI London: \$442,321)	442,968
Customer accounts	161,549
Derivatives	264
Other liabilities	1,651
Capital and reserves	62,394
	668,826

Notes to the financial statements

31 December 2018

21. DISCONTINUED OPERATIONS AND ASSETS AND LIABILITIES OF DISPOSAL GROUP (continued)

(c) Loss on sale of Paris Branch

	2018	
	US\$000	US\$000
Total assets of Paris branch (excluding group injection)	294,422	
Total liabilities of Paris branch (excluding group injection)	(234,422)	
Net assets of Paris branch (excluding group injections)		<u>60,000</u>
Consideration received by NBKI London (19.68% of NBK France S.A.)		<u>(49,209)</u>
Total loss on sale of Paris branch		<u>10,791</u>

The above loss is recognised in the profit or loss accounts of NBKI during 2018.

22. RELATED PARTY TRANSACTIONS

Related parties comprise board members and senior officers of the Bank, their close family members and companies controlled by them or close family members, National Bank of Kuwait SAKP and its subsidiaries. Certain related parties were customers of the Bank in the ordinary course of business. Transactions with related parties were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with unrelated parties and did not involve more than a normal amount of risk. There are no provisions for credit losses against loans and advances to related parties as at 31 December 2017 and 31 December 2018.

	2018 US\$000	2017 US\$000
Board members & senior officers of the Banks		
Customer deposits	1,827	5,886
Interest expense	7	16
Loans and advances to customers	4,098	4,318
Interest income	127	26
Parent Company		
Deposits with banks	3,175	18,602
Other assets	1,651	1,000
Due to banks and other financial institutions	125,653	371,955
Other liabilities	11,313	12,656
Contingent liabilities	38,928	37,578
Fully owned subsidiaries of the Parent Company		
Loans and advances to customers	10,241	10,812
Other assets	1	58
Due to banks and other financial institutions	102	5,370
Customer deposits	15,370	16,074
Contingent liabilities	164	165
		40

Notes to the financial statements

31 December 2018

22. RELATED PARTY TRANSACTION (continued)

	2018 US\$000	2017 US\$000
Partly owned subsidiaries of the Parent Company		
Due to banks and other financial institutions	53,426	4,649
Other liabilities	17	-
Contingent liabilities	186	429
Interest expenses	-	45
Fee income	1,793	3

23. DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial instruments that derive their value by referring to interest rates, foreign exchange rates, indices of prices or rates and credit rating or credit indices. Notional principal amounts merely represent amounts to which a rate or price is applied to determine the amounts of cash flows to be exchanged and do not represent the potential gain or loss associated with the market or credit risk of such instruments.

Derivative financial instruments are carried at fair value in the statement of financial position. Positive fair value represents the cost of replacing all transactions with a fair value in the Bank's favour had the rights and obligations arising from that instrument been closed in an orderly market transaction at the reporting date. Credit risk in respect of derivative financial instruments is limited to the positive fair value of the instruments. Negative fair value represents the cost to the Bank arising from replacing contracts with its counterparties.

The Bank deals in interest rate swaps to manage its interest rate risk on interest bearing assets and liabilities. Similarly the Bank deals in forward foreign exchange contracts for customers and to manage its foreign currency positions and cash flows.

Interest rate swaps used to hedge the change in fair value of the Bank's financial assets and liabilities and which qualifies as effective hedging instruments are disclosed as 'held as fair value hedges'. Forward foreign exchange contracts are carried out for customers or used for hedging purpose but do not meet the qualifying criteria for hedge accounting. The foreign currency risk exposures on account of derivative financial instruments for customers are covered by entering into opposite transactions (back to back) with counterparties or by other risk mitigating transactions.

Interest rate swaps

Interest rate swaps are contractual agreements between two counterparties to exchange interest payments on a defined principal amount for a fixed period of time. In cross currency interest rate swaps, the Bank exchanges interest payment in two different currencies on a defined principal amount for a fixed period of time and also exchanges defined principal amounts in two different currencies at inception of the contract and re-exchanges principal amounts on maturity.

Forward foreign exchange

Forward foreign exchange contracts are agreements to buy or sell currencies at a specified rate and at a future date. The fair value of derivative financial instruments included in the financial statements, together with their notional amounts is summarised as follows:

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23. DERIVATIVES FINANCIAL INSTRUMENTS (continued)

	2018			2017		
	<i>Positive fair value US\$000</i>	<i>Negative fair value US\$000</i>	<i>Notional US\$000</i>	<i>Positive fair value US\$000</i>	<i>Negative fair value US\$000</i>	<i>Notional US\$000</i>
Interest rate swaps (held as fair value hedges)	1,292	9,085	123,764	797	11,981	160,872
Forward foreign exchange contracts	13,410	10,325	2,345,861	942	20,779	1,515,624
	14,702	19,410	2,469,625	1,739	32,760	1,676,496

Gain on hedged fixed income financial assets amounted to US\$ 10,624 thousand (2017: US\$ 14,541 thousand) accounted for through other comprehensive income.

24. COMMITMENTS AND CONTINGENT LIABILITIES

Set out below are the notional principal amounts of off-balance sheet transactions. The notional principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. These credit commitments do not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

	2018 US\$000	2017 US\$000
<i>Contingent liabilities:</i>		
Acceptances and endorsements	186	6,249
Financial guarantees	215,591	357,823
Irrevocable letters of credit	3,909	106,551
ECL on guarantees and letter of credit	(517)	-
At 31 December	219,169	470,623
<i>Commitments:</i>		
Undrawn, formal standby facilities, credit lines and other commitments to lend	98,296	79,106

Operating lease commitments – Bank as a lessee

The Bank has entered into commercial leases on land and building and computer and other equipment. The leases include a renewal option at the end of their term. There is no restriction placed upon the lessee by entering into the lease.

At the year-end, annual commitments under non-cancellable operating leases were:

	2018 US\$000	2017 US\$000
Expiring:		
Within one year	1,337	1,873
In one to five years	4,068	6,547
More than 5 years	4,527	5,671
	9,932	14,091

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25. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

Level 2: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using quoted prices for identical or similar instruments in markets that are considered less than active or other valuation techniques in which all significant inputs are observable from market data.

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

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

The following table provides the fair value measurement hierarchy of the Bank's financial instruments recorded at fair value:

<i>2018</i>	<i>Level 1</i> <i>US\$000</i>	<i>Level 2</i> <i>US\$000</i>	<i>Level 3</i> <i>US\$000</i>	<i>Total</i> <i>US\$000</i>
Equities	-	-	49,832	49,832
Debt securities at FVPL	-	-	6,024	6,024
Debt securities at FVOCI	167,566	-	-	167,566
Less: ECL (Debt Securities)	(9)	-	-	(9)
	<u>167,557</u>	<u>-</u>	<u>55,856</u>	<u>223,413</u>
Derivative financial instruments (note 23)		<u>(4,708)</u>		<u>(4,708)</u>
<i>2017</i>	<i>Level 1</i> <i>US\$000</i>	<i>Level 2</i> <i>US\$000</i>	<i>Level 3</i> <i>US\$000</i>	<i>Total</i> <i>US\$000</i>
Equities	2	-	556	558
Debt securities	259,859	-	-	259,859
	<u>259,861</u>	<u>-</u>	<u>556</u>	<u>260,417</u>
Derivative financial instruments (note 23)	<u>-</u>	<u>(31,021)</u>	<u>-</u>	<u>(31,021)</u>

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25. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

The management does not consider there to be a material difference in the carrying value and the fair value of instruments not measured at fair value.

Debt securities included in level 2 consists of unquoted corporate bonds issued by banks. The fair values of these securities are estimated using valuation techniques with observable inputs. Derivatives are valued using valuation techniques which include forward pricing and swap models using present value calculations. The models incorporate various inputs such as foreign exchange spot and forward rates and interest yield curves. The impact of non-performance risk is not considered in the valuation as it is not significant.

The table below analyses the movement in level 3 and the income (interest and realised gain) generated during the year.

	<i>At 1 January 2018 US\$000</i>	<i>Additions US\$000</i>	<i>Change in fair value US\$000</i>	<i>Sale US\$000</i>	<i>Exchange rate movements US\$000</i>	<i>At 31 December 2018 US\$000</i>	<i>Net gains in the statement of income US\$000</i>
Equities	556	49,209	67	-	-	49,832	-
Debt securities at FVPL	-	6,024	-	-	-	6,024	-
	<u>556</u>	<u>55,233</u>	<u>67</u>	<u>-</u>	<u>-</u>	<u>55,856</u>	<u>-</u>
	<i>At 1 January 2017 US\$000</i>	<i>Additions US\$000</i>	<i>Change in fair value US\$000</i>	<i>Sale US\$000</i>	<i>Exchange rate movements US\$000</i>	<i>At 31 December 2017 US\$000</i>	<i>Net gains in the statement of income US\$000</i>
Equities	396	-	160	-	-	556	-
Debt securities	1	-	-	(1)	-	-	-
	<u>397</u>	<u>-</u>	<u>160</u>	<u>(1)</u>	<u>-</u>	<u>556</u>	<u>-</u>

Equity included in this category is a strategic equity investment which is not traded in an active market. The fair value of this equity investment is estimated using an internal valuation technique, which includes taking observable market information and applying an appropriate discount rate. Sensitivity analysis for fair value estimations on equity investments, by varying input assumptions in the range from 5% to 10% (2017: range from 5% to 10%), did not indicate any material impacts. The impacts on statement of financial position or statement of income, ranged from US\$ 25 thousand to US\$ 52 thousand (2017: US\$ 27 thousand to US\$ 55 thousand). Debt securities included in this category for year ended 31 December 2018 consists of unquoted corporate bonds issued by banks and financial institutions.

Other financial assets and liabilities are carried at amortised cost and the carrying values are not materially different from their fair values as most of these assets and liabilities are of short term maturities or are re-priced immediately based on market movement in interest rates. Fair values of remaining financial assets and liabilities carried at amortised cost are estimated mainly using discounted cash flow models (Level 3) incorporating certain assumptions such as credit spreads that are appropriate in the circumstances. Sensitivity analysis on fair value estimations, by varying input assumptions by a reasonable margin, did not indicate any material impacts on statement of financial position or statement of income.

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26. RISK MANAGEMENT

Risk is inherent in the Bank's activities but is managed in a structured, systematic manner through risk management policies which embed risk management into organisational structure, risk measurement and monitoring processes. The overall risk management direction and oversight are provided by the Board of Directors with the support of the Board Audit and Risk Committee. The Bank's Risk Management and Internal Audit functions assist Executive Management in controlling and actively managing the Bank's overall risk profile.

The Bank is primarily exposed to credit risk, liquidity risk, market risk and operational risk.

In accordance with sound management and with regulatory requirements, the Bank has implemented process for the measurement and management of risk commensurate with the Bank's size and business model.

Financial transactions and outstanding exposures are quantified and compared against authorised risk limits, whereas non-financial risks are monitored against policy guidelines and key risk and control indicators. Any discrepancies, excesses or deviation are escalated to management for appropriate action. Any breach of a risk tolerance that is defined in the NBKI Risk Appetite Statement is reported to Board.

The Bank uses interest rate swaps, forward foreign exchange contracts and other instruments to manage the financial risks resulting from changes in interest rates and foreign exchange.

The Bank's risk management framework has specific guidelines that focus on maintaining a diversified portfolio to avoid excessive concentration of risk.

26.1 CREDIT RISK

Credit risk is the risk of suffering loss because scheduled payments associated with a debt, or with a collection of debts, are not received in full and on time in line with agreed contractual obligations. Credit risk arises mainly from interbank, commercial and consumer loans and advances, and loan commitments arising from such lending activities, but can also arise from credit enhancement provided, such as credit derivatives (CDS), financial guarantees, letters of credit, endorsements and acceptances.

The Bank is also exposed to other credit risks arising from investments in debt securities and other exposures arising from its trading activities including non-equity trading portfolio assets and derivatives as well as settlement balances with market counterparties and reverse repurchase agreements.

Credit risk is the single largest risk for the Bank's business. All policies relating to credit risk are reviewed by the Board of Directors. The Board Audit and Risk Committee and the Board oversee credit risk on a quarterly basis.

Credit limits are established for all customers after a careful assessment of their creditworthiness. Procedures outlined in the Bank's Credit Policies require that all credit proposals be subjected to detailed screening by the Credit Risk Department before submission to the Credit Approval Committee. Whenever necessary, loans are secured by acceptable forms of collateral to mitigate the related credit risks.

The Bank has an internal Credit Risk Committee ("CRC") that monitors credit exposure at a portfolio level, where CRC may take early preventative actions including making adjustments to credit policy. CRC's governance responsibilities have been expanded to include the approval of provisions, both collective and on individually impaired facilities, in line with changes to accounting treatments. CRC meets regularly throughout the year.

The Bank further limits credit risk through diversification of its assets by geography and industry sector. In addition, all credit facilities are continually monitored based on a periodical review of the credit performance and account rating.

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26.1 CREDIT RISK (continued)

26.1.1 CREDIT RISK MEASUREMENT

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Bank measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9. See note 26.1.2 for more details.

Credit risk grading

The Bank uses internal credit risk grades that reflect its assessment of the probability of default of individual counterparties. The Bank use calibrated rating models tailored to the various categories of counterparty. Borrower and loan specific information collected at the time of application (such as disposable income, and level of collateral for retail exposures; and turnover and industry type for wholesale exposures) is fed into these models. This is supplemented with external data such as credit bureau scoring information on individual borrowers. In addition, the models enable expert judgement from the Credit Risk Officer to be fed into the final internal credit rating for each exposure. This allows for considerations which may not be captured as part of the other data inputs into the model.

26.1.2 EXPECTED CREDIT LOSS MEASUREMENT

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

- A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Bank.
- If there is a significant increase in credit risk ('SICR') since the initial recognition identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. Please refer to note 26.1.2.1 for a description of how the Bank determines when a significant increase in credit risk has occurred.
- If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 26.1.2.2 for a description of how the Bank defines credit-impaired and default.
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stage 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis. Please refer to note 26.1.2.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL.
- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information. Note 26.1.2.4 includes an explanation of how the Bank has incorporated this in its ECL models.
- Purchased or originated credit-impaired financial assets are those financial assets that are credit impaired on initial recognition. Their ECL is always measured on a lifetime basis.

Further explanation is also provided of how the Bank determines appropriate groupings when ECL is measured on a collective basis (note 26.1). The following diagram summarises the impairment requirements under IFRS 9 (other than purchased or originated credit-impaired financial assets):

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26.1 CREDIT RISK (continued)

← Change in credit quality since initial recognition →

Stage 1	Stage 2	Stage 3
(Initial recognition) 12-month expected credit losses	(Significant increase in credit risk since initial recognition) Lifetime expected credit losses	(Credit-impaired assets) Lifetime expected credit losses

The key judgements and assumptions adopted by the Bank in addressing the requirements of the standard are discussed below:

26.1.2.1 Significant increase in credit risk (SICR)

The Bank considers a financial instrument to have experienced a significant increase in credit risk when one or more of the following quantitative or qualitative criteria have been met:

Quantitative criteria:

a) Significant increase in credit risk ("SICR") – Externally-rated portfolio

To determine if the risk of default of a financial instrument has increased significantly since initial recognition, the current risk of default at the reporting date would be compared with the risk of default at initial recognition. This assessment of whether there has been a significant increase in credit risk is required to be carried out at each reporting date. An asset can move into and out of the lifetime expected credit losses category (Stage 2 and 3) based on a pre-defined pattern obtained from the historical default rates or delinquency status of accounts across various internal rating grades, products or sectors.

This portfolio includes, but is not limited to, bonds, investments, sovereign and corporate obligors that are externally rated.

There are certain portfolios for the Bank (e.g. Bonds) where external ratings are applicable and used to assist in credit decisions. Final external rating is derived using the Median logic as stipulated in the Basel guidelines.

The staging criterion for the same would require 2-Grade downgrade (without considering modifiers in the rating) for any facility that was within "investment grade" at inception. Any facility which was below "investment grade" at inception would be tagged as Stage 2 if there was a downgrade of one or more Grade in its rating.

Downgrade Matrix for Externally-Rated Portfolio

Additionally, as per IFRS 9, "a financial instrument with an external rating grade within "investment grade" (BBB- or higher by S&P/Fitch) is an example of an instrument that may be considered to have low credit risk". Any facility without external rating at inception would be considered for staging based on the following;

Instrument with rating in "investment grade" (BBB- or better) at reporting date would be considered in Stage 1. Instrument with rating in non-investment grade at reporting date would be considered in Stage 2.

If an instrument / exposure is 'Unrated', then the rating is considered to be the lower of the "country ceiling" (which is the sovereign rating of the country) of the exposure and Ba1 (effectively non-investment grade, thereby Stage 2). If the country is also unrated, then the exposure is classified as Stage 2.

With particular reference to Cash and Short-Term deposits to banks, given the very short maturity of 7 days, this portfolio is considered to be in Stage 1.

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26.1 CREDIT RISK (continued)

b) Significant increase in credit risk ("SICR") – Internally-rated portfolio

Post the consideration of externally-rated portfolio, internally-rated (based on MRA ratings) would be evaluated.

Based on the rating migration data and historical default rates across the Bank's corporate portfolio, following criteria are fixed for determining SICR:

Downgrade Matrix for Internally-Rated Portfolio for stage 1 and stage 2:

Based on Grade movements (Internally-rated portfolio)

Inception	Current Grade												Down Grade
	1	2	3	4	5	6	7	8	9	10	11	12	
1	S-1	S-1	S-1	S-1	S-2	S-2	S-2	S-2	S-2	S-2	S-2	S-2	4
2	S-1	S-1	S-1	S-1	S-2	S-2	S-2	S-2	S-2	S-2	S-2	S-2	3
3	S-1	S-1	S-1	S-1	S-2	S-2	S-2	S-2	S-2	S-2	S-2	S-2	2
4	S-1	S-1	S-1	S-1	S-1	S-2	S-2	S-2	S-2	S-2	S-2	S-2	2
5	S-1	S-1	S-1	S-1	S-1	S-1	S-2	S-2	S-2	S-2	S-2	S-2	2
6	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-2	S-2	S-2	S-2	S-2	2
7	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-2	S-2	S-2	S-2	S-2	1
8	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-2	S-2	S-2	S-2	1
9	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-2	S-2	S-2	1
10	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-2	S-2	1
11	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-2	1
12	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	S-1	0

Key: S-1 – Stage 1; S-2 – Stage 2

Above rating migration will be applied without considering modifiers in the ratings.

The Bank denotes the counterparty assessment as the L1 rating of the counterparty. The L1 rating is the obligor rating with no consideration of credit risk mitigation such as guarantees and collateral coverage. The effect of any bank, corporate or sovereign guarantees is captured in L2, and of collateral in L3 ratings. The assessment shown above is derived from the L1 ratings of the borrower.

Final L2 rating for any obligor will be the better of the L1 and L2 ratings. Similarly, the final L3 rating for any obligor will be the best of L1, L2, and L3 ratings.

c) Stage Assessment Based on Grade Downgrade Matrix:

In case L1 rating is present both at inception and current, then the above downgrade matrix would be applicable to that set of borrowers considering the L1 inception and current rating levels. Note that the renewed facilities are currently assessed based on new dates in line with their renewal. The credit committee revisits each case of the renewal request.

In case L1 rating is not present either at inception or currently for the borrower and L2 ratings are present both at inception and currently, then the above downgrade matrix would be applicable to that set of borrowers considering the L2 inception and current rating levels.

In case L2 is not present either at inception or currently for the borrower and L3 rating are present at both inception and currently, then the above downgrade matrix would be applicable to that set of borrowers considering the L3 inception and current rating levels.

Notes to the financial statements

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26.1 CREDIT RISK (continued)

d) Stage Assessment Based on Absolute Rating:

In case the inception rating is not available to perform stage assessment based on Grade downgrade matrix, stage assessment will be done based on the current rating as follows. Any facility which has a current L1 rating would be considered for staging based on the absolute L1 rating on the reporting date. Instruments with rating as 1, 2, 3, 4, and 5 (investment grade) at reporting date would be considered in Stage 1. Instruments with rating in 6, 7, 8, 9, 10, 11 and 12 grades (non-investment) at reporting date would be considered in Stage 2.

In the absence of an absolute L1 rating, the L2 rating would be used, if available, and in case only the L3 current rating is available, then the above absolute grade would be applicable to that set of borrowers at the L3 absolute rating level. The Bank is working towards reducing the extent of the unrated portfolio by having an MRA rating and subsequently will be using the L1 or L2 ratings for staging.

e) Stage Assessment for Unrated Portfolio based on Assumptions:

If an instrument / exposure is 'Unrated', then the rating applied is Moody's equivalent grade for the PD, which is the worse of the TTC PD (Central tendency PD of internally rated portfolio for country of risk) and the country's PD (based on Sovereign rating of the country of risk), and if this rating is of non-investment grade (less than BBB) at the reporting date then it would be considered as Stage 2. If the TTC for the country of risk is not available, the TTC for the booking location will be applied, based on which (investment/non-investment grade) the final stage will be allocated.

f) Significant increase in credit risk ("SICR") – DPD

Superseding the SICR criteria for the above, any facility of the Bank would be tagged as Stage 2 in case the delinquency measure of the same is 30 days past due (DPD) or more but less than 90 DPD.

IFRS 9 presumes 30 DPD criterion for Stage 2 classification. This criterion would be treated as an overlay for the overall book of the Bank. (e.g. a rated instrument is classified as Stage 1 from the grade downgrade criterion, but would be tagged as Stage 2 if the delinquency is above 30 DPD).

Qualitative criteria:

a) Use of early warning indicators for SICR

Apart from the above-mentioned staging criteria based upon rating grades and DPD buckets, the following qualitative criteria are evaluated by the Management to categorize a particular borrower into Stage 2 by providing appropriate reasoning for the same. Early Warning Signal (EWS) signals are broken into two parts.

Financial Warning Signals:

- Decrease in Revenue/Sales by 30% or more
- Decrease in net profit by 30% or more
- Increase in Accounts Receivables Days on hand by 30% or more
- Increase in Inventory Days on hand by 30% or more
- Decrease in Financial Payments Coverage Ratio using EBITDA by 30% or more
- Increase in balances due from/Due to related parties by 30% or more
- Decrease in Cash Flow from operating activities by 30% or more

Non-financial Warning Signals:

- Late interest payments
- Delay in providing financial statements or other data
- Unclear company strategy
- Existence of administrative problems in the company

Governance and frequency for monitoring EWS is performed regularly as per the procedures.

b) Management of stage override mechanism

Any requests for overrides, as an exception to the staging policy are formally be communicated to the relevant approving authority (Provision Committee for the Group – refer ECL policy on governance framework). The final Stage allocations would be determined by this Authority.

Notes to the financial statements

31 December 2018

26.1 CREDIT RISK (continued)

26.1.2.2 Definition of default and credit-impaired assets

The Bank defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Quantitative criteria:

The default definition used is consistent with the one used for regulatory purposes and is defined as 90 days past due (DPD) for any facility or tagging the facility as "impaired" for internal credit management purposes. Any facility that would be tagged as default under this definition as of the reporting date would be tagged in the stage 3 population. Additionally, the Bank will assess 'significant decrease in risk' from time to time before moving these facilities from stage 3 (default) to Stage 2/Stage 1.

Please note that the above criterion of 90 days is fixed for corporate and retail portfolios, whereas for investments the definition of default shall be considered if the coupon or principal payment is past due for 1 day.

For the externally-rated portfolio, the default grade is defined as 'D' for S&P and Fitch, and 'C' for Moody's.

Qualitative criteria:

Any credit-impaired facility or stressed facility that has been restructured would also be tagged as default. This is in line with the definition of credit-impaired asset in the IFRS 9 standard. The borrower meets unlikelihood to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

- The borrower is in long-term forbearance
- The borrower is deceased
- The borrower is insolvent
- The borrower is in breach of financial covenant(s)
- An active market for that financial asset has disappeared because of financial difficulties
- Concessions have been made by the lender relating to the borrower's financial difficulty
- It is becoming probable that the borrower will enter bankruptcy
- Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses.

The credit above have been applied to all financial instruments held by the Bank and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss given Default (LGD) throughout the Bank's expected loss calculations.

The restructured facilities would be required to complete the moratorium period (if any) and meet the scheduled payments (all on current basis) for at least 1 year, or as determined by the Bank for consideration for tagging the facility in Stage 2 / Stage 1.

This period has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions.

26.1.2.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques

The Expected Credit Loss (ECL) is measured on either a 12 month (12M) or Lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD), defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "Definition of default and credit-impaired" above), either over the next 12 months (12M PD) or over the remaining lifetime (Lifetime PD) of the obligation.
- EAD is based on the amounts the Bank expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD). For example for a revolving commitment, the Bank includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.

Notes to the financial statements

31 December 2018

26.1 CREDIT RISK (continued)

- Loss Given Default (LGD) represents the Bank's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD). LGD is calculated on a 12 month or lifetime basis where 12 month LGD is the percentage of loss expected to be made if the default occurs in the next 12 months and Lifetime LGD is the percentage of loss expected to be made if the default occurs over the remaining expected lifetime of the loan.

The ECL is determined by projecting the PD, LGD and EAD for each future month and for each individual exposure or collective segment. These three components are multiplied together and adjusted for the likelihood of survival (i.e., the exposure has not prepaid or defaulted in an earlier month). This effectively calculates an ECL for each future month, which is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

The Lifetime PD is developed by applying a maturity profile to the current 12M PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the lifetime of the loans. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and credit grade band. This is supported by historical analysis.

The 12 month and lifetime EADs are determined based on the expected payment profile which varies by product type.

- For amortising products and bullet repayment loans, this is based on the contractual repayments owed by the borrower over a 12 month or lifetime basis. This will also be adjusted for any expected overpayments made by a borrower. Early repayment / refinance assumptions are also incorporated into the calculation.
- For revolving products, the exposure at default is predicted by taking the current drawn balance and adding a "credit conversion factor" which allows for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type and current limit utilization band based on analysis of the Bank's recent default data.

The 12 month and lifetime LGDs are determined based on the factors which impact the recoveries made post default. These vary by product type.

- For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market / book values due to forced sales, time to repossession and recovery costs observed.
- For unsecured products, LGD's are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. These LGD's are influenced by collection strategies including contracted debt sales and price.

Forward looking economic information is also included in determining the 12 month and lifetime PD, EAD and LGD. These assumptions vary by product type. See note 26.1.2.4 for explanation of forward looking information and its inclusion in ECL calculations.

The assumptions underlying the ECL calculation – such as how the maturity profile of the PDs and how collateral values change etc. – are monitored and reviewed on a quarterly basis.

There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

26.1.2.4 Forward looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporated forward looking information. The Bank has performed historical analysis and identified the key economic variables impacting credit risk and expected credit losses for each portfolio.

Forward looking information is incorporated by NBKI in the form of macro-economic factors mainly UK GDP and Equity prices. Macro-economic factors operate based on the country of risk of the obligor.

Currently, the Bank is using three scenarios; base line scenario (scenario 1), stronger near-term growth (scenario 2) and moderate recession (scenario 3)

Notes to the financial statements

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26.1 CREDIT RISK (continued)

26.1.3 Loss allowance

The loss allowance recognised in the period is impacted by a variety of factors, as described below:

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increase (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent “step up” (or “step down”) between 12 month and Lifetime ECL;
- Additional allowances for new financial instruments recognized during the period as well as releases for financial instruments de-recognised in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;
- Impact on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Financial assets derecognized during the period and write-offs of allowances related to assets that were written off during the period.

The following tables explain the changes in the loss allowance between the beginning and the end of the annual period impacted by these factors:

ON BALANCE SHEET	<i>Opening balance (US\$000)</i>	<i>Increase due to origination and acquisition (US\$000)</i>	<i>Decrease due to derecognition repayments and disposals (US\$000)</i>	<i>Changes due to change in credit risk (net) (US\$000)</i>	<i>Closing balance (US\$000)</i>
Stage 1:					
Allowances for financial assets without increase in credit risk					
Debt securities measured at FVOCI (note 15)	10	3	(4)	-	9
Central banks (note 11)	429	2	(429)	-	2
Credit institutions (note 12 & 13)	441	39	(315)	-	165
Loans and advances to customers (note 14)	1,633	369	(760)	-	1,242
	2,513	413	(1,508)	-	1,418
Stage 2:					
Allowances for debt instruments with significant increase in credit risk / not impaired					
Credit institutions	4	-	-	(4)	-
Loans and advances to customers (note 14)	74	-	-	(72)	2
	78	-	-	(76)	2

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26.1 CREDIT RISK (continued)

ON BALANCE SHEET	Opening balance (US\$000)	Increase due to origination and acquisition (US\$000)	Decrease due to derecognition repayments and disposals (US\$000)	Changes due to change in credit risk (net) (US\$000)	Closing balance (US\$000)
Stage 3:					
Allowances for credit impaired debt instruments					
Loans and advances to customers (note 14)	663	-	-	240	903
	3,254	413	(1,508)	164	2,323
OFF BALANCE SHEET					
Commitments and contingent liabilities (note 18 & 24)					
Stage 1:	776	26	(285)	-	517
Stage 2:	936	-	(936)	-	-
	1,712	26	(1,221)	-	517
	4,966	439	(2,729)	164	2,840

The net movement of \$2,126,470 includes derecognition of Paris related ECL of \$1,711,392 (note 21) resulting a net write back relating to London of \$415,078.

26.1.4 MAXIMUM EXPOSURE TO CREDIT RISK

The following table contains an analysis of the credit risk exposure of financial instruments for which an ECL allowance is recognised. The gross carrying amount of financial assets below also represents the Bank's maximum exposure to credit risk on these assets.

Financial assets by instrument and by counterparty sector: financial assets at FVOCI

	Carrying Amount (US\$000)	Gross Carrying Amount (US\$000)			Accumulated Impairment (US\$000)		
		Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3
		All risks	Significant increase in credit risk	Credit impaired			
General government	118,935	118,938	-	-	(3)	-	-
Financial corporations (note 15)	48,622	48,628	-	-	(6)	-	-
	167,557	167,566	-	-	(9)	-	-
Hedged loans (note 14)	22,523	22,544	-	-	(21)	-	-
Financial assets at FVOCI	190,080	190,110	-	-	(30)	-	-

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26.1 CREDIT RISK (continued)

Financial assets by instrument and by counterparty sector: financial assets at amortised cost

	Carrying Amount (US\$000)	Gross Carrying Amount (US\$000)			Accumulated Impairment (US\$000)		
		Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3
		All risks	Significant increase in credit risk	Credit impaired			
Cash and cash equivalents (note 11)	223,793	223,795	-	-	(2)	-	-
On demand and short notice (note 12)	277,733	277,741	-	-	(8)	-	-
Credit institutions (note 12 & 13)	570,194	570,351	-	-	(157)	-	-
Loans and advances (note 14)	1,201,996	1,194,599	892	8,631	(1,221)	(2)	(903)
Financial assets at amortised cost	2,273,716	2,266,486	892	8,631	(1,388)	(2)	(903)

Information on how the Expected Credit Loss (ECL) is measured and how the three stages above are determined is included in note 26.1.2 'Expected credit loss measurement'

Financial assets subject to impairment that are past due

DAYS	Carrying Amount									
	Stage 1 Assets with no significant increase in credit risk (US\$000)			Stage 2 Assets with significant increase in credit risk but not impaired (US\$000)			Stage 3 Credit impaired assets (US\$000)			
	Not past due	≤ 30	>30≤ 90	>90	≤ 30	>30≤ 90	>90	≤ 30	>30 ≤ 90	>90
Debt securities	167,557	-	-	-	-	-	-	-	-	-
On demand and short notice	277,733	-	-	-	-	-	-	-	-	-
Credit institutions	570,194	-	-	-	-	-	-	-	-	-
Loans and advances	1,215,902	-	-	-	890	-	772	-	6,955	-
TOTAL	2,231,386	-	-	-	890	-	772	-	6,955	-

The following disclosures highlight the diversity of exposures.

An analysis of loans and advances to banks and customers and contingent liabilities before and after taking account of collateral held or other credit enhancements, is as follows:

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26.1 CREDIT RISK (continued)

	2018		2017	
	Carrying Amount US\$000	Net exposure US\$000	Carrying Amount US\$000	Net exposure US\$000
Deposit with banks	830,523	830,523	982,433	982,433
Other assets	19,877	19,877	11,760	11,760
Loans and advances to banks	17,404	17,404	17,500	17,500
Loans and advances to customers	1,224,519	79,634	1,383,302	178,588
Contingent liabilities	317,465	316,753	549,729	548,342

Collateral and other credit enhancements

The amount, type and valuation of collateral are based on guidelines specified in the risk management framework. The main types of collateral accepted includes real estate, quoted shares, cash collateral and bank guarantees. The revaluation and custody of collateral are performed independently of the business units.

26.1.5 RISK CONCENTRATION OF THE MAXIMUM EXPOSURE TO CREDIT RISK

Concentrations of credit risk arise from exposure to customers having similar characteristics in terms of the geographic location in which they operate or the industry sector in which they are engaged, such that their ability to discharge contractual obligations may be similarly affected by changes in political, economic or other conditions.

Credit risk can also arise due to a significant concentration of Bank's assets to any single counterparty. This risk is managed by diversification of the portfolio. The Bank's internal limit is 22.5% of capital to any single obligor group. The ten largest loans and advances to customers outstanding as a percentage of gross loans and advances to customers as at 31 December 2018 is 34% (2017: 40%).

The Bank's financial assets and off-balance sheet items, before taking into account any collateral held or credit enhancements can be analysed by the following geographic regions:

2018

Geographic region	MENA	North America	Europe	Asia	Others	Total
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
Balances with central banks	-	-	221,827	-	-	221,827
Deposits with banks	228,503	72,510	525,307	4,272	-	830,592
Loans and advances to banks	-	-	-	-	17,500	17,500
Loans and advances to customers	255,555	-	677,359	-	293,752	1,226,666
Investments securities	48,628	64,644	54,917	-	6,024	174,213
Investment in group entity	-	-	49,209	-	-	49,209
Other assets	3,439	-	30,635	-	-	34,074
	<u>536,125</u>	<u>137,154</u>	<u>1,559,254</u>	<u>4,272</u>	<u>317,276</u>	<u>2,554,081</u>
Commitments and contingent liabilities (note 24)	79,461	-	238,521	-	-	317,982
	<u>615,586</u>	<u>137,154</u>	<u>1,797,775</u>	<u>4,272</u>	<u>317,276</u>	<u>2,872,063</u>

Notes to the financial statements

31 December 2018

26.1 CREDIT RISK (continued)

2017

Geographic region	MENA US\$000	North America US\$000	Europe US\$000	Asia US\$000	Others US\$000	Total US\$000
Balances with central banks	-	-	363,490	-	-	363,490
Deposits with banks	344,471	15,727	616,683	5,552	-	982,433
Loans and advances to banks	-	-	-	-	17,500	17,500
Loans and advances to customers	290,915	-	664,451	-	427,936	1,383,302
Investments available-for-sale	49,575	67,049	143,235	-	-	259,859
Other assets	998	2	11,203	-	-	12,203
	<u>685,959</u>	<u>82,778</u>	<u>1,799,062</u>	<u>5,552</u>	<u>445,436</u>	<u>3,018,787</u>
Commitments and contingent liabilities (note 24)	144,953	75,063	329,713	-	-	549,729
	<u>830,912</u>	<u>157,841</u>	<u>2,128,775</u>	<u>5,552</u>	<u>445,436</u>	<u>3,568,516</u>

The Bank's financial assets and off-balance sheet items, before taking into account any collateral held or credit enhancements, can be analysed by the following industry sectors:

Industry sector	2018 US\$000	2017 US\$000
Manufacturing	129,816	184,921
Banks and other financial institutions	1,231,146	1,607,967
Construction	88,870	107,639
Real Estate	1,127,195	1,219,196
Retail	6,060	6,061
Government	118,938	244,133
Others	170,038	198,599
	<u>2,872,063</u>	<u>3,568,516</u>

26.1.6 Write off policy

The Bank writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Bank's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovering in full.

The Bank may write off financial assets that are still subject to enforcement activity. The outstanding contractual amounts of such assets written off during the year 31 December 2018 was \$15,000,000. The Bank still seeks to recover amounts it is legally owed in full but which have been partially written off due to no reasonable expectation of full recovery.

Notes to the financial statements

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26.2 LIQUIDITY RISK

Liquidity risk is the risk that the Bank will be unable to meet its financial liabilities when they fall due. To limit this risk, management has arranged diversified funding sources and manages its assets with liquidity in mind. The Bank ensures that it has sufficient liquidity even in stress scenarios, and liquidity adequacy is monitored daily. The table below summarises the maturity profile of Bank's assets, liabilities and equity based on contractual cash flows and maturity dates. This does not necessarily take account of the effective maturities.

	<i>Up to 3 Months US\$000</i>	<i>3 to 12 Months US\$000</i>	<i>Over 1 year US\$000</i>	<i>Total US\$000</i>
2018				
Assets				
Cash and cash equivalents	222,722	1,071	-	223,793
Deposits with banks	829,994	529	-	830,523
Loans and advances to banks	-	-	17,404	17,404
Loans and advances to customers	213,885	86,325	924,309	1,224,519
Investment securities	57,910	6,025	110,269	174,204
Investment in group entity	-	-	49,209	49,209
Fixed assets	-	-	2,794	2,794
Other assets	33,886	290	797	34,973
	<u>1,358,397</u>	<u>94,240</u>	<u>1,104,782</u>	<u>2,557,419</u>
Liabilities and equity				
Due to banks and other financial institutions	408,112	599,675	-	1,007,787
Customer deposits	1,052,041	115,149	-	1,167,190
Certificates of deposit issued	20,000	-	-	20,000
Other liabilities	33,015	3,612	13,375	50,002
Share capital and reserves	-	-	312,440	312,440
	<u>1,513,168</u>	<u>718,436</u>	<u>325,815</u>	<u>2,557,419</u>
	<i>Up to 3 Months US\$000</i>	<i>3 to 12 Months US\$000</i>	<i>Over 1 year US\$000</i>	<i>Total US\$000</i>
2017				
Assets				
Cash and cash equivalents	366,212	-	-	366,212
Deposits with banks	935,049	47,384	-	982,433
Loans and advances to banks	-	-	17,500	17,500
Loans and advances to customers	102,102	251,176	1,030,024	1,383,302
Investment securities	128,388	14,846	117,183	260,417
Fixed assets	-	-	1,682	1,682
Other assets	11,642	862	995	13,499
	<u>1,543,393</u>	<u>314,268</u>	<u>1,167,384</u>	<u>3,025,045</u>
Liabilities and equity				
Due to banks and other financial institutions	843,035	513,292	-	1,356,327
Customer deposits	1,174,595	129,309	-	1,303,904
Certificate of deposits issued	-	15,000	-	15,000
Other liabilities	31,070	1,210	16,915	49,195
Share capital and reserves	-	-	300,619	300,619
	<u>2,048,700</u>	<u>658,811</u>	<u>317,534</u>	<u>3,025,045</u>

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26.2 LIQUIDITY RISK (continued)

The liquidity profile of financial liabilities of the Bank summarised below reflects the cash flows including future interest payments over the life of these financial liabilities based on contractual repayment arrangements.

	<i>Up to 3 months US\$000</i>	<i>3 to 12 Months US\$000</i>	<i>Over 1 Year US\$000</i>	<i>Total US\$000</i>
2018				
Financial Liabilities				
Due to banks and other financial institutions	409,331	607,231	-	1,016,562
Customer deposits	1,052,337	116,069	-	1,168,406
Certificates of deposits	20,008	-	-	20,008
	<u>1,481,676</u>	<u>723,300</u>	<u>-</u>	<u>2,204,976</u>
Contingent liabilities and commitments				
Contingent liabilities	54,307	77,552	87,828	219,687
Irrevocable commitments	2,520	-	95,775	98,295
	<u>56,827</u>	<u>77,552</u>	<u>183,603</u>	<u>317,982</u>
Derivatives				
Interest rate swaps (net interest)	111	982	7,911	9,004
	<u>111</u>	<u>982</u>	<u>7,911</u>	<u>9,004</u>
	<i>Up to 3 months US\$000</i>	<i>3 to 12 Months US\$000</i>	<i>Over 1 Year US\$000</i>	<i>Total US\$000</i>
2017				
Financial Liabilities				
Due to banks and other financial institutions	843,141	517,337	-	1,360,478
Customer deposits	1,189,112	115,430	-	1,304,542
Certificates of deposits	-	15,234	-	15,234
	<u>2,032,253</u>	<u>648,001</u>	<u>-</u>	<u>2,680,254</u>
Contingent liabilities and commitments				
Contingent liabilities	85,074	255,816	129,733	470,623
Irrevocable commitments	5,868	4,800	68,438	79,106
	<u>90,942</u>	<u>260,616</u>	<u>198,171</u>	<u>549,729</u>
Derivatives				
Interest rate swaps (net interest)	340	2,578	14,858	17,776
	<u>340</u>	<u>2,578</u>	<u>14,858</u>	<u>17,776</u>

Notes to the financial statements

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26.3 MARKET RISK

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market prices. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, foreign exchange rates and equity prices.

26.3.1 INTEREST RATE RISK

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Bank is not excessively exposed to interest rate risk. Most exposures arising on medium term fixed rate lending or fixed rate borrowing are covered by interest rate swaps. Furthermore, the re-pricing gaps of its assets and liabilities are carefully monitored and controlled through limits pre-established by the Board of Directors and adjusted where necessary, to reflect the changing market conditions.

Interest rate sensitivity

Interest rate sensitivity of profit measures the effect of the assumed changes in interest rates on the net interest income for one year, based on the interest bearing financial assets and financial liabilities held at the year end. This includes the effect of hedging instruments but excludes undrawn loan commitments. The sensitivity on equity is the impact arising from changes in interest rate on fair value of available-for-sale investments. Sensitivity to interest rate movements will be on a symmetric basis as financial instruments giving rise to non-symmetric movements are not significant.

Based on the Bank's financial assets and financial liabilities held at the year end, an assumed 25 basis points increase in interest rate, with all other variables held constant, would impact the Bank's profit and equity as follows:

Currency	Movement in basis points	<u>2018</u>	<u>2017</u>
		<i>Effect on Profit US\$000</i>	<i>Effect on Profit US\$000</i>
GBP	+25	849	789
USD	+25	(1,252)	(1,917)
EUR	+25	119	2,002

26.3.2 FOREIGN EXCHANGE RISK

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Foreign exchange risks are controlled through monitoring against limits pre-established by the Board of Directors on currency position exposures. In general assets are typically funded in the same currency as that of the business being transacted to eliminate exchange exposures or are covered by forward foreign exchange contracts. Appropriate segregation of duties exists between the treasury front and back office functions, while compliance with position limits is independently monitored on an ongoing basis.

The Bank does not have significant net open positions in any foreign currencies and accordingly there is no significant impact on the income statement or equity as a result of foreign exchange rate fluctuations.

Notes to the financial statements

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26.4 OPERATIONAL RISK

Operational risk is the risk of loss arising from inadequate or failed internal processes, human error, systems failure or from external events. The Bank has a set of policies and procedures, which are approved by the Board of Directors and are applied to identify, assess and supervise operational risk in addition to other types of risks relating to the banking and financial activities of the Bank. Operational risk management is overseen by the Risk Management Department, which ensures compliance with policies and procedures and monitors operational risk as part of overall Bank risk management.

27. CAPITAL MANAGEMENT (Unaudited)

A key objective of the Bank is to maximise shareholders' value within board risk tolerances, whilst maintaining a strong capital base to support the development of its business and comply with internal and external capital requirements.

Capital adequacy is monitored on a regular basis against both regulatory and internal capital requirements. The Bank ensures that it has adequate capital even in stress scenarios through the Individual Capital Adequacy Assessment Process.

	<i>2018</i> <i>US\$000</i>	<i>2017</i> <i>US\$000</i>
Risk Weighted Assets	1,433,337	1,715,439
Capital available		
Common Equity Tier 1 capital	265,092	294,983
Tier 1 capital	265,092	294,983
Tier 2 capital	-	-
Total capital	265,092	294,983
Common Equity Tier 1 capital adequacy ratio	18.5%	17.2%
Tier 1 capital adequacy ratio	18.5%	17.2%
Total capital adequacy ratio	18.5%	17.2%