

BAHRAIN DEVELOPMENT BANK B.S.C. (c)

**INDEPENDENT AUDITOR'S REPORT AND
CONSOLIDATED FINANCIAL STATEMENTS**

31 DECEMBER 2019

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2019

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BAHRAIN DEVELOPMENT BANK B.S.C. (c)
CORPORATE INFORMATION

Commercial registration no. 26226 obtained on 20 January 1992

Directors

Mr. Khalid Al Rumaihi – Chairman
Ms. Sabah Khalil Almoayyed - Board Member
Mr. Tariq Abduljalil Al Saffar – Board Member
Mr. Marwan Khalid Tabbara – Board Member
Ms. Tala Abdulrahman Fakhro – Board Member
Mr. Ghassan Ghaleb Abdulaal – Board Member
Ms. Maryam Adnan Al Ansari – Board Member
Ms. Marwa Khaled Al Saad – Board Member

Registered office

Building 170
Road 1703
Diplomatic Area
PO Box 20501
Manama
Kingdom of Bahrain

External Auditors

Ernst & Young
PO Box 140
Manama
Kingdom of Bahrain

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BAHRAIN DEVELOPMENT BANK B.S.C. (c)

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the accompanying consolidated financial statements of Bahrain Development Bank B.S.C. (c) (the "Bank") and its subsidiaries (together "the Group"), which comprise the consolidated statement of financial position as at 31 December 2019, and the consolidated statements of profit or loss, other comprehensive income, changes in equity and cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2019, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

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

Other information

Other information consists of the information included in the Group's 2019 Annual Report, other than the consolidated financial statements and our auditor's report thereon. The Board of Directors is responsible for the other information. Prior to the date of this auditors' report, we obtained the Chairman's statement which forms part of the annual report, and the remaining sections of the annual report are expected to be made available to us after that date.

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

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

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BAHRAIN DEVELOPMENT BANK B.S.C. (c) (continued)

Report on the Audit of the Consolidated Financial Statements (continued)

Responsibilities of the Board of Directors for the consolidated financial statements

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

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

Auditor's Responsibilities for the audit of the consolidated financial statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BAHRAIN DEVELOPMENT BANK B.S.C. (c) (continued)

Report on the Audit of the Consolidated Financial Statements (continued)

Auditor's Responsibilities for the audit of the consolidated financial statements (continued)

- Conclude on the appropriateness of the Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

Report on Other Legal and Regulatory Requirements

As required by the Bahrain Commercial Companies Law and Volume 1 of the Central Bank of Bahrain (CBB) Rule Book, we report that

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the Report of the Board of Directors is consistent with the consolidated financial statements;
- c) we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2019 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position; and

**INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF
BAHRAIN DEVELOPMENT BANK B.S.C. (c) (continued)**

Report on Other Legal and Regulatory Requirements (continued)

- d) satisfactory explanations and information have been provided to us by the Board of Directors in response to all our requests.



Partner's registration no. 45
24 February 2020
Manama, Kingdom of Bahrain

Bahrain Development Bank B.S.C. (c)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2019

	Note	2019 BD '000	2018 BD '000
ASSETS			
Cash and balances with Central Bank of Bahrain	7	1,976	2,218
Placement with banks and other financial institutions	7	14,850	21,917
Islamic financing and loans to customers	8	76,731	85,866
Investment securities	9	41,447	31,144
Investment in associates	10	322	259
Investment properties	11	11,527	12,000
Property and equipment	12	1,991	1,155
Other assets	13	2,416	3,646
TOTAL ASSETS		151,260	158,205
LIABILITIES AND EQUITY			
Liabilities			
Term loans	14	42,293	50,607
Deposits	15	34,918	35,001
Other liabilities		4,723	5,106
Total liabilities		81,934	90,714
Equity			
Share capital	16	65,000	65,000
Statutory reserve	17	1,186	1,186
Other capital contribution	18	4,048	4,048
Other reserves		654	(150)
Accumulated losses		(1,544)	(2,580)
Equity attributable to owners of the Bank		69,344	67,504
Non-controlling interest		(18)	(13)
Total equity		69,326	67,491
TOTAL LIABILITIES AND EQUITY		151,260	158,205


Khalid Al Rumaihi
Chairman


Ghassan Ghaleb Abdulaal
Director

The accompanying notes 1 to 38 form part of these consolidated financial statements.


Bahrain Development Bank B.S.C. (c)

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2019

	Note	2019 BD '000	2018 BD '000
Income			
Islamic financing and interest income	19	8,234	8,268
Islamic financing and interest expense	20	(1,588)	(1,870)
Net Islamic financing and interest income		6,646	6,398
Fee and commission income	21	357	231
Investment income	22	(288)	379
Rental income		1,706	2,007
Other income	23	635	1,171
Total operating income		9,056	10,186
Expenses			
Staff costs		(4,170)	(4,324)
Other operating expenses		(3,472)	(3,227)
Total operating expenses		(7,642)	(7,551)
Allowance for expected credit losses / provision - net	24	(440)	(3,982)
Impairment on investment in associates	10	-	(92)
Total expected credit losses / impairment		(440)	(4,074)
Net operating income / (losses)		974	(1,439)
Share of profit from associates	10	63	113
Net profit / (loss) for the year		1,037	(1,326)
Net profit / (loss) for the year attributable to:			
- Owners of the Bank		1,036	(1,323)
- Non-controlling interest		1	(3)
		1,037	(1,326)


Khalid Al Rumaihi
Chairman


Ghassan Ghaleb Abdulaal
Director

The accompanying notes 1 to 38 form part of these consolidated financial statements.

Bahrain Development Bank B.S.C. (c)
**CONSOLIDATED STATEMENT OF OTHER
 COMPREHENSIVE INCOME**

For the year ended 31 December 2019

<i>Note</i>	2019 BD '000	2018 BD '000
Net income / (loss) for the year	1,037	(1,326)
Other comprehensive income:		
<i>Items that will not be reclassified to profit or loss in subsequent periods:</i>		
Changes in fair value through other comprehensive income reserve (equity instruments)	(25)	1
<i>Items that will be reclassified to profit or loss in subsequent periods:</i>		
Changes in fair value of investments classified as fair value through other comprehensive income (debt instruments)	829	(312)
Total comprehensive income / (loss) for the year	1,841	(1,637)
Total comprehensive income / (loss) attributable to:		
- Owners of the Bank	1,840	(1,634)
- Non-controlling interest	1	(3)
	1,841	(1,637)

The accompanying notes 1 to 38 form part of these consolidated financial statements.

Bahrain Development Bank B.S.C. (c)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2019

		Equity attributable to owners of the Bank							
	Share capital BD '000	Statutory reserve BD '000	Other capital contribution BD '000	Other reserves BD '000	Accumulated losses BD '000	Total BD '000	Non - controlling interest BD '000	Total equity BD '000	
As at 1 January 2019	65,000	1,186	4,048	(150)	(2,580)	67,504	(13)	67,491	
Total comprehensive income for the year	-	-	-	804	1,036	1,840	1	1,841	
Minority interest movement	-	-	-	-	-	-	(6)	(6)	
As at 31 December 2019	65,000	1,186	4,048	654	(1,544)	69,344	(18)	69,326	
		Equity attributable to owners of the Bank							
	Share capital BD '000	Statutory reserve BD '000	Other capital contribution BD '000	Other reserves BD '000	Accumulated losses BD '000	Total BD '000	Non - controlling interest BD '000	Total equity BD '000	
As at 1 January 2018	65,000	1,186	4,048	161	(1,257)	69,138	(10)	69,128	
Total comprehensive loss for the year	-	-	-	(311)	(1,323)	(1,634)	(3)	(1,637)	
As at 31 December 2018	65,000	1,186	4,048	(150)	(2,580)	67,504	(13)	67,491	

The accompanying notes 1 to 38 form part of these consolidated financial statements.

Bahrain Development Bank B.S.C. (c)

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2019

	Note	2019 BD '000	2018 BD '000
OPERATING ACTIVITIES			
Profit / loss for the year		1,037	(1,326)
Adjustments for:			
Depreciation		854	893
Allowance for expected credit losses / provision - net	24	440	3,982
Impairment on investment in associates	10	-	92
Changes in fair value of investments classified as fair value through profit or loss	22	348	(84)
Dividend income	22	(77)	(90)
Share of profit from associates	10	(63)	(113)
Loss on foreign currency translation		17	76
Operating profit before changes in operating assets and liabilities		2,556	3,430
Changes in operating assets and liabilities:			
Placement with banks and other financial institutions having original maturity of more than 90 days		2,272	1,841
Islamic financing and loans to customers		9,908	22,114
Other assets		277	(1,630)
Deposits		(83)	(11,439)
Other liabilities		(618)	(265)
Net cash from operating activities		14,312	14,051
INVESTING ACTIVITIES			
Additions to property and equipment	12	(1,217)	(364)
Purchase of investment securities		(54,830)	(32,065)
Proceeds from sale of investment securities		44,970	16,019
Addition to investment properties *	11	-	(435)
Dividend income received	22	77	90
Liquidation of Investment Securities		8	-
Net cash used in investing activities		(10,992)	(16,755)
FINANCING ACTIVITIES			
Repayment of term loans	14	(8,314)	(5,780)
Loan drawn down	14	-	4,713
Net cash used in financing activities		(8,314)	(1,067)
NET DECREASE IN CASH AND CASH EQUIVALENTS		(4,994)	(3,771)
Cash and cash equivalents at beginning of the year		12,753	16,524
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	7	7,759	12,753
Additional information:			
Islamic financing and interest received		8,038	7,840
Islamic financing and interest paid		1,667	1,872

*The addition to property and equipment and other liabilities of BD 741 thousand is a non-cash item.

The accompanying notes 1 to 38 form part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2019

1 INCORPORATION AND ACTIVITIES

Bahrain Development Bank B.S.C. (c) ("the Bank" or "BDB") was established as a Bahraini closed shareholding company by Legislative Decree number 19 dated 11 December 1991 and commenced operations on 20 January 1992. The Bank is registered with the Ministry of Industry, Commerce and Tourism (MOICT) under commercial registration (CR) number 26226. The Bank's registered office is in the Kingdom of Bahrain. The Bank is operating as a retail bank with special waivers under a license issued by the Central Bank of Bahrain ("CBB").

The core activities of the Bank consist of advancing loans for project finance, working capital, premises and equipment for developing industries and service sectors such as Tourism, Health and Education in the Kingdom of Bahrain, and also invests in the share capital of such entities. As part of this activity, the Bank also renders management consultancy services and subscribes to ordinary and preference shares in locally incorporated companies. Additionally, loans are advanced for Agriculture, Fisheries and Higher Education purposes. Other activities of the Bank comprise making a direct contribution towards the economic development of the Kingdom of Bahrain.

These consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors of the Bank on 24 February 2020.

2 BASIS OF PREPARATION**2.1 Statement of compliance**

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

2.2 Accounting convention

These consolidated financial statements are prepared on a historical cost basis, except for certain investment securities carried at fair value through profit or loss, or through other comprehensive income, that have been measured at fair value.

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

2.3 Basis of consolidation

These consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries (the "Group"), all of which have 31 December as their year end and are incorporated in the Kingdom of Bahrain. The Bank has the following principal subsidiaries:

	<i>Ownership interest</i>		<i>Principal activity</i>
	<i>2019</i>	<i>2018</i>	
Bahrain Business Incubator Centre S.P.C.	100%	100%	Development and assistance to emerging Bahraini entrepreneurs
Bahrain Export Development Center S.P.C.*	100%	100%	Management consultancy activities
Al-Waha Venture Capital Fund Company	99%	99%	Trusts, Funds and Similar Financial Entities - Fund Company
Middle East Corner Consultancy Co. W.L.L. (MECC) **	28.60%	28.60%	Consultancy to small and medium enterprises

* BEDC is in the process of liquidation.

** The Bank is exposed, or has rights, to variable returns from its involvement with MECC; and has the ability to affect those returns through its power over MECC and thus is deemed as a subsidiary of the Bank. The bank's petition for forced liquidation is pending with the court.

As at 31 December 2019

2 BASIS OF PREPARATION (continued)

2.3 Basis of consolidation (continued)

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

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

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

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

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

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

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

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

3 SIGNIFICANT ACCOUNTING JUDGMENT AND ESTIMATES

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

Going concern

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

3 SIGNIFICANT ACCOUNTING JUDGMENT AND ESTIMATES (continued)

Fair value of financial instruments

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

Business model in classifying financial instruments

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

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

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

Impairment of financial instruments

Assessment of whether credit risk on the financial asset has increased significantly since initial recognition and incorporation of forward-looking information in the measurement of expected credit losses (ECL).

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

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

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

4 NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2019

4 NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE (continued)

- Amendments to IFRS 3: Definition of a Business;
- Amendments to IAS 1 and IAS 8: Definition of Material; and
- Interest Rate Benchmark Reform: Amendments to IFRS 9, IAS 39 and IFRS.

Interest Rate Benchmark Reform Amendments to IFRS 9, IAS 39 and IFRS 7 includes a number of reliefs, which apply to all hedging relationships that are directly affected by interest rate benchmark reform. A hedging relationship is affected if the reform gives rise to uncertainties about the timing and or amount of benchmark based cash flows of the hedged item or the hedging instrument. As a result of interest rate benchmark reform, there may be uncertainties about the timing and or amount of benchmark-based cash flows of the hedged item or the hedging instrument during the period before the replacement of an existing interest rate benchmark with an alternative nearly risk-free interest rate (an RFR). These amendments are effective for annual periods beginning on or after 1 January 2020, with early application permitted. The Group is currently assessing the impact of this standard and will apply from the effective date.

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

5 NEW STANDARDS AND INTERPRETATIONS ISSUED AND EFFECTIVE

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in previous year, except for the adoption of the following new standards or amendments to existing standards, applicable to the Group, and which are effective for annual periods beginning on or after 1 January 2019:

- IFRS 16 Leases (IFRS 16);
- IFRIC Interpretation 23 Uncertainty over Income Tax Treatment; and
- Amendments to IFRS 9 Prepayment features with negative compensation.

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

- IFRS 3 Business combinations;
- IAS 12 Income taxes; and
- IAS 23 Borrowing costs.

The above new standards, interpretations and amendments to IFRSs which are effective for annual accounting periods starting from 1 January 2019, did not have any material impact on the accounting policies, financial position or performance of the Group, except for the adoption of IFRS 16, which is explained below.

5.1 IFRS 16 - Leases (IFRS 16)

IFRS 16 supersedes IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for most leases under a single on-balance sheet model. Lessor accounting under IFRS 16 is substantially unchanged from IAS 17. Lessors will continue to classify leases as either operating or finance leases using similar principles as in IAS 17. Therefore, IFRS 16 did not have an impact for leases where the Group is the lessor.

Prior to the adoption of IFRS 16, the Group accounted for and classified each of its leases (as lessee) at the inception date as either a finance lease or an operating lease in accordance with IAS 17. Upon adoption of IFRS 16, the Group applied a single recognition and measurement approach for all leases that it is the lessee, except for short-term leases and leases of low-value assets. The Group recognised lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets. The Group adopted IFRS 16 using the modified retrospective method of adoption with the date of initial application of 1 January 2019 and accordingly, the comparative information is not restated. The Group elected to use the transition practical expedient allowing the standard to be applied only to contracts that were previously identified as leases applying IAS 17 and IFRIC 4 at the date of initial application.

5 NEW STANDARDS AND INTERPRETATIONS ISSUED AND EFFECTIVE (continued)

5.1 IFRS 16 - Leases (IFRS 16) (continued)

The Group has recorded right-of-use assets representing the right to use the underlying assets under premises and equipment and the corresponding lease liabilities to make lease payments under other liabilities. The right-of-use assets and lease liabilities recorded as at 1 January 2019 amounted to BD 741 thousand, with no impact on retained earnings. When measuring lease liabilities, the Group reassessed its outstanding lease arrangements as at 31 December 2018 and discounted future lease payments using the BIBOR of 2% at 1 January 2019. Lease costs for the year ended 31 December 2019 relating to lease liabilities and depreciation relating to right-of-use assets were included under other expenses and depreciation lines in the statement of profit or loss.

The accounting policies of the Group upon adoption of IFRS 16 are as follows:

a) Right of use assets

The Group recognises right of use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right of use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any re-measurement of lease liabilities. The cost of right of use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Unless the Group is reasonably certain to obtain ownership of the leased asset at the end of the lease term, the recognised right of use assets are depreciated on a straight-line basis over the shorter of its estimated useful life and the lease term. Right of use assets are subject to impairment. The carrying value of right-of-use assets are recognised under premises and equipment in the statement of financial position.

b) Lease liabilities

At the commencement date of the lease, the Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term. In calculating the present value of lease payments, the Group uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable, in this case BIBOR. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments or a change in the assessment to purchase the underlying asset and is recognised under other liabilities in the statement of financial position.

6 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

6.1 Investment in associates

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

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

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

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

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

As at 31 December 2019

6 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**6.1 Investment in associates (continued)**

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

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

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

6.2 Property and equipment

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

6.2.1 Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

If significant parts of an item of property and equipment have different useful lives, then they are accounted for as separate items (major components) of property and equipment.

Any gain or loss on disposal of an item of property and equipment (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised within other income in the consolidated statement of profit or loss.

6.2.2 Subsequent measurement

Subsequent expenditure is capitalised only when it is probable that the future economic benefits of the expenditure will flow to the Group. Ongoing repairs and maintenance are expensed as incurred.

6.2.3 Depreciation

Depreciation is calculated to write off the cost of property and equipment less their estimated residual values using the straight-line method over their estimated useful lives, and is generally recognised in the consolidated statement of profit or loss. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Land is not depreciated. The estimated useful lives of significant items of property and equipment are as follows:

Buildings on freehold premises	15 - 30 years
Furniture, fixtures, vehicles, computers and office	3 - 5 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

6.2.4 Reclassification to investment property

When the use of a property changes from owner occupied to investment property, the property is classified to investment property and carried at cost in line with the accounting policy as per note 6.3.

6 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

6.3 Investment property

Investment properties are those which are held by the Group to earn rental income or for capital appreciation or both. Investment properties are stated at cost less accumulated depreciation and any impairment losses. Depreciation is calculated on cost using the straight-line method at annual rates which are intended to write off the cost of the investment property over their estimated useful lives. Any gain or loss on disposal of the investment property (calculated as the difference between the net proceeds from the disposal and the carrying amount of the item) is recognized in the consolidated statement of profit or loss.

6.4 Accounts receivable

Accounts receivable are stated at original invoice amount net of discounts and provisions for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when there is no possibility of recovery.

6.5 Term loans

Term loans are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

6.6 Deposits

Deposits are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

6.7 Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

6.8 Employees' end of service benefits

Pension rights (and other social benefits) for Bahraini employees are covered by the General Organisation for Social Insurance scheme to which employees and employers contribute monthly on a fixed-percentage-of salaries basis. The Group's share of contributions to this scheme, which is a defined contribution scheme under IAS 19 - Employees Benefits, is recognised as an expense in the consolidated statement of profit or loss.

Expatriate employees are entitled to leaving indemnities payable under the Bahraini Labour law for the Private Sector 2012, based on length of service and final remuneration. Provision for this which is unfunded has been made by calculating the notional liability had all employees left at the reporting date. These charges are recognised as an expense in the consolidated statement of profit or loss.

6.9 Income recognition

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or financial liability (or, where appropriate, a shorter period to the carrying amount of the financial asset or financial liability). When calculating the effective interest rate, the Group estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

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

6.10 Dividend income

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

6.11 Fee and commission income

Fee and commission income and related expenses that are integral to the effective interest rate on a financial asset or financial liability are included in the measurement of the effective interest rate.

6 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

6.11 Fee and commission income (continued)

Other fee and commission income including account servicing fees, investment management fees, sales commission, placement fees and syndication fees are recognised as the related services are performed. If a loan commitment is not expected to result in the draw-down of a loan, then the related loan commitment fee is recognised on a straight-line basis over the commitment.

Other fee and commission expense relate mainly to transaction and service fees, which are expensed as the service is received.

6.12 Rental income

Rental income from investment property is recognised as revenue on a straight line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

6.13 Other capital contribution

This represents a non-reciprocal contribution, has no interest and no repayment terms and will only be repaid on liquidation of the Bank and accordingly, it has been classified as equity.

6.14 Foreign currencies

Transactions in foreign currencies are translated into the functional currency at the spot exchange rates at the date of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into the functional currency at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between the amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortised cost in the foreign currency translated at the spot exchange rate at the end of the year.

Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated into the functional currency at the spot exchange rate at the date on which the fair value is determined. Non-monetary items that are measured based on historical cost in a foreign currency are translated using the spot exchange rate at the date of the transaction.

Foreign currency differences arising on translation are generally recognised in the consolidated statement of profit or loss.

6.15 Cash and cash equivalents

Cash and cash equivalents includes notes and coins on hand, unrestricted balances held with the Central Bank and highly liquid financial assets with original maturities of three months or less from the date of acquisition that are subject to insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

6.16 Derivatives

In the ordinary course of business, the Bank enters into transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payment is dependent upon movements in price in one or more underlying financial instruments, reference rate or index. Derivative financial instruments include forward exchange contracts.

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

6.17 Financial assets and financial liabilities

The Bank's key accounting policies in compliance with IFRS 9 are summarised below:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2019

6 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**6.17 Financial assets and financial liabilities (continued)****6.17.1 Impairment of financial assets**

Impairment of financial assets are determined using an "expected credit loss" model ("ECL") as required under IFRS 9. This impairment model is also applied to certain loan commitments and financial guarantees. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case, the allowance is based on the change in the ECLs over the life of the asset. Under IFRS 9, credit losses are recognized earlier than under the previous standard.

6.17.2 Expected credit loss (ECL)

The Bank recognises ECL on the following financial assets that are not measured at fair value through profit or loss:

- a) Debt investments;
- b) Placements with banks and other financial institutions;
- c) Islamic financing and loans to customers;
- d) Letters of credit and bank guarantees; and
- e) Irrevocable undrawn commitments.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the other financial assets on which credit risk has not increased significantly since their initial recognition, for which ECL is measured as 12-month ECL. 12-month ECL are the portion of ECL that result from default events on a financial asset that is possible within the 12 months after the reporting date.

6.17.3 Presentation of allowance for ECL in the statement of financial position

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

- a) financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets; and
- b) where a financial instrument includes both a drawn and an undrawn component (as in the case of overdraft, letter of credit / bank guarantee limits etc.), the Bank presents a loss allowance for the approved limit of the facility in 'other liabilities'.

6.17.4 Write-offs

The Bank's accounting policy for write-offs under IFRS 9 remains the same. Financial assets are written off either partially or in their entirety only when the Bank has thoroughly explored most avenues of recovery and it is recognized thereafter that the outstanding amount of the debt is clearly not recoverable. However, in all written-off cases, the Bank's efforts towards the recovery of the outstanding amount continues and periodic updates are provided to the Board of Directors. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to 'other income'.

7 CASH AND CASH EQUIVALENTS

	2019 BD '000	2018 BD '000
Cash and balances with Central Bank of Bahrain	1,976	2,218
Placement with banks and other financial institutions	14,850	21,917
	<u>16,826</u>	<u>24,135</u>
Less: reserve with Central Bank of Bahrain	(1,494)	(1,530)
Less: placements with banks and other financial institutions having original maturity of more than 90 days	(7,660)	(9,913)
Add: allowance for expected credit losses	87	61
Cash and cash equivalents at end of the year	<u>7,759</u>	<u>12,753</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2019

7 CASH AND CASH EQUIVALENTS (continued)

	2019 BD '000	2018 BD '000
Cash and balances with Central Bank of Bahrain (excluding reserves)	482	688
Placements with banks and other financial institutions having original maturity of 90 days or less	7,277	12,065
	<u>7,759</u>	<u>12,753</u>

8 ISLAMIC FINANCING AND LOANS TO CUSTOMERS

	2019 BD '000	2018 BD '000
Project finance - Islamic	73,418	89,689
Project finance - conventional	19,965	15,360
Fisheries and agriculture	3,905	4,228
Other loans	1,549	1,159
	<u>98,837</u>	<u>110,436</u>
Less: allowance for expected credit losses / provision *	<u>(22,106)</u>	<u>(24,570)</u>
	<u>76,731</u>	<u>85,866</u>

* This includes credit losses of BD 13,591 thousand (31 December 2018: BD 15,573 thousand) against Islamic financing to customers.

Below is the movement for expected credit losses on Islamic financing and loans to customers:

	2019			Total BD '000
	Stage 1 12-months ECL BD '000	Stage 2 Life time ECL not credit impaired BD '000	Stage 3 Lifetime ECL credit- impaired BD '000	
Balance at 1st January	742	998	22,830	24,570
Changed due to financial assets recognised in opening balances that have:				
- transferred to 12-month ECL	577	(491)	(86)	-
- transferred to Stage 2 (lifetime ECL not credit-impaired)	(24)	150	(126)	-
- transferred to Stage 3 (lifetime ECL credit-impaired)	(22)	(277)	299	-
Net re-measurement of loss allowance	233	112	1,468	1,813
Recoveries / write-backs	(864)	(289)	(1,433)	(2,586)
Allowance for expected credit losses - net	(100)	(795)	122	(773)
Write offs during the year	-	(7)	(1,684)	(1,691)
Balance at 31 December	<u>642</u>	<u>196</u>	<u>21,268</u>	<u>22,106</u>

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As at 31 December 2019

8 ISLAMIC FINANCING AND LOANS TO CUSTOMERS (continued)

	2018			
	Stage 1 12-months ECL	Stage 2 Life time ECL not credit impaired	Stage 3 Lifetime ECL credit- impaired	Total
	BD '000	BD '000	BD '000	BD '000
Balance as at 1 January	754	186	18,096	19,036
Transition adjustment	112	996	2,118	3,226
Opening balance as at 1 Balance at 1st January	866	1,182	20,214	22,262
Changed due to financial assets recognised in opening balances that have:				
- transferred to 12-month ECL	323	(87)	(236)	-
- transferred to Stage 2 (lifetime ECL not credit-impaired)	(38)	329	(291)	-
- transferred to Stage 3 (lifetime ECL credit-impaired)	(59)	(528)	587	-
Net re-measurement of loss allowance	147	521	3,976	4,644
Recoveries / write-backs	(495)	(416)	(523)	(1,434)
Allowance for expected credit losses - net	(122)	(181)	3,513	3,210
Write offs during the year	(2)	(3)	(897)	(902)
Balance at 31 December	742	998	22,830	24,570

At 31 December 2019, interest in suspense on past due loans that are credit impaired amounted to BD3,800 thousand (31 December 2018: BD 2,109 thousand) and are treated as a memorandum account.

The fair value of the collateral consisting of cash, securities and real estate that the Group holds relating to loans individually determined to be impaired at 31 December 2019 amounts to BD 13,594 thousand (31 December 2018: BD 9,011 thousand).

The contractual amount outstanding on financing assets written off by the Group as at 31 December 2019 and that are still subject to enforcement activity was BD 5,876 thousand (31 December 2018: BD 4,536 thousand).

9 INVESTMENT SECURITIES

	2019 BD '000	2018 BD '000
At fair value through profit or loss		
Conventional equities	5,245	4,612
Islamic equities	355	676
	<u>5,600</u>	<u>5,288</u>
At fair value through other comprehensive income:		
Conventional equities	181	184
Conventional debt securities*	17,521	6,504
Sukuk*	6,498	6,093
	<u>24,200</u>	<u>12,781</u>
At amortized cost:		
Conventional debt securities*	11,647	13,075
	<u>41,447</u>	<u>31,144</u>

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As at 31 December 2019

9 INVESTMENT SECURITIES (continued)

*These exposures to the home country sovereign i.e. Kingdom of Bahrain are considered to be low risk and fully recoverable and hence, ECL assumed to be insignificant.

10 INVESTMENT IN ASSOCIATES

	<i>Ownership interest</i>		<i>Principal activity</i>
	2019	2018	
Arabian Taxi Company ("ATC")	20%	20%	Operating and managing taxi services
EBDA Bank ("EBDB")	21.13%	21.13%	Providing microfinance and related advisory services.

Associates are incorporated in Bahrain and accounted for using the equity method in these consolidated financial statements.

	2019	2018
	BD '000	BD '000
<i>Carrying amount of investment in associated companies</i>		
At 1 January	259	419
Share of profit from associates	63	113
Changes in statement of changes in equity	-	(181)
Impairment on investment in associates	-	(92)
At 31 December	322	259

11 INVESTMENT PROPERTIES

	2019	2018
	BD '000	BD '000
At 1 January	12,000	12,033
Transfer from property and equipment	-	435
Depreciation charge for the year	(473)	(468)
At 31 December	11,527	12,000

As of 31 December 2019, investment properties include 4 buildings (2018: 4 buildings) with a fair value of BD 15,047 thousand (2018: BD 17,498 thousand) as determined by the management.

The fair value measurement of the investment properties has been categorized as a Level 3 fair value based on the inputs to the valuation technique used. The discounted cash flows model considers the present value of net cash flows to be generated from the property, taking into account the expected rental growth rate, void periods, occupancy rate, lease incentive costs such as rent-free periods and other costs not paid by tenants. The expected net cash flows are discounted using risk-adjusted discounted rates. Among other factors, the discount rate estimation considers quality of a building and its location, tenant credit quality and lease terms.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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12 PROPERTY AND EQUIPMENT

	<i>Freehold land BD '000</i>	<i>Right of Use BD '000</i>	<i>Freehold premises BD '000</i>	<i>Furniture, fixtures, vehicles and office equipment BD '000</i>	<i>Total BD '000</i>
Cost:					
At 1 January 2019	293	-	1,659	1,917	3,869
Additions	-	741	-	476	1,217
Disposals / write offs	-	-	-	(4)	(4)
At 31 December 2019	293	741	1,659	2,389	5,082
Depreciation:					
At 1 January 2019	-	-	1,297	1,417	2,714
Charge for the year	-	34	55	292	381
Disposals	-	-	-	(4)	(4)
At 31 December 2019	-	34	1,352	1,705	3,091
Net book values:					
At 31 December 2019	293	707	307	684	1,991
At 31 December 2018	293	-	362	500	1,155

13 OTHER ASSETS

	<i>2019 BD '000</i>	<i>2018 BD '000</i>
Rent and other account receivables - net	394	1,450
Receivable related to Sitra Mall	-	1,159
Interest receivable	1,326	566
Receivable from Ministry of Finance	418	222
Prepayments and other assets	278	249
	2,416	3,646

As at 31 December 2019, the ECL on other assets amounted BD 2,490 thousand (31 December 2018: BD 1,942 thousand).

14 TERM LOANS

	<i>2019 BD '000</i>	<i>2018 BD '000</i>
Kuwait Fund for Arab Economic Development	-	1,327
Saudi Fund for Development	8,023	8,526
Arab Fund for Economic and Social Development	34,270	40,754
	42,293	50,607

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at 31 December 2019

14 TERM LOANS (continued)

The movement of the term loans during the year is as follows:

	2019 BD '000	2018 BD '000
At 1 January 2019	50,607	51,674
Loan drawn down	-	4,713
Repayment of loans	(8,314)	(5,780)
At 31 December 2019	<u>42,293</u>	<u>50,607</u>

Kuwait Fund for Arab Economic Development

The Bank had obtained a loan from Kuwait Fund for Arab Economic Development (KFAED) in 1998. The entire facility has been drawn down and was repayable in thirty equal half yearly instalments, which commenced from 15 May 2005. This bears an interest and management fees of 1.5% and 0.5% respectively. The Ministry of Finance is a guarantor to the loan.

The loan proceeds were utilised by the Bank to advance loans to customers. One of the covenants of KFAED's loan agreement requires the Bank to repay KFAED any margin earned in excess of a spread of 4% ("interest differentials") on such loans to customers. The interest differentials are deposited into KFAED's bank account maintained by the Bank in a fiduciary capacity. The balance at year end was BD 2 thousand (2018: the same). This account can be used only for development activities such as training, feasibility studies and technical assistance to borrowers agreed by both the parties. During 2019, no amount was utilised for such purposes (2018: same).

Saudi Fund for Development

During 2012, the Bank obtained a loan of SAR 100 million from Saudi Fund for Development. The facility has been fully availed and is repayable semi-annually in 25 years (5 years grace period for principal) at an interest rate of 2.0%. The Ministry of Finance is a guarantor to the loan.

Arab Fund for Economic and Social Development

During 2013, the Bank had obtained a loan of USD 30 million from Arab Fund for Economic and Social Development (AFESD). The facility has been fully availed and is repayable semi-annually in 10 years (3 years grace period for principal) at an interest rate of 3.0%. During 2014, the Bank had obtained a second loan of USD 50 million from AFESD. The facility has been fully availed and is repayable semi-annually in 10 years (3 years grace period for principal) at an interest rate of 3.0%. During 2016, the Bank had obtained a third loan of USD 50 million from AFESD. The facility has been fully availed and is repayable semi-annually in 10 years (3 years grace period for principal) at an interest rate of 3.0%.

15 DEPOSITS

	2019 BD '000	2018 BD '000
Deposits from banks (note a)	5,467	-
Deposits from customers (note b)	29,451	35,001
	<u>34,918</u>	<u>35,001</u>

Note a: Deposits from banks BD 5,467 thousand (31 December 2018: BD nil thousand) is from Islamic banks placed with BDB on a Wakala basis.

Note b: Deposits from customers include BD 15,432 thousand (31 December 2018: BD 1,250 thousand) kept as margin deposits against financings provided.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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16 SHARE CAPITAL

	2019	2018
	BD '000	BD '000
Authorized:		
100 million (2018: 100 million) shares of BD 1 each	100,000	100,000
Issued and fully paid-up:		
65 million (2018: 65 million) shares of BD 1 each	65,000	65,000

17 STATUTORY RESERVE

In accordance with the provisions of the Bahrain Commercial Companies Law and the Bank's articles of association, an amount equivalent to 10% of the net profit for the year is transferred to the statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve totals 50% of the paid up share capital. This reserve is not distributable, but can be utilised for the purposes of a distribution in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the CBB. No such transfers have been made during the year ended 31 December 2019 and 2018, as the Bank is having accumulated losses.

18 OTHER CAPITAL CONTRIBUTION

Other capital contribution mainly includes a contribution by a majority shareholder for a non-monetary asset in the form of a commercial property to the Bank. The property has been classified as an investment property (refer note 11) that was recognised at its fair value on the date of transfer and as a capital contribution in the statement of changes in equity of BD 3,623 thousand.

19 ISLAMIC FINANCING AND INTEREST INCOME

	2019	2018
	BD '000	BD '000
Profit on Islamic financing	4,969	6,267
Interest on conventional loans	1,133	631
Profit and interest on securities	1,740	873
Profit and interest on placements	392	497
	8,234	8,268

20 ISLAMIC FINANCING AND INTEREST EXPENSE

	2019	2018
	BD '000	BD '000
Interest on term loans	1,305	1,422
Interest on deposits from customers	260	388
Profit on deposits from Islamic banks	17	34
Interest on deposits from conventional banks	6	26
	1,588	1,870

21 FEE AND COMMISSION INCOME

	2019	2018
	BD '000	BD '000
On Islamic financing and loans to customers	311	212
On contingent liabilities	46	19
	357	231

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22 INVESTMENT INCOME

	2019 BD '000	2018 BD '000
(Loss) / gain on sale of FVTPL investments	(17)	205
Changes in fair value of investments classified as FVTPL	(348)	84
Dividend income	77	90
	<u>(288)</u>	<u>379</u>

23 OTHER INCOME

This mainly includes recovery of written-off non-performing loans amounting to BD 441 thousand (2018: BD 955 thousand).

24 ALLOWANCE FOR EXPECTED CREDIT LOSSES / PROVISION - NET

	2019 BD '000	2018 BD '000
Placement with banks and other financial institutions	26	(16)
Islamic financing and loans to customers	(773)	3,210
Other assets	953	925
Off-balance sheet exposures	234	(137)
	<u>440</u>	<u>3,982</u>

25 CONTINGENT LIABILITIES AND COMMITMENTS

The Bank issues letters of credit and guarantees to its existing customers. These instruments commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import of goods.

Irrevocable commitments to extend credit are the Islamic financing and loans, which have been approved by the Bank but have not been disbursed as of the reporting date.

Details of contingent liabilities and commitments are given below:

	2019 BD '000	2018 BD '000
Contingent liabilities:		
Letters of credit *	46	34
Letters of guarantee *	1,461	1,439
	<u>1,507</u>	<u>1,473</u>
Commitments:		
Irrevocable commitments to extend credit *	3,557	1,323
Commitment to invest in equity **	2,752	3,485
	<u>6,309</u>	<u>4,808</u>
	<u>7,816</u>	<u>6,281</u>

* The Bank carries an allowance of ECL of BD 352 thousand (31 December 2018: 117 thousand) against these off-balance sheet items which is classified under other liabilities.

** This represents the Bank's commitment to invest a 10% equity portion in Al-Waha Venture Capital Fund established with a total value of USD 100 million (equivalent BD 37.7 million). During the year, the Bank paid BD 739 thousand (2018: 285 thousand) toward this commitment.

26 FAIR VALUES OF FINANCIAL INSTRUMENTS

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

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

Underlying the definition of fair value is a presumption that an enterprise is a going concern without any intention or need to liquidate, curtail materially the scale of its operations or undertake a transaction on adverse terms.

The Group measures fair values of financial instruments using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements.

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

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

Level 3: Valuation techniques using significant unobservable inputs. This category includes instruments where the valuation technique includes inputs not based on market observable data.

Term loans obtained by the Bank are from Development Funds in Kuwait and the Kingdom of Saudi Arabia. There is no secondary market for such loans which are at lower than market rates due to the nature of these loans. The Bank has estimated that its financing rates and terms are comparable to that of the objectives of other similar development banks in the region and accordingly believes the carrying value of term loans obtained are a close approximation of their fair values.

The fair value of deposits approximates the carrying value as at the reporting date given their short term nature.

There is no change in the valuation techniques used for valuation of investments during the period as compared to the year ended 31 December 2019.

The valuation technique for Level 2 financial assets is arrived on the basis of the market multiples approach and discounted cash flows. The key inputs used include a range of weighted average cost of capital used for discounting cash flows, discount for lack of marketability, control premium etc.

The bank uses various valuation techniques such as discounted cash flows, market multiples and adjusted net assets value to arrive at the fair value of Level 3 financial assets. The key inputs used are discount rate and growth rate, price earning multiple and net assets value. The reasonable potential shift in any of the above mentioned inputs will not have any significant effect on the consolidated statement of profit and loss.

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26 FAIR VALUES OF FINANCIAL INSTRUMENTS (continued)

The table below analyses financial instruments, measured at fair value as at both reporting dates, in the fair value hierarchy into which the fair value measurement is categorised. The fair values of financial assets and financial liabilities carried at amortised cost approximate their carrying values as at the reporting dates.

<i>Financial assets measured at fair value:</i>	<i>Level 1 BD '000</i>	<i>Level 2 BD '000</i>	<i>Level 3 BD '000</i>	<i>Total fair value BD '000</i>	<i>Total carrying value BD '000</i>
<u>31 December 2019</u>					
Investment securities - equity	1	354	5,426	5,781	5,781
Investment securities - debt	24,019	-	-	24,019	24,019
<u>31 December 2018</u>					
Investment securities - equity	96	580	4,796	5,472	5,472
Investment securities - debt	12,597	-	-	12,597	12,597

The Bank has outstanding forward forex contracts to buy USD from Central Bank of Bahrain ("CBB") with a nominal value of BD 27,808 thousand (2018: BD 35,114 thousand) with tenors of less than one year. Given that BD is currently pegged against the USD and the interest differential between BD and USD is not being marginal, the Bank deems the fair value of these contracts to be insignificant.

Below is the reconciliation of Level 3 financial assets carried at fair value:

	2019 BD '000	2018 BD '000
At beginning of the year	4,796	5,508
Changes in fair value recognised in the statement of profit or loss	(84)	137
Additions during the year	739	336
Sales made during the year	-	(1,185)
Written off during the year	(25)	-
At end of the year	5,426	4,796

Sensitivity analysis

FVTPL investments comprises investments in private equity entities and funds. The main principles, estimates and assumptions adopted to arrive at fair value include estimated future cash flows which have been provided by the management of the investee companies but have been reviewed for reasonableness by the Group and the external valuer. Cash flows have been projected for an initial period of five years or over the project life in certain cases and then a terminal value has been estimated at a growth rate of 2% to 3%.

The potential effect of using reasonable possible alternative assumptions for fair valuing the investments at FVTPL are summarised below:

<i>Valuation technique used</i>	<i>Key unobservable inputs</i>	<i>Fair value at 31 December 2019 BD '000</i>	<i>Reasonable possible shift +/- (in any input)</i>	<i>Impact on profit or loss BD '000</i>
Discounted cash flow	Discount rate	3,054	+/- 0.5%	(61) / 67
	Growth rate		+/- 0.5%	42 / (38)
Market Multiples	P/E Multiple	354	+/- 5%	20 / (20)
Adjusted Net Assets Value	NAV	2,367	+/- 5%	71 / (31)

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26 FAIR VALUES OF FINANCIAL INSTRUMENTS (continued)

<i>Valuation technique used</i>	<i>Key unobservable inputs</i>	<i>Fair value at 31 December 2018 BD '000</i>	<i>Reasonable possible shift +/- (in any input)</i>	<i>Impact on profit or loss BD '000</i>
Discounted cash flow	Discount rate	4,082	+/- 0.5%	(78) / 84
	Growth rate		+/- 0.5%	51 / (47)
Market Multiples	P/E Multiple	580	+/- 5%	29 / (29)
Adjusted Net Assets Value	NAV	530	+/- 5%	66 / (66)

27 RELATED PARTY TRANSACTIONS

The Group enters into transactions with related parties which comprise major shareholders, associates, directors, senior management and entities controlled jointly or significantly influenced by such related parties in the ordinary course of business at agreed rates. Amounts due from related parties are unsecured.

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

	<i>Directors and key management personnel BD '000</i>	<i>Shareholders and related companies BD '000</i>	<i>Total BD '000</i>
31 December 2019			
Islamic financing and loans to customers	455	114	569
Investment in associates	-	322	322
Other assets	-	418	418
Deposits	4	3,721	3,725
	<i>Directors and key management personnel BD '000</i>	<i>Shareholders and related companies BD '000</i>	<i>Total BD '000</i>
31 December 2018			
Islamic financing and loans to customers	295	12	307
Investment in associates	-	283	283
Other assets	-	222	222
Deposits	152	7,638	7,790

The transactions with related parties included in the consolidated statement of profit or loss are as follows:

	<i>Directors and key management personnel BD '000</i>	<i>Shareholders and related companies BD '000</i>	<i>Total BD '000</i>
2019			
Islamic financing and interest income	15	9	24
Islamic financing and interest expense	-	57	57
Share of profit for associates	-	63	63

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27 RELATED PARTY TRANSACTIONS (continued)

	<i>Directors and key management personnel BD '000</i>	<i>Shareholders and related companies BD '000</i>	<i>Total BD '000</i>
<i>2018</i>			
Islamic financing and interest income	10	11	21
Islamic financing and interest expense	-	55	55
Share of profit for associates	-	113	113
Other expenses	-	27	27

Compensation of key management personnel is as follows:

	<i>2019 BD '000</i>	<i>2018 BD '000</i>
Board remuneration	178	80
Salary and short-term employee benefits	908	779
Termination benefits	87	148
	1,173	1,007

28 RISK MANAGEMENT

Risk is inherent in the Bank's activities but is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. In the course of its regular business, the Bank is exposed to multiple risks notably credit risk, liquidity risk, market risk, operational risk and other risks like compliance risk, strategic risks and reputational risks. A well-established risk governance and ownership structure ensures oversight and accountability of the effective management of risk at the Bank. The Bank's risk governance is manifested in a set of established policies, procedures and controls through which the existing organizational structure meets its strategic targets. This philosophy revolves around the knowledge of various risks and their willingness to accept the same commensurating with their risk appetite and strategic plan approved by the Board of Directors.

a) Organizational structure

A cohesive organizational structure is established within the Bank in order to identify, assess, monitor, and mitigate risks.

b) Board of Directors

The Board of Directors ("BOD") is responsible for the overall direction, supervision and control of the Bank. Oversight of the day-to-day management of the Bank is conducted by the BOD committees, the Chairman and the Chief Executive Officer ("CEO"). The BOD has overall responsibility for the Bank including approving and overseeing the implementation of its strategic objectives, risk strategy, corporate governance and corporate values within the agreed framework in accordance with relevant statutory and regulatory structures. The BOD currently comprises eight members.

c) Audit & Governance Committee of the board

The Audit & Governance Committee ("AGC") comprises three members of the Board and the Head of Internal Audit is the AGC's Secretary. This AC is principally responsible for reviewing the internal audit program and assist the Board in carrying out its duties regarding the integrity of the Bank's financial reporting system, adequacy of the Bank's internal control and risk management processes, to oversee the external and internal audit functions, and the Bank's compliance with legal and regulatory requirements.

28 RISK MANAGEMENT (continued)

d) Nomination & Remuneration Committee of the board

The Nomination & Remuneration Committee ("NRC") comprises three members of the BOD (including the Chairman) and the Head of Human Resources & Corporate Communications is the committee's Secretary. NRC has the overall responsibility of setting the criteria and processes for identification of candidates for the Board level committees and senior management. The Committee also assists the Board of Directors in establishing a fair and transparent process for the remuneration of directors, other Board Committees and the Chief Executive Officer and of the Executive Management. The Committee approves and oversees reward design and ensures that the reward is appropriate and consistent with the Bank's culture, business and risk strategy, performance as well as with any legal or regulatory requirements. NRC also oversees the Bank's HR policies and rewards policy framework, corporate governance practices.

e) Investment & Credit Committee of the Board

The Investment & Credit Committee ("ICC") comprises four members of the BOD. The Committee has overall responsibility of setting the criteria for managing credit and investment risks and oversee the investment and credit strategies and objectives of the Bank. The Committee assists the Board of Directors in managing credit risk and reviews internal credit policies, grants approvals for credit and investment facilities in addition to reviewing the quality and performance of the Bank's lending portfolio and investment in line with the agreed risk appetite and best credit risk management practices.

f) Risk Committee of the Board

The Risk Committee ("RC") comprises three members of the BOD. The Committee has overall responsibility of overseeing the Bank's enterprise risk management framework, approach and pertinent policies. The Committee recommends to the Board, guidelines in relation to the Bank's current and potential future risk exposures and risk strategy, determination of risk appetite including risk limits and tolerance levels as well as the Bank's capital and liquidity strategy.

g) Executive Management

Executive Management is responsible for the day to day operations towards achieving the strategic goals within the pre-defined risk appetite and approved strategy as a whole.

h) Management Executive Committee

The Management Executive Committee ("MEC") is a senior management level committee that has been entrusted with the role of supporting the CEO to determine and implement the Bank's strategic plan as approved by the BOD. The responsibilities of MEC include approving and monitoring the Bank's various business activities in accordance with the strategic plan approved by the Board.

In order to fulfil its responsibilities, the Committee has appointed other Sub-Committees and delegated specific tasks and adequate powers and authorities for effectively and efficiently carrying out the responsibilities assigned to them. The composition, guiding principles and detailed roles and responsibilities of MEC are covered in the MEC's charter.

i) Risk Executive Committee

The Risk Executive Committee ("REC") has the primary responsibility of overseeing the Bank's activities in managing credit risk, market risk, liquidity risk, operational risk, legal risk and other risks. REC has to ensure that the Bank has adequate risk management framework, policies, procedures and processes in place in order to identify, measure, monitor, mitigate and manage risks across all of its operations.

j) Asset and Liability Committee

The Assets and Liabilities Committee ("ALCO") is mainly responsible for defining long-term strategic plans and short-term tactical initiatives for directing asset and liability allocation prudently for the achievement of the Bank's strategic goals. ALCO monitors the Bank's liquidity and market risks and the Bank's risk profile in the context of economic developments and market fluctuations, to ensure that the Bank's ongoing activities are compatible with the risk / reward guidelines approved by the Delegated Approval Authority / Board.

28 RISK MANAGEMENT (continued)

k) Credit Committee

The Credit Committee ("CC") has the responsibility to grant / approve credit facilities as within their Delegated Authority and also makes decisions relating to the execution of investments in line with the Bank's investment strategy and management of credit and concentration risks. Proposals exceeding their Delegated Authority are escalated to the ICC for consideration.

l) Risk management

Risk Management Department is an independent function responsible for the preparation, implementation and updating the policies and procedures within the framework of the Bank's strategy and in line with the guidelines of the CBB. They are also responsible for the identification and continuous evaluation of all significant risks, design and implementation of appropriate internal controls to mitigate the risks and the processes involved in the remedial function. The risk management department is overseen by the Chief Risk Officer.

m) Legal Department

The Bank has engaged a panel of external legal counsels to handle all legal cases initiated for recovery of difficult loan cases. The progress and outcomes on such cases are monitored by the Head of Legal.

n) Internal Audit Department

Risk Management processes are audited annually by Internal Audit, which examines the adequacy of the controls in place in addition to compliance with the policies by the respective departments. The internal audit results are discussed with the MEC and the findings, together with recommendations, to mitigate the findings are presented to the Audit & Governance Committee of the Board.

o) Treasury Department

The Treasury Department is responsible for the day to day operations necessary to fund banking activities and implement ALCO's strategies in managing / optimizing interest rate and liquidity risks.

p) Risk Measurement and Reporting Systems

Monitoring and controlling risks is primarily performed based on the approved limits and the strong internal control structures established by the Board. The limits reflect the business strategy and the market environment in which the Bank operates as well as the level of risk that the Bank is willing to accept.

Strict assessment processes are factored during the review and approval processes. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities. Specifically tailored risk reports are prepared and distributed to ensure that all business divisions have access to extensive, necessary and up-to-date information.

Quarterly updates are provided to the BOD and on a monthly basis to all other members of the management on the utilization of market limits, proprietary investments, liquidity and other developments.

q) Risk Mitigation

Significant risk mitigation activities are focused in the credit area. The risk mitigation process comprises of an appropriate and adequate structure for the credit facilities at the initial stage followed by ongoing and regular monitoring, enforceable documentation and collateral.

The various risks to which the Group is exposed and how the Group manages them is discussed in the notes below.

29 CREDIT RISK

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's loans and Islamic financing to customers, placements and debt securities.

The Group's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the banking business, and these risks are an inevitable consequence of participating in financial markets. The Group's aim is therefore to achieve an appropriate balance between risk and return and minimize potential adverse effects on the Bank's financial performance.

The Group's risk management policies, procedures and systems are designed to identify and analyze these risks and to set appropriate risk mitigants and controls. The Bank reviews its risk management policies and systems on an ongoing basis to reflect changes in markets, products and emerging best practices.

Risk management is performed by the Credit Risk Management Unit under policies approved by the Board of Directors. The Credit Risk Management Unit identifies and evaluates financial risks in close co-operation with the Bank's operating units. The most important types of risks identified by the Bank are credit risk, liquidity risk and market risk. Market risk includes currency risk, profit rate risk, and price risk.

29.1 Credit risk

Credit risk is considered to be the most significant and pervasive risk for the Bank. The Bank takes on exposure to credit risk, which is the risk that the counter-party to a financial transaction will fail to discharge an obligation causing the Bank to incur a financial loss. Credit risk arises principally from financing (credit facilities provided to customers), deposits held with other banks and investments made in debt type instruments. Further, there is credit risk in certain off-balance sheet financial instruments, including guarantees relating to the purchase and sale of foreign currencies, letters of credit, acceptances and commitments to extend the credit. Credit risk monitoring and control is performed by the Credit Risk Management Unit (CRMU) which sets parameters and thresholds for the Bank's financing activities.

29.2 Significant Increase In Credit Risk (SICR)

To determine whether credit risk has significantly increased since initial recognition, the Group compares the risk of default at the assessment date with the risk of default at initial recognition. This assessment is to be carried out at each assessment date.

Using its expert credit judgment and, where possible, relevant historical experience, the Bank may determine that an exposure has undergone a significant increase in credit risk based on particular qualitative indicators that it considers are indicative of such an increase and whose effect may not otherwise be fully reflected in its quantitative analysis on a timely basis. The Bank monitors the effectiveness of the criterion used to identify SICR by regular reviews and validations.

The Bank classifies its financial instruments into Stage 1, Stage 2 and Stage 3, based on the applied methodology, as described below:

Stage 1: for financial instruments where there has not been a SICR since initial recognition and that are not credit-impaired on origination, the Bank recognises an allowance based on the 12-month ECL. All accounts at origination are classified as Stage 1.

Stage 2: for financial instruments where there has been a SICR since initial recognition but are not credit-impaired, the Bank recognises an allowance for the lifetime ECL for all financings and loans categorised in this stage based on the actual / expected maturity profile including restructuring or rescheduling of facilities.

Stage 3: for credit-impaired financial instruments, the Bank recognises the lifetime ECL. A customer is classified under Stage 3 based on a default identification process i.e. Days Past Due (DPD) of 90 days or more.

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29 CREDIT RISK (continued)**29.3 Measurement of ECL**

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

<i>Type of financial instrument</i>	<i>Measurement basis</i>
a) Financial assets that are not credit-impaired at the reporting date	As the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive).
b) Financial assets that are credit-impaired at the reporting date	As the difference between the gross carrying amount and the present value of estimated future cash flows.
c) Irrevocable undrawn commitments	As the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive.
d) Letters of credit and bank guarantees	As the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

The Bank measures an ECL at an individual instrument level taking into account the projected cash flows, Probability of Default (PD), Loss Given Default (LGD), Credit Conversion Factor (CCF) and discount rate.

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

- a) Probability of Default (PD);
- b) Loss Given Default (LGD); and
- c) Exposure At Default (EAD).

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

Linear Regression has been used to develop macroeconomic models specific to portfolios of the bank. Department variable has been the default rate specific to portfolios and independent variables considered are Macro variables.

The Modelling methodology adopted by the Bank involved a systematic approach with statistically rigorous analyses' to arrive at the final model for each of the portfolios. The underlying development process involved steps of data transformation, variable reduction, model performance , check for variable collinearity etc.

LGD is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset.

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

The period of exposure limits the period over which possible defaults are considered and thus affects the determination of PDs and measurement of ECLs (especially for Stage 2 accounts with lifetime ECL).

29 CREDIT RISK (continued)

29.3 Measurement of ECL (continued)

Subject to using a maximum of a 12-month PD for financial assets for which credit risk has not significantly increased, the Bank measures ECL considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for risk management purposes, the Bank considers a longer period. The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee.

For facilities that include both a drawn and an undrawn commitment component, the Bank measures ECL over a period longer than the maximum contractual period if the Bank's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Bank's exposure to credit losses to the contractual notice period. These facilities do not have a fixed term or repayment structure and are managed on a collective basis. The Bank can cancel them with immediate effect but this contractual right is not enforced in the normal day-to-day management but only when the Bank becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Bank expects to take and that serve to mitigate ECL. These include a reduction in limits, cancellation of the facility and / or turning the outstanding balance into a loan with fixed repayment terms.

29.4 Generating the term structure of PD

The Bank collects performance and default information about its credit risk exposures analyzed by type of product and borrower as well as by credit risk grading.

The Bank employs statistical models to analyze the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

This analysis includes the identification and calibration of relationships between changes in default rates and macro-economic factors as well as in-depth analysis of the impact of certain other factors (e.g. forbearance experience) on the risk of default. For most exposures, key macro-economic indicators include: gross domestic product / economic growth, interest rates, unemployment rates and inflation.

Based on consideration of a variety of external actual and forecast information, the Bank formulates a 'base case' view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios (i.e. on incorporation of forward-looking information). The Bank then uses these forecasts to adjust its estimates of PDs.

For the financing portfolio, through the yearly review of the corporate portfolio, the Bank observes yearly performances to compute a count based PD over the one year horizon for the past 5 years.

PDs for each segment are measured using observed default estimation and PD is calculated based on a DPD bucket level for each segment separately. Under this analysis, the delinquency status of accounts is tracked at an interval of one year with a moving month cycle. A minimum of 5 year DPD data is considered.

29.5 Restructured financial assets

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

In project finance, there could be delays in implementation of the project and in some cases, the projects may take a longer time to generate surplus. The Bank has in such cases, where there is a genuine need and commitment from the customer, approved a restructuring.

Maximum tenor of the facility post restructuring does not exceed 15 years from the first disbursement of the facility. As has been prescribed by the CBB, restructured accounts are transferred to Stage 2 directly for a minimum period of 12 months.

29 CREDIT RISK (continued)

29.6 Credit-impaired financial assets

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

29.7 Definition of 'Default' and 'Cure'

The Bank's definition of default is aligned with regulatory guidelines and internal Credit Risk Management practices. Defaulted assets will fall under the Stage 3. In general, a counterparty is considered in default and hence a relevant financial asset or a group of financial assets is impaired if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment; rather the combined effect of several events may have caused the expected credit losses as a result of future events, no matter how likely, are not recognised. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the holder of the asset. The following are certain indicators to identify the impairment of assets (indicators are not necessarily to be observed on an individual basis):

- a) significant financial difficulty of the issuer or the obligor;
- b) material breach of facility covenants, conditions and contract (subject to management
- c) grant to the borrower a concession that the lender would not otherwise consider except for
- d) imminent bankruptcy or other financial reorganization of the borrower;
- e) significant downgrading in credit rating by an external credit rating agency;
- f) disappearance of an active market because of financial difficulties;
- g) presence of past due contractual payments of either principal or profit; or / and
- h) deterioration in the value of security and likelihood of successfully realising it.

In general, counterparties with facilities exceeding 90 days past dues are considered in default.

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

29.8 Incorporation of forward looking assumptions

The Bank incorporates forward-looking assumptions into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. The Bank annually sources macro-economic forecast data for various variables from many databases including the International Monetary Fund (IMF) database for Bahrain, Bloomberg, Reuters and World Bank.

Macro-economic variables are checked for correlation with the PD for the past five years and only those variables for which the movement can be explained are used. Management judgment is exercised when assessing the macroeconomic variables.

i) Limits and concentrations

Limits are assigned for each individual counterparty group and for each industrial segment. The Bank also monitors credit exposures, and continually assesses the creditworthiness of counterparties to the transactions. In addition, the Bank obtains security, where appropriate, enters into master netting agreements and collateral arrangements with counterparties, and limits the duration of exposures.

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

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29 CREDIT RISK (continued)**29.8 Incorporation of forward looking assumptions (continued)****i) Limits and concentrations (continued)**

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

ii) Maximum exposure to credit risk without taking account of any collateral

The table below shows the maximum exposure to credit risk as at the reporting date.

	2019	2018
	BD '000	BD '000
Balances with Central Bank of Bahrain	1,709	1,991
Placement with banks and other financial institutions	14,850	21,917
Islamic financing and loans to customers	76,731	85,866
Investment securities	35,666	25,672
Other assets	2,148	3,397
	131,104	138,843
Contingent liabilities	1,507	1,473
Commitments	3,557	1,323
	5,064	2,796
Maximum credit risk exposure	136,168	141,639

iii) External credit assessment

The Bank does not use any external credit assessment institutions and the risk rating for the exposures are based on the internal credit framework and policy guidelines of the Bank.

iv) Concentration of credit risk

Since the Group's operations are restricted only to the Kingdom of Bahrain, it is primarily effected by the changes in the economic and other conditions prevailing in the Kingdom of Bahrain.

	2019	2018
	BD '000	BD '000
Industry sector		
Banks and financial institutions	52,225	49,580
Trading and manufacturing	48,688	49,856
Education and health	6,777	6,488
Hospitality, media and transportation	8,392	7,894
Fisheries, agriculture and dairy	6,216	5,457
Food processing	1,587	2,836
Others	12,283	19,528
	136,168	141,639

v) Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the facility structure and the associated credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters. The main types of collateral obtained are cash margin, bank guarantees and real estate title deeds.

Market value of collateral is closely monitored by the Bank in addition to requesting additional collateral in accordance with the underlying agreement and evaluation of the adequacy of the allowance for impairment / ECL.

It is the Bank's policy to normally dispose off repossessed collateral in an orderly fashion after due notice has been provided to the defaulting customer. The proceeds are used to reduce or settle the outstanding claim. The Bank did not occupy repossessed properties for its own business use, as at the reporting date.

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29 CREDIT RISK (continued)**v) Collateral and other credit enhancements (continued)**

The Group holds collateral and other credit enhancements against certain of its credit exposures. The Group closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Group will take possession of the collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

	2019				
	<i>Gross Exposures</i>	<i>Expected Credit Loss</i>	<i>Carrying Amount</i>	<i>FV of Collateral Held</i>	<i>Guarantee Available</i>
	<i>BD 000</i>	<i>BD 000</i>	<i>BD 000</i>	<i>BD 000</i>	<i>BD 000</i>
Project finance - Islamic	19,372	12,817	6,555	6,057	5,791
Project finance - conventional	15,642	7,490	8,152	10,977	-
Fisheries and agriculture	1,733	41	1,692	-	1,692
Other loans	921	919	2	-	-
Total	37,668	21,268	16,400	17,034	7,483
	2018				
	<i>Gross exposure</i>	<i>Expected Credit Loss</i>	<i>Carrying Amount</i>	<i>FV of Collateral Held</i>	<i>Guarantee Available</i>
	<i>BD 000</i>	<i>BD 000</i>	<i>BD 000</i>	<i>BD 000</i>	<i>BD 000</i>
Project finance - Islamic	23,036	13,956	9,080	5,074	6,482
Project finance - conventional	12,803	7,612	5,191	9,441	-
Fisheries and agriculture	1,439	-	1,439	-	1,439
Other loans	1,151	1,262	(111)	-	-
Total	38,428	22,830	15,598	14,515	7,920

vi) Carrying amount per class of financial assets whose terms have been renegotiated

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

	2019	2018
	BD '000	BD '000
Islamic financing and loans to customers	417	89

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29 CREDIT RISK (continued)

vii) Credit quality per class of financial assets

The following table sets out information about the credit quality of financial assets measured at amortised cost. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

	2019			2018	
	Stage 1	Stage 2	Stage 3	Total	Total
	12-months	Life time	Lifetime		
	ECL	ECL not credit impaired	ECL credit impaired	BD '000	BD '000
BD '000	BD '000	BD '000	BD '000	BD '000	
Placement with banks and other financial institutions	14,937	-	-	14,937	21,978
Less: Allowance for ECL	(87)	-	-	(87)	(61)
	<u>14,850</u>	<u>-</u>	<u>-</u>	<u>14,850</u>	<u>21,917</u>
Islamic financing and loans to customers					
Corporate	30,852	575	23,891	55,318	60,083
SME	12,757	893	5,987	19,637	23,794
Small business	11,811	717	4,234	16,762	19,723
Taxi loans	-	-	59	59	135
Education loans	355	28	1,229	1,612	1,720
Overdrafts	580	-	535	1,115	755
Others	2,395	206	1,733	4,334	4,226
	<u>58,750</u>	<u>2,419</u>	<u>37,668</u>	<u>98,837</u>	<u>110,436</u>
Less: Allowance for ECL	(642)	(196)	(21,268)	(22,106)	(24,570)
	<u>58,108</u>	<u>2,223</u>	<u>16,400</u>	<u>76,731</u>	<u>85,866</u>
Off-balance sheet exposures					
Letters of credit and bank guarantees	1,456	-	51	1,507	1,473
Undrawn commitments	3,557	-	-	3,557	1,323
Less: Allowance for ECL	(301)	-	(51)	(352)	(117)
	<u>4,712</u>	<u>-</u>	<u>-</u>	<u>4,712</u>	<u>2,679</u>
Other assets	12	26	3,098	3,136	2,322
Less: Allowance for ECL	(1)	(6)	(3,040)	(3,047)	(2,232)
	<u>11</u>	<u>20</u>	<u>58</u>	<u>89</u>	<u>90</u>

30 MARKET RISK

Market risk is the risk of loss attributable to adverse changes in the values of financial instruments, whether on or off-balance sheet, as a result of changes in market rates (such as interest rates and foreign exchange rates) or price.

i) Interest rate risk

Interest rate risk arises from the possibility that changes to the interest rates will affect future profitability or the fair values of the financial instruments. The Bank is exposed to interest rate risk due to mismatches of interest rate repricing of assets and liabilities. Positions are monitored periodically to ensure that this is maintained within the established limits.

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30 MARKET RISK (continued)**i) Interest rate risk (continued)**

The Bank primarily deals with 4 currencies, namely Bahraini Dinars, Kuwaiti Dinars, Saudi Riyals and United States Dollars, in which the Bank's interest sensitive financial instruments are denominated predominantly. The following table demonstrates the Bank's sensitivity to a reasonable possible change in interest rates, with all other variables held constant.

	<i>Change in basis points</i>	<i>Impact of change on net interest Income</i>		<i>Change in basis points</i>	<i>Impact of change on net interest Income</i>	
		2019	2018		2019	2018
		<i>BD '000</i>	<i>BD '000</i>		<i>BD '000</i>	<i>BD '000</i>
Bahraini Dinars	+100	1,074	1,031	-100	(1,074)	(1,031)
Kuwaiti Dinars	+100	1	-	-100	(1)	-
Saudi Riyals	+100	(1)	(4)	-100	1	4
United States Dollars	+100	(327)	(405)	-100	327	405

ii) Currency risk

Currency risk is the risk that the value of the financial instrument will fluctuate due to changes in foreign exchange rates. Net open positions are monitored on a daily basis to ensure compliance within the established limits.

The Bank views the Bahraini Dinar as its functional currency. In the opinion of the Bank's management, the currency risk for any position held in US dollar is insignificant since the Bahraini Dinar is pegged to the US dollar. The Bank had the following significant net open exposures denominated in foreign currencies as of 31 December 2019 and 2018:

	<i>Equivalent long /</i>	
	2019	2018
Kuwaiti Dinars	65	71
US Dollars	(78)	340
Euro	6	1
GBP	7	5
Saudi Riyals	57	(17)
UAE Dirhams	4	5

31 EQUITY PRICE RISK

Equity price risk is the risk that the fair values of equities or managed funds decrease as a result of changes in the corresponding value of equity indices or the value of individual equity stocks. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

The effect on profit or loss (as a result of a change in the fair value of equity instruments held as FVTPL) due to a reasonably possible change in equity indices, with all other variables held constant, is as follows:

	<i>Trading Equities</i>		<i>% change in Index</i>	<i>Effect on profit or loss</i>	
	2019	2018		Total 2019	Total 2018
	<i>BD '000</i>	<i>BD '000</i>		<i>BD '000</i>	<i>BD '000</i>
Bahrain Bourse	1	96	± 15%	0	14

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32 MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below summarises the maturity profile of the Group's assets and liabilities as at 31 December 2019 and 2018 based on expected maturities.

	Up to 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 months to 1 year BD '000	1 to 3 years BD '000	Over 3 years BD '000	Total BD '000	Carrying amount BD '000
31 December 2019								
Assets								
Cash and balances with Central Bank of Bahrain	1,976	-	-	-	-	-	1,976	1,976
Placements with banks and other financial institutions	7,274	5,125	-	2,451	-	-	14,850	14,850
Islamic financing and loans to customers	3,582	7,428	9,506	14,566	45,258	19,357	99,696	76,731
Investment securities	18,146	-	-	-	-	23,301	41,447	41,447
Investment in associates	-	-	-	-	-	322	322	322
Investment properties	-	-	-	-	-	11,527	11,527	11,527
Property and equipment	-	-	-	-	-	1,991	1,991	1,991
Other assets	-	-	2,416	-	-	-	2,416	2,416
Total assets	30,978	12,553	11,921	17,017	45,258	56,498	174,225	151,260
Liabilities								
Term loans	-	251	3,242	3,493	13,972	21,335	42,293	42,293
Deposits	11,466	7,933	3,464	524	36	11,495	34,918	34,918
Other liabilities	-	-	4,723	-	-	-	4,723	4,723
Total liabilities	11,466	8,184	11,429	4,017	14,008	32,830	81,934	81,934
Net liquidity gap	19,512	4,369	492	13,000	31,250	23,668		
Cumulative liquidity gap	19,512	23,881	24,374	37,374	68,624	92,291		

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32 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

	Up to 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 months to 1 year BD '000	1 to 3 years BD '000	Over 3 years BD '000	Total BD '000	Carrying amount BD '000
<i>31 December 2018</i>								
Assets								
Cash and balances with Central Bank of Bahrain	2,218	-	-	-	-	-	2,218	2,218
Placements with banks and other financial institutions	13,029	-	618	8,270	-	-	21,917	21,917
Islamic financing and loans to customers	3,640	7,949	10,808	18,687	53,890	18,320	113,294	85,866
Investment securities	19,264	-	-	-	-	11,880	31,144	31,144
Investment in associates	-	-	-	-	-	259	259	259
Investment properties	-	-	-	-	-	12,000	12,000	12,000
Property, plant and equipment	-	-	-	-	-	1,155	1,155	1,155
Other assets	-	-	3,646	-	-	-	3,646	3,646
Total assets	38,151	7,949	15,072	26,957	53,890	43,614	185,633	158,205
Liabilities								
Term loans	-	-	4,157	4,157	13,972	28,322	50,607	50,607
Deposits	13,880	2,397	7,445	1,279	-	10,000	35,001	35,001
Other liabilities	-	-	5,106	-	-	-	5,106	5,106
Total liabilities	13,880	2,397	16,708	5,436	13,972	38,322	90,714	90,714
Net liquidity gap	24,271	5,552	(1,636)	21,522	39,918	5,292		
Cumulative liquidity gap	24,271	29,823	28,188	49,709	89,627	94,919		

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33 LIQUIDITY RISK

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2019 and 2018 based on the contractual undiscounted repayment obligations. See note 33 for the expected maturities of these liabilities.

31 December 2019

	On demand BD '000	Up to 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 months to 1 year BD '000	1 to 3 years BD '000	Over 3 years BD '000	Total BD '000
Term loans	-	-	332	8,785	8,997	34,795	27,599	80,508
Deposits	11,435	31	7,933	3,464	524	36	11,495	34,918
Other liabilities	-	-	-	4,723	-	-	-	4,723
Total liabilities	11,435	31	8,265	16,972	9,521	34,831	39,094	120,149

31 December 2018

	On demand BD '000	Up to 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 months to 1 year BD '000	1 to 3 years BD '000	Over 3 years BD '000	Total BD '000
Term loans	-	-	-	9,944	9,879	14,279	73,656	107,758
Deposits	-	13,880	2,397	7,445	1,279	-	10,000	35,001
Other liabilities	-	-	5,106	-	-	-	-	5,106
Total liabilities	-	13,880	7,503	17,389	11,158	14,279	83,656	147,865

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33 LIQUIDITY RISK (continued)

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

	On demand BD '000	Less than 3 months BD '000	3 to 12 months BD '000	1 to 5 years BD '000	Total BD '000
31 December 2019					
Contingent liabilities	337	195	330	645	1,507
Commitments	3,557	-	2,752	-	6,309
Total	3,894	195	3,082	645	7,816
31 December 2018					
Contingent liabilities	382	122	701	268	1,473
Commitments	1,323	-	3,557	291	5,171
Total	1,705	122	4,258	559	6,644

Liquidity Credit Ratio

NSFR	2019	2018
	420%	190%
	2019	2018
	139%	173%

The Bank expects that not all of the commitments will be drawn before expiry of the commitments.

34 OPERATIONAL AND LEGAL RISK

Legal risk is the risk arising from the potential that unenforceable contracts, lawsuits or adverse judgments can disrupt or otherwise negatively affect the operations of the Group. The Group has developed controls and procedures to identify legal risks and believes that losses, if any will not be material.

Operational risk is the exposure to loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Group has clearly defined operations procedures for each of its products and services. It also has computer systems that enable it to run operations with speed and accuracy. The operational risk management unit operates independently from other units of the Bank and reports to the Chief Risk Officer. It conducts regular reviews of all business areas of the Bank and reports control deficiencies and exceptions to the Bank's policies and procedures. It also recommends measures to mitigate operational risk, which are implemented by management immediately. The Bank also has a contingency plan to take care of any failure of its computer systems. Regular back-ups are made for all important datasets, and stored outside the Bank's premises. This ensures that in case of any system failure, the Bank will be able to continue its operations without losing critical data or business transactions. As part of its disaster recovery plan, the Bank has established a back-up site which would operate during an emergency.

The Bank has a specific Business Continuity Plan ("BCP") team. The main objective of the BCP is to ensure that in the event of full or partial disaster, the Bank should be able to continue providing essential services to customers minimizing any adverse effects on the Bank's business, through business impact analysis, business restoration plans and procedures, for the identified critical functions. The Bank is conducting risk and control self assessments and capturing operational loss data in accordance with Basel III / CBB guidelines.

35 DERIVATIVES

A derivative is a financial contract between two parties where payments are dependent upon movements in the price of one or more underlying financial instrument, reference rate or index. In the ordinary course of business, the Group enters into forex forward contracts. The use of derivatives is governed by the Group's policies approved by the Board of Directors. The Group enters into derivative contracts for the purpose of reducing risks from potential movements in foreign exchange rates. The Group has entered into forex forward contracts with the Central Bank of Bahrain with a nominal value of BD 27,808 thousand (31 December 2018: BD 35,114 thousand).

36 CAPITAL ADEQUACY

The risk asset ratio, calculated in accordance with the capital adequacy guidelines approved by the CBB, for the Bank is as follows:

	2019 BD '000	2018 BD '000
Capital base		
Tier 1 capital	69,344	68,820
Tier 2 capital	1,233	1,884
Total capital base (a)	<u>70,577</u>	<u>70,704</u>
Risk-weighted assets (b)	134,416	148,451
Capital adequacy ratio (a/b*100)	52.51%	46.56%
Minimum requirement	14.0%	14.0%

The CBB sets and monitors capital requirements for the Bank as a whole. In implementing current capital requirements, the CBB requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. The capital adequacy regulations of the CBB are based on the principles of Basel III of the IFSB guidelines.

36 CAPITAL ADEQUACY (continued)

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

- Tier 1 capital, includes CET1 and AT1.

CET1 comprise of ordinary share capital that meet the classification as common shares for regulatory purposes, disclosed reserves including share premium, general reserves, legal / statutory reserve, common shares issued by consolidated banking subsidiaries of the Bank and held by third parties, retained earnings after regulatory adjustments relating to goodwill and items that are included in equity which are treated differently for capital adequacy purposes.

AT1 comprise of instruments that meet the criteria for inclusion in AT1, instruments issued by consolidated banking subsidiaries of the Bank held by third parties which meet the criteria of AT1, and regulatory adjustments applied in calculation of AT1.

Tier 2 capital, includes instruments issued by the Bank that meet the criteria for inclusion in Tier 2 capital, stock surplus resulting from issue of Tier 2 capital, instruments issued by consolidated banking subsidiaries of the Bank held by third parties that meet the criteria for inclusion in Tier 2, general provisions held against unidentified losses on financing and qualify for inclusion within Tier 2, asset revaluation reserve from revaluation of fixed assets and instruments purposes and regulatory adjustments applied in the calculation of Tier 2 capital.

The regulatory adjustments are subject to limits prescribed by the CA module, these deductions would be effective in a phased manner through transitional arrangements from 2015 to 2018. The regulations prescribe higher risk weights for certain exposures that exceed materiality thresholds. These regulatory adjustments are required for certain items such as goodwill on mortgage service right, deferred tax assets, cash flow hedge reserve, gain on sale of related securitization transactions, defined benefit pension fund assets and liabilities, investment in own shares and reciprocal cross holdings in the capital of Banking and financial entities, investment in the capital of Banking and financial entities that are outside the scope of regulatory consolidation and where the bank does not own more than 10% of issued common share capital of the entity and significant investments in the capital of banking and financial entities that are outside the scope of regulatory consolidation.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

Capital management

The primary objectives of the Bank's capital management are i) to ensure that the Bank complies with externally imposed capital requirements ii) maintain healthy capital ratios in order to support its business and iii) to maximise shareholders' value. The Bank manages its capital structure and makes adjustments to it in the light of changes in business conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders or issue capital securities.

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37 CLASSIFICATION OF ASSETS AND LIABILITIES

The following table provides a reconciliation between line items in the statement of financial position and categories of financial instruments.

	<i>Designated as at FVTPL</i>	<i>FVOCI – sukuk/debt instruments</i>	<i>FVOCI – equity instruments</i>	<i>Amortised cost / others</i>	<i>Total</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
31 December 2019					
Assets					
Cash and balances with Central Bank of Bahrain	-	-	-	1,976	1,976
Placements with banks and other financial institutions	-	-	-	14,850	14,850
Islamic financing and loans to customers	-	-	-	76,731	76,731
Investment securities	5,600	24,019	181	11,647	41,447
Investment in associates	-	-	-	322	322
Investment properties	-	-	-	11,527	11,527
Property and equipment	-	-	-	1,991	1,991
Other assets	-	-	-	2,416	2,416
Total assets	5,600	24,019	181	121,460	151,260
Liabilities					
Term loans	-	-	-	42,293	42,293
Deposits	-	-	-	34,918	34,918
Other liabilities	-	-	-	4,723	4,723
Total liabilities	-	-	-	81,934	81,934

The following table provides a reconciliation between line items in the statement of financial position and categories of financial instruments.

	<i>Designated as at FVTPL</i>	<i>FVOCI – debt instruments</i>	<i>FVOCI – equity instruments</i>	<i>Amortised cost / others</i>	<i>Total</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
31 December 2018					
Assets					
Cash and balances with Central Bank of Bahrain	-	-	-	2,218	2,218
Placements with banks and other financial institutions	-	-	-	21,917	21,917
Islamic financing and loans to customers	-	-	-	85,866	85,866
Investment securities	5,288	12,597	184	13,075	31,144
Investment in associates	-	-	-	259	259
Investment properties	-	-	-	12,000	12,000
Property and equipment	-	-	-	1,155	1,155
Other assets	-	-	-	3,646	3,646
Total assets	5,288	12,597	184	140,136	158,205
Liabilities					
Term loans	-	-	-	50,607	50,607
Deposits	-	-	-	35,001	35,001
Other liabilities	-	-	-	5,106	5,106
Total liabilities	-	-	-	90,714	90,714

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38 COMPARATIVE FIGURES

Certain of the prior year figures have been reclassified to conform to the current year presentation. Such reclassifications did not affect previously reported net loss, total assets, total liabilities and total equity of the Group.