BANK OF CHINA LTD.
(ABU DHABI BRANCH)

FINANCIAL STATEMENTS

31 DECEMBER 2018

EY
Building a better working world

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INDEPENDENT AUDITORS' REPORT TO THE HEAD OFFICE OF BANK OF CHINA LIMITED - ABU DHABI BRANCH

Opinion
We have audited the financial statements of Bank of China Limited - Abu Dhabi Branch (the "Branch"), which comprise the statement of financial position as at 31 December 2018, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Branch as at 31 December 2018 and its financial performance and its cash flow 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 financial statements section* of our report. We are independent of the Branch in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (the "IESBA Code")* together with the ethical requirements that are relevant to our audit of the financial statements in the United Arab Emirates, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of management for the financial statements
Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs and in compliance with the applicable provisions of the UAE Federal Law No (2) of 2015 and the UAE Union Law No. 10 of 1980, as amended, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

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INDEPENDENT AUDITORS' REPORT TO THE HEAD OFFICE OF BANK OF CHINA LIMITED - ABU DHABI BRANCH (continued)

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

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

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

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

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

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Branch'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 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 Branch to cease to continue as a going concern.

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

We communicate with the management 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.

For Ernst & Young

TS. Hari Gopal

Signed by:
Thodla Hari Gopal
Partner
Registration No: 689

26 March 2019

Abu Dhabi, United Arab Emirates

中国银行 阿布扎比分行
BANK OF CHINA ABU DHABI BRANCH

Bank of China Ltd. - Abu Dhabi Branch

STATEMENT OF FINANCIAL POSITION

As at 31 December 2018

	Notes	*2018 AED'000*	*2017 AED'000*
ASSETS			
Cash and balances with the UAE Central Bank	8	**452,026**	435,808
Due from banks	9	**299,204**	73,648
Due from related parties	20	**23,821**	4,442
Loans and advances, net	10	**497,270**	932,979
Other assets	11	**3,896**	4,406
Property and equipment	12	**5,088**	286
Intangible assets	13	**46**	103
TOTAL ASSETS		**1,281,351**	1,451,672
LIABILITIES AND EQUITY			
Liabilities			
Customer deposits	14	**287,701**	262,376
Due to related parties	20	**559,408**	819,780
Due to banks and other financial institutions	9	**41,810**	181
Other liabilities	15	**10,038**	7,012
Total liabilities		**898,957**	1,089,349
Equity			
Allocated capital	17	**367,200**	367,200
Statutory reserve	18	**2,684**	1,736
Credit risk reserve	22	**10,593**	-
Retained earnings		**1,917**	(6,613)
Total equity		**382,394**	362,323
TOTAL LIABILITIES AND EQUITY		**1,281,351**	1,451,672

Gao Xiaoming
General Manager

The attached notes 1 to 22 form part of these financial statements.

تلفون : ٠٩٩٩ ٤١٨ ٢ ٩٧١+، فاكس : ٠٩٩٦ ٤١٨ ٢ ٩٧١+، الوحدة ٤٦١١-٤٦٠٨، الطابق ٤٦، برج أداكس التجاري، جزيرة الريم، ص.ب. ٧٣٠٩٨، أبو ظبي، ا.ع.م.
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STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2018

	Notes	2018 AED'000	2017 AED'000
Interest income	4	**48,050**	27,686
Interest expense	5	**(26,496)**	(26,867)
Interest income, net		**21,554**	819
Net fees and commission income	6	**2,358**	2,789
Net foreign exchange income		**958**	166
Trading (loss)/gain on derivative financial instruments		**(171)**	29,216
Net operating income		**24,699**	32,990
General and administrative expenses	7	**(12,297)**	(10,334)
Profit for the year before provisions		**12,402**	22,656
Net provision on credit facilities	9, 10	**(443)**	(1,889)
Profit for the year before tax		**11,959**	20,767
Income tax expense	16	**(2,481)**	(3,411)
PROFIT FOR THE YEAR		**9,478**	17,356
OTHER COMPREHENSIVE INCOME		**-**	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**9,478**	17,356

The attached notes 1 to 22 form part of these financial statements.

Bank of China Ltd. - Abu Dhabi Branch

STATEMENT OF CHANGES IN HEAD OFFICE EQUITY

For the year ended 31 December 2018

	Allocated capital AED'000	*Statutory reserve AED'000*	*Credit risk reserve AED'000*	*Retained earnings AED'000*	*Total AED'000*
At 1 January 2017	367,200	-	7,400	(22,233)	352,367
Total comprehensive income for the year	-	-	-	17,356	17,356
Transfer to statutory reserve	-	1,736	-	(1,736)	-
Transfer to provision for credit losses	-	-	(7,400)	-	(7,400)
At 31 December 2017	367,200	1,736	-	(6,613)	362,323
Transition adjustment on adoption of IFRS 9 at 1 January 2018	-	-	-	10,593	10,593
Transfer to credit risk reserve	-	-	10,593	(10,593)	-
As at 1 January 2018	367,200	1,736	10,593	(6,613)	372,916
Total comprehensive income for the year	-	-	-	9,478	9,478
Transfer to statutory reserve	-	948	-	(948)	-
At 31 December 2018	**367,200**	**2,684**	**10,593**	**1,917**	**382,394**

The attached notes 1 to 22 form part of these financial statements.

STATEMENT OF CASH FLOWS
For the year ended 31 December 2018

	Notes	*2018* *AED'000*	*2017* *AED'000*
OPERATING ACTIVITIES			
Profit for the year before taxation		**11,959**	20,767
Adjustments for:			
Depreciation and amortization	12, 13	**376**	809
Provision for credit losses	9, 10	**443**	1,889
Foreign currency translation difference on bond payable		-	28,754
Operating cash flows before changes in working capital		**12,778**	52,219
Changes in working capital:			
Cash reserve requirement with Central Bank of UAE	8	**22,863**	(41,744)
Due from banks	9	**(259,691)**	164,220
Due from related parties	20	-	22,656
Loans and advances	10	**445,984**	(545,529)
Other assets	11	**510**	(1,244)
Customer deposits	14	**25,325**	73,238
Due to banks	9	**41,629**	30
Due to related parties	20	**(260,372)**	590,402
Other liabilities	15	**541**	(18,562)
Net cash from operating activities		**29,567**	295,686
INVESTING ACTIVITY			
Payment for purchase of property and equipment	12	**(5,121)**	(149)
Net cash used in investing activity		**(5,121)**	(149)
FINANCING ACTIVITY			
Repayment of bond proceeds		-	(1,082,000)
Net cash used in financing activity		-	(1,082,000)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		**24,446**	(786,463)
Cash and cash equivalents, beginning of year		**444,363**	1,230,826
CASH AND CASH EQUIVALENTS, END OF YEAR		**468,809**	444,363

Interest received in 2018 was AED 44,662 thousand (31 December 2017: AED 26,442 thousand) and interest paid in 2018 was AED 24,803 thousand (2017: AED 26,343 thousand).

1 ACTIVITIES

Bank of China Limited (the "Head Office") is a public limited company incorporated in Beijing, People's Republic of China and the address of its registered office is No.1, Fuxingmennei Street, Beijing (100818).

The principal activity of the Abu Dhabi Branch of Bank of China Limited (the "Branch") in the United Arab Emirates ("UAE") is wholesale banking.

The registered address of the Branch is Ground Floor, Mansour Tower, Al Salam Street, Abu Dhabi, UAE.

The financial statements of the Branch were approved for issuance on 21 March 2019.

2 BASIS OF PREPARATION

The financial statements of the Branch have been prepared in accordance with International Financial Reporting Standards ("IFRS") and Interpretations ("IFRIC") issued by the International Accounting Standards Board ("IASB") and applicable requirements of the United Arab Emirates Laws.

The financial statements are prepared under the historical cost basis except for derivative financial instruments that have been measured at fair value.

The financial statements have been presented in UAE Dirhams, which is also the functional currency of the Branch, rounded to the nearest thousand except when otherwise stated.

The Bank's statement of financial position is not presented using a current / non- current classification. However, the following balances would generally be classified as current: cash and cash equivalents, interest receivable, other assets and interest payable. The following would generally be classified as non-current: property and equipment and intangible assets. The following balances are of mixed nature including both current and non-current positions: due from other banks, due from group entities, loans and advances, due to customers, due to other banks, due to group entities, other liabilities and derivative financial instruments.

3 SIGNIFICANT ACCOUNTING POLICIES

Changes in accounting policies and disclosures
The accounting policies used in the preparation of these financial statements are consistent with those used in the previous financial year, except for the adoption of new standards and the amendments to the existing standards relevant to the Branch, effective as of 1 January 2018. The nature and the impact of each is described below:

IFRS 15: Revenue from Contracts with Customers
IFRS 15 was issued in May 2014 and is effective for annual periods commencing on or after 1 January 2018. IFRS 15 establishes a new five-step model that will apply to revenue arising from contracts with customers. The adoption of IFRS 15 which is effective for annual accounting period starting from 1 January 2018 did not have any material impact on the accounting policies, financial position or performance of the Branch.

IFRS 9: Financial Instruments
The Branch has adopted IFRS 9 issued in July 2014 with a date of initial application of 1 January 2018. The requirements of IFRS 9 represent a significant change from IAS 39 Financial Instruments: Recognition and Measurement. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

The Branch has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018 and are disclosed on Note 3.1.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Changes in accounting policies and disclosures (continued)

IFRS 9: Financial Instruments (continued)
The key changes to the Branch's accounting policies resulting from the adoption of IFRS 9 are summarised below:

Classification and measurement of financial assets and financial liabilities:
IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The classification of financial assets under IFRS 9 is generally based on the business model in which how a financial asset is managed and its contractual cash flow characteristics. IFRS 9 eliminated the previous IAS 39 categories of held to maturity, loans and receivables and available for sale.

The impact of adoption of IFRS 9 on the Branch's financial assets is presented in note 3.1. The adoption of IFRS 9 did not have a significant effect on the Branch's accounting policies for financial liabilities.

Impairment of financial assets:
IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' (ECL) model. The new impairment model applies to financial assets measured at amortised cost, all other debt financial assets not measured at fair value through profit and loss, together with loan commitments and financial guarantee contracts. Under IFRS 9, credit losses are recognised earlier than under IAS 39.

The Branch's accounting policies for classification, measurement and impairment of financial assets under IFRS 9 is explained in detail below.

Hedging:
As the Branch currently do not have hedges, there was no impact of adoption on IFRS 9 with regards to hedging.

Other amendments to IFRSs which are effective for annual accounting period starting from 1 January 2018 did not have any material impact on the accounting policies, financial position or performance of the Branch.

IFRS 7R
To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial Instruments: Disclosures was updated and the Branch has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in Note 3 and the detailed qualitative and quantitative information about the ECL calculations such as the assumptions and inputs used are set out in Note 22.

Reconciliations from opening to closing ECL allowances are presented in notes 9 and 10.

Initial measurement and recognition of financial assets and financial liabilities
A financial asset or a financial liability is recognised when the Branch becomes a party to the contractual provisions of the instrument. All regular way purchase and sale of financial assets are recognised using trade date accounting i.e. the date the Branch receives or delivers the assets. Changes in fair value between the trade date and settlement date are recognised in the income statement or in other comprehensive income in accordance with the policy applicable to the related instrument. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulations or conventions in the market place. Loans and advances to customers are recognised when funds are transferred to the customers' accounts. The Branch recognises balances due to customers when funds are transferred to the Branch.

All financial assets or financial liabilities are initially measured at fair value. Transaction costs are added to the cost of all financial instruments. When the fair value of financial instruments at initial recognition differs from the transaction price, the Branch accounts for the Day 1 profit or loss, as described below.

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

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Changes in accounting policies and disclosures (continued)

Financial assets and liabilities

Classification and measurement of financial assets and financial liabilities
The Branch determines classification and measurement category of financial assets, except derivatives, based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

From 1 January 2018, the Branch classifies their financial assets based on the business model for managing the assets and the asset's contractual terms, measured at amortised cost, as explained below.

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at fair value through profit and loss when they are held for trading and derivative instruments or the fair value designation is applied.

Due from banks and loans and advances to customers
Before 1 January 2018, financial assets included due from bank and loans and advances to customers with fixed or determinable payments that were not quoted in an active market, other than those:

- that the Branch intends to sell immediately or in the near term
- that the Branch, upon initial recognition, designated as at FVTPL or as available-for-sale
- for which the Branch may not recover substantially all of its initial investment, other than because of credit deterioration, which were designated as available-for-sale.

From 1 January 2018, the Branch only measures due from banks and loans and advances to customers if both of the following conditions are met:

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

The details of these conditions are outlined below.

Business model assessment
The Branch determines its business model at the level that best reflects how they manage financial assets to achieve their business objective. The Branch's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the key management personnel;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected)

The expected frequency, value and timing of sales are also important aspects of the Branch's assessment.

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

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Changes in accounting policies and disclosures (continued)

Financial assets and liabilities (continued)

Classification and measurement of financial assets and financial liabilities (continued)

The SPPI test
Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Branch assesses whether the financial instruments' cash flows meet the solely payments of principal and interest test (the 'SPPI test').

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

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

The Branch classifies financial assets upon initial recognition of IFRS 9 into following categories

- Amortised cost (AC)
- Fair value through profit and loss (FVTPL)
- Fair value through other comprehensive income (FVOCI)

Financial assets classified at AC are subsequently measured at amortised cost using the effective interest method adjusted for impairment losses, if any. Interest income, foreign exchange gains/losses and impairment are recognised in the income statement. Any gain or loss on derecognition is recognised in the income statement. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The amortisation is included in "Interest income" in the income statement. The losses arising from impairment are recognised in the income statement under "net provision on credit facilities".

The Branch classifies cash and balances with central bank, due from banks and loans and advances as AC.

Fair Value Through Profit and Loss (FVTPL)
The Branch classifies financial assets as FVTPL when they have been purchased primarily for short-term profit making through trading activities or form part of a portfolio of financial instruments that are managed together, for which there is evidence of a recent pattern of short-term profit.

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

Financial assets classified as FVTPL are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in the income statement. Interest income and dividends are recognised in the income statement according to the terms of the contract, or when the right to payment has been established.

The Branch measures derivatives as at FVTPL and the positive and negative fair value of these derivatives are included in other assets and other liabilities, respectively.

Reclassifications
Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Branch changes its business model for managing financial assets.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Changes in accounting policies and disclosures (continued)

Financial assets and liabilities (continued)

Derecognition of financial assets and financial liabilities

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

If the terms of a financial asset are modified, the Branch evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value.

A financial asset (in whole or in part) is derecognised either when:

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

Where the Branch has transferred their right to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Branch's continuing involvement in the asset.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the branch would be required to repay.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the income statement.

Financial guarantees, letters of credit and undrawn loan commitments

In the ordinary course of business, the Branch gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognized in the financial statements at fair value, being the premium received, in other liabilities. Subsequent to initial recognition, the Branch's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and - under IAS 39 - the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee, or - under IFRS 9 - an ECL provision as set out in notes 9 and 10. The premium received is recognised in the income statement in 'net fees and commission income' on a straight-line basis over the life of the guarantee in line with IFRS 15.

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

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

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Changes in accounting policies and disclosures (continued)

Financial assets and liabilities (continued)

Impairment of financial assets
IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' (ECL) model. The Branch recognises expected credit losses (ECL) for cash and balances with the UAE Central Bank, loans and advances and due from banks.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL). The Branch's policies for determining if there has been a significant increase in credit risk are set out in note 22.

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

Both LTECLs and 12mECLs are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments.

The Branch has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument.

The Branch applies a three-stage approach to measuring ECL. Assets migrate through the following three stages based on the change in credit quality since initial recognition.

Stage 1: 12 months ECL
For exposures where there has not been a significant increase in credit risk since initial recognition, the portion of the lifetime ECL associated with the probability of default events occurring within next 12 months is recognised.

Stage 2: Lifetime ECL – not credit impaired
For credit exposures where there has been a significant increase in credit risk since initial recognition but that are not credit impaired, a lifetime ECL is recognised.

Stage 3: Lifetime ECL – credit impaired
Financial assets are assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred.

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

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

- Probability of default (PD) -The PD is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.
- Exposure at default (EAD) - The EAD is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.
- Loss given default -The LGD is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

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

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Changes in accounting policies and disclosures (continued)

Financial assets and liabilities (continued)

The calculation of ECLs (continued)
For revolving facilities that include both a loan and an undrawn commitment loan commitments and letters of credit, ECLs are calculated and presented together with the loan.

The Branch has considered the following regulatory guidance of the regulator in arriving at ECL impairment:

- Probationary period of a minimum of 3 instalments (for repayments which are on a quarterly basis or shorter) and 12 months (in cases where instalments are on a longer frequency than quarterly) after the restructuring, before upgrading from Stage 3 to 2.
- Requirement of 5 years data to be included in the IFRS 9 models for the purpose of assessment of the ECL.

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

Loss allowances for ECL are presented as a deduction from the gross carrying amount of the financial assets for AC.

Forward looking information
The Branch incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. Macro-economic factors are considered for this purpose by applying forward looking information such as GDP growth percentage.

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. The methodologies and assumptions including any forecasts of future economic conditions are reviewed regularly.

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

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

Write-offs
Loans and advances together with the associated provision account are written off when there is no realistic prospect of future recovery and all collateral have been realised or have been transferred to the Branch. If a write off is later recovered, the recovery is recognised in the income statement.

Derivative financial instruments
Derivatives generally include interest rate swaps, forward foreign exchange contracts and options. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives with positive fair values (unrealised gains) are included in other assets and derivatives with negative fair values (unrealised losses) are included in other liabilities in the statement of financial position.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

The Branch has consistently applied the following accounting policies to all periods presented in these financial statements, except for the changes explained in above:

Financial Instruments (relating to prior to 1 January 2018)
A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Classification of financial instruments
The Branch classifies financial instruments as "financial instruments at fair value through profit or loss" and "loans and receivables". Financial liabilities are carried at amortized cost. Management determines the appropriate classification of each instrument at the time of acquisition.

Recognition
A financial asset or a financial liability is recognised when the Branch become a party to the contractual provisions of the instrument. All regular way purchase and sale of financial assets are recognised using settlement date accounting i.e. the dates the Branch receives or delivers the assets. Changes in fair value between the trade date and settlement date are recognised in the statement of comprehensive income in accordance with the policy applicable to the related instrument. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulations or conventions in the market place.

Initial Measurement
All financial assets or financial liabilities are initially measured at fair value. Transaction costs are added to the cost of all financial instruments except for financial assets classified as investments at fair value through profit or loss. Transaction costs on financial assets classified as investments at fair value through profit or loss are recognised in the statement of comprehensive income.

Subsequent classification & measurement
Loans and receivables
These are non-derivative financial assets having fixed or determinable payments that are not quoted in an active market. These are subsequently measured at amortised cost using the effective interest method less any provision for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The amortisation is included in "Interest income" in the statement of comprehensive income. The losses arising from impairment are recognised in the statement of comprehensive income under "Net provision on credit facilities".

Cash and balances with banks, deposits and current account with related parties, loans and advances and certain other assets are classified as "loans and receivables".

Financial liabilities carried at amortised cost
These are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate. Due to banks, customers' deposits, borrowings and current account from related parties and certain other liabilities are classified as "financial liabilities carried at amortised cost".

Derivative financial instruments
The Branch enters into forward foreign exchange contracts to manage its exposure to fluctuations in exchange rates. Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at fair value. Derivatives with positive fair values (unrealised gains) are included in other assets and derivatives with negative fair values (unrealised losses) are included in other liabilities in the statement of financial position.

Financial guarantees
In the ordinary course of business, the Branch gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognized in the financial statements at fair value, being the premium received, in other liabilities. The premium received is amortized in the statement of comprehensive income in "net fees and commission income" on a straight-line basis over the life of the guarantee. The guarantee liability is subsequently measured at higher of the amount initially recognised less amortization or the value of any financial obligation that may arise there from. Any increase in the liability relating to the financial guarantees is recognised in the financial statements.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments (relating to prior to 1 January 2018) (continued)

De-recognition
A financial asset (in whole or in part) is derecognised either when:

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

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

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Branch would be required to pay.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the statement of comprehensive income.

Offsetting
Financial assets and liabilities are offset when the Branch has a legally enforceable right to set off the recognised amounts and intend to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

Impairment of financial assets
The Branch assesses at each reporting date whether there is any objective evidence that an individually significant financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets are impaired if and only if, there is objective evidence of impairment as a result of one or more loss events that has occurred after the initial recognition of the financial asset and that the loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets. For the purpose of assessing impairment, the financial assets are grouped at the lowest levels for which there are separately identifiable cash flows.

For loans and receivables, if there is objective evidence of impairment loss, the financial asset is written down to its recoverable amount. For loans and receivables with fixed interest rates, the recoverable amount is the present value of expected future cash flows discounted at the original effective interest rate and for loans and receivables with variable interest rates, the recoverable amount is discounted at the current effective interest rate as determined under the contract. Future cash flow includes amounts recoverable from guarantees and collateral.

Financial guarantees are assessed and provision made in a similar manner as for loans and receivables. The carrying amount of the asset is reduced through the use of a provision account and the amount of impairment loss is recognised in the statement of comprehensive income. If in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reversed by adjusting the provision account. The amount of the increase or reversal is recognised in the statement of comprehensive income. Loans and receivables together with the associated provision account are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Branch. If a write off is later recovered, the recovery is recognised in the statement of comprehensive income.

In addition, the Branch has also considered the Central Bank of UAE directives to maintain a minimum general provision of 1.5% on total Risk Weighted Assets. This is further discussed in note 22.

Certain other assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less cost of sale and value in use.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments (relating to prior to 1 January 2018) (continued)

Renegotiated loans

In the event of a default, the Branch seeks to restructure loans rather than take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. When the terms and conditions of these loans are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether these loans remain past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur.

Collateral repossessed

The Bank's accounting policy under IFRS 9 remains the same as it was under IAS 39. The Bank's policy is to determine whether a repossessed asset can be best used for its internal operations or should be sold. Assets determined to be useful for the internal operations are transferred to their relevant asset category at the lower of their repossessed value or the carrying value of the original secured asset. Assets for which selling is determined to be a better option are transferred to assets held for sale at their fair value (if financial assets) and fair value less cost to sell for non-financial assets at the repossession date in, line with the Bank's policy.

Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and balances with the UAE Central Bank and with other financial institutions with original maturities of three months or less, excluding statutory deposits required to be maintained with the Central Bank of UAE, net of amounts due to banks with original maturity not exceeding three months.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and impairment losses. Depreciation is provided on all property and equipment at rates calculated to write off the cost of each asset on a straight-line basis over its estimated useful lives.

The assets residual values, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each financial year end. The estimated useful lives of the assets for the calculation of depreciation are as follows:

Category	Useful life (in years)	Residual value
Office equipment	5	3%
Furniture and fixtures	5	3%
Leasehold improvements	3	0%
Motor vehicles	6	3%
Computer and accessories	3	0%

The carrying amounts of property and equipment are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the assets are written down to their recoverable amounts and the impairment loss is recognised in the statement of comprehensive income. Any gain or loss on the disposal of property and equipment is recognised in the statement of comprehensive income.

Intangible assets

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses, if any. The cost of the intangible asset is the purchase price together with any incidental expenses of acquisition. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of intangible assets and the benefits can be measured reliably. All other expenditure is recognised in the statement of comprehensive income as an expense is incurred. The amortisation charge for the year is calculated on a straight line basis after taking into account the residual value, if any. The residual values and useful lives are reviewed and adjusted, if appropriate, at the end of each reporting period. Amortisation on additions is charged from the month the asset is available for use. No amortisation is charged in the month of disposal.

Gains and losses on sale of intangible assets are included in the statement of comprehensive income.

End of service benefits

With respect to its national employees, the Branch make contributions to a pension fund established by the UAE General Pension and Social Security Authority calculated as a percentage of the employees' salaries. The Branch's obligations are limited to these contributions, which are expensed when due.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

End of service benefits (continued)
In accordance with IAS 19, the Branch provides end of service benefits to its other employees. The entitlement to these benefits is usually based upon the employees' length of service and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment and are not less than the liability arising under the UAE Labour and National Pension and Social Security Laws.

Fair value measurement
For those assets and liabilities carried at fair value, the Branch measures fair value at each reporting date. 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 of financial instruments 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 the Branch. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

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

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

Fair values for financial instruments traded in active markets are based on closing bid prices. For all other financial instruments including instruments for which the market has become inactive, the fair value is determined by using appropriate valuation techniques. Valuation techniques include the fair value derived from recent arm's length transaction, comparison to similar instruments for which market observable prices exist, discounted cash flow method or other relevant valuation techniques commonly used by market participants.

Fair values of non-financial instruments are measured based on valuation provided by independent valuators.

The fair value of a derivative financial instrument is the equivalent of the unrealised gain or loss from marking to market the derivative financial instrument, using relevant market rates or internal pricing models.

All assets and liabilities for which fair value is measured are categorised and disclosed in the financial statements as follows:

- Level 1 - Quoted (unadjusted) market prices in active markets for identical assets or liabilities.
- Level 2 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable. Valuation is derived from recent arm's length transaction, comparison to similar instruments for which market observable prices exists which includes price to book value multiples, price earnings multiples, net asset value issued by the Fund Manager and external quotes.
- Level 3 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable. Valuation techniques include discounted cash flow method, book value method or other relevant valuation techniques commonly used by market participants. The significant inputs for these valuation techniques include market interest rates, discount rates, terminal growth rate, illiquidity discount and cash flow estimates.

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

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition
Interest income and expenses are recognised on an effective interest basis. Once a financial instrument categorised as loans and receivables is impaired, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Interest income and expenses for all interest bearing financial instruments are recognised within the statement of comprehensive income.

Fees and commission income that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate. Other fees and commissions are recognised over the period of service or when rendered.

Taxation
Taxation is provided for in accordance with local regulations for assessment of tax on branches of foreign banks operating in the Emirate of Abu Dhabi.

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

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the reporting date.

Foreign currencies
Foreign currency transactions are recorded at rates of exchange ruling at value dates of the transaction. Monetary assets and liabilities in foreign currencies outstanding at the year-end are translated into UAE Dirhams at rates of exchange ruling at the statement of financial position date.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary assets and liabilities in foreign currencies that are stated at fair value are translated to UAE Dirhams at the foreign exchange rates ruling at the dates that the values were determined. In case of non-monetary assets whose changes in fair values are recognised directly in other comprehensive income, related foreign exchange differences are also recognised directly in other comprehensive income. For other non-monetary assets, foreign exchange differences are recognised directly in the statement of comprehensive income.

Provisions
Provisions are recognised when the Branch has a present obligation (legal or constructive) as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation

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

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

3.1 Transition
Changes in accounting policies resulting from the adoption of IFRS 9 are described below:

a) Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2017 under IFRS 9.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Transition (continued)

b) The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

- The determination of the business model within which a financial asset is held.
- The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.
- If a debt security had low credit risk at the date of initial application of IFRS 9, then the Branch has assumed that credit risk on the asset had not increased significantly since its initial recognition.

The impact of this change in accounting policy as at 1 January 2018 is as follows

	AED 000
Opening loan loss provision balance under IAS 39 (1 January 2018)	12,684
Adjustment on adoption of IFRS 9 reflected in retained earnings	(10,593)
Adjusted ECL balance under IFRS 9 (1 January 2018)	**2,091**

The following table shows reconciliation of original classification and carrying value in accordance with IAS 39 and the new measurement classification under IFRS 9 for the Branch's financial assets as at 1 January 2018.

Financial assets	*IAS 39 Classification*	*IFRS 9 Classification*	*IAS 39 Carrying Value AED 000*	*IFRS 9 Transition Impact AED 000*	*IFRS 9 Carrying Value AED 000*
Cash and balances with central bank	Loans & receivables	Amortised cost	435,808	-	435,808
Due from banks	Loans & receivables	Amortised cost	73,648	(54)	73,594
Loans & advances	Loans & receivables	Amortised cost	932,979	8,500	941,479
Total			**1,442,435**	**8,446**	**1,450,881**

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

The following table reconciles the aggregate opening loan loss provision allowances under IAS 39 and provisions for loan commitments and financial guarantee contracts (included under loans and advances) in accordance with IAS 37 Provisions Contingent Liabilities and Contingent Assets to the ECL allowances under IFRS 9:

	Loan loss provision under IAS 39/IAS 37 at 31 December 2017 AED 000	*Re-measurement AED 000*	*ECLs under IFRS 9 at 1 January 2018 AED 000*
Impairment allowance for loans and receivables and due from banks at amortised cost under IFRS 9	9,708	(8,446)	1,262
Financial guarantees	1,866	(1,369)	497
Letters of credit for customers	1	1	2
Other commitments	1,109	(779)	330
	12,684	**(10,593)**	**2,091**

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of estimates and judgements

The Branch based their assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising beyond the control of the Branch. Such changes are reflected in the assumptions when they occur.

The basis used by management in determining the carrying values of loans and advances and the underlying risk therein are discussed below:

Impairment losses on loans and advances

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Branch's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Branch's internal credit grading model, which assigns PDs to the individual grades
- The Branch's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment
- The segmentation of financial assets when their ECL is assessed on a collective basis
- Development of ECL models, including the various formulas and the choice of inputs
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDSs, EADs and LGDs
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

Fair value measurement

When the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be measured based on quoted prices in active markets, their fair value is measured using valuation techniques including the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgement is required in establishing fair values. Judgements include considerations of inputs such as liquidity risk, credit risk and volatility. Any changes in these estimates as well as the use of different, but equally reasonable estimates may have an impact on their carrying amounts.

Judgements

In the process of applying the Branch's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect in the amounts recognised in the financial statements:

Classification of financial assets

Following 1 January 2018, the Branch determines the classification of financial assets based on the assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding. Refer Note 3 classification of financial assets for more information.

Prior to 1 January 2018, on acquisition of financial assets, management decides whether it should be classified as investments at fair value through profit or loss or investments available for sale or loans and receivables. Further, determining whether or not the market for a quoted financial instrument is active requires judgement based on assessment of the volume/market conditions and availability of ready and regular quotes.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

Standards/amendments issued but not yet effective
The following relevant IASB standards have been issued but are not yet effective and have not been early adopted by the Branch.

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

4 INTEREST INCOME

	2018 ***AED'000***	*2017* *AED'000*
Loans and advances	**35,019**	17,403
Due from related parties (Note 20)	**5,667**	5,021
Due from banks	**7,364**	5,262
	48,050	27,686

5 INTEREST EXPENSE

	2018 ***AED'000***	*2017* *AED'000*
Bond	**-**	19,463
Due to related parties (Note 20)	**24,724**	6,755
Customer deposits	**1,723**	641
Due to banks	**49**	8
	26,496	26,867

6 NET FEE AND COMMISSION INCOME

	2018 ***AED'000***	*2017* *AED'000*
Fee and commission income	**2,532**	3,285
Fee and commission expense	**(174)**	(496)
	2,358	2,789

7 GENERAL AND ADMINISTRATIVE EXPENSES

	2018 *AED'000*	*2017* *AED'000*
Staff costs	**7,231**	5,992
Rental expenses	**1,859**	1,259
Advertising and business promotion expenses	**418**	263
Communication expenses	**450**	1,008
Depreciation and amortization (Note 12, Note 13)	**376**	809
Repairs and maintenance	**450**	254
Travelling expenses	**59**	36
Legal and professional fees	**785**	465
Other expenses	**669**	248
	12,297	10,334

8 CASH AND BALANCES WITH THE UAE CENTRAL BANK

	2018 *AED'000*	*2017* *AED'000*
Balances with the UAE Central Bank:		
Current account	**421,138**	382,057
Cash reserve requirement	**30,888**	53,751
	452,026	435,808

The cash reserve requirement is maintained with the UAE Central Bank in UAE Dirhams and US Dollars and cannot be withdrawn without its approval. Accordingly, these deposits are not available to finance the day to day operations of the Branch. The level of reserve required changes every month in accordance with UAE Central Bank directives and is based on outstanding deposit balances.

9 DUE FROM/TO BANKS

	2018 *AED'000*	*2017* *AED'000*
Due from banks comprise:		
Current account with other banks	**23,850**	57,864
Deposits with banks	**275,475**	15,784
Less: Expected credit loss (9.1)	**(121)**	-
	299,204	73,648

	2018 *AED'000*	*2017* *AED'000*
Due to banks comprise:		
Term deposits	**36,730**	-
Demand and call deposits	**5,080**	181
	41,810	181

9 DUE FROM/TO BANKS (continued)

9.1 Movement of expected credit loss are as follows:

	2018 AED'000	2017 AED'000
Balance at 1 January	-	-
Provided during the year	121	-
Balance at 31 December	121	-

10 LOANS AND ADVANCES

	2018 AED'000	2017 AED'000
Loans and advances (10.1)	499,679	945,663
Allowance for impairment against loans and advances – ECL(10.2)	(2,409)	(12,684)
Loans and advances, net	497,270	932,979

10.1 Analysis of loans and advances

	2018 AED'000	2017 AED'000
Trade finance - bills discounting	13,725	124,233
Syndicated loans	212,591	326,169
Bilateral loans	273,363	495,261
Balance at 31 December	499,679	945,663

10.2 Movement of provision for credit losses are as follows:

	2018 AED'000	2017 AED'000
Balance at 1 January	12,684	3,364
Expected credit loss – IFRS 9 transition adjustment (Note 3.1)	(10,593)	-
Adjusted balance at 1 January	2,091	3,364
Provided during the year	322	1,889
Transfer from credit risk reserve	-	7,400
Exchange rate differences	(4)	31
Balance at 31 December	2,409	12,684

Past due but not impaired
Loans and advances less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary. There were no past due but not impaired loans or advances as at 31 December 2018 (2017: nil).

10 LOANS AND ADVANCES (continued)

10.2 Movement of provision for credit losses are as follows: (continued)

Impairment allowance for loans and advances
The tables below show the credit quality and the maximum exposure to credit risk based on the Branch's internal credit rating system and year-end stage classification.

An analysis of the ECL included under each stage classification is as follows:

In AED 000	2018			
Grades	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Performing*				
Normal grade (AAA1 – A3)	2,362	-	-	2,362
Watchlist grade (A4 – C)	47	-	-	47
Non- performing*				
Sub-standard grade (D)	-	-	-	-
Doubtful grade (D)	-	-	-	-
Loss grade (D)	-	-	-	-
Total	**2,409**	-	-	**2,409**

* The internal rating grades of the Branch corresponding to the grades mentioned above are described in note 22A.

An analysis of changes in the gross carrying amount in relation to loans and advances is as follows:

	2018			
In AED 000	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying amount as at 1 January 2018	945,663	-	-	945,663
New assets originated or purchased	1,068,827	-	-	1,068,827
Assets derecognised or repaid (excluding write offs)	(1,514,811)	-	-	(1,514,811)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Recoveries	-	-	-	-
Amounts written off	-	-	-	-
At 31 December 2018	**499,679**	-	-	**499,679**

Loans and advances in the statement of financial position are stated net of impairment allowances and interest in suspense. The movements for expected credit losses and interest in suspense are as follows:

Internal rating grade	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL allowance as at 1 January 2018	2,091	-	-	2,091
Net new assets originated	318	-	-	318
At 31 December 2018	**2,409**	-	-	**2,409**

10 LOANS AND ADVANCES (continued)

10.2 Movement of provision for credit losses are as follows: (continued)

Economic sector risk concentration for the loans and advances:

	2018 *AED'000*	*2017* *AED'000*
Manufacturing	**72,083**	144,245
Banks and other financial institutions	**13,725**	124,232
Mining and quarrying	**165,285**	159,273
Electricity, water, gas and health services	**103,028**	162,190
Construction	**38,289**	145,691
Transportation and communication	**81,559**	88,856
Services	**25,710**	121,176
Total	**499,679**	945,663

10.3 Modified and renegotiated loans

There were no modified or renegotiated loans as at 31 December 2018 (2017: nil).

11 OTHER ASSETS

	2018 *AED'000*	*2017* *AED'000*
Interest receivable	**3,388**	3,214
Others	**508**	1,192
	3,896	4,406

12 PROPERTY AND EQUIPMENT

	Furniture and fixtures AED'000	*Motor vehicle AED'000*	*Computer and accessories AED'000*	*Leasehold improvements AED'000*	*Office equipment AED'000*	*Total AED'000*
Cost:						
At 31 December 2017	231	152	280	1,633	72	2,368
Additions during the year	180	257	658	3,924	102	5,121
At 31 December 2018	**411**	**409**	**938**	**5,557**	**174**	**7,489**
Accumulated depreciation:						
At 31 December 2017	(134)	(80)	(204)	(1,633)	(31)	(2,082)
Charge for the year	(51)	(40)	(71)	(140)	(17)	(319)
At 31 December 2018	**(185)**	**(120)**	**(275)**	**(1,773)**	**(48)**	**(2,401)**
Net carrying amount:						
At 31 December 2018	**226**	**289**	**663**	**3,784**	**126**	**5,088**
At 31 December 2017	97	72	76	-	41	286

13 INTANGIBLE ASSETS

	Computer software AED '000
Cost:	
At 1 January 2018	346
At 31 December 2018	**346**
Accumulated amortisation:	
As at 1 January 2018	(243)
Charge for the year	(57)
At 31 December 2018	**(300)**
Net carrying amount:	
At 31 December 2018	**46**
At 31 December 2017	103

14 CUSTOMER DEPOSITS

	2018 AED'000	*2017 AED'000*
Current accounts	**144,900**	175,901
Term deposits	**142,801**	86,475
	287,701	262,376

At 31 December 2018, term deposits amounting to AED 38 million (2017: AED 29 million) were held as cash collateral for facilities granted to customers.

15 OTHER LIABILITIES

	2018 AED'000	*2017 AED'000*
Inward remittances	**2,118**	-
Deferred fee income	**156**	1,590
Interest expense payable	**1,693**	746
Employee cost accruals	**2,629**	2,342
Provision for tax (Note 16)	**2,481**	1,943
Other provisions and payables	**961**	391
	10,038	7,012

16 TAXATION

The taxable income is calculated after making certain adjustments to the profit before tax for the year and is based on the tax regulations of Abu Dhabi. The components of income tax expense for the year ended 31 December 2018 and 2017 are:

	2018 *AED'000*	*2017* *AED'000*
Current income tax	**2,481**	1,943
	2,481	1,943
Deferred tax		
Relating to taxable losses of the prior years	-	1,468
Income tax expense reported in the income statement	**2,481**	3,411

The relationship between the tax expense for the year and the accounting profit before tax for the year is as follows:

	2018 *AED'000*	*2017* *AED'000*
Accounting profit before tax	**11,959**	20,767
Non-deductible expenses	**443**	1,889
Taxable income for the year	**12,402**	22,656
Less: Tax loss for the year 2015	-	(5,595)
Less: Tax loss for the year 2016	-	(7,342)
Net taxable income for the year	**12,402**	9,719
Tax at the applicable rate of 20%	**2,481**	1,943
Taxation charge for the year - current	**2,481**	1,943
Taxation charge for the year – deferred	-	1,468
	2,481	3,411

The movement in the provision for taxation is as follows:

	2018 *AED'000*	*2017* *AED'000*
Balance at the beginning of the year	**1,943**	-
Provided during the year	**2,481**	1,943
Less: Tax paid during the year	**(1,943)**	-
Balance at the end of the year	**2,481**	1,943

17 ALLOCATED CAPITAL

In accordance with the UAE Union Law Number 10 of 1980, as amended, allocated capital represents the amount of funds provided by the Head Office.

18 STATUTORY RESERVE

In accordance with Article 82 of the UAE Union Law Number 10 of 1980, 10% of the annual profit for the year is transferred to a statutory reserve until this reserve equals 50% of the allocated capital. Accordingly, a transfer of AED 948 thousand (2017: AED 1,736) has been made during the year. This reserve is not available for distribution, except under the circumstances stipulated by law.

19 CONTINGENCIES AND COMMITMENTS

	2018 *AED'000*	*2017* *AED'000*
Letters of guarantee	**319,884**	426,620
Letter of credit	**-**	3,892
Undrawn credit commitments	**118,820**	147,932
Total	**438,704**	578,444

Guarantees and standby letters of credit, which represent irrevocable assurances that the Branch will make payments in the event that a customer cannot meet his obligations to third parties, carry the same credit risk as loans and advances.

Documentary and commercial letters of credit, which are written undertakings by the Branch on behalf of a customer authorising a third party to draw drafts on the Branch up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore have significantly less risk. Cash requirements under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Branch does not generally expect the third party to draw funds under the agreement.

Undrawn credit commitments represent unused portions of authorizations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Branch is potentially exposed to loss for an amount equal to the total unused commitments. However, the likely amount of loss, though not easy to quantify, is considerably less than the total unused commitments since most commitments to extend credit are contingent upon customers' maintaining specific credit standards. While there is some credit risk associated with the remainder of commitments, the risk is considered limited, since it results from the possibility of unused portions of loan authorizations being drawn by the customer and, second, from these drawings subsequently not being paid as due. The Branch monitors the term to maturity of the credit commitments because longer term commitments generally have a greater degree of credit risk than the shorter term commitments. The total outstanding contractual amount of the commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments may expire or terminate without being funded.

Guarantees and acceptances include AED 143 million (2017: AED 6.8 million) incurred on behalf of other branches of the Head Office.

As at 31 December 2018, the gross balance of contingent liabilities in Stage 1 amounted to AED 438,704 thousand. The ECL for Stage 1 amounted to AED 392 thousand and is included under loans and advances (2017: AED 2,976 thousand).

The maturity profile of contingencies and commitments is as follows:

2018	***No later than 1 year AED'000***	***Over 1 year up to 5 years AED'000***	***Over 5 years AED'000***	***Total AED'000***
Guarantees and acceptances	**216,914**	**6,554**	**96,416**	**319,884**
Undrawn credit commitments	**118,820**	**-**	**-**	**118,820**
Total	**335,734**	**6,554**	**96,416**	**438,704**

19 CONTINGENCIES AND COMMITMENTS (continued)

2017	*No later than 1 year AED'000*	*Over 1 year up to 5 years AED'000*	*Over 5 years AED'000*	*Total AED'000*
Guarantees and acceptances	316,287	13,943	96,390	426,620
Letters of credit	3,892	-	-	3,892
Undrawn credit commitments	15,733	132,199	-	147,932
Total	335,912	146,142	96,390	578,444

20 RELATED PARTY TRANSACTIONS AND BALANCES

Related parties represent the Head Office, group entities, Directors of the Head Office, major shareholders of Head Office, senior management personnel of the Head Office and Branches, transactions with close members of their families and entities controlled, jointly controlled or significantly influenced by such parties. The terms of these transactions are approved by the Branch's management

Transactions with related parties

	2018 AED'000	*2017 AED'000*
Interest income on deposits with the related parties	**5,667**	5,021
Interest expense on deposits from the related parties	**24,724**	6,755

Balances with related parties

	2018 AED'000	*2017 AED'000*
Due from Related Parties		
Current account	**23,821**	4,442
	23,821	4,442

22% (2017: 75%) of the loans and advances which are neither past due nor impaired are fully secured by guarantees from the Head Office through its branches.

	2018 AED'000	*2017 AED'000*
Due to Related Parties		
Term deposits	**509,210**	817,855
Current account	**50,198**	1,925
	559,408	819,780
Interest payable	**932**	596

Key management compensation:

	2018 AED'000	*2017 AED'000*
Remuneration to key management personnel	**893**	821

21 FAIR VALUES OF FINANCIAL INSTRUMENTS

Financial instruments
Financial instruments generally comprise of financial assets, financial liabilities and derivatives.

Financial assets consist of cash and deposits with Central Bank of UAE, deposits with banks and loans and advances, certain other assets. Financial liabilities consist of due to banks, customer deposits and certain other liabilities. Derivatives consists of forward foreign exchange contracts.

The fair value of financial instruments is categorised as:

Financial instruments carried at amortised cost
The fair value of financial instruments carried at amortised cost are not materially different from their carrying value as most of these assets and liabilities are of short term maturities or are re-priced regularly based on market movement in interest rates.

Fair values of other financial instruments are not materially different from their carrying values.

22 FINANCIAL RISK MANAGEMENT

The Branch'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 financial business. The Branch's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Branch's financial performance.

The main sources of financial risk that the Branch faces arise from financial instruments which are fundamental to the Branch's business and constitute the core of its operations. Financial instruments create, modify or reduce the liquidity, credit and market risks of the Branch's statement of financial position. Consequently, the Branch devotes considerable resources to maintaining effective controls to manage, measure and mitigate each of these risks and regularly reviews its risk management procedures and systems to ensure that they continue to meet the needs of the business.

Managing financial risks, especially credit risk is a fundamental part of the Branch's business activity and an essential component of the planning process. The Branch achieves its risk management goals by keeping risk management at the centre of the executive agenda and by building a culture that measures risk management with everyday business decision making.

The Branch ensures that it has the capacity to manage the risk in its new and growing businesses, and that its business plans are consistent with the risk appetite, that is, the level of risk that the Branch is willing to accept in fulfilling its business objectives.

The Branch's risk management policies are designed to identify and analyse risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits. These policies provide written principles for overall risk management, as well as specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments.

The most relevant risks are credit risk, market risk (which includes price risk, currency risk and interest rate risk, liquidity risk, prepayment risk and operational risk.

A. Credit risk

Credit risk is defined as the risk that the Branch's customers, clients or counterparties fail to perform or are unwilling to pay interest, repay the principal or otherwise to fulfil their contractual obligations under loan agreements or other credit facilities, thus causing the Branch to suffer a financial loss. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the Branch's portfolio, could result in losses that are different from those provided for at the end of the reporting period. Management therefore carefully manages its exposure to credit risk. Credit exposures arise principally in loans and advances, balances with banks, other receivables and unfunded exposures such as letters of credit, letters of guarantee and undrawn commitments.

22 FINANCIAL RISK MANAGEMENT (continued)

A. Credit risk (continued)

Credit risk, both on and off balance sheet, is actively managed and monitored in accordance with defined credit policies and procedures. The creditworthiness of each counterparty is evaluated and appropriate credit limits are established. Established limits and actual levels of exposure are regularly reviewed and updated by management. Credit review procedures are designed to identify, at an early stage, exposures which require more detailed monitoring and review.

In managing its portfolio, the Branch utilises ratings and other measures and techniques which seek to take account of all aspects of perceived risk. The Branch uses CCMS as its internal credit-rating engine. The CCMS tool provides the ability to analyse a business and produce risk ratings at both the obligor and facility level. The analysis supports the usage of financial factors as well as non-financial subjective factors. Where applicable, the Branch also uses external ratings by recognised rating agencies for externally rated portfolios.

Definition of default

The Branch considers a financial asset to be in default and therefore Stage 3 (credit impaired) for ECL calculations when:

- the borrower is unlikely to pay its credit obligations to the Branch in full, without recourse to actions such as realising security (if any is held) by the Branch;
- the borrower is past due more than 90 days on any material credit obligation to the Branch; or borrower is considered as credit impaired based on qualitative assessment for internal credit risk management purposes

Any credit impaired or stressed facility that has been restructured would also be considered as in default. The restructured facilities would be required to complete the moratorium period (if any) and meet the scheduled payments (all on current basis) for at least 1 year, or as determined by the Branch for consideration for moving the facility to stage 2/stage 1.

The Branch considers a variety of indicators that may indicate unlikeliness to pay as part of a qualitative assessment of whether a customer is in default. Such indicators include:

- breaches of covenants
- borrower having past due liabilities to public creditors or employees
- borrower is deceased

Significant increase in credit risk

The Branch continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12months ECL or life time ECL, the Branch assesses whether there has been a significant increase in credit risk since initial recognition. The quantitative criteria used to determine a significant increase in credit risk is a series of relative and absolute thresholds. All financial assets that are 30 days past due are generally deemed to have significant increase in credit risk since initial recognition and migrated to stage 2 even if other criteria's do not indicate a significant increase in credit risk.

Credit facilities are classified under Stage 2 when there has been a downgrade in the facility's credit rating by 2 grades for the facilities with Investment Grade and by 1 grade for those with Non-Investment Grade.

The Branch also considers that events as mentioned below are indicators of significant increase in credit risk as opposed to a default.

- Significant deterioration of credit risk rating of the borrower with consideration to relative increase in PD.
- Accounts expired (pending renewal) for a period of 6 months or more (excluding all accounts with technical reasons).
- Contractual disputes between borrower and contracting entity, leading to detrimental impact on the borrower's cash flow.
- Management dispute or loss of key management personnel leading to detrimental impact on borrowers' repayment capacity.
- Restructured accounts where there is principal haircut, or a standstill agreement is signed or where the restructured account carries specific provision.

The Branch considers a financial instrument with an external rating of "investment grade" as at the reporting date to have low credit risk.

22 FINANCIAL RISK MANAGEMENT (continued)

A. Credit risk (continued)

PD estimation process
The Probability of Default (PD) is the likelihood that an obligor will default on its obligations in the future.

PD estimation process requires the use of separate PD for a 12-month duration and lifetime duration depending on the stage allocation of the obligor. A PD used for IFRS 9 should reflect the Branch's estimate of the future asset quality. The Through The Cycle (TTC) PDs are generated from CCMS based on the internal/external credit ratings. The Branch converts the TTC PD to a Point In Time (PIT) PD term structures using appropriate models and techniques.

Exposure at default
Exposure at default (EAD) represents the amount which the obligor will owe to the Branch at the time of default. The Branch considers variable exposures that may increase the EAD in addition to the drawn credit line. These exposures arise from undrawn limits and contingent liabilities. Therefore, the exposure will contain both on and off balance sheet values. EAD is estimated taking into consideration the contractual terms such as coupon rates, frequency, reference curves, maturity, pre-payment options, amortization schedule, usage given default, etc.

Loss Given Default
Loss Given Default (LGD) is the magnitude of the likely loss if there is a default. The Branch 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.

Incorporation of forward-looking information
The Branch considers key economic variables that are expected to have an impact on the credit risk and the ECL in order to incorporate forward looking information into the ECL models. These primarily reflect reasonable and supportable forecasts of the future macro-economic conditions. The consideration of such factors increases the degree of judgment in determination of ECL. The Branch employs statistical models (Z macro model) to incorporate macro-economic factors on historical default rates. The Branch considers scenarios of forecasts of macro-economic data separately for each geographical segments and appropriate probability weights are applied to these scenarios to derive a probability weighted outcome of expected credit loss. The management reviews the methodologies and assumptions including any forecasts of future economic conditions on a regular basis.

Derivative financial instruments
Credit risk in respect of derivative financial instruments is limited to those with positive fair values.

Individually impaired
There are no loans or advances individually impaired as at 31 December 2018 (2017: nil).

Risk limit control and mitigation policies
The Branch maintains and manages limits and controls concentrations of credit risk wherever they are identified, in particular to individual counterparties and groups, and to industries and countries.

The credit risk is primarily managed by placing limits on the amount of risk accepted in relation to one borrower or groups of borrowers. Such risks are monitored on a daily basis.

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing the lending limits where appropriate.

As part of the Branch's credit risk management policies and practices, it obtains security where deemed necessary for loans and advances. The security types are pledges of cash deposit and bank guarantees.

22 FINANCIAL RISK MANAGEMENT (continued)

A. Credit risk (continued)

Maximum exposure to credit risk before collateral held or other credit enhancements
The following table represents a worst case scenario of credit risk exposure to the Branch at 31 December 2018 and 2017 without taking into account any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures set out below are based on gross carrying amounts before provisions which will be larger than that reported in the statement of financial position. For off-balance sheet assets, the exposures set out below are based on gross carrying amounts before Credit Conversion Factor ("CCF"), Credit Risk Mitigation ("CRM") and ECL.

	2018 AED'000	*2017 AED'000*
Due from banks	**299,325**	73,648
Due from related parties	**23,821**	4,442
Loans and advances	**499,679**	945,663
Other assets (excluding prepayments)	**3,607**	3,406
	826,432	1,027,159
Contingencies and commitments (Note 19)	**438,704**	578,444

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

The main types of collateral obtained are cash, securities, and charges over tangible properties and counter-guarantees. At 31 December 2018, of the total outstanding loans and advances, AED 499,679 thousand (31 December 2017: AED 945,663 thousand) were secured with a collateral value of AED 346,148 thousand (31 December 2017: AED 878,098 thousand).

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

Concentration of credit risk by geographical area
The following table breaks down the Branch's main credit exposures at their carrying amounts, as categorised by geographical regions as of 31 December 2018 and 2017. For on-balance sheet assets, the exposures set out below are based on gross carrying amounts before provisions which will be larger than that reported in the statement of financial position. For this table, the Branch has allocated exposures to regions based on the country of domicile of its counterparties.

31 December 2018	***United Arab Emirates AED'000***	***Asia AED'000***	***Others AED'000***	***Total AED'000***
Assets				
Due from banks	-	**275,475**	**23,850**	**299,325**
Due from related parties	-	**23,821**	-	**23,821**
Loans and advances	**69,326**	**348,794**	**81,559**	**499,679**
Other assets (excluding prepayments)	**166**	**3,022**	**419**	**3,607**
	69,492	**651,112**	**105,828**	**826,432**

22 FINANCIAL RISK MANAGEMENT (continued)

A. Credit risk (continued)

Concentration of credit risk by geographical area (continued)

31 December 2017	*United Arab Emirates AED'000*	*Asia AED'000*	*Others AED'000*	*Total AED'000*
Assets				
Due from banks	-	15,783	57,865	73,648
Due from related parties	-	4,442	-	4,442
Loans and advances	240,240	630,165	75,258	945,663
Other assets (excluding prepayments)	192	3,214	-	3,406
	240,432	653,604	133,123	1,027,159

Concentration of credit risk by industry
The following table breaks down the Branch's main credit exposures on loans and advances, due from other banks and due from related parties and off balance sheet items categorised by industry as of 31 December 2018 and 2017.

For on-balance sheet assets, the exposures set out below are based on gross carrying amounts before provisions which will be larger than that reported in the statement of financial position. For off-balance sheet assets, the exposures set out below are based on gross carrying amounts before Credit Conversion Factor (CCF) and Credit Risk Mitigation (CRM)s.

	On balance sheet items				
31 December 2018	***Loans and advances AED'000***	***Amounts due from other banks and group entities AED'000***	***Total funded AED'000***	***Off balance sheet items AED'000***	***Total AED'000***
Crude oil, gas, mining andf quarrying	**165,285**	-	**165,285**	**91,825**	**257,110**
Electricity	**103,028**	-	**103,028**	-	**103,028**
Manufacturing	**72,083**	-	**72,083**	**13,503**	**85,586**
Construction	**38,289**	-	**38,289**	**63,658**	**101,947**
Telecommunication and transportation	**81,559**	-	**81,559**	**45,223**	**126,782**
Financial institutions	**13,724**	**323,146**	**336,870**	**200,608**	**537,478**
Services	**25,711**	-	**25,711**	**23,887**	**49,598**
	499,679	**323,146**	**822,825**	**438,704**	**1,261,529**

22 FINANCIAL RISK MANAGEMENT (continued)

A. Credit risk (continued)

Concentration of credit risk by industry (continued)

	On balance sheet items				
31 December 2017	*Loans and advances AED'000*	*Amounts due from other banks and group entities AED'000*	*Total funded AED'000*	*Off balance sheet items AED'000*	*Total AED'000*
Crude oil, gas, mining and quarrying	159,273	-	159,273	91,800	251,073
Electricity	162,190	-	162,190	-	162,190
Manufacturing	144,245	-	144,245	14,327	158,572
Construction	145,691	-	145,691	76,556	222,247
Telecommunication and transportation	88,856	-	88,856	130,552	219,408
Financial institutions	124,232	78,090	202,322	234,819	437,141
Services	121,176	-	121,176	30,390	151,566
Total exposures	945,663	78,090	1,023,753	578,444	1,602,197

Gross credit exposures by residual contractual maturity

31 December 2018	***Up to 3 months AED'000***	***3 to 12 months AED'000***	***1 to 5 years AED'000***	***Over 5 years AED'000***	***Total AED'000***
Due from banks	**207,500**	**91,825**	-	-	**299,325**
Due from related parties	**23,821**	-	-	-	**23,821**
Loans and advances	**370**	**97,099**	**230,940**	**171,270**	**499,679**
Total funded	**231,691**	**188,924**	**230,940**	**171,270**	**822,825**

31 December 2017	*Up to 3 months AED'000*	*3 to 12 months AED'000*	*1 to 5 years AED'000*	*Over 5 years AED'000*	*Total AED'000*
Due from banks	73,648	-	-	-	73,648
Due from related parties	4,442	-	-	-	4,442
Loans and advances	347,295	326,320	152,610	119,438	945,663
Total funded	425,385	326,320	152,610	119,438	1,023,753

Impairment Reserve Under the Central Bank of UAE (CB UAE) Guidance

The Central Bank of UAE issued its IFRS 9 guidance in March 2018 addressing various implementation challenges and practical implications for Banks adopting IFRS 9 in the UAE.

The guidance states that if in the first year of implementation the specific provision along with suspended interest / profit and general provisions (1.5% of Total Credit Risk Weight Asset "CRWA") as per CBUAE requirements (Circular 28/2010), is higher than the impairment allowance computed under IFRS 9, the difference individually shall be transferred to an impairment reserve as an appropriation from the retained earnings. This impairment reserve shall further be split into specific provision difference (*Impairment Reserve: Specific*) and the collective / general provision difference (*Impairment Reserve: General*). This impairment reserve shall not be available for payment of dividend.

Also, the regulation specifies that the *Impairment Reserve: General* shall be allowed to be included in regulatory capital up to a maximum of 1.25% of risk weighted assets as per Basel, where this is not already utilized.

22 FINANCIAL RISK MANAGEMENT (continued)

A. Credit risk (continued)

Impairment Reserve: General

	2018 *AED 000*
General provisions under Circular 28/2010 of CB UAE	**13,123**
Stage 1 and Stage 2 provisions under IFRS 9	**(2,530)**
General provision transferred to the credit risk reserve*	**10,593**

Impairment Reserve: Specific

	2018 *AED 000*
Specific provisions under Circular 28/2010 of CB UAE	-
Stage 3 provisions under IFRS 9	-
Specific provision transferred to the impairment reserve*	-
Total provision transferred to the impairment reserve	-

**In the case where provisions under IFRS 9 exceed provisions under CBUAE, no amount shall be transferred to the impairment reserve.*

The Bank's internal credit rating grades for the year ended 31 December 2018:

Internal rating grade	*Internal risk rating description*	*Cash and balances with the UAE Central bank AED'000*	*Contingencies and commitments AED'000*	*Due from banks AED'000*	*Interest AED'000*	*Loans and advances AED'000*	*Due from related parties AED'000*	*Total*
AAA1-AAA4	Very low	452,026	-	15,897	764	-	23,821	**492,508**
AAA5 - AAA7	Low	-	96,416	7,953	-	62,076	-	**166,445**
AA1 - AA3	relatively low	-	40,952	-	-	13,355	-	**54,307**
A1 - A3	Medium	-	301,336	-	2,624	340,504	-	**644,464**
A4 - BB2	Relatively high	-	-	275,475	-	10,284	-	**285,759**
B1 - C	Very high	-	-	-	-	73,460	-	**73,460**
D	Default	-	-	-	-	-	-	-
		452,026	**438,704**	**299,325**	**3,388**	**499,679**	**23,821**	**1,716,944**

B. Market risk

The Branch takes on exposure to market risks, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate and currency, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads and foreign exchange rates. Market risk consists of price risk, currency risk and interest rate risk.

The Assets Liability Committee ("ALCO") is responsible for formalising the Branch's key financial indicators and ratios, set the thresholds to manage and monitor market risk and also analyse the sensitivity of the Branch's interest rate and maturity mis-matches. ALCO also guides the Branch's investment decisions and provides guidance in terms of interest rate and currency movements.

22 FINANCIAL RISK MANAGEMENT (continued)

B. Market risk (continued)

B.1 Price risk

Price risk is the risk that the value of the entity's financial instruments will fluctuate as a result of changes in market prices caused by factors other than interest rates or foreign currency movements. The price risk arises primarily from uncertainty about the future price of financial instruments that the entity holds. The Branch does not hold significant financial instruments whose value is affected by changes in market prices and, therefore the Branch is not exposed to price risk.

B.2 Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates and arises from financial instruments denominated in a foreign currency.

The Branch takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Head Office sets limits on the level of exposure by currency and in aggregate for both overnight and intra-day positions, which are monitored daily. The table below summarises the Branch's exposure to foreign currency risk. Included in the table are the Branch's financial instruments at carrying amounts, categorised by currency before provisions.

USD is the major foreign currency. Since AED is pegged to USD there is no effect on net profit and all other net currency exposures are not significant. At 31 December 2018 and 31 December 2017, the Branch had the following net currency exposures. As the Branch's functional currency is AED, the Branch is not exposed to any currency risk on its exposures to AED:

31 December 2018	*AED AED'000 (equivalent)*	*US$ AED'000 (equivalent)*	*HKD AED'000 (equivalent)*	*CNY AED'000 (equivalent)*	*EUR AED'000 (equivalent)*	*Total AED'000 (equivalent)*
Assets						
Cash and balances with the UAE Central Bank	425,388	26,638	-	-	-	452,026
Due from banks	-	299,204	-	-	-	299,204
Due from related parties	-	5,749	43	16,752	1,277	23,821
Loans and advances	27,862	456,061	-	13,347	-	497,270
Other assets excluding prepayments	2,479	776	-	337	-	3,592
Total financial assets	455,729	788,428	43	30,436	1,277	1,275,913
Liabilities						
Customer deposits	21,994	253,440	-	10,954	1,313	287,701
Due to related parties	50,215	495,842	-	13,351	-	559,408
Due to banks	5,085	36,725	-	-	-	41,810
Other liabilities excluding deferred income	5,935	3,947	-	-	-	9,882
Total financial liabilities	83,229	789,954	-	24,305	1,313	898,801
Net position	372,500	(1,526)	43	6,131	(36)	377,112

22 FINANCIAL RISK MANAGEMENT (continued)

B. Market risk (continued)

B.2 Currency risk (continued)

31 December 2017	*AED AED'000 (equivalent)*	*US$ AED'000 (equivalent)*	*HKD AED'000 (equivalent)*	*CNY AED'000 (equivalent)*	*EUR AED'000 (equivalent)*	*Total AED'000 (equivalent)*
Assets						
Cash and balances with the UAE Central Bank	387,257	48,551	-	-	-	435,808
Due from banks	-	57,864	-	15,784	-	73,648
Due from related parties	-	2,189	934	1,001	318	4,442
Loans and advances, gross	14,603	746,347	102,819	81,894	-	945,663
Other assets excluding prepayments	942	2,100	-	364	-	3,406
Total financial assets	402,802	857,051	103,753	99,043	318	1,462,967
Liabilities						
Customer deposits	31,212	214,315	-	16,517	332	262,376
Due to related parties	1,925	635,256	101,990	80,609	-	819,780
Due to banks	-	-	-	181	-	181
Other liabilities excluding deferred income	4,878	395	-	150	-	5,423
Total financial liabilities	38,015	849,966	101,990	97,457	332	1,087,760
Net position	364,787	7,085	1,763	1,586	(14)	375,207

B3. Interest rate risk

The table below summarises the average interest rate on the outstanding interest bearing balances by major currencies for monetary financial instruments:

At 31 December 2018	***AED %***	***CNY %***	***US$ %***	***EUR %***	***HKD %***
Assets					
Due from banks	-	-	**3.12**	-	-
Due from related parties	-	-	-	-	-
Loans and advances	**7.17**	**4.75**	**4.28**	-	-
Liabilities					
Due to banks	-	-	**3.20**	-	-
Due to related parties	-	**4.60**	**3.27**	-	-
Customer deposits	-	**3.25**	**2.15**	-	-

At 31 December 2017	*AED %*	*CNY %*	*USD %*	*EUR %*	*HKD %*
Assets					
Due from banks	-	4.60	-	-	-
Due from related parties	-	-	-	-	-
Loans and advances	5.72	4.70	3.02	-	2.85
Liabilities					
Due to banks	-	-	3.20	-	-
Due to related parties	-	4.46	2.28	-	1.20
Customer deposits	-	3.00	1.73	-	-

22 FINANCIAL RISK MANAGEMENT (continued)

B. Market risk (continued)

B3. Interest rate risk (continued)

Interest rate risk is also assessed by measuring the impact of reasonable possible change in interest rate movements. The Branch assumes a fluctuation in interest rates of 100 basis points (bps) as being reasonable and estimates the following impact on the results and equity for the year:

	Interest income AED'000	***Interest expense AED'000***
At 31 December 2018		
Fluctuation of 100 bps	**8,683**	**7,819**

	Interest income AED'000	*Interest expense AED'000*
At 31 December 2017		
Fluctuation of 200 bps	12,843	11,048

The above sensitivity analysis does not incorporate actions that could be taken by management to mitigate the effect of interest rate movements.

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Branch takes on exposures to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce losses in the event that unexpected movements arise. The ALCO sets limits on the level of mismatch of interest rate re-pricing that may be undertaken, which is monitored daily by the treasury function.

22 FINANCIAL RISK MANAGEMENT (continued)

B. Market risk (continued)

B3. Interest rate risk (continued)

The table below summarises the Branch's exposure to interest rate risks. It includes the Branch's financial instruments at gross carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

2018

	Less than 3 months AED'000	*3 months to 1 year AED'000*	*Over 1 year up to 5 years AED'000*	*Over 5 years AED'000*	*Non interest bearing AED'000*	*Total AED'000*
Assets:						
Cash and balances with UAE Central Bank	-	-	-	-	452,026	452,026
Due from banks	275,475	-	-	-	23,850	299,325
Due from related parties	-	-	-	-	23,821	23,821
Loans and advances, gross	499,679	-	-	-	-	499,679
Other assets excluding prepayments	-	-	-	-	8,592	8,592
Total	775,154	-	-	-	508,289	1,283,443
Liabilities:						
Customer deposits	61,077	44,076	-	-	182,548	287,701
Due to related parties	472,480	36,730	-	-	50,198	559,408
Due to banks	36,730	-	-	-	5,080	41,810
Other liabilities excluding deferred income	-	-	-	-	7,774	7,774
Total	570,287	80,806	-	-	245,600	896,693
Interest rate sensitivity gap	204,867	(80,806)	-	-	262,689	386,750

22 FINANCIAL RISK MANAGEMENT (continued)

B. Market risk (continued)

B3. Interest rate risk (continued)

2017

	Less than 3 months AED'000	*3 months to 1 year AED'000*	*Over 1 year up to 5 years AED'000*	*Over 5 years AED'000*	*Non interest bearing AED'000*	*Total AED'000*
Assets:						
Cash and balances with UAE Central Bank	-	-	-	-	435,808	435,808
Due from banks	15,784	-	-	-	57,864	73,648
Due from related parties	-	-	-	-	4,442	4,442
Loans and advances, gross	466,733	478,930	-	-	-	945,663
Other assets excluding prepayments	-	-	-	-	3,406	3,406
Total	482,517	478,930	-	-	501,520	1,462,967
Liabilities:						
Customer deposits	46,202	11,016	-	-	205,158	262,376
Due to related parties	520,543	297,312	-	-	1,925	819,780
Due to banks	-	-	-	-	181	181
Other liabilities excluding deferred income	-	-	-	-	5,423	5,423
Total	566,745	308,328	-	-	212,687	1,087,760
Interest rate sensitivity gap	(84,228)	170,602	-	-	288,833	375,207

22 FINANCIAL RISK MANAGEMENT (continued)

C. Liquidity risk

Liquidity risk is the risk that the Branch will not be able to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments to lend.

The Branch manages its liquidity in accordance with the Central Bank of the UAE's requirements and the Bank's internal guidelines mandated by ALCO. The Central Bank of the UAE has reserve requirements on deposits ranging between 1% and 14% on demand and time deposits. The Central Bank of the UAE also imposes mandatory 1:1 advances to deposit ratio whereby loans and advances (combined with inter-bank placements having a remaining term of greater than three months) should not exceed stable funds as defined by the Central Bank of the UAE. ALCO monitors liquidity ratios on a regular basis and for covering the risk of any mismatch in liquidity, Head Office funding is available to the Bank.

The table below presents the cash flows payable by the Branch under non-derivative financial instruments by remaining contractual maturity at the statement of financial position date. The amounts disclosed in the table are the contractual discounted cash flows.

Financial liabilities *31 December 2018*	*On demand AED'000*	*Less than 3 months AED'000*	*3 to 12 months AED'000*	*1 to 5 years AED'000*	*Over 5 years AED'000*	*Total AED'000*
Customer deposits	**144,900**	**93,925**	**48,876**	-	-	**287,701**
Due to related parties	**50,198**	**380,655**	**36,730**	**91,825**	-	**559,408**
Due to banks	**5,080**	**36,730**	-	-	-	**41,810**
Other liabilities excluding deferred income	**8,189**	**1,693**	-	-	-	**9,882**
Total discounted financial liabilities	**208,367**	**513,003**	**85,606**	**91,825**	-	**898,801**

Financial liabilities *31 December 2017*	*On demand AED'000*	*Less than 3 months AED'000*	*3 to 12 months AED'000*	*1 to 5 years AED'000*	*Over 5 years AED'000*	*Total AED'000*
Customer deposits	205,158	49,874	7,344	-	-	262,376
Due to related parties	1,924	367,470	358,586	91,800	-	819,780
Due to banks	181	-	-	-	-	181
Other liabilities excluding deferred income	2,734	2,689	-	-	-	5,423
Total undiscounted financial liabilities	209,997	420,033	365,930	91,800	-	1,087,760

D. Prepayment risk

Prepayment risk is the risk that the Branch will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected such as fixed rate loans and advances when interest rates fall. Majority of the Branch's interests bearing financial assets are at floating rates.

E. Operational risk

Operational risk is the risk of loss caused by failures in operational processes, people, fraud, external events and system failures that supports operational processes. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Branch cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Branch is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

22 FINANCIAL RISK MANAGEMENT (continued)

E. Operational risk (continued)

The Branch manages this risk by setting policies and procedures, which are approved by the Head office and are applied to identify, assess and supervise operational risk in addition to other types of risks relating to the banking and financial activities of the Branch. The Branch manages operational risk through the Risk Management Division of the Branch and the guidance of Head Office.

F. Capital management

The Central Bank of the UAE sets and monitors capital requirements for the Branch.

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

- Tier 1 capital, which includes allocated capital, statutory reserve and retained earnings, after deductions for goodwill and intangible assets, if any.
- Tier 2 capital, which includes qualifying subordinated liabilities.

During the year ended 31 December 2018 and 2017, the Branch complied in full with capital requirements. All banks operating in U.A.E. are required to maintain a minimum capital adequacy of 12%

There have been no material changes in the Branch's management of capital during the year.

	Basel III	*Basel III*
	2018 ***AED 000***	*2017* *AED 000*
Tier 1 capital		
Allocated capital	**367,200**	367,200
Statutory reserves	**2,684**	1,736
Retained earnings	**1,917**	(6,613)
Total	**371,801**	362,323
Tier 2 capital		
Collective impairment provision	**8,855**	10,579
Total capital base	**380,656**	372,902
Regulatory adjustments		
Goodwill and other intangibles	**(46)**	(103)
Total capital base	**380,610**	372,799
Risk-weighted assets		
Credit Risk	**590,316**	846,291
Market Risk	**90**	507
Operational Risk	**23,849**	23,847
Total risk-weighted assets	**614,255**	870,645
Capital adequacy ratio (%)	**61.97%**	42.83%

Risk weighted assets relating to credit risk as at 31 December 2018 is AED 590,316 thousand