

The National Bank of Ras Al-Khaimah (P.S.C.)

**Report and consolidated financial statements
for the year ended 31 December 2018**

The National Bank of Ras Al-Khaimah (P.S.C.)

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DIRECTORS' REPORT TO THE SHAREHOLDERS

For and on behalf of the Board of Directors

We are pleased to present the results of RAKBANK (the "Bank") and its subsidiaries (collectively known as the "Group") for the year ended 31 December 2018. Net Profit for the year amounted to AED 917.5 million, an increase of AED 107.0 million (13.2%) over the previous year. Total Assets stood at AED 52.7 billion, increasing by 8.5% on 2017. Gross Loans and Advances closed at AED 34.8 billion, up by 4.8% over the previous year. The Return on Average Assets ratio closed the year at 1.8% compared to 1.8% for the previous year and Return on Average Equity was 13.5%, compared to 10.6% in 2017.

Financial performance

The increase of AED 107 million in Net Profit was due to an increase of Net Interest Income, a reduction in provisions for expected credit losses offset by an increase in Operating Expenses and a decline in Non-Interest Income.

Gross Interest Income and Income from Islamic Financing increased by AED 333.5 million, which was offset by an increase in Interest Expense and Distributions to Depositors of AED 288.0 million, leading to a net increase to Net Interest Income and Net Income from Islamic Financing of AED 45.5 million. Interest income from conventional loans and investments increased by 9.5%, while interest costs on conventional deposits and borrowings rose by AED 231.5 million. Net income from Sharia-compliant financing increased by AED 11.5 million.

Non-Interest Income declined by AED 28.3 million to AED 1.1 billion. This was mainly due to a decrease of AED 61.2 million in Investment Income compared to 2017. Investment Income was low, due to lower trading gains on Investments. This was partially offset by an increase in net fees and commission income of AED 12.7 million and AED 24.0 million in foreign exchange and derivative income.

Operating Expenses increased by AED 41.9 million, up by 2.9% over the previous year. This was mainly due to an increase of AED 7.0 million in staff and outsourced staff costs, AED 15.7 million in computer expenses and AED 13.8 million in other operating expenses. The Group's Cost to Revenue ratio increased to 38.9% compared to 38.0% for the previous year.

Operating Profit before impairment losses decreased by AED 24.8 million from 2017. This was offset by a decrease in provisions for credit losses by 8.5% from the previous year. Total impairment provision for the year was AED 1.4 billion compared to AED 1.6 billion in 2017.

The Non-Performing Loans and Advances to Gross Loans and Advances ratio rose to 4.2% from 4.0% in the previous year. However, net credit losses to average loans and advances reduced, closing at 4.1% compared to 5.0% in 2017.

Total Assets rose by 8.5% to AED 52.7 billion compared to 2017. This was due to an increase in Gross Loans and Advances of AED 1.6 billion, lending to banks, which grew by AED 956 million and an increase in investments of AED 1.6 billion. Wholesale Banking and Financial Institutions lending grew by 22.2%, up by AED 1.4 billion from the previous year. Retail banking's loan portfolio was down by AED 346 million and Business Banking's loan portfolio was up by AED 494 million compared to 2017.

Customer deposits grew by 6.1% to AED 34.1 billion compared to 2017. This growth came mainly from an increase of AED 2.7 billion in time deposits.

After taking into consideration the profit for 2018 and expected dividend, the Bank's Capital adequacy ratio as per Basel III was 17.2% at year-end, compared with 20.7% at the end of 2017. This level of capital provides the Bank with ample room for growth in 2018. The regulatory Eligible Liquid Asset ratio at the end of the year was 14.5%, compared to 15.0% the previous year. The Advances to Stable Resources ratio stood at a comfortable 94.5% compared to 87.8% at the end of 2017.

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DIRECTORS' REPORT TO THE SHAREHOLDERS (continued)

Ratings

The Bank is currently rated by the following agencies. The ratings are given below:

Rating agency	Last update	Deposits	Outlook
Moody's	January 2019	Baa1/P-2	Stable
Fitch	December 2018	BBB+/F2	Stable
Capital Intelligence	August 2018	A-/A2	Stable

Developments in 2018

- The RAK Department of Finance along with the Electronic Government Authority extended their partnership with RAKBANK as exclusive acquiring bank and STS PayOne, a leading provider of ePayment solutions, to launch RAK SmartPay as an integrated e-payment system in Ras Al Khaimah.
- RAKBANK, Mohammed Bin Rashid Fund (MBRF) reaffirm partnership to facilitate SME financing. The MBRF of Dubai SME, the agency of the Department of Economic Development in Dubai mandated to develop the SME sector, signed a MoU with RAKBANK to facilitate SME access to competitive financing solutions.
- RAKBANK signs an agreement with Sri Lanka's Cargills Bank to offer money remittance through Ripple. The agreement with Sri Lanka's Cargills Bank offers instant, frictionless, and secure money transfer services to Sri Lanka via blockchain using the Ripple platform.
- RAKBANK announced its recent partnership with the Finance Department (Government of Ras Al Khaimah) to facilitate their requirements on cash management and payment gateway solutions.
- RAKBANK partners with INPAY- a European Fintech remittance service provider – to offer faster money remittance services to 25 European countries through RAKMoneyTransfer.
- RAKBANK and FC Barcelona announced a strategic regional partnership for 3 years whereby RAKBANK has become the official bank of FC Barcelona in the United Arab Emirates. This partnership entails the launch of new FC Barcelona dedicated co-branded affinity MasterCard credit card.
- RAKBANK partners with Xpress Money to offer convenient money transfer services to 20 countries through RAKMoneyTransfer.
- RAKBANK partnered with Air Arabia and MasterCard® to launch a co-branded MasterCard Platinum Credit Card, which cardholders can use globally for purchases and cash withdrawals.
- RAKBANK announced its partnership with Federal Electricity & Water Authority to facilitate FEWA bill payment solution through the Bank's Digital Banking platform and other touch points for customers residing in Ras Al Khaimah, Ajman, Umm al Quwain, and Fujairah. Similarly, the Bank signed an agreement with Sharjah Electricity & Water Authority.
- RAKBANK announced a strategic partnership with Etisalat's 'Hello Business Hub', a one-stop location that enables small and medium businesses (SMBs) and start-ups to set up their operations in the UAE.
- RAKBANK hosted the second edition of RAKBANK Ride - one of the most anticipated cycling events in Ras Al Khaimah that attracted more than 500 cyclists.

DIRECTORS' REPORT TO THE SHAREHOLDERS (continued)

Developments in 2018 (continued)

- RAKBANK launched a contactless cash withdrawal facility that is available on more than 170 NFC enabled ATMs. The Bank has more than 200,000 active cardholders that are able to use their NFC enabled RAKBANK credit or debit card at any of the NFC enabled ATMs to conveniently withdraw cash.
- RAKBANK introduced the RAKGOLD initiative, a division of its Treasury department, which represents the establishment of the Middle East region's first full service end-to-end Bullion Banking unit.
- RAKBANK partnered with C3 and Farnek in order to host a financial literacy campaign at both the Dubai and Ras al Khaimah headquarters. The objective of the financial literacy campaign was to highlight to the Farnek blue collar employees, also C3 prepaid cardholders, about the ability to instantly transfer money to select Asian countries at competitive rates with RAKBANK's RAKMoneyTransfer remittance service.
- RAKBANK raised awareness about the tax system that was implemented back in January 2018 by inviting its Business Banking customers to attend a comprehensive workshop on Value Added Tax (VAT) at the RAKBANK headquarters in Dubai Silicon Oasis.
- The American University of Ras Al Khaimah (AURAK) announced the grand opening of the new RAKBANK Building, which currently houses AURAK's School of Business and the Office of Academic Support Services. The Bank directly supported the setting up of AURAK's School of Business and the Office of Academic Support Services.
- RAKBANK has signed an agreement with Kamakura Corporation to implement Kamakura's solutions for its balance sheet management and funds transfer pricing.
- Sage, the market leader in cloud business management solutions, and RAKBANK announced a partnership agreement, whereby RAKBANK will offer Sage accounting software to support its Business Banking customers of all sizes and across all industries.

Recognition in 2018

- Best Customer Happiness Centre at Customer Happiness Summit and Awards 2018
- Best Marketing, Social Media, and Brand - International Business Excellence Awards
- 'Best SME Bank in the UAE' by the Banker Middle East Industry Awards 2018
- Asian Banker for 'Best Blockchain' under the 'Technology Innovation Awards' category
- Asian Banker for 'Best API Platform Initiative Application or Programme in the Middle East', under the 'Technology Innovation Awards' category
- Best Deposit Product in the Middle East' by the Asian Banker's Middle East & Africa Awards
- 'Best SME Customer Service Award' from Banker Middle East
- Dubai Quality Appreciation Award – 2017 cycle
- Dubai Service Excellence Scheme Award – 2017 cycle
- Best Omnichannel Experience award – Genesys
- RAKBANK has been recognized by the Dubai Police as 'Best Supporting Bank'
- Best Technological Innovation in Payment – B2C by Seamless Awards 2018
- Service Recognition Award by Sharjah Electricity and Water Authority
- Home Loan Provider of the Year by yallacompare at the Banking and Insurance Awards 2018
- Best Customer Loyalty Program for RAKrewards program at Service Olympian Awards 2017
- Best Smart Service Transformation Initiative for Digital Banking App at Service Olympian Awards 2017
- Overall Best Live Chat performance at Service Olympian Awards 2017
- Overall Best Website at Service Olympian Awards 2017
- Best Overall Customer Experience at Gulf Digital Experience Awards
- New Product Improvement for RAKIslamic Fawrun Deposits at Gulf Digital Experience Awards
- Best Social Media and Email Campaign at Gulf Digital Experience Awards
- Most Innovative Outward Remittance Services (RMT) - UAE, by Global Banking & Finance Review Awards 2018.

DIRECTORS' REPORT TO THE SHAREHOLDERS (continued)***Outlook for 2019***

The business climate in 2018 remained uncertain, but for established SMEs it was better than it has been for some time, and we believe this is likely to continue into 2019. An issue for such business in the past has been over-leveraging, but the growing influence of the UAE Credit Bureau has brought new discipline into the segment, which has fed down to the quality of lending RAKBANK has been able to make. In terms of market headwinds, we aren't out of the woods yet, but the local economy is showing signs of a return to healthier levels of growth, and we are in a better position than ever before to exploit it.

Despite a movement towards bank consolidation in the UAE in 2018, we consider ourselves a robust institution with a distinctive niche, a tried and tested business model, and a reputation that we have worked hard to build and strengthen over the past 3 years. We are a different organization to the one that started this journey in 2015. We will now continue our transformation journey, becoming a stronger and more diverse bank in 2019 and beyond.



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H.E. Mohamed Omran Alshamsi
Chairman

INDEPENDENT AUDITOR'S REPORT

The Shareholders
The National Bank of Ras Al-Khaimah (P.S.C.)
Ras Al-Khaimah
United Arab Emirates

Report on the audit of the consolidated financial statements

Opinion

We have audited the consolidated financial statements of **The National Bank of Ras Al-Khaimah P.S.C., Ras Al Khaimah, United Arab Emirates** (the "Bank") and its subsidiaries (together referred to as the "Group") which comprise the consolidated statement of financial position as at 31 December 2018, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

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

Basis for Opinion

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

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Impairment against loans and advances

Risk

The audit of loan impairment is a key area of focus because of the size of loans and advances (representing 62% of total assets) and due to the significance of the estimates and judgments used in classifying loans and advances into various stages and determining related provision requirements as per the expected credit loss model. Further, there were significant changes in the accounting policies, extensive transition disclosure requirements and numerous estimates and judgements involved in the first time adoption of IFRS 9 which are detailed in Note 41 to the consolidated financial statements.

How the matter was addressed in our audit

We obtained a detailed understanding of the Group's loans and advances business processes and the accounting policies on adoption of IFRS 9 including the critical accounting estimates and judgments used. We have audited the IFRS 9 ECL models as of 1 January 2018 and 31 December 2018.

We tested the design, implementation and operating effectiveness of the relevant controls which included testing:

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INDEPENDENT AUDITOR'S REPORT (continued)

*Impairment against loans and advances (continued)***Risk**

The Group has applied the requirement of IFRS 9 retrospectively without restating the comparative figures. The difference between previously reported carrying amounts as of 31 December 2017 and new carrying amounts as of 1 January 2018, mainly arising from impairment, has been recognized in the opening retained earnings.

The key changes arising from the adoption of IFRS 9 are that the Group's credit losses are now based on expected credit losses ("ECL") rather than an incurred loss model. The description of accounting policies applied by the Group post implementation of IFRS 9 are detailed in Note 3 to the consolidated financial statements.

The Group employs statistical models for ECL calculations including key variables used in the calculation of probability of default (PD), loss given default (LGD); and exposure at default (EAD), which are defined in Note 3 to the consolidated financial statements.

In determining the ECL provisions for loans and advances, the Group applies significant judgements and estimates of the following areas:

- Identification of significant increase in credit risk and credit impaired loans.
- Qualitative and quantitative reasonable and supportable forward looking information.
- Overrides in staging model applied to reflect current or future external factors that are not necessarily covered in the ECL model.
- Assumptions used in determining financial condition of the counterparty and expected future cash flows.

Individually assessed loans represent mainly, corporate and commercial loans which are assessed in order to determine whether there exists any objective evidence that a loan is impaired. Loans are classified as impaired as soon as there is doubt about the borrower's ability to meet payment obligations to the Group in accordance with the original contractual terms and are classified as stage 3 as per IFRS 9.

Impaired loans are measured on the basis of the present value of expected future cash flows including observable market price or fair value of the collateral and many other factors that involve a significant degree of judgement.

How the matter was addressed in our audit

- System-based and manual controls over the recognition of impaired loans and advances;
- Controls over the ECL calculation models including data inputs;
- Controls over collateral valuation estimates
- Controls over governance and approval process related to impairment provisions and ECL Models including continuous reassessment by the management.

We understood and evaluated the theoretical soundness of the ECL model by involving our internal experts to ensure its compliance with the requirements of the standard. We tested the mathematical integrity of the ECL model by performing recalculations on a sample of the loans and advances. We checked consistency of various inputs and assumptions used by the Group's management to determine impairment.

We selected a sample of loans and advances and checked the accuracy of the Exposure at Default (EAD), appropriateness of the Probability of Default (PD) and calculations of the Loss Given Default (LGD) used by the management in their ECL calculations.

We checked the appropriateness of the Group's determination of significant increase in credit risk and the resultant basis for classification of exposures into various stages. For samples of exposures, we checked the appropriateness of the Group's staging and challenged a sample of staging overrides undertaken by management.

For forward looking assumptions used by the Group's management in its ECL calculations, we held discussions with management and corroborated the assumptions using publicly available information.

For exposures determined to be individually impaired, we tested a sample of loans and advances and examined management's estimate of future cash flows, assessed their reasonableness and checked the resultant provision calculations. Further, we focused our attention on individually significant exposures, where we tested the estimates and assumptions used by management underlying the impairment identification and quantification, valuation of underlying collateral by external experts and estimated recovery on default.

We checked the appropriateness of the opening balance adjustments and have ensured Group's full compliance with the transitional disclosure requirements as per the relevant standards, as well as the completeness and sufficiency of the year-end disclosures.

INDEPENDENT AUDITOR'S REPORT (continued)***Reliability and continuity of the information technology and systems******Risk***

Failure of not having appropriate IT systems and controls in place may lead to severe consequences on business continuance and the financial reporting process.

How the matter was addressed in our audit

▪ We evaluated the design and operating effectiveness of Group's IT access controls over the information systems that are critical to financial reporting. We tested IT general controls (logical access, change management and aspect of IT operational controls). This included testing that requests for access to systems were appropriately reviewed and authorised and access for terminated or transferred employees is revoked in timely manner. We tested the user authentication, privilege access controls around key application systems and infrastructure supporting them. We tested the Group's periodic review of access rights. We inspected requests of changes to systems for appropriate approval and authorisation. We considered the control environment relating to various automated calculations, automated access controls, configurable controls and other application layer controls identified as key to our audit.

Other information

The Board of Directors is responsible for the other information. The other information comprises the annual report of the Group. We obtained the Director's report to the shareholders prior to the date of this auditor's report, and the remaining information of the annual report is expected to be made available to us after that date. The other information does not include the consolidated financial statements and our auditor's report thereon.

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

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

When we read the remaining information of the annual report of the Group, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of management and those charged with governance for the consolidated financial statements

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

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

INDEPENDENT AUDITOR'S REPORT (continued)***Auditor's responsibilities for the audit of the consolidated financial statements***

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by 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 Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the subsidiaries of the Bank to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

INDEPENDENT AUDITOR'S REPORT (continued)**Report on other legal and regulatory requirements**

As required by the UAE Federal Law No. (2) of 2015, we report that:

- i) We have obtained all the information we considered necessary for the purposes of our audit;
- ii) The consolidated financial statements of the Group have been prepared and comply, in all material respects, with the applicable provisions of the UAE Federal Law No. (2) of 2015;
- iii) The Group has maintained proper books of account;
- iv) The financial information included in the Directors' report is consistent with the Group's books of account;
- v) Note 7 to the consolidated financial statements of the Group discloses securities purchased or invested in shares during the financial year ended 31 December 2018;
- vi) Note 35 to the consolidated financial statements of the Bank discloses material related party transactions, the terms under which they were conducted and principles of managing conflict of interests;
- vii) Based on the information that has been made available to us nothing has come to our attention which causes us to believe that the Bank has contravened during the financial year ended 31 December 2018 any of the applicable provisions of the UAE Federal Law No. (2) of 2015 or of its Articles of Association which would materially affect its activities or its financial position as at 31 December 2018; and
- viii) Note 42 to the consolidated financial statements of the Bank discloses social contributions made during the financial year ended 31 December 2018.

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

Deloitte & Touche (M.E.)



Akbar Ahmad
Registration No.: 1141
30 January 2019
Dubai
United Arab Emirates

**Consolidated statement of financial position
as at 31 December 2018**

	Notes	2018 AED'000	2017 AED'000
ASSETS			
Cash and balances with UAE Central Bank	4	4,947,996	4,740,566
Due from other banks, net	5	4,755,542	3,799,239
Loans and advances, net	6	32,860,662	32,240,193
Investment securities, net	7	7,189,133	5,568,749
Insurance contract assets and receivables, net	8	388,594	424,897
Customer acceptances		561,704	171,307
Other assets	9	952,644	545,935
Goodwill and other intangible assets	10	167,723	170,932
Property and equipment	11	859,942	875,340
Total assets		52,683,940	48,537,158
LIABILITIES AND EQUITY			
Liabilities			
Due to other banks	12	4,381,462	2,764,199
Deposits from customers	13	34,139,784	32,175,874
Debt securities in issued and other long term borrowings	14	4,826,105	4,169,302
Insurance contract liabilities and payables	15	511,395	516,991
Customer acceptances		561,704	171,307
Other liabilities	16	1,103,515	871,041
Total liabilities		45,523,965	40,668,714
Equity			
Share capital	17	1,676,245	1,676,245
Legal reserve	18	950,431	950,431
Retained earnings		1,479,856	2,101,295
Other reserves	19	3,007,575	3,089,364
Equity attributable to owners of the Bank		7,114,107	7,817,335
Non-controlling interests	20	45,868	51,109
Total equity		7,159,975	7,868,444
Total Liabilities and Equity		52,683,940	48,537,158

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H.E. Mohamed Omran Alshamsi
Chairman

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Peter William England
Chief Executive Officer

The accompanying notes form an integral part of these consolidated financial statements.

**Consolidated income statement
for the year ended 31 December 2018**

	Notes	2018 AED'000	2017 AED'000
Interest income	21	3,048,835	2,783,368
Interest expense	21	(591,412)	(359,956)
Net interest income		2,457,423	2,423,412
Income from Islamic financing	22	407,033	339,025
Distribution to depositors	22	(95,754)	(39,215)
Net income from Islamic financing		311,279	299,810
Net interest income and net income from Islamic financing		2,768,702	2,723,222
Net fees and commission income	23	729,698	717,012
Foreign exchange and derivative income		155,221	131,217
Gross insurance underwriting profit	24	58,154	74,675
Investment income	25	26,725	87,891
Other operating income		88,486	75,828
Non-interest income		1,058,284	1,086,623
Operating income		3,826,986	3,809,845
Operating expenses	26	(1,488,320)	(1,446,380)
Operating profit before provision for impairment		2,338,666	2,363,465
Provision for credit loss, net	30	(1,421,146)	(1,552,963)
Profit for the year		917,520	810,502
<i>Attributed to:</i>			
Owners of the Bank		912,626	800,459
Non-controlling interests		4,894	10,043
Profit for the year		917,520	810,502
<i>Earnings per share:</i>			
Basic and diluted in AED	27	0.54	0.48

The accompanying notes form an integral part of these consolidated financial statements.

**Consolidated statement of comprehensive income
for the year ended 31 December 2018**

	2018 AED'000	2017 AED'000
Profit for the year	917,520	810,502
<i>Other comprehensive (loss)/income</i>		
<i>Items that may be reclassified subsequently to profit or loss</i>		
Net changes in fair value of investment securities (debt instruments) at FVOCI	(111,079)	(9,486)
Net changes in fair value of investment securities (equity instruments) available for sale	-	(4,126)
Net changes in fair value arising from cash flow hedges	(987)	(1,745)
<i>Items that may not be reclassified subsequently to profit or loss</i>		
Net changes in fair value of investment securities (equity instruments) at FVOCI	(25,098)	-
Other comprehensive loss for the year	(137,164)	(15,357)
Total comprehensive income for the year	780,356	795,145
<i>Attributed to:</i>		
Owners of the Bank	776,116	785,217
Non-controlling interests	4,240	9,928
Total comprehensive income for the year	780,356	795,145

The accompanying notes form an integral part of these consolidated financial statements.

**Consolidated statement of changes in equity
for the year ended 31 December 2018**

	Share capital AED'000	Legal reserve AED'000	Retained earnings AED'000	Other reserves AED'000	Equity attributable to owners of the Bank AED'000	Non- controlling interests AED'000	Total AED'000
Balance at 1 January 2017	1,676,245	950,431	1,879,029	3,031,209	7,536,914	43,465	7,580,379
Profit for the year	-	-	800,459	-	800,459	10,043	810,502
Other comprehensive loss	-	-	-	(15,242)	(15,242)	(115)	(15,357)
Total comprehensive income for the year	-	-	800,459	(15,242)	785,217	9,928	795,145
Zakat	-	-	(394)	-	(394)	-	(394)
Transfer to regulatory credit risk reserve	-	-	(71,000)	71,000	-	-	-
Treasury stock	-	-	-	2,397	2,397	-	2,397
Directors' remuneration	-	-	(4,000)	-	(4,000)	-	(4,000)
Dividend paid	-	-	(502,799)	-	(502,799)	(2,284)	(505,083)
Balance at 31 December 2017	1,676,245	950,431	2,101,295	3,089,364	7,817,335	51,109	7,868,444
Balance at 1 January 2018	1,676,245	950,431	2,101,295	3,089,364	7,817,335	51,109	7,868,444
Impact of adopting IFRS 9 1 January 2018	-	-	(976,181)	4,743	(971,438)	(6,054)	(977,492)
Balance at 1 January 2018, as restated	1,676,245	950,431	1,125,114	3,094,107	6,845,897	45,055	6,890,952
Profit for the year	-	-	912,626	-	912,626	4,894	917,520
Other comprehensive loss	-	-	-	(136,510)	(136,510)	(654)	(137,164)
Total comprehensive income for the year	-	-	912,626	(136,510)	776,116	4,240	780,356
Transfer to regulatory impairment reserve - specific	-	-	(49,978)	49,978	-	-	-
Dividend paid	-	-	(502,873)	-	(502,873)	(3,427)	(506,300)
Directors' remuneration	-	-	(5,033)	-	(5,033)	-	(5,033)
At 31 December 2018	1,676,245	950,431	1,479,856	3,007,575	7,114,107	45,868	7,159,975

The accompanying notes form an integral part of these consolidated financial statements.

**Consolidated statement of cash flows
for the year ended 31 December 2018**

	2018 AED'000	2017 AED'000
<i>Cash flows from operating activities</i>		
Profit for the year	917,520	810,502
<i>Adjustments:</i>		
Provision for credit loss, net	1,421,146	1,552,963
Depreciation and impairment of property and equipment	101,619	98,193
Amortisation of intangible assets	3,209	3,209
Fair valuation of asset acquired	-	350
Insurance related provision released	-	(12,000)
Amortisation of discount/premium relating to investments securities	(56,683)	(3,142)
Net changes in fair value arising from hedge and forex revaluation	(17,824)	-
Impairment provision investment securities	-	7,838
Gain on sale of investment securities held through other comprehensive income	(398)	(86,263)
Gain on sale of investment securities held through profit or loss	(9,628)	(5,297)
Fair value loss/(gain) on FVTPL investment securities	1,681	(81)
Changes in operating assets and liabilities	2,360,642	2,366,272
Increase in deposits with the UAE Central Bank	(120,472)	(153,227)
Increase in due from other banks with original maturities of three months or over	(903,907)	(1,216,093)
Increase in loans and advances, net	(2,925,138)	(5,067,287)
Decrease/(increase) in insurance contract assets and receivables	13,885	(83,938)
Increase in other assets and customer acceptances	(797,105)	(191,765)
Increase in due to other banks	1,617,263	1,202,322
Increase in deposits from customers	1,963,910	2,777,689
(Decrease)/increase in insurance contract liabilities and payables	(5,596)	51,165
Increase in other liabilities and customer acceptances	614,020	277,879
Net cash generated from/(used in) operating activities	1,817,502	(36,983)
<i>Cash flows from investing activities</i>		
Purchase of investment securities	(3,967,772)	(7,406,851)
Purchase of property and equipment	(86,294)	(101,184)
Proceeds from maturity/disposal of investment securities	2,261,515	6,722,612
Proceeds from disposal of property and equipment	73	495
Net cash used in investing activities	(1,792,478)	(784,928)
<i>Cash flows from financing activities</i>		
Dividends paid	(506,300)	(505,083)
Zakat paid	-	(394)
Directors' remuneration	(5,033)	(4,000)
Issue of debt security and other long term borrowings	656,803	1,439,230
Treasury stock	-	2,397
Net cash generated from financing activities	145,470	932,150
Net increase in cash and cash equivalents	170,494	110,239
Cash and cash equivalents, beginning of the year	2,252,198	2,141,959
Cash and cash equivalents, end of the year (Note 33)	2,422,692	2,252,198

The accompanying notes form an integral part of these consolidated financial statements.

**Notes to the consolidated financial statements
for the year ended 31 December 2018**

1. Incorporation and principal activities

The National Bank of Ras Al-Khaimah (P.S.C.) (the “Bank”) is a public shareholding company incorporated in the Emirate of Ras Al-Khaimah in the United Arab Emirates (“UAE”). The head office of the Bank is located at the National Bank of Ras Al-Khaimah building, Al Rifa area, Exit No. 129, Sheikh Mohammed Bin Zayed Road, Ras Al-Khaimah, UAE.

The Bank is engaged in providing retail, commercial banking and treasury services through a network of thirty eight branches in the UAE.

At 31 December 2018, The National Bank of Ras Al-Khaimah (P.S.C.) comprises the Bank and six subsidiaries (together referred to as the “Group”). The consolidated financial statements for the year ended 31 December 2018 comprises the Bank and following direct subsidiaries:

<i>Subsidiary</i>	<i>Authorised and issued capital</i>	<i>Ownership interest</i>	<i>Incorporated</i>	<i>Principal Activities</i>
Ras Al Khaimah National Insurance Company PSC (“RAKNIC”)	AED 110 million	79.23%	UAE	All type of insurance business.
RAK Islamic Finance Company Pvt. J.S.C**	AED 100 million	99.9%*	UAE	To sell sharia compliant financial products
BOSS FZCO	AED 500,000	80%*	UAE	Back office support services to the Bank.
RAK Technologies FZCO	AED 500,000	80%*	UAE	Technological support services to the Bank.
Rakfunding Cayman Limited	Authorised USD 50,000 Issued USD 100	100%	Cayman Island	To facilitate the issue of Euro medium term notes (EMTN) and other long term borrowings under the Bank’s USD 2 billion EMTN program.
Rak Global Markets Cayman Limited	Authorised USD 50,000 Issued USD 1	100%	Cayman Island	To facilitate Treasury transactions.

*These represent legal ownership of the Bank. However, beneficial ownership is 100% as the remaining interest is held by a related party on trust and for the benefit of the Bank.

**On 19 April 2018, the shareholders at the annual general meeting resolved to liquidate RAK Islamic Finance Company Pvt. J.S.C. (the “Company”) and transfer the net assets and obligations to the Bank at book value. On 21 June 2018, the shareholders approved in the General Assembly to liquidate the Company and resolved to dissolve it in accordance with the provisions of the Federal Law No. (2) of 2015, the Company is under final stages of liquidation.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

2. Application of new and revised International Financial Reporting Standards (IFRS)

2.1 New and revised IFRSs applied with no material effect on the consolidated financial statements

The following new and revised IFRSs, which became effective for annual periods beginning on or after 1 January 2018, have been adopted in these consolidated financial statements. The application of these revised IFRSs has not had any material impact on the amounts reported for the current and prior years but may affect the accounting for future transactions or arrangements.

- Annual Improvements to IFRS Standards 2014 - 2016 Cycle amending IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 28 *Investment in Associates and Joint Ventures*.
- IFRIC 22 *Foreign Currency Transactions and Advance Consideration*
- Amendments to IFRS 2 *Share Based Payment* regarding classification and measurement of share based payment transactions.
- Amendments to IAS 40 *Investment Property* to state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use.
- Amendments to IAS 28 *Investments in Associates and Joint Ventures*
- Amendments to IFRS 15 *Revenue from Contracts with Customers* to clarify three aspects of the standard (identifying performance obligations, principal versus agent considerations, and licensing) and to provide some transition relief for modified contracts and completed contracts.
- Amendments to IFRS 4 *Insurance Contracts*: Relating to the different effective dates of IFRS 9 *Financial Instruments* and the forthcoming new insurance contracts standard.

2.2 New and revised IFRS in issue but not yet effective

The Group has not yet applied the following new and revised IFRSs that have been issued but are not yet effective:

<u>New and revised IFRSs</u>	<u>Effective for annual periods beginning on or after</u>
IFRIC 23 <i>Uncertainty over Income Tax Treatments</i>	1 January 2019
The interpretation addresses the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. It specifically considers:	
<ul style="list-style-type: none"> • Whether tax treatments should be considered collectively; • Assumptions for taxation authorities' examinations; • The determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and • The effect of changes in facts and circumstances. 	
Annual Improvements to IFRS Standards 2015 - 2017 Cycle amending IFRS 3 <i>Business Combinations</i> , IFRS 11 <i>Joint Arrangements</i> , IAS 12 <i>Income Taxes</i> and IAS 23 <i>Borrowing Costs</i> .	1 January 2019
Amendments to IFRS 9 <i>Financial Instruments</i> : Relating to prepayment features with negative compensation. This amends the existing requirements in IFRS 9 regarding termination rights in order to allow measurement at amortised cost (or, depending on the business model, at fair value through other comprehensive income) even in the case of negative compensation payments.	1 January 2019

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

2. Application of new and revised International Financial Reporting Standards (“IFRS”) (continued)

2.2 *New and revised IFRS in issue but not yet effective (continued)*

<u><i>New and revised IFRSs</i></u>	<u><i>Effective for annual periods beginning on or after</i></u>
Amendments to IAS 28 <i>Investment in Associates and Joint Ventures</i> relating to long-term interests in associates and joint ventures. These amendments clarify that an entity applies IFRS 9 <i>Financial Instruments</i> to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied.	1 January 2019
IFRS 16 <i>Leases</i>	1 January 2019
IFRS 16 specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16’s approach to lessor accounting substantially unchanged from its predecessor, IAS 17.	
Amendments to IAS 19 <i>Employee Benefits</i> relating to Plan Amendment, Curtailment or Settlement. This amendment mentions that if a plan amendment, curtailment or settlement occurs, it is now mandatory that the current service cost and the net interest for the period after the remeasurement are determined using the assumptions used for the remeasurement. In addition, amendments have been included to clarify the effect of a plan amendment, curtailment or settlement on the requirements regarding the asset ceiling.	1 January 2019
Amendment to IFRS 3 <i>Business Combinations</i> relating to definition of a business	1 January 2020
Amendments to IAS 1 and IAS 8 relating to definition of material	1 January 2020
Amendments to References to the <i>Conceptual Framework</i> in IFRS Standards - amendments to IFRS 2, IFRS 3, IFRS 6, IFRS 14, IAS 1, IAS 8, IAS 34, IAS 37, IAS 38, IFRIC 12, IFRIC 19, IFRIC 20, IFRIC 22, and SIC-32 to update those pronouncements with regard to references to and quotes from the framework or to indicate where they refer to a different version of the Conceptual Framework	1 January 2020
IFRS 17 <i>Insurance Contracts</i>	1 January 2021
IFRS 17 requires insurance liabilities to be measured at a current fulfilment value and provides a more uniform measurement and presentation approach for all insurance contracts. These requirements are designed to achieve the goal of a consistent, principle-based accounting for insurance contracts. IFRS 17 supersedes IFRS 4 <i>Insurance Contracts</i> as of 1 January 2021.	
Amendments to IFRS 10 <i>Consolidated Financial Statements</i> and IAS 28 <i>Investments in Associates and Joint Ventures</i> (2011) relating to the treatment of the sale or contribution of assets from and investor to its associate or joint venture.	Effective date deferred indefinitely. Adoption is still permitted.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

**2. Application of new and revised International Financial Reporting Standards (“IFRSs”)
(continued)**

2.2 New and revised IFRS in issue but not yet effective (continued)

Management anticipates that these new standards, interpretations and amendments will be adopted in the Group’s consolidated financial statements as and when they are applicable and adoption of these new standards, interpretations and amendments, except for IFRS 16 and 17, may have no material impact on the consolidated financial statements of the Group in the period of initial application.

The Group has adopted IFRS 9 as issued by the IASB in July 2014 with a date of transition of 1 January 2018, which resulted in changes in accounting policies and adjustments to amounts previously recognized in the consolidated financial information. The Group did not early adopt any part of IFRS 9 in previous periods.

2.3 New and revised IFRSs applied with material effect on the consolidated financial statements

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

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

Set out below are the disclosures relating to the impact of IFRS 9 on the Group. Further details of the specific IFRS 9 policies applied in the current period are described in more details in Note 3.

The following table reconciles the original measurement categories and carrying amounts in accordance with IAS 39 and the new measurement categories with those under IFRS 9 for the Group’s financial assets and financial liabilities as at 1 January 2018:

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount AED’000	Impact of IFRS 9		
				Re-measurement AED’000	Re-classification AED’000	New carrying amount AED’000
Financial assets						
On balance sheet						
Cash and balances with the Central Bank	Loans and receivables	Amortised cost	4,740,566	-	-	4,740,566
Due from other banks	Loans and receivables	Amortised cost	3,799,239	(19,693)	-	3,779,546
Loans and advances, net	Loans and receivables	Amortised cost	32,240,193	(912,475)	-	31,327,718
Investment securities - debt	Available-for-sale	Amortised cost	3,447,430	(19,389)	5,477	3,433,518
Investment securities - debt	Available-for-sale	FVOCI	2,014,277	(571)	-	2,013,706
Investment securities - equity	Available-for-sale	FVOCI	37,576	-	-	37,576
Investment securities - equity	Available-for-sale	FVTPL	25,186	-	-	25,186
Investment securities - Funds	Available-for-sale	FVTPL	40,006	-	-	40,006
Investment securities - Funds	Held for trading	FVTPL	4,274	-	-	4,274
Insurance contract assets and receivables	Loans and receivables	Amortised cost	424,897	(27,972)	-	396,925
Customer acceptances	Loans and receivables	Amortised cost	171,307	(1,226)	-	170,081
Interest rates swaps and other derivatives	Held at fair value	FVTPL	25,540	-	-	25,540
			46,970,491	(981,326)	5,477	45,994,642
Off balance sheet						
Loan commitments, financial guarantees and letters of credit	Amortised cost	Amortised cost	1,283,090	(1,643)	-	1,281,447
			48,253,581	(982,969)	5,477	47,276,089

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

**2. Application of new and revised International Financial Reporting Standards (“IFRSs”)
(continued)**

**2.3 New and revised IFRSs applied with material effect on the consolidated financial statements
(continued)**

The impact from the adoption of IFRS 9 as at 1 January 2018 has resulted in a decrease in retained earnings by AED 976.2 million, increase in other reserves by AED 4.7 million and decrease in non-controlling interest by AED 6.1 million:

	Retained earnings AED’000	Other reserves AED’000	Non- controlling interest AED’000
Closing balance under IAS 39 (31 December 2017)	2,101,295	3,089,364	51,109
<i>Impact on reclassification and re-measurement:</i>			
Investment securities (equities) at fair value through comprehensive income reclassified to fair value through profit or loss	(640)	640	-
Investment securities (funds) at fair value through other comprehensive income reclassified to fair value through profit or loss	1,374	(1,374)	-
Investment securities (debt) reclassified from available-for-sale to those measured at amortised cost	-	5,477	-
	<u>734</u>	<u>4,743</u>	<u>-</u>
<i>Impact on recognition of expected credit losses:</i>			
Due from other banks	(19,565)	-	(128)
Loans and advances, net	(912,475)	-	-
Investment securities (debt) at fair value through comprehensive income	(455)	-	(116)
Investment securities (debt) at amortised cost	(19,389)	-	-
Insurance contract assets and receivables	(22,162)	-	(5,810)
Customer acceptances	(1,226)	-	-
Financial guarantees and letters of credit	(1,643)	-	-
	<u>(976,915)</u>	<u>-</u>	<u>(6,054)</u>
Opening balance under IFRS 9 on date of initial application of 1 January 2018	<u>1,125,114</u>	<u>3,094,107</u>	<u>45,055</u>

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

**2. Application of new and revised International Financial Reporting Standards (“IFRSs”)
(continued)**

**2.3 New and revised IFRSs applied with material effect on the consolidated financial statements
(continued)**

The following table reconciles the closing impairment allowance for financial assets in accordance with IAS 39 as at 31 December 2017 to the opening expected credit loss (ECL) allowance determined in accordance with IFRS 9 as at 1 January 2018:

	31 December 2017 AED’000	Re- measurement AED’000	1 January 2018 as restated AED’000
Due from other banks	-	19,693	19,693
Loans and advances, net	995,171	912,475	1,907,646
Investment securities	-	19,960	19,960
Insurance contract assets and receivables	23,973	27,972	51,945
Customer acceptances	-	1,226	1,226
Loan commitments, financial guarantees and letters of credit	-	1,643	1,643
	<u>1,019,144</u>	<u>982,969</u>	<u>2,002,113</u>

The impact of adoption for certain financial assets in the above tables was amended, as compared to the impact disclosed in the first quarter, to reflect the refined reclassification and measurement, and impact of expected credit losses on the retained earnings and other reserves opening balances pertaining to the Bank and its subsidiaries.

3. Significant accounting policies

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

The accounting policies used for the financial assets and financial liabilities for the comparative figures as of 31 December 2017 under IAS 39 are consistent with those disclosed in 31 December 2017 consolidated financial statements and should be read in conjunction with those.

(a) Basis of preparation

The consolidated financial statements of the Group are prepared under the historical cost basis except for certain financial instruments which are measured at fair value. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

(b) Consolidation

These consolidated financial statements incorporate the financial statements of the Bank and entities controlled by the Bank and its subsidiaries. Control is achieved when the Bank:

- has power over an investee,
- is exposed, or has rights, to variable returns from its involvement with the investee, and
- has the ability to use its power over the investee to affect the amount of the investor’s returns.

The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(b) Consolidation (continued)

When the Group has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Group considers all relevant facts and circumstances in assessing whether or not the Group's voting rights in an investee are sufficient to give it power, including:

- the size of the Group's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Group, other vote holders and other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Group has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns and previous shareholders' meetings.

Consolidation of a subsidiary begins when the Bank obtains control over the subsidiary and ceases when the Bank loses control over the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated income statement from the date the Bank gains control until the date when the Bank ceases to control the subsidiary.

Profit or loss of each component of other comprehensive income is attributable to the owners of the Group and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Bank and to the non-controlling interest even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

All intragroup assets, liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

Changes in the Group's ownership interest in existing subsidiaries

Changes in the Group's ownership interests in subsidiaries that do not result in the Group losing control over the subsidiaries are accounted for as equity transactions. The carrying amounts of the Group's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to owners of the Bank.

When the Group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), and liabilities of the subsidiary and any non-controlling interests. All amounts previously recognised in other comprehensive income are accounted for as if the Group had directly disposed of the related assets or liabilities of the subsidiary (i.e. reclassified to profit or loss or transferred to another category of equity as specified by applicable IFRSs). The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IAS39: Financial Instruments: *Recognition and Measurement* or, when applicable, the cost on initial recognition of an investment in an associate or a joint venture.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(c) Islamic financing

The Group engages in Shari'ah compliant Islamic banking activities through various Islamic instruments such as Murabaha, Salam, Mudaraba, and Wakala. The accounting policy for initial recognition, subsequent measurement and derecognition of Islamic financial assets and liabilities are as per Note 3(e).

i) Murabaha financing

A sale contract whereby the Group sells to a customer commodities and other assets at an agreed upon profit mark up on cost. The Group purchases the assets based on a promise received from customer to buy the item purchased according to specific terms and conditions. Profit from Murabaha is quantifiable at the commencement of the transaction. Such income is recognised as it accrues over the period of the contract on effective profit rate method on the balance outstanding.

ii) Salam

Bai Al Salam is a Sale contract where the Customer (Seller) undertakes to deliver/supply a specified tangible asset to the Group (Buyer) at mutually agreed future date(s) in exchange for an advance price fully paid on the spot by the buyer.

Revenue on Salam financing is recognised on the effective profit rate basis over the period of the contract, based on the Salam capital outstanding.

iii) Mudaraba

A contract between the Group and a customer, whereby one party provides the funds (Rab Al Mal-customer) and the other party (the Mudarib- the Group) invests the funds in a project or a particular activity and any profits generated are distributed between the parties according to the profit shares that were pre-agreed in the contract. The Mudarib would bear the loss in case of default, negligence or violation of any of the terms and conditions of the Mudaraba, otherwise, losses are borne by the Rab Al Mal.

iv) Wakala

An agreement between the Group and customer whereby one party (Rab Al Mal-principal) provides a certain sum of money to an agent (Wakil), who invests it according to specific conditions in return for a certain fee (a lump sum of money or a percentage of the amount invested). The agent is obliged to return the invested amount in case of default, negligence or violation of any of the terms and conditions of the Wakala. The Group may be Wakil or Rab Al Mal depending on the nature of the transaction.

Estimated income from Wakala is recognised on an accrual basis over the period, adjusted by actual income when received. Losses are accounted for on the date of declaration by the agent.

v) Ijara

Ijara financing is a finance lease agreement whereby the Group (lessor) leases an asset based on the customer's (lessee) request and promise to lease the assets for a specific period in lieu of rental instalments. Ijara ends in transferring the ownership of the asset to the lessee at the end of the lease inclusive of the risks and rewards incident to an ownership of the leased assets. Ijara assets are stated at amounts equal to the net investment outstanding in the lease including the income earned thereon less impairment provisions.

(d) Business combination and goodwill

Business combination

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition related costs are generally recognised in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(d) Business combination and goodwill (continued)

Business combination (continued)

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Non-controlling interests that are present ownership interests and entitle their holder to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at the non-controlling interests' proportionate share of the recognised amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis. Other types of non-controlling interests are measured at fair value or, when applicable, on the basis specified in another IFRS.

When the consideration transferred by the Group in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition date fair value and included as part of the consideration transferred in a business combination. Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the 'measurement period' (which cannot exceed one year from acquisition date) about facts and circumstances that existed at the acquisition date.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is remeasured at subsequent reporting dates in accordance with IFRS 9 and IAS 37 Provisions, Contingent Liabilities and Contingent Assets, as appropriate, with the corresponding gain or loss being recognised in profit and loss.

When a business combination is achieved in stages, the Group's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date (i.e. the date when the Group obtains control) and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in consolidated statement of comprehensive income are reclassified to profit or loss where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see above), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognised at that date.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

3. Significant accounting policies (continued)

(d) *Business combination and goodwill (continued)*

Goodwill

Goodwill arising of an acquisition of a business combination is carried at cost as established at the date of acquisition of the business less accumulated impairment losses, if any.

For the purposes of impairment testing, goodwill is allocated to each of the Group's cash-generating units (or groups of cash-generating units) that is expected to benefit from the synergies of the combination.

A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently when there is an indication that the unit might be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata based on the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in profit or loss. An impairment loss recognised for goodwill is not reversed in the subsequent periods.

On disposal of the relevant cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

(e) *Significant accounting policies introduced on adoption of IFRS 9*

(i) Classification of financial assets and financial liabilities

Financial assets

On initial recognition, a financial asset is classified as measured: at amortised cost, Fair Value through Other Comprehensive Income (FVOCI) or Fair Value through Profit and Loss (FVTPL). A financial asset is measured at amortised cost if it meets both the following conditions and is not designated as at FVTPL:

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

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

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

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

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Group may irrevocably designate a financial asset that 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.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

3. Significant accounting policies (continued)

(e) Significant accounting policies introduced on adoption of IFRS 9 (continued)

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

Financial liabilities

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

- Financial liabilities at fair value through profit or loss: the classification is applied to derivatives and other financial liabilities designated as such at initial recognition. Gains and losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in fair value of the financial liability that is attributable to the changes in credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains or losses attributable to changes in the credit risk of the liability are also presented in the profit or loss;
- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition or when the continuing involvement approach applies. When the transfer of financial assets did not qualify for derecognition, a financial liability is recognised for the consideration received for the transfer; and
- Financial guarantee contracts and loan commitments.

Business model assessment

The Bank makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- The stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated - e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and
- its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

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

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(e) Significant accounting policies introduced on adoption of IFRS 9 (continued)

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

Assessment whether contractual cash flows are solely payments of principal and interest (“SPPI Test”)

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

In assessing whether the contractual cash flows are solely payments of principal and interest, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition.

In making the assessment, the Group considers:

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

Reclassifications

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

Derecognition

Any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as FVOCI is not recognised in profit or loss account on derecognition of such securities.

(ii) Measurement of financial assets and financial liabilities

Investment securities

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

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

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

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

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(e) Significant accounting policies introduced on adoption of IFRS 9 (continued)

(ii) Measurement of financial assets and financial liabilities (continued)

Investment securities (continued)

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

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

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

Financial liabilities

All financial liabilities are measured at amortised cost.

(iii) Impairment

Measurement of ECL

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

- Deposits and balances and due from banks;
- Debt investment securities carried at FVOCI and amortised cost;
- Loans and advances to customers;
- Insurance assets and receivables
- Customer acceptances and other financial assets;
- Loan commitments; and
- Financial guarantees and contracts

No impairment loss is recognised on equity investments.

With the exception of purchased or originated credit impaired (POCI) financial assets (which are considered separately below), ECLs are required to be measured through a loss allowance at an amount equal to:

- 12-month ECL, i.e. lifetime ECL that result from those default events on the financial instrument that are possible within 12 months after the reporting date, (referred to as Stage 1); or
- full lifetime ECL, i.e. lifetime ECL that result from all possible default events over the life of the financial instrument, (referred to as Stage 2 and Stage 3).

A loss allowance for full lifetime ECL is required for a financial instrument if the credit risk on that financial instrument has increased significantly since initial recognition. For all other financial instruments, ECLs are measured at an amount equal to the 12-month ECL.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(e) Significant accounting policies introduced on adoption of IFRS 9 (continued)

(iii) Impairment (continued)

Measurement of ECL (continued)

ECL is a probability-weighted estimate of the present value of credit losses. These are measured as the present value of the difference between the cash flows due to the Group under the contract and the cash flows that the Group expects to receive arising from the weighting of multiple future economic scenarios, discounted at the asset's interest rate.

- for undrawn loan commitments, the ECL is the difference between the present value of the difference between the contractual cash flows that are due to the Group if the holder of the commitment draws down the loan and the cash flows that the Group expects to receive if the loan is drawn down; and
- for financial guarantee contracts, the ECL is the difference between the expected payments to reimburse the holder of the guaranteed debt instrument less any amounts that the Group expects to receive from the holder, the debtor or any other party.

The Group measures ECL on an individual basis, or on a collective basis for portfolios of loans that share similar economic risk characteristics. The measurement of the loss allowance is based on the present value of the asset's expected cash flows using the asset's original interest rate, regardless of whether it is measured on an individual basis or a collective basis.

The Group employs statistical models for ECL calculations. For measuring ECL under IFRS 9, the key input would be the term structure of the following variables:

- probability of default (PD);
- loss given default (LGD); and
- exposure at default (EAD).

These parameters will be derived from our internally developed statistical models and other historical data. They will be adjusted to reflect forward-looking information.

Expected life

For instruments in Stage 2 or Stage 3, loss allowances reflect expected credit losses over the expected remaining lifetime of the instrument. For most instruments, the expected life is limited to the remaining contractual life. An exemption is provided for certain instruments with the following characteristics: (a) the instrument includes both a loan and undrawn commitment component; (b) the contractual ability to demand repayment and cancel the undrawn commitment is present; and (c) the exposure to credit losses is not limited to the contractual notice period. For products in scope of this exemption, the expected life may exceed the remaining contractual life and is the period over which our exposure to credit losses is not mitigated by our normal credit risk management actions. This period varies by product and risk category and is estimated based on our historical experience with similar exposures and consideration of credit risk management actions taken as part of our regular credit review cycle. Products in scope of this exemption include credit cards, overdraft balances and certain revolving lines of credit. Determining the instruments in scope for this exemption and estimating the appropriate remaining life based on our historical experience and credit risk mitigation practices requires significant judgment.

Credit-impaired financial assets

A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Credit-impaired financial assets are referred to as Stage 3 assets. Evidence of credit-impairment includes observable data about the following events:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the disappearance of an active market for a security because of financial difficulties; or
- the purchase of a financial asset at a deep discount that reflects the incurred credit losses.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(e) Significant accounting policies introduced on adoption of IFRS 9 (continued)

(iii) Impairment (continued)

Credit-impaired financial assets (continued)

It may not be possible to identify a single discrete event-instead, the combined effect of several events may have caused financial assets to become credit-impaired. The Group assesses whether debt instruments that are financial assets measured at amortised cost or FVOCI are credit-impaired at each reporting date. To assess if sovereign and corporate debt instruments are credit impaired, the Group considers factors such as timing of coupon payments, credit ratings and the ability of the borrower to raise funding.

A loan is considered credit-impaired when a concession is granted to the borrower due to a deterioration in the borrower's financial condition, unless there is evidence that as a result of granting the concession the risk of not receiving the contractual cash flows has reduced significantly and there are no other indicators of impairment. For financial assets where concessions are contemplated but not granted the asset is deemed credit impaired when there is observable evidence of credit-impairment including meeting the definition of default. The definition of default (see below) includes unlikelihood to pay indicators and a backstop if amounts are overdue for 90 days or more.

Purchased or originated credit-impaired (POCI) financial assets

POCI financial assets are treated differently because the asset is credit-impaired at initial recognition. For these assets, the Group recognises all changes in lifetime ECL since initial recognition as a loss allowance with any changes recognised in profit or loss. A favourable change for such assets creates an impairment gain.

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised and ECL are measured as follows:

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset. The cash shortfalls are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Write-offs

Financial assets are written off when there is no reasonable expectation of recovery, such as a debtor failing to engage in a repayment plan with the company. The Group categorises a loan or receivable for write off when a debtor fails to make contractual payments greater than 180 days past due. Where loans or receivables have been written off, the Group continues to engage in enforcement activity to attempt to recover the receivable due. Where recoveries are made, these are recognised in profit or loss.

Financial guarantee contracts

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

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

3. Significant accounting policies (continued)

(e) Significant accounting policies introduced on adoption of IFRS 9 (continued)

(iii) Impairment (continued)

Financial guarantee contracts (continued)

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

- the amount of the loss allowance determined in accordance with IFRS 9; and
- the amount initially recognised less, where appropriate, cumulative amount of income recognised in accordance with the Group's revenue recognition policies.

Financial guarantee contracts not designated at FVTPL are presented as provisions in the consolidated statement of financial position and the remeasurement is presented in other revenue.

The Group has not designated any financial guarantee contracts as at FVTPL.

Curing period

The Group continues to monitor such financial instruments for a minimum probationary period of 12 months to confirm if the risk of default has decreased sufficiently before upgrading such exposure from Lifetime ECL (Stage 2) to 12 months ECL (Stage 1).

The Group is observing a 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.

(iv) Derivatives and hedging

IFRS 9 introduces a new hedge accounting model that expands the scope of hedged items and risks eligible for hedge accounting and aligns hedge accounting more closely with risk management. The new model no longer specifies quantitative measures for effectiveness testing and does not permit hedge de-designation. As a result, the 80-125% range under IAS 39 is replaced by an objectives-based test that focuses on the economic relationship between the hedged item and the hedging instrument, and the effect of credit risk on that economic relationship.

IFRS 9 also introduces rebalancing of hedging relationships, whereby, if a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio under IFRS 9, but the risk management objective for that designated hedging relationship remains the same, the Bank shall adjust the hedge ratio of the hedging relationship so that it meets the qualifying criteria again.

Gains and losses arising from changes in the fair value of derivatives that are not the hedging instrument in a qualifying hedge are recognised as they arise in profit or loss. Gains and losses are recorded in income from trading activities except for gains and losses on those derivatives that are managed together with financial instruments designated at fair value; these gains and losses are included in 'Other Operating Income'.

(f) *Due from/to banks*

Amounts due from/to banks are initially recognised at fair value and measured subsequently at amortised cost using the effective interest method. Impairment of amount due from banks is assessed as outlined in the accounting policy for financial instruments.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(g) Cash and cash equivalents

In the consolidated statement of cash flows, cash and cash equivalents include cash on hand, money in current and call accounts and placements with original maturity of less than three months excluding the statutory deposit required to be maintained with the UAE Central Bank.

(h) Customer acceptances

Acceptances arise when the Group is under an obligation to make payments against documents drawn under letters of credit. Acceptances specify the amount of money, the date and the person to which the payment is due. After acceptance, the instrument becomes an unconditional liability (time draft) of the Group and is therefore recognised as a financial liability in the consolidated statement of financial position with a corresponding contractual right of reimbursement from the customer recognised as a financial asset. Acceptances have been considered within the scope of IFRS 9 - Financial Instruments: *Recognition and Measurement* and are recognised as a financial liability in the consolidated statement of financial position with a contractual right of reimbursement from the customer as a financial asset. Therefore, commitments in respect of acceptances have been accounted for as financial assets and financial liabilities.

(i) Derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of various derivative instruments are disclosed in Note 32.

Fair value hedge

The fair value change on qualifying hedging instruments is recognised in profit or loss except when the hedging instrument hedges an equity instrument designated at FVTOCI in which case it is recognised in OCI. The Group has not designated fair value hedge relationships where the hedging instrument hedges an equity instrument designated at FVTOCI.

The carrying amount of a hedged item not already measured at fair value is adjusted for the fair value change attributable to the hedged risk with a corresponding entry in profit or loss. For debt instruments measured at FVTOCI, the carrying amount is not adjusted as it is already at fair value, but the part of the fair value gain or loss on the hedged item associated with the hedged risk is recognised in profit or loss instead of OCI. When the hedged item is an equity instrument designated at FVTOCI, the hedging gain/loss remains in OCI to match that of the hedging instrument.

Where hedging gains/losses are recognised in profit or loss, they are recognised in the same line as the hedged item.

The Group discontinues hedge accounting only when the hedging relationship (or a part thereof) ceases to meet the qualifying criteria (after rebalancing, if applicable). This includes instances when the hedging instrument expires or is sold, terminated or exercised. The discontinuation is accounted for prospectively.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(i) Derivative financial instruments (continued)

Fair value hedge (continued)

The fair value adjustment to the carrying amount of hedged items for which the EIR method is used (i.e. debt instruments measured at amortised cost or at FVOCI) arising from the hedged risk is amortised to profit or loss commencing no later than the date when hedge accounting is discontinued.

Cash flow hedge

The effective portion of changes in the fair value of derivatives and other qualifying hedging instruments that are designated and qualify as cash flow hedges is recognised in the cash flow hedging reserve, a separate component of OCI, limited to the cumulative change in fair value of the hedged item from inception of the hedge less any amounts recycled to profit or loss.

Amounts previously recognised in OCI and accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss, in the same line as the recognised hedged item. If the Group no longer expects the transaction to occur that amount, is immediately reclassified to profit or loss.

The Group discontinues hedge accounting only when the hedging relationship (or a part thereof) ceases to meet the qualifying criteria (after rebalancing, if applicable). This includes instances when the hedging instrument expires or is sold, terminated or exercised, or where the occurrence of the designated hedged forecast transaction is no longer considered to be highly probable. The discontinuation is accounted for prospectively. Any gain/loss recognised in OCI and accumulated in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the gain/loss accumulated in equity is reclassified and recognised immediately in profit or loss.

(j) Debt securities issued

Debt issued is recognised initially at fair value, net of transaction costs incurred. After initial measurement, debt issued is subsequently measured at amortised cost using the effective interest rate. 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.

(k) Property and equipment

Land and buildings comprise branches, offices and certain residential premises purchased for occupation of management and staff. Property and equipment is stated at cost less accumulated depreciation. Cost includes expenditure that is directly attributable to the acquisition of the items.

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

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(k) Property and equipment (continued)

Land is not depreciated as it is deemed to have an infinite life. Depreciation on other assets is calculated using the straight-line method to write down the cost of assets to their estimated residual values over their expected useful economic lives as follows:

	<u>Years</u>
Buildings	15 - 30
Computer equipment and software	4 - 15
Furniture, fixtures and equipment	4 - 6
Leasehold improvements	2 - 6
Motor vehicles	2 - 4

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Capital work in progress is stated at cost and is transferred to the appropriate asset category when it is brought into use and is depreciated in accordance with the Group's accounting policy.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Gains and losses on disposal of property and equipment are determined by comparing the sales proceeds to the carrying value of the asset disposed and are taken into account in determining operating income.

(l) Employee benefits

(i) Defined contribution plan

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an employee benefit expense in consolidated income statement in the periods during which services are rendered by employees. Pension contributions are made in respect of UAE national employees to the UAE General Pension and Social Security Authority in accordance with the UAE Federal Law No (7), 1999 for Pension and Social Security.

(ii) Defined benefit plan

Provision is made for the end of service benefits due to non-UAE nationals in accordance with the UAE Labour Law for their periods of service up to the financial position date. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation. The provision arising is disclosed as 'provision for employees' end of service benefits' under other liabilities in the consolidated statement of financial position.

(iii) Short-term employee benefits

Short-term employee benefits obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

A provision is made for the estimated liability for employees' entitlements to annual leave and leave passage as a result of services rendered by the employees up to financial position date. This provision is included in other liabilities.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(m) Fiduciary assets

Assets and the income arising on the Group's fiduciary activities, where it acts in a fiduciary capacity such as nominee, trustee or agent, are excluded from these consolidated financial statements. Income earned by the Group from its fiduciary services is recognised in accordance with the accounting policy on fees and commission income.

(n) Share capital

(i) Share issue costs

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds.

(ii) Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Group's shareholders.

(o) Provisions and contingent liabilities

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

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset only if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Contingent liabilities, which include certain guarantees and letters of credit, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the Group's control; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the consolidated financial statements but are disclosed in the notes to the consolidated financial statements, unless they are remote.

(p) Deposits from customers

Deposits from customers are recognised initially at fair value, net of transaction costs incurred. Deposits from customers are subsequently carried at amortised cost using the effective interest method.

(q) Foreign currencies

Items included in the consolidated financial statements of the Group are measured using UAE Dirhams which is the currency of the primary economic environment in which the Group operates ('functional currency'). The consolidated financial statements are presented in UAE Dirhams. Foreign currency transactions are translated into the UAE Dirham at the rate ruling on the transaction date. Monetary assets and liabilities denominated in foreign currencies are re-translated into UAE Dirhams at the rates ruling at the consolidated statement of financial position date. Any resultant gains or losses are accounted for in the consolidated income statement other than for items presented in other comprehensive income. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(r) Interest income and expense

Interest income and expense are recognised in the consolidated income statement for all instruments measured at amortised cost using the effective interest method. Interest earned whilst holding investment securities is reported in interest income in the consolidated income statement.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(s) Fee and commission income

Fees and commissions, other than loan arrangement fees, are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred and recognised as an adjustment to the effective interest rate on the loan. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-proportionate basis. Fees earned on the Bank's fiduciary activities are recognised over the period in which the service is provided. The same principle is applied to custody services that are continuously provided over an extended period of time.

(t) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(u) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Chief Operating Decision-maker. The Chief Operating Decision-maker is the person or group that allocates resources to and assesses the performance of the operating segments of an entity. All transactions between business segments are conducted on an arm's length basis, with intra-segment revenue and costs being eliminated. Income and expenses directly associated with each segment are included in determining business segment performance. In accordance with IFRS 8 Operating Segments, the Group has the following business segments: retail banking, Wholesale banking, business banking, treasury and Insurance business.

(v) Intangible assets

Intangible assets acquired in a business combination are measured on initial recognition at cost, which is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the consolidated income statement in the expense category consistent with the function of the intangible asset.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(v) Intangible assets (continued)

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash generating unit level. Such intangibles are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

(i) License

The license represents the right to conduct insurance operations, which is granted by the relevant insurance regulator. This license is assessed as having an indefinite useful life and included in goodwill.

(ii) Customer relationships

The value of customer relationships represents the value of future cash flows expected from renewals and the cross-selling of new products to customers known and identified at the time of the acquisition and will be amortised on a straight line basis over the estimated useful life which is four years.

(w) Insurance contracts

Insurance and reinsurance contracts held

The Group, through its insurance subsidiary RAKNIC, issues contracts that transfer insurance risks in the general insurance category. The general insurance category comprises Casualty, Group Life, Financial Lines, Fire, Marine, Energy and Accident and Health.

The Group writes the following types of insurance contracts:

- Accident insurance
- Property insurance
- Motor insurance
- Fire insurance
- Casualty insurance
- Medical insurance
- Marine insurance
- Engineering insurance
- Group life insurance

Provision is made for premium deficiency arising from general insurance contracts where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the reporting date exceeds the unearned premiums provision and already recorded claim liabilities in relation to such policies. The provision for premium deficiency is calculated by reference to classes of business which are managed together, after taking into account the future investment return on investments held to back the unearned premiums and claims provisions.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

3. Significant accounting policies (continued)

(w) *Insurance contracts (continued)*

Insurance and other receivables

Insurance and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less impairment losses. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables.

Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate.

The carrying amount of the receivable is reduced through the use of an allowance account, and the amount of the loss is recognised in the consolidated income statement within general and administration expenses. When a receivable is uncollectible, it is written off against the allowance account for that receivable. Subsequent recoveries of amounts previously written off are credited as other operating income in the consolidated income statement.

Deferred acquisition costs

The costs attributable to the acquisition of new business for insurance contracts and renewing existing contracts are capitalised as an intangible asset under Deferred Acquisition Costs (DAC). All other costs are recognised as expenses when incurred. DAC are subsequently amortised over the life of the contracts as premium is earned.

Deferred acquisition costs are reviewed by category of business at the end of each reporting period and are written off where they are no longer considered to be recoverable.

Classification

The Group issues contracts that transfer either insurance risk or both insurance and financial risks.

Contracts under which the Group accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder are classified as insurance contracts. Insurance risk is significant if an insured event could cause the Group to pay significant additional benefits due to happening of the insured event compared to its non-happening.

Insurance contracts may also transfer some financial risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

Contracts where insurance risk is not significant are classified as investment contracts.

Once a contract is classified as an insurance contract it remains classified as an insurance contract until all rights and obligations are extinguished or expired.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

3. Significant accounting policies (continued)

(w) Insurance contracts (continued)

Recognition and measurement

i. Premiums

Gross premiums written reflect business incepted during the year, and exclude any fees and other amounts collected with and calculated based on premiums. These are recognised when underwriting process is complete and policies are issued.

The earned position of premium is recognised as an income. Premiums are earned from the date of attachment of risk over the indemnity period and unearned premium is calculated using the basis described below.

ii. Unearned premium provision

Unearned premiums are computed using statistical models to spread premium written evenly over period of coverage and are at least equal to the minimum stipulated by the UAE Insurance Law.

Claims

Claims outstanding comprise provisions for the Group's estimate of the ultimate cost of settling all claims incurred but unpaid at the reporting date whether reported or not, and related internal and external claims handling expense reduced by expected salvage and other recoveries. Claims outstanding are assessed by reviewing individual reported claims. Provisions for claims outstanding are not discounted. Adjustments to claims provisions established in prior periods are reflected in the consolidated financial statements of the period in which the adjustments are made. The methods used, and the estimates made, are reviewed regularly. Provision is also made for any claims incurred but not reported ("IBNR") at the date of the consolidated statement of financial position on the basis of management estimates.

Liability adequacy test

At the end of each reporting period, the Group assesses whether its recognised insurance liabilities are adequate using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities is inadequate in the light of estimated future cash flows, the entire deficiency is immediately recognised in profit or loss and an unexpired risk provision is created.

Provision is made for premium deficiency arising from general insurance contracts where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the reporting date exceeds the unearned premiums provision and already recorded claim liabilities in relation to such policies. The provision for premium deficiency is calculated by reference to classes of business which are managed together, after taking into account the future investment return on investments held to back the unearned premiums and claims provisions.

Reinsurance

The Group cedes reinsurance in the normal course of business for the purpose of limiting its net loss potential through the diversification of its risks. Assets, liabilities and income and expense arising from ceded reinsurance contracts are presented separately from the assets, liabilities, income and expense from the related insurance contracts because the reinsurance arrangements do not relieve the Group from its direct obligations to its policyholders.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

3. Significant accounting policies (continued)

(w) Insurance contracts (continued)

Reinsurance (continued)

Amounts due to and from reinsurers are accounted for in a manner consistent with the related insurance policies and in accordance with the relevant reinsurance contracts. Reinsurance premiums are deferred and expensed using the same basis as used to calculate unearned premium reserves for related insurance policies. The deferred portion of ceded reinsurance premiums is included in reinsurance assets.

Reinsurance assets are assessed for impairment at each reporting date. A reinsurance asset is deemed impaired if there is objective evidence, as a result of an event that occurred after its initial recognition, that the Group may not recover all amounts due, and that event has a reliably measurable impact on the amounts that the Group will receive from the reinsurer. Impairment losses on reinsurance assets are recognised in the consolidated income statement in the period in which they are incurred.

Profit commission in respect of reinsurance contracts is recognised on an accrual basis.

Deferred acquisition cost

For general insurance contracts, the deferred acquisition cost asset represents the position of acquisition costs which corresponds to the proportion of gross premiums written that is unearned at the reporting date.

Insurance receivables and payables

Amounts due from and to policyholders, agents and reinsurers are financial instruments and are included in insurance receivables and payables, and not in insurance contract provisions or reinsurance assets.

Insurance contract provision and reinsurance assets

Insurance contract liabilities towards outstanding claims are made for all claims intimated to the Group and still unpaid at the statement of financial position date, in addition for claims incurred but not reported. The unearned premium considered in the insurance contract liabilities comprise the estimated proportion of the gross premiums written which relates to the periods of insurance subsequent to the consolidated statement of financial position date.

The reinsurers' portion towards the above outstanding claims, claims incurred but not reported and unearned premium is classified as reinsurance contract assets in the consolidated financial statements.

4. Cash and balances with UAE Central Bank

	2018 AED'000	2017 AED'000
Cash in hand	979,697	1,025,962
Balances with the UAE Central Bank	326,800	193,577
Statutory deposit with the UAE Central Bank	3,091,499	3,021,027
Certificates of deposit with the UAE Central Bank	550,000	500,000
	4,947,996	4,740,566

Statutory deposits maintained with the UAE Central Bank represent deposits at stipulated percentages of the Group's demand, savings, time and other deposits. These are only available for day-to-day operations under certain specified conditions and cannot be withdrawn without the Central Bank's prior approval.

Cash in hand, balances and statutory deposit with the UAE Central Bank are non-interest bearing. Certificates of deposit carry an interest rate of 2.25% to 2.35% (2017: 1.25%) per annum.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

5. Due from other banks, net

	2018 AED'000	2017 AED'000
Placements with other banks	563,076	944,523
Demand deposits	714,553	277,161
Banker's acceptances	2,012,723	1,806,712
Syndicated loans	1,474,788	701,022
Other	21,542	69,821
	<hr/>	<hr/>
Total due from other banks	4,786,682	3,799,239
Provision for credit loss	(31,140)	-
	<hr/>	<hr/>
Due from other banks, net	<u>4,755,542</u>	<u>3,799,239</u>

The below represents deposits and balances due from:

	2018 AED'000	2017 AED'000
Banks in UAE	715,691	220,742
Banks outside UAE	4,070,991	3,578,497
	<hr/>	<hr/>
	<u>4,786,682</u>	<u>3,799,239</u>

6. Loans and advances, net

	2018 AED'000	2017 AED'000
<i>(a) Loans and advances</i>		
Retail banking loans	18,483,144	18,828,884
Wholesale banking loans	7,937,821	6,494,211
Business banking loans	8,406,309	7,912,269
	<hr/>	<hr/>
Total loans and advances [Note 6(b)]	34,827,274	33,235,364
Provision for credit losses [Note 6(c)]	(1,966,612)	(995,171)
	<hr/>	<hr/>
Net loans and advances	<u>32,860,662</u>	<u>32,240,193</u>
<i>(b) Analysis of loans and advances</i>		
Personal loans	7,057,161	6,381,452
Mortgage loans	4,744,304	4,625,072
Credit cards	3,215,481	3,551,725
Auto loans	1,595,257	2,336,306
Business banking RAK finance loans	4,413,098	4,684,424
Business banking other loans	3,993,211	3,227,845
Wholesale banking loans	7,937,821	6,494,211
Other retail loans	1,870,941	1,934,329
	<hr/>	<hr/>
Total loans and advances	<u>34,827,274</u>	<u>33,235,364</u>

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

6. Loans and advances, net (continued)

	2018 AED'000	2017 AED'000
(c) Provision for credit losses		
Balance at the beginning of the year	995,171	1,053,429
Impact of adoption of IFRS 9	912,475	-
Impairment allowance for the year	1,507,990	1,685,001
Written-off during the year	(1,449,024)	(1,743,259)
Balance at the end of the year	1,966,612	995,171
(d) Provision for credit losses of loans and advances, net		
Impairment allowance for the year	1,507,990	1,685,001
Net recovery during the year	(115,796)	(132,038)
	1,392,194	1,552,963

Net recovery mainly represents amounts subsequently recovered from fully written-off loans.

(e) Islamic financing assets

The below table summarises the Islamic financing assets that are part of loans and advances above:

	2018 AED'000	2017 AED'000
i) Islamic financing assets		
Islamic retail financing assets	3,347,024	2,941,075
Islamic business banking assets	1,432,433	1,143,475
Islamic wholesale banking assets	722,012	344,451
Total Islamic financing assets	5,501,469	4,429,001
Provision for impairment	(253,145)	(123,835)
	5,248,324	4,305,166
ii) Analysis of Islamic financing assets		
Islamic salam personal finance	2,166,272	1,529,271
Islamic auto murabaha	360,579	643,196
Islamic business banking finance	1,432,433	1,143,475
Islamic Ijara property finance	711,058	647,941
Islamic credit cards	107,533	119,676
Islamic wholesale banking	722,012	344,451
Islamic finance - other	1,582	991
	5,501,469	4,429,001

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

7. Investment securities, net

a) Investments

	2018 AED'000	2017 AED'000
<i>Securities at fair value through other comprehensive income</i>		
Quoted equity securities	210,924	61,068
Unquoted equity securities	2,612	1,694
Quoted debt securities*	2,196,564	5,185,470
Quoted funds	-	20,853
Unquoted funds	-	19,153
Unquoted debt securities	-	276,237
	<u>2,410,100</u>	<u>5,564,475</u>
<i>Securities at fair value through profit or loss</i>		
Quoted funds	22,964	4,274
Unquoted funds	38,004	-
	<u>60,968</u>	<u>4,274</u>
<i>Securities held at amortised cost</i>		
Quoted debt securities*	4,417,540	-
Unquoted debt securities	338,550	-
	<u>4,756,090</u>	<u>-</u>
Total investment securities	7,227,158	5,568,749
Provision for credit losses	(38,025)	-
Investment securities, net	7,189,133	5,568,749

*As at 31 December 2018, quoted debt securities with book value of AED 1,549 million (31 December 2017: AED 1,324 million) have been given as collateral against repo borrowings of AED 1,377 million (31 December 2017: AED 1,248 million) [Note 12].

Note 2.3 shows the original classification under IAS 39 for the comparative 31 December 2017.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

7. Investment securities, net (continued)

b) The composition of the investment portfolio by category is as follows:

	2018 AED'000	2017 AED'000
Federal and local Government - UAE	497,210	343,081
Government related entity - UAE	1,065,897	1,063,428
Government - GCC	1,304,226	1,001,112
Government - other	944,621	332,519
Banks and financial institutions - UAE	536,479	443,836
Banks and financial institutions - GCC	171,666	226,782
Banks and financial institutions - other	1,015,293	1,034,342
Public limited companies - UAE	564,022	441,310
Public limited companies - GCC	269,111	276,158
Public limited companies - other	584,129	299,139
Total debt securities	6,952,654	5,461,707
Quoted equity securities	210,924	61,068
Quoted funds	22,964	25,127
Unquoted funds	38,004	19,153
Unquoted equity securities	2,612	1,694
Total investment securities	7,227,158	5,568,749

c) Movement in investment securities

	Securities at fair value through other comprehensive income AED'000	Securities fair value through profit and loss AED'000	Securities held at amortised cost AED'000	Total AED'000
At 1 January 2018	5,564,475	4,274	-	5,568,749
Purchases	589,175	495,022	2,883,575	3,967,772
Reclassification from FVOCI to amortised cost	(3,447,430)	-	3,452,907	5,477
Transfers	(65,192)	65,192	-	-
Proceeds from disposal/maturities	(106,948)	(511,467)	(1,643,100)	(2,261,515)
Net changes in fair value due to revaluation	(136,177)	-	-	(136,177)
Net changes in fair value due to hedge and forex	19,590	-	(1,766)	17,824
Net changes in fair value through profit or loss	-	(1,681)	-	(1,681)
Amortization of premium/discount	(7,791)	-	64,474	56,683
Profit on sale/maturity	398	9,628	-	10,026
At 31 December 2018	2,410,100	60,968	4,756,090	7,227,158

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

7. Investment securities, net (continued)

c) Movement in investment securities (continued)

	Securities available for sale AED'000	Securities held for trading AED'000	Securities held to maturity AED'000	Total AED'000
At 1 January 2017	4,793,693	16,989	-	4,810,682
Purchases	5,733,040	1,673,811	-	7,406,851
Proceeds from disposal/maturities	(5,030,708)	(1,691,904)	-	(6,722,612)
Net fair value loss on revaluation	(13,612)	-	-	(13,612)
Impairment/net changes in fair value through profit/(loss)	(7,343)	81	-	(7,262)
Amortization of discount	3,142	-	-	3,142
Profit on sale/ maturity	86,263	5,297	-	91,560
At 31 December 2017	<u>5,564,475</u>	<u>4,274</u>	<u>-</u>	<u>5,568,749</u>

8. Insurance contract assets and receivables, net

	2018 AED'000	2017 AED'000
Reinsurance contract assets		
Claims reported unsettled	84,016	85,532
Claims incurred but not reported	29,271	21,825
Deferred reinsurance premium and commission	93,668	79,772
Total reinsurance contract assets	<u>206,955</u>	<u>187,129</u>
Insurance related receivables		
Premium receivables	217,797	227,372
Reinsurance companies	10,544	33,810
Insurance agents and brokers	788	939
Gross insurance related receivables	<u>229,129</u>	<u>262,121</u>
Insurance contract assets and receivables	<u>436,084</u>	<u>449,250</u>
Provision for credit loss	(45,605)	(23,973)
Provision others	(1,885)	(380)
Total provisions doubtful receivables	<u>(47,490)</u>	<u>(24,353)</u>
Insurance contract assets and receivables, net	<u>388,594</u>	<u>424,897</u>

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

9. Other assets

	2018 AED'000	2017 AED'000
Interest receivable	279,424	222,853
Profit receivable on Islamic financing assets	60,814	52,598
Prepayments and deposits	84,654	84,350
Foreign exchange and other derivative contracts (Note 32)	57,505	25,540
Insurance related receivables and assets	70,376	45,383
Other	399,871	115,211
	<u>952,644</u>	<u>545,935</u>

10. Goodwill and other intangible assets

	Goodwill including insurance license AED'000	Intangibles- customer relationship AED'000	Goodwill and other intangible assets AED'000
Cost			
At 1 January 2017	166,386	12,835	179,221
At 31 December 2017	<u>166,386</u>	<u>12,835</u>	<u>179,221</u>
At 31 December 2018	<u>166,386</u>	<u>12,835</u>	<u>179,221</u>
Accumulated amortization			
At 1 January 2017	-	(5,080)	(5,080)
Charge for the year	-	(3,209)	(3,209)
At 31 December 2017	-	<u>(8,289)</u>	<u>(8,289)</u>
Charge for the year	-	(3,209)	(3,209)
At 31 December 2018	-	<u>(11,498)</u>	<u>(11,498)</u>
Net book value			
At 31 December 2018	<u>166,386</u>	<u>1,337</u>	<u>167,723</u>
At 31 December 2017	<u>166,386</u>	<u>4,546</u>	<u>170,932</u>

For the purpose of impairment assessment, goodwill is allocated to the Group's insurance business. Goodwill is tested for impairment annually or at a more frequent basis when there is evidence that the fair value of the unit is less than the carrying value. The impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit, pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognized for goodwill is not reversed in a subsequent period.

Management has carried out an impairment test for goodwill at the year end and has concluded that no impairment has taken place. For this purpose, the recoverable amount of each cash generating unit has been determined based on a value-in-use calculation using cash flow projections, based on financial budgets approved by senior management, covering a five year period. Cash flows beyond the five-year period are extrapolated using a growth rate, which management believes approximates the long term growth rate for the industry in which the cash generating unit operates.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

11. Property and equipment

	Land and buildings AED'000	Leasehold improvements AED'000	Other fixed assets AED'000	Capital work-in- progress AED'000	Total AED'000
<i>Cost</i>					
At 31 December 2016	705,623	103,575	894,492	19,220	1,722,910
Additions	-	91	25,480	75,613	101,184
Transfers	5,050	4,808	58,027	(67,885)	-
Disposals	-	(38)	(18,055)	-	(18,093)
At 31 December 2017	710,673	108,436	959,944	26,948	1,806,001
Additions	4,521	-	9,503	72,270	86,294
Transfers	2,145	5,408	66,145	(73,698)	-
Disposals	-	-	(4,565)	-	(4,565)
At 31 December 2018	717,339	113,844	1,031,027	25,520	1,887,730
<i>Accumulated depreciation and impairment</i>					
At 31 December 2016	164,578	91,455	594,033	-	850,066
Charge for the year	24,878	6,021	67,294	-	98,193
Disposals	-	(38)	(17,560)	-	(17,598)
At 31 December 2017	189,456	97,438	643,767	-	930,661
Charge for the year	23,813	4,896	71,527	-	100,236
Disposals	-	-	(4,492)	-	(4,492)
Impairment charge	1,383	-	-	-	1,383
At 31 December 2018	214,652	102,334	710,802	-	1,027,788
<i>Net book value</i>					
At 31 December 2018	502,687	11,510	320,225	25,520	859,942
At 31 December 2017	521,217	10,998	316,177	26,948	875,340

Other fixed assets include computer equipment, furniture and fixtures, equipment and motor vehicles. Capital work in progress mainly comprises the costs pertaining to various system enhancements and set up costs for branches and offices.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

12. Due to other banks

	2018 AED'000	2017 AED'000
Term borrowings	3,000,065	1,351,629
Repurchase agreements (Note 7)	1,377,152	1,247,673
Demand deposits	4,245	164,897
	<u>4,381,462</u>	<u>2,764,199</u>

13. Deposits from customers

	2018 AED'000	2017 AED'000
Time deposits	13,432,712	10,683,274
Current accounts	16,531,178	17,289,030
Saving deposits	2,908,097	3,103,402
Call deposits	1,267,797	1,100,168
	<u>34,139,784</u>	<u>32,175,874</u>

Time deposits include AED 1,872 million (2017: AED 1,544 million) held by the Group as cash collateral for loans and advances granted to customers.

The below table summarises the Islamic deposits of customers that are part of deposits from customers above:

	2018 AED'000	2017 AED'000
Wakala deposits	2,580,538	779,242
Mudaraba term investment deposits	14,755	15,275
Murabaha term deposit	1,441,875	736,063
Qard-E-Hassan - current accounts	754,907	793,969
Mudaraba - current accounts	476,743	698,753
Mudaraba - saving accounts	179,408	162,494
Mudaraba - call deposits	26,352	27,816
	<u>5,474,578</u>	<u>3,213,612</u>

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

14. Debt securities issued and other long term borrowings

	2018 AED'000	2017 AED'000
USD 500 million medium term note issued at discount in September 2014 (a)	1,549,098	1,832,325
USD 300 million medium term note issued at premium in March 2015 (a)	1,103,044	1,105,376
USD 50 million private placement at discount in July 2017 (a)	182,945	182,669
USD 145 million private placement net of discount (a)	523,009	-
USD 350 million syndicated borrowing (b)	1,285,550	1,285,550
USD 80 million bilateral borrowing (c)	293,840	-
Less: Own investment in debt securities issued	(89,452)	(211,720)
Less: Debt securities issue cost	(1,415)	(4,597)
Less: Syndicated loan issue costs	(6,332)	(9,735)
Less: Private placement loan issue costs	(183)	-
Less: bilateral borrowing issue costs	(396)	-
Fair value adjustment on hedged debt securities in issue	(13,603)	(10,566)
	<u>4,826,105</u>	<u>4,169,302</u>

- (a) The Group issued USD 500 million Euro Medium Term Notes (EMTN) in September 2014 under its USD 1 billion EMTN programme through its subsidiary RAK Funding Cayman Limited. The initial tranche was issued at a discounted rate of 99.275%. In March 2015, a second tranche of USD 300 million were issued under this programme at a premium rate of 100.875%. These EMTN's mature in 2019 and carry a fixed interest rate of 3.25% per annum which is payable half-yearly in arrears. Moreover, the Group increased its EMTN Programme to USD 2 billion year.

Under the same EMTN Programme, the Group issued USD 50 million floating rate notes in July 2017 through a private placement which matures in 2021. These carry a floating rate of USD 3 months LIBOR +1.5% per annum.

During the second quarter of 2018, the Group issued USD 145 million of floating rate notes in September 2018 through a private placement with an interest rate of USD 3 months LIBOR +1.4% which mature in in September 2023.

During fourth quarter of 2018 the Group cancelled its debt security amounting to USD 77.93 million. The end of year the balance of EMTN in issue is USD 722.07 million against original issue of USD 800 million.

- (b) During the third quarter of year 2017, the Group arranged a three year syndicated borrowing of USD 350 million maturing in 2020. This syndicated borrowing carries an interest rate of USD 3 months LIBOR + 1.55% per annum.
- (c) In September 2018 the Group borrowed USD 80 million at an interest rate of USD 3 months LIBOR + 1.25% per annum and matures in September 2021.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

14. Debt securities in issue and other long term borrowing (continued)

Reconciliation of liabilities arising from financing activities

The table below details changes in the Group's liabilities arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the Group's consolidated statement of cash flows as cash flows from financing activities:

	1 January 2018 AED'000	Financing cash flows AED'000	Non cash changes AED'000	31 December 2018 AED'000
Fixed rate Euro medium term notes	2,710,818	(89,452)	(73,694)	2,547,672
Floating rate notes issued in 2017	182,669	-	276	182,945
Bilateral borrowing	-	293,362	82	293,444
Floating rate notes issued in 2018	-	521,731	1,095	522,826
Syndicated borrowing	1,275,815	-	3,403	1,279,218
Total liabilities from financing activities	4,169,302	725,641	(68,838)	4,826,105

15. Insurance contract liabilities and payables

	2018 AED'000	2017 AED'000
<i>Insurance contract liabilities</i>		
Claims reported unsettled, net	112,644	117,058
Claims incurred but not reported	57,017	51,171
Unearned premiums	233,921	190,862
Total insurance contract liabilities	403,582	359,091
<i>Insurance related payables</i>		
Creditors	71,629	73,073
Reinsurance payables	12,801	58,064
Commission payables	23,383	26,763
Total insurance related payables	107,813	157,900
Insurance contract liabilities and payables	511,395	516,991

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

16. Other liabilities

	2018	2017
	AED'000	AED'000
Interest payable	137,825	84,361
Profit distributable on Islamic deposits	30,273	9,489
Accrued expenses	155,955	122,065
Provision for employees' end-of-service benefits (Note 29)	113,402	122,891
Foreign exchange and other derivatives derivative contracts (Note 32)	100,480	23,236
Credit card payables and liabilities	117,036	23,812
Managers cheques issued	99,427	214,069
Mortgage payables and liabilities	11,632	13,399
Asset based finance payables and liabilities	15,152	39,855
Insurance related payables and liabilities	34,339	35,248
Provision for expected credit loss on financial guarantees, letter of credit and customer acceptances	7,862	-
Other	280,132	182,616
	1,103,515	871,041

17. Share capital and dividends

At 31 December 2018, the authorised, issued and fully paid share capital of the Bank comprised: 1,676 million shares of AED 1 each (31 December 2017: 1,676 million shares of AED 1 each).

At the meeting held on 14 March 2018, the shareholders of the Bank approved a cash dividend of 30% amounting to AED 503 million of the issued and paid up capital in respect of the year ended 31 December 2017 (2016: 30% cash dividend amounting to AED 503 million). Further, AED 4 million was approved as Directors' remuneration for year 2017.

The Board of Directors has proposed a cash dividend of 30 fils per share and also Directors' remuneration of AED 4.7 million at their meeting held on 30 January 2019.

18. Legal reserve

In accordance with the UAE Federal Law No (2) of 2015 and Articles of Association of the Bank, 10% of the Bank's net profit for the year is transferred to a legal reserve, until such time as the balance in the reserve equals 50% of the issued share capital. Since the legal reserve of the Bank is equal to 50% of Bank's issued capital, profit was not appropriated to legal reserve during the year. This reserve is not available for distribution. Additionally, the subsidiaries of the Bank also appropriate their profit to a legal reserve which is added to the Bank's legal reserve.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

19. Other reserves

	Voluntary reserve AED'000	General banking risk reserve AED'000	Credit risk reserve AED'000	Regulatory credit risk reserve AED'000	Regulatory impairment reserve - specific * AED'000	Treasury stock elimination AED'000	Fair value reserve AED'000	Total AED'000
At 31 December 2016	337,208	1,000,000	1,250,000	421,000	-	(2,397)	25,398	3,031,209
Changes during the year	-	-	-	71,000	-	2,397	(15,242)	58,155
At 31 December 2017	337,208	1,000,000	1,250,000	492,000	-	-	10,156	3,089,364
Changes during the year	-	-	492,000	(492,000)	49,978	-	(131,767)	(81,789)
At 31 December 2018	337,208	1,000,000	1,742,000	-	49,978	-	(121,611)	3,007,575

In accordance with the Articles of Association of the Bank, 10% of the net profit for the year is to be transferred to a voluntary reserve until such time as the balance in the reserve equals 20% of the issued share capital. Since the voluntary reserve of the Bank is equal to 20% of Bank's issued capital, profit was not appropriated to voluntary reserve during the year. Additionally, the subsidiaries of the Bank also appropriate their profit to such reserve which is added to the Bank's voluntary reserve. This reserve is available for distribution.

The Bank maintains a general banking risk reserve to address the risks inherent in the Bank's operating environment. Contributions to this reserve are made at the discretion of the Directors. This reserve is available for distribution.

The Bank has also established a special reserve for credit risk. Contributions to this reserve are voluntary and made at the discretion of the Directors. This reserve is available for distribution.

The Bank has a non-distributable special reserve titled as 'Regulatory Credit Risk Reserve' and this reserve was maintained at least at a level of 1.5% of the credit risk weighted assets at the end of each financial year, as instructed by the UAE Central Bank. Balance in this reserve has been transferred to credit risk reserve on implementation of IFRS 9 from 1 January 2018.

Treasury stock elimination amount represented the shares of the National Bank of Ras Al-Khaimah (P.S.C.) owned by RAK National Insurance Company P.S.C. which were sold during 2017. Fair value reserve pertains to the revaluation of the Group's available for sale investments and cash flow hedges taken to other comprehensive income.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

19. Other reserves (continued)

*The CBUAE issued its IFRS 9 guidance on 30 April 2018 via notice No.: CBUAE/BSD/2018/458 addressing various implementation challenges and practical implications for banks adopting IFRS 9 in the UAE (“the Guidance”).

Pursuant to clause 6.4 of the Guidance, the reconciliation between general and specific provision under Circular 28/2010 of CBUAE and IFRS 9 is as follows:

	2018 AED'000
<i>Impairment reserve: General</i>	
General provisions under Circular 28/2010 of CBUAE	571,951
Less: Stage 1 and Stage 2 provisions under IFRS 9	1,178,094
	<hr/>
General provision transferred to the regulatory impairment reserve	<hr/>
<i>Impairment reserve: Specific</i>	
Specific provisions under Circular 28/2010 of CBUAE	914,424
Less: Stage 3 provisions under IFRS 9	864,446
	<hr/>
Specific provision transferred to the regulatory impairment reserve	49,978
	<hr/>
Total provision transferred to the regulatory impairment reserve	49,978
	<hr/> <hr/>

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

20. Non-controlling interests

	Year ended 31 December 2018 AED'000	Year ended 31 December 2017 AED'000
Balance at the beginning of the year	51,109	43,465
Impact of adopting IFRS 9	(6,054)	-
Profit for the year	4,894	10,043
Dividends paid	(3,427)	(2,284)
Change in other comprehensive income for the year	(654)	(115)
	<hr/>	<hr/>
Balance at the end of the year	45,868	51,109
	<hr/> <hr/>	<hr/> <hr/>

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

21. Interest income and interest expense

	2018 AED'000	2017 AED'000
<i>Interest income</i>		
Personal loans	365,575	338,852
Mortgage loans	180,592	160,829
Credit cards	672,306	714,757
Auto loans	93,770	108,426
Business banking RAK finance loans	638,830	687,800
Wholesale banking loans	327,376	205,141
Business banking loans	275,681	247,013
Other retail loans	66,173	47,389
Investment securities	276,907	189,484
Deposits with the U.A.E. Central Bank	9,842	4,475
Other banks	141,783	79,202
	<u>3,048,835</u>	<u>2,783,368</u>
<i>Interest expense</i>		
Deposits from customers	329,574	240,173
Debt securities issued and other long term borrowings	186,395	88,248
Borrowings from other banks	75,443	31,535
	<u>591,412</u>	<u>359,956</u>

22. Income from Islamic financing and distribution to depositors

	2018 AED'000	2017 AED'000
<i>Income from Islamic financing</i>		
Islamic salam personal finance	160,224	105,112
Islamic auto Murabaha	32,295	52,128
Islamic business banking finance	154,909	141,308
Islamic wholesale banking finance	26,607	11,908
Islamic ijara property finance	32,998	28,569
	<u>407,033</u>	<u>339,025</u>
<i>Distribution to depositors</i>		
Distribution of profit on Islamic term investment deposits	88,733	34,728
Distribution of profit on Islamic demand deposits	7,021	4,487
	<u>95,754</u>	<u>39,215</u>

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

23. Net fees and commission income

	2018 AED'000	2017 AED'000
Personal loans	52,363	36,307
Mortgage loans	26,019	28,317
Credit cards	260,511	265,475
Auto loans	16,792	13,867
RAK Finance business loans	52,155	48,848
Wholesale banking	51,578	42,543
Other business banking	146,699	115,969
Fiduciary income	29,853	59,415
Bancassurance	46,508	56,850
Other	47,220	49,421
	<u>729,698</u>	<u>717,012</u>

24. Gross insurance underwriting profit

	2018 AED'000	2017 AED'000
Gross insurance premium	503,304	466,015
Less: insurance premium ceded to reinsurers	(201,950)	(181,313)
Net retained premium	<u>301,354</u>	<u>284,702</u>
Net change in unearned premium reserve	(14,428)	(1,342)
Net insurance premium	<u>286,926</u>	<u>283,360</u>
Gross claims incurred	(338,306)	(269,716)
Insurance claims recovered from reinsurers	147,304	93,406
Net claims incurred	<u>(191,002)</u>	<u>(176,310)</u>
Gross commission earned	17,613	12,525
Less: commission incurred	(55,383)	(44,900)
Net commission incurred	<u>(37,770)</u>	<u>(32,375)</u>
Gross underwriting profit	<u>58,154</u>	<u>74,675</u>

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

25. Investment income

	2018 AED'000	2017 AED'000
Dividend income	18,380	4,088
Net gain on disposal of investments	10,026	91,560
Fair value loss, net	(1,681)	(7,757)
	<u>26,725</u>	<u>87,891</u>

26. Operating expenses

	2018 AED'000	2017 AED'000
Staff and outsourced staff cost (Note 28)	927,194	920,209
Depreciation and amortisation	103,445	101,402
Computer expenses	102,721	86,990
Occupancy costs	99,529	104,054
Legal and collections charges	67,756	64,096
Communication costs	44,622	41,899
Marketing expenses	24,721	23,195
Other	118,332	104,535
	<u>1,488,320</u>	<u>1,446,380</u>

27. Earnings per share

The basic earnings per share is calculated by dividing the net profit attributable to owners of the Parent by the weighted average number of ordinary shares in issue during the year:

	2018	2017
Profit for the year (AED'000) [attributed to owners of the Bank]	912,626	800,459
Weighted average number of shares in issue (in 000's)	1,676,245	1,676,245
Basic earnings per share (AED)	0.54	0.48

There were no potentially dilutive shares as at 31 December 2018 and 2017.

28. Staff and outsourced staff costs

	2018 AED'000	2017 AED'000
Salaries, allowances and bonus	797,744	801,587
Pension	11,205	9,387
End-of-service benefits	22,883	13,910
Other	95,362	95,325
	<u>927,194</u>	<u>920,209</u>

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

29. Provision for staff end-of-service benefits

	2018 AED'000	2017 AED'000
Balance at 1 January	122,891	112,139
(Payment)/net charge during the year	(9,489)	10,752
Balance at 31 December	113,402	122,891

Provision for employees' end of service indemnity is made in accordance with the Company's policy which meets the requirements of U.A.E. labour laws, and is based on current remuneration and cumulative years of service at the reporting date.

30. Provision for credit loss, net

	2018 AED'000	2017 AED'000
Net impairment charge on loans and advances	1,392,194	1,552,963
Net impairment charge on due from other banks	11,447	-
Net impairment charge on investment securities	18,065	-
Net impairment release on insurance contracts	(5,553)	-
Net impairment charge on commitments and customer acceptances, guarantees and letter of credits	4,993	-
Net impairment charge for the year	1,421,146	1,552,963

31. Contingencies and commitments

	2018 AED'000	2017 AED'000
Irrevocable commitments to extend credit	2,020,404	533,133
Letters of guarantee	1,374,083	1,040,287
Letters of credit	157,350	242,803
Capital commitments and other contingencies	27,549	13,519
	3,579,386	1,829,742

Letters of credit are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank, up to a stipulated amount, under specific terms and conditions. These letters of credit are collateralised by the underlying shipments of goods to which they relate and therefore have significantly less risk.

Guarantees commit the Bank to make payment on behalf of customers contingent upon the production of documents or failure of the customer to perform under the terms of the contract. Guarantees include AED 100 million guarantee given by the Bank for its subsidiary RAK Islamic Finance Company which is under liquidation.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

31. Contingencies and commitments (continued)

Cash requirements under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in 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 risk associated with the remainder of commitments, the risk is viewed as modest, since it results firstly from the possibility of the unused portion of loan authorisations being drawn by the customer, and second, from these drawings subsequently not being repaid as due. The Bank monitors the term to maturity of credit commitments because longer term commitments generally have a greater degree of risk than shorter term commitments. Commitments to extend credit amounting to AED 6,708 million (2017: AED 8,364 million) are revocable at the option of the Bank and not included in the above table.

The Group is holding AED 7.86 million (31 December 2017: Nil) provision for expected credit loss on financial guarantee contracts and letter of credits as per IFRS 9, out of which AED 5.95 Million (31 December 2017: Nil) of provision relates to irrevocable commitments.

32. Forward foreign exchange and other derivative contracts

Foreign exchange contracts comprise commitments to purchase foreign and domestic currencies on behalf of customers and in respect of the Bank's undelivered spot transactions.

Outstanding forward foreign exchange contracts, interest rate swaps and other derivative contracts at 31 December 2018 and 31 December 2017 are as follows:

	Fair Values		
	Assets AED'000	Liability AED'000	Notional AED'000
31 December 2018			
Foreign exchange contracts	35,838	45,986	10,776,194
Interest rate swaps	12,828	49,028	6,072,864
Other derivative contracts	8,839	5,466	4,136,281
	<u>57,505</u>	<u>100,480</u>	
31 December 2017			
Foreign exchange contracts	13,065	3,023	4,838,782
Interest rate swaps	2,759	12,267	3,856,482
Other derivative contracts	9,716	7,946	3,449,561
	<u>25,540</u>	<u>23,236</u>	

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

33. Cash and cash equivalents

	2018 AED'000	2017 AED'000
Cash in hand and current account with UAE Central Bank	1,306,497	1,219,539
Due from other banks	4,786,682	3,799,239
	<u>6,093,179</u>	<u>5,018,778</u>
Less: Due from other banks with original maturity of three months or more	(3,670,487)	(2,766,580)
	<u>2,422,692</u>	<u>2,252,198</u>

34. Operating segments

Following the management approach of IFRS 8, operating segments are reported in accordance with the internal reporting to the management, which is responsible for allocating resources to the reportable segments and assesses its performance. All operating segments used by the Group meet the definition of a reportable segment under IFRS 8.

The Group has five main business segments:

- Retail banking - incorporating individual customer and certain business current accounts, savings accounts, deposits, credit and debit cards, individual customer loans and mortgages;
- Wholesale banking - incorporating transactions with corporate bodies including government and public bodies and comprising of loans, advances, deposits and trade finance transactions of corporate customers and financial institutions;
- Business banking - incorporating transactions comprising of loans, advances, deposits and trade finance transactions of SME;
- Treasury - incorporating activities of the dealing room, related money market, and foreign exchange transactions and hedging activities with other banks and financial institutions including the UAE Central Bank, none of which constitute a separately reportable segment; and
- Insurance business - incorporating all insurance related transactions of its subsidiary Ras Al Khaimah National Insurance Company PSC.

The above segments include conventional and Islamic products and services of the Group.

As the Group's segment operations are all financial with a majority of revenues deriving from interest and fees and commission income, the management relies primarily on revenue and segmental results to assess the performance of the segment.

Funds are ordinarily allocated between segments, resulting in funding cost transfers disclosed in inter-segment revenue. Interest charged for these funds is based on the Bank's funds transfer pricing policy. There are no other material items of income or expense between the business segments.

The Group's management reporting is based on a measure of net profit comprising net interest income, loan impairment charges, net fee and commission income, other income and non-interest expenses.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

34. Operating segments (continued)

The segment information provided to the management for the reportable segments for the period ended 31 December 2018 and 2017 is as follows:

	Retail Banking AED'000	Wholesale Banking AED'000	Business Banking AED'000	Treasury and other AED'000	Insurance business AED'000	Unallocated AED'000	Consolidation adjustments AED'000	Total AED'000
<i>31 December 2018</i>								
Net external interest income	1,289,949	226,659	865,596	66,720	9,718	-	(1,219)	2,457,423
Income from Islamic financing net of distribution to depositors	199,299	(21,543)	137,425	(3,902)	-	-	-	311,279
Transfer pricing (expense)/income	(298,701)	(678)	63,817	235,562	-	-	-	-
Net interest income and net income from Islamic financing	1,190,547	204,438	1,066,838	298,380	9,718	-	(1,219)	2,768,702
Non-interest income	551,092	56,449	257,655	136,002	66,338	-	(9,252)	1,058,284
Operating income	1,741,639	260,887	1,324,493	434,382	76,056	-	(10,471)	3,826,986
Operating expense excluding depreciation and amortisation	(785,654)	(41,239)	(186,926)	(16,838)	(52,851)	(310,365)	9,010	(1,384,863)
Depreciation and amortisation	(32,579)	(1,699)	(1,271)	(896)	(3,813)	(59,991)	(3,208)	(103,457)
Total operating expense	(818,233)	(42,938)	(188,197)	(17,734)	(56,664)	(370,356)	5,802	(1,488,320)
Impairment charge, net	(666,240)	(78,319)	(661,365)	(20,853)	5,631	-	-	(1,421,146)
Net profit/(loss)	257,166	139,630	474,931	395,795	25,023	(370,356)	(4,669)	917,520
Segment assets	18,520,294	11,279,785	8,739,961	12,647,473	840,600	-	(296,550)	51,733,563
Unallocated assets	-	-	-	-	-	952,377	-	952,377
Total assets	18,520,294	11,279,785	8,739,961	12,647,473	840,600	952,377	(296,550)	52,683,940
Segment liabilities	10,687,837	12,164,606	13,635,231	7,996,057	612,876	-	(140,153)	44,956,454
Unallocated liabilities	-	-	-	-	-	567,511	-	567,511
Total liabilities	10,687,837	12,164,606	13,635,231	7,996,057	612,876	567,511	(140,153)	45,523,965

Notes to the consolidated financial statements for the year ended 31 December 2018 (continued)

34. Operating segments (continued)

	Retail Banking AED'000	Wholesale Banking AED'000	Business Banking AED'000	Treasury and other AED'000	Insurance business AED'000	Unallocated AED'000	Consolidation adjustments AED'000	Total AED'000
<i>31 December 2017</i>								
Net external interest income	1,295,816	125,276	902,075	93,230	7,015	-	-	2,423,412
Income from Islamic financing net of distribution to depositors	162,141	(101)	137,770	-	-	-	-	299,810
Transfer pricing (expense)/income	(235,158)	20,404	1,994	212,760	-	-	-	-
Net interest income and net income from Islamic financing	1,222,799	145,579	1,041,839	305,990	7,015	-	-	2,723,222
Non-interest income	564,460	49,494	213,617	181,203	71,000	-	6,849	1,086,623
Operating income	1,787,259	195,073	1,255,456	487,193	78,015	-	6,849	3,809,845
Operating expense excluding depreciation and amortisation	(794,201)	(30,966)	(180,386)	(13,633)	(42,240)	(293,032)	9,480	(1,344,978)
Depreciation and amortisation	(31,777)	(950)	(1,281)	(785)	(3,822)	(59,579)	(3,208)	(101,402)
Total operating expense	(825,978)	(31,916)	(181,667)	(14,418)	(46,062)	(352,611)	6,272	(1,446,380)
Impairment charge, net	(664,990)	(88,918)	(799,055)	-	-	-	-	(1,552,963)
Net profit/(loss)	296,291	74,239	274,734	472,775	31,953	(352,611)	13,121	810,502
Segment assets	19,237,425	8,905,676	7,884,657	10,778,747	862,082	-	(324,705)	47,343,882
Unallocated assets	-	-	-	-	-	1,193,276	-	1,193,276
Total assets	19,237,425	8,905,676	7,884,657	10,778,747	862,082	1,193,276	(324,705)	48,537,158
Segment liabilities	10,201,822	11,442,964	12,097,717	5,982,655	609,072	-	(171,469)	40,162,761
Unallocated liabilities	-	-	-	-	-	505,953	-	505,953
Total liabilities	10,201,822	11,442,964	12,097,717	5,982,655	609,072	505,953	(171,469)	40,668,714

Comparative figures of 31 December 2017 were reclassified between operating segments for some loans. The Group enhanced its transfer pricing methodology as of 1 January 2018 and the transfer pricing income/expense across segments as at 31 December 2018 differs from 31 December 2017.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

35. Related parties balances

Related parties comprise key management, businesses controlled by shareholders and directors as well as businesses over which they exercise significant influence. During the year, the Group entered into transactions with related parties in the ordinary course of business. The transactions with related parties and balances arising from these transactions are as follows:

	2018 AED'000	2017 AED'000
<i>Transactions during the year</i>		
Interest income	7,522	464
Interest expense	55,755	31,160
Commission income	564	6,471
Directors' and key management personnel's remuneration and other expenses	28,487	27,570
	<u>28,487</u>	<u>27,570</u>
<i>Balances</i>		
<i>Loans and advances:</i>		
- Shareholders and their related companies	276,457	114,881
- Directors and their related companies	8,076	3,271
- Key management personnel	3,692	5,320
	<u>288,225</u>	<u>123,472</u>
<i>Deposits</i>		
- Shareholders and their related companies	2,047,914	2,563,879
- Directors and their related companies	5,344	5,757
- Key management personnel	16,525	11,777
	<u>2,069,783</u>	<u>2,581,413</u>
<i>Irrecoverable commitments and contingent liabilities and forward contracts</i>		
- Shareholders and their related companies	190,373	235,368
- Directors and their related companies	40	43
	<u>190,413</u>	<u>235,411</u>
<i>Insurance related receivables</i>		
Due from policy holders	12,580	13,690
<i>Insurance related payables</i>		
Due to policy holders	199	168

36. Fiduciary activities

The Bank holds assets in a fiduciary capacity for its customers without recourse. At 31 December 2018, such assets amounted to AED 1,945 million (2017: AED 1,963 million) and are excluded from the consolidated financial statements of the Group.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)****37. Legal proceedings**

The Bank is involved in various legal proceedings and claims arising in the ordinary course of business. While the outcome of these matters cannot be predicted with certainty, management does not believe that these matters will have a material adverse effect on the Bank's consolidated financial statements if settled unfavourably.

The Bank's subsidiary, RAKNIC in common with other insurance companies, is involved as defendant in a number of legal cases in respect of its underwriting activities. A provision is made in respect of each individual case where it is probable that the outcome would result in a loss to the Group in terms of an outflow of economic resources and a reliable estimate of the amount of outflow can be made.

38. Comparative figures

No items have been reclassified in the consolidated statement of financial position for the prior year ended 31 December 2017.

39. Financial risk management***Risk management review***

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

The Group's risk management policies are designed to identify and analyze these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Group regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

Credit risk

Credit risk is defined as the risk that the Group's customers, clients or counter parties 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 Group to suffer a financial loss.

Credit risk also arises through the downgrading of counter parties, whose credit instruments are held by the Group, thereby resulting in the value of the assets to fall. As credit risk is the Group's most significant risk, considerable resources, expertise and controls are devoted to managing this risk within the core departments of the Bank.

The Group's credit policy provides for the development of a systematic and consistent approach to identifying and managing borrower and counter party risks contained in all retail, business banking, and wholesale banking assets.

The Chief Credit Officer and team are responsible for recognition and management of credit risk both at transaction and portfolio levels and to ensure that risk procedures are adhered to in a manner consistent with the framework set out in the Credit Policy, Product Programs Guidelines, Credit circulars and comply with regulatory norms. The Credit risk management for Retail Loans is managed by the team within the Chief Risk Officer.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39. Financial risk management (continued)

Credit risk (continued)

The Group manages, limits and controls concentration of credit risk wherever it is identified - in particular, to individual counterparties and groups, and to industries and countries. The Group has a Product Program Guide that sets limits of exposure and lending criteria. The Group also has credit limits that set out the lending and borrowing limits to/from other banks.

The Group stratifies the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on an ongoing basis. Limits on the level of credit risk by product, industry sector and by country are approved by the Credit Committee and the Board of Directors.

The Group builds, validates and uses Credit Scoring tools that are populated by internally and externally derived historical data, forward looking models and behavioural models to assess counterparty risk on a customer and portfolio level for some of its Retail products.

Significant increase in credit risk

The Group monitors all financial assets that are subject to impairment requirements to assess whether there has been a significant increase in credit risk since initial recognition. If there has been a significant increase in credit risk, the Group will measure the loss allowance based on lifetime rather than 12-month ECL.

Internal credit risk ratings

In order to minimize credit risk, the Group has tasked its credit committee to develop and maintain the Group's credit risk grading to categorize exposures according to their degree of risk of default. The Group's credit risk grading framework comprises ten categories. The credit rating information is based on a range of data that is determined to be predictive of the risk of default and applying experienced credit judgement. The nature of the exposure and type of borrower are taken into account in the analysis. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default. The table below provides a mapping of the Group's internal credit risk grades to external ratings:

Group's Credit Risk Grades	Moody's Rating	Internal Description
1	Aaa	Low to fair risk
2+	Aa1	Low to fair risk
2	Aa2	Low to fair risk
2-	Aa3	Low to fair risk
3+	A1	Low to fair risk
3	A2	Low to fair risk
3-	A3	Low to fair risk
4+	Baa1	Low to fair risk
4	Baa2	Low to fair risk
4-	Baa3	Low to fair risk
5+	Ba1	Low to fair risk
5	Ba2	Low to fair risk
5-	Ba3	Low to fair risk
6+	B1	Medium
6	B2	Medium
6-	B3	Medium
7+	Caa1	Medium high
7	Caa2	Medium high
7-	Caa3	Monitoring
8	Default	Substandard
9	Default	Doubtful
10	Default	Loss

Notes to the consolidated financial statements for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Credit risk (continued)

Internal credit risk ratings (continued)

The credit risk grades are designed and calibrated to reflect the risk of default as credit risk deteriorates. As the credit risk increases the difference in risk of default between grades changes. Each exposure is allocated to a credit risk grade at initial recognition, based on the available information about the counterparty. All exposures are monitored and the credit risk grade is updated to reflect current information. The monitoring procedures followed are both general and tailored to the type of exposure.

The following data are typically used to monitor the Group's exposures:

- Payment record, including payment ratios and ageing analysis;
- Extent of utilization of granted limit;
- Forbearances (both requested and granted);
- Changes in business, financial and economic conditions;
- Credit rating information supplied by external rating agencies;
- For retail exposures: internally generated data of customer behaviour, affordability metrics etc.; and
- For corporate exposures: information obtained by periodic review of customer files including audited financial statements review, market data such as prices of credit default swaps (CDS) or quoted bonds where available, changes in the financial sector the customer operates etc.

The Group uses credit risk grades as a primary input into the determination of the term structure of the PD for exposures. The Group collects performance and default information about its credit risk exposures analyzed by jurisdiction or region and by type of product and borrower as well as by credit risk grading. The information used is both internal and external depending on the portfolio assessed.

The Group analyses the relevant delinquency data available and using a variety of statistical models then estimates the remaining lifetime PD of exposures and how these are expected to change over time. The factors taken into account in this process include macro-economic data such as Oil Price, Economic Complexity Index (ECI), inflation, real estate prices & vacancy rates, hotel occupancy rates and so on. The Group generates a 'base case' scenario of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios. The Group then uses these forecasts, which are probability-weighted, to adjust its estimates of PDs.

The Group uses different criteria to determine whether credit risk has increased significantly per portfolio of assets. The criteria used are both quantitative changes in PDs as well as qualitative, qualitative criteria includes but not limited to:

- Lag PD
- Average Oil prices and change in oil prices
- Abu Dhabi hotel room occupancy
- Change in economic composite indicator.

Loan commitments are assessed along with the category of loan the Group is committed to provide, i.e. commitments to provide mortgages are assessed using similar criteria to mortgage loans, while commitments to provide a corporate loan are assessed using similar criteria to corporate loans.

Irrespective of the outcome of the above assessment, the Group presumes that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due unless the Group has reasonable and supportable information that demonstrates otherwise.

The Group has monitoring procedures in place to make sure that the criteria used to identify significant increases in credit are effective, meaning that significant increase in credit risk is identified before the exposure is defaulted or when the asset becomes 30 days past due. The Group performs periodic back testing of its ratings to consider whether the drivers of credit risk that led to default were accurately reflected in the rating in a timely manner.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39. Financial risk management (continued)

Credit risk (continued)

Incorporation of forward-looking information

The Group uses forward-looking information that is available without undue cost or effort in its assessment of significant increase of credit risk as well as in its measurement of ECL. The Group employs experts who use external and internal information to generate a 'base case' scenario of future forecast of relevant economic variables along with a representative range of other possible forecast scenarios. The external information used includes economic data and forecasts published by governmental bodies and monetary authorities.

The Group applies probabilities to the forecast scenarios identified. The base case scenario is the single most-likely outcome and consists of information used by the Group for strategic planning and budgeting. The Group has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using a statistical analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses. The Group has not made changes in the estimation techniques or significant assumptions made during the reporting period.

The Group has performed a sensitivity analysis on how ECL on the main portfolios will change if the key assumptions used to calculate ECL change by 5%. The table below outlines the total ECL per portfolio as at 31 December 2018, if the assumptions used to measure ECL remain as expected (amount as presented in the statement of financial position), as well as if each of the key assumptions used change by plus or minus 5%. The changes are applied in isolation for illustrative purposes, and are applied to each probability-weighted scenarios used to develop the estimate of expected credit losses. In reality, there will be interdependencies between the various economic inputs and the exposure to sensitivity will vary across the economic scenarios:

		Average PD (Stage 1)	Average PD (Stage 2)	Average LGD	ECL
<i>Loans and advances - auto</i>					
	As expected	3.50%	59.31%	46.06%	64,915
Average Oil Prices (Quarter 3 lag)	+ [5]%	3.40%	57.64%	46.06%	63,952
	- [5]%	3.59%	60.95%	46.06%	65,876
	As expected	3.50%	59.31%	46.06%	64,915
Average Oil Prices YOY Change (Quarter 3 lag)	+ [5]%	3.47%	58.87%	46.06%	64,660
	- [5]%	3.52%	59.74%	46.06%	65,169
<i>Loans and advances - credit cards</i>					
	As expected	2.66%	69.06%	74.84%	288,314
Average Oil Prices (Quarter 1 lag)	+ [5]%	2.63%	68.20%	74.84%	286,851
	- [5]%	2.69%	69.92%	74.84%	289,776
<i>Loans and advances - expat</i>					
	As expected	3.87%	69.36%	85.21%	283,511
Non-Oil ECI Quarterly YOY Change (Quarter 2 lag)	+ [5]%	3.79%	67.37%	85.21%	278,775
	- [5]%	3.96%	71.35%	85.21%	288,237
<i>Loans and advances - mortgage</i>					
	As expected	1.29%	44.80%	13.80%	67,475
ECI Quarterly YOY Change (Quarter 3 lag)	+ [5]%	1.27%	43.97%	13.80%	67,157
	- [5]%	1.31%	45.62%	13.80%	67,793
<i>Loans and advances - national</i>					
	As expected	2.49%	65.98%	67.54%	157,166
Abu Dhabi Hotel Room Occupancy (Quarter 2 lag)	+ [5]%	2.22%	59.73%	67.54%	145,050
	- [5]%	2.76%	72.05%	67.54%	169,044
<i>Loans and advances - R&A finance</i>					
	As expected	7.44%	79.29%	90.41%	670,356
Average Oil Prices (Quarter 2 lag)	+ [5]%	7.32%	77.99%	90.41%	662,956
	- [5]%	7.57%	80.58%	90.41%	677,755

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39. Financial risk management (continued)

Credit risk (continued)

Measurement of ECL

The key inputs used for measuring ECL are:

- Probability of default (PD);
- Loss given default (LGD); and
- Exposure at default (EAD).

As explained above these figures are generally derived from internally developed statistical models and other historical data and they are adjusted to reflect probability-weighted forward-looking information.

PD is an estimate of the likelihood of default over a given time horizon. It is estimated as at a point in time. The calculation is based on statistical rating models, and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models are based on market data (where available), as well as internal data comprising both quantitative and qualitative factors. PDs are estimated considering the contractual maturities of exposures and estimated prepayment rates. The estimation is based on current conditions, adjusted to take into account estimates of future conditions that will impact PD.

LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from any collateral. The LGD models for secured assets consider forecasts of future collateral valuation taking into account sale discounts, time to realization of collateral, cross-collateralization and seniority of claim, cost of realization of collateral and cure rates (i.e. exit from non-performing status). LGD models for unsecured assets consider time of recovery, recovery rates and seniority of claims. The calculation is on a discounted cash flow basis, where the cash flows are discounted by the original EIR of the loan. Regulatory LGDs are taken for portfolios with limited historic data and low default portfolios.

EAD is an estimate of the current exposure for funded facilities. For non-funded facilities the EAD is taken as the product of the applicable credit conversion factors and contract values. Exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities. The Group's modelling approach for EAD reflects expected changes in the balance outstanding over the lifetime of the loan exposure that are permitted by the current contractual terms, such as amortization profiles, early repayment or overpayment, changes in utilization of undrawn commitments and credit mitigation actions taken before default. The Group uses EAD models that reflect the characteristics of the portfolios.

The Group measures ECL considering the risk of default over the maximum contractual period (including extension options) over which the entity is exposed to credit risk and not a longer period, even if contact extension or renewal is common business practice. However, for financial instruments such as credit cards, revolving credit facilities and overdraft facilities that include both a loan and an undrawn commitment component, the Group's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Group's exposure to credit losses to the contractual notice period. For such financial instruments the Group measures ECL over the period that it is exposed to credit risk and ECL would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. These financial instruments do not have a fixed term or repayment structure and have a short contractual cancellation period. However, the Group does not enforce in the normal day-to-day management the contractual right to cancel these financial instruments. This is because these financial instruments are managed on a collective basis and are cancelled only when the Group becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Group expects to take to mitigate ECL, e.g. reduction in limits or cancellation of the loan commitment.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39. Financial risk management (continued)

Credit risk (continued)

Groupings based on shared risks characteristics

When ECL are measured on a collective basis, the financial instruments are grouped based on shared risk characteristics, such as:

- Instrument type;
- Credit risk grade;
- Collateral type;

The groupings are reviewed on a regular basis to ensure that each group is comprised of homogenous exposures.

The Group uses external benchmark information for portfolios with limited historical data and for low default portfolios where there is no instances of historical default.

The Group has in place policies, which govern the determination of eligibility of various collaterals including credit protection, to be considered for credit risk mitigation, which includes the minimum operational requirements that are required for the specific collateral to be considered as effective risk mitigating. The Group's major collaterals are mortgaged properties, investments, vehicles & other registerable assets.

The collateral is valued periodically ranging from quarterly to annually, depending on the type of collateral. Specifically for mortgaged property, a framework for valuation of mortgaged properties is established to ensure adequate policies and procedures are in place for efficient and proper conduct of valuation of mortgaged properties and other related activities in relation to the interpretation, monitoring and management of valuation of mortgaged properties.

Maximum exposure to credit risk before collateral held or other credit enhancements

	Maximum exposure	
	2018	2017
	AED'000	AED'000
<i>Credit risk exposures relating to on-balance sheet assets are as follows:</i>		
Due from other banks	4,755,542	3,799,239
Loans and advances	32,860,662	32,240,193
Insurance contract assets and receivables	294,926	345,125
Customer acceptances	561,704	171,307
Investment securities	7,189,133	5,568,749
Other assets	499,459	369,152
<i>Credit risk exposures relating to off-balance sheet items are as follows:</i>		
Loan commitments and other off balance sheet items	3,551,837	1,816,223
	49,713,263	44,309,988

The above table represents a worst case scenario of credit risk exposure to the Group at 31 December 2018 and 2017 without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the consolidated statement of financial position.

As can be seen above, the most significant exposures arise from loans and advances to customers (including commitments) and amounts due from banks.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39. Financial risk management (continued)

Credit risk (continued)

Maximum exposure to credit risk before collateral held or other credit enhancements (continued)

Management is confident in its ability to continue to control and minimise the loss arising from its exposure to credit risk resulting from its loans and advances portfolio, investment securities portfolio and amounts due from banks based on the following:

- Mortgage loans, loan against investments, asset based finance, property loans and auto loans, which are backed by collateral together, a significant portion 28% (2017: 29%) of loans and advances.
- 7.6% (2017: 7.5%) of the loans comprise of restructured loans, where the Group has aligned its lending rates to current prevailing market lending rates and extended or modified payment arrangements to manage credit risk. 77.1% (2017: 81%) of these restructured loans are performing loans.
- The Bank continuously reviews its credit and credit underwriting policies and changes are made based on the Management Information System (MIS) reports and the patterns that emerge from these reports.

A significant portion of investment securities comprise debt instruments that are issued by government, reputable quasi-government organisations and financial institutions.

Amounts due from banks

The Group held amounts due from banks of AED 4,755 million (2017: AED 3,799 million) which represents its maximum credit exposure on these assets. The balance due from banks includes AED 563.1 million (2017: AED 944.5 million) placements with banks, banker's acceptances of AED 2,013 million (2017: AED 1,807 million) and syndicated loans of AED 1,475 million (2017: 701 million). Remaining balances due from banks and other financial institutions are held with reputable organisations within and outside UAE, where the risk of default is considered low. Bank has provided AED 31.1 million for expected credited loss under IFRS 9 for due from banks.

Investment securities

Investment securities comprise debt securities issued by the Government, organisations which are quasi-governmental and local and foreign reputable organisations.

The table below presents an analysis of debt securities by rating agency designation at 31 December 2018 and 2017, based on Moody's, Standard and Poor's and Fitch ratings or their equivalent:

	2018 AED'000	2017 AED'000
AA to AA-	756,441	610,949
A+ to A-	1,114,229	829,323
BBB+ to BBB-	2,033,557	2,229,012
BB+ to BB	779,922	395,619
B+ to B-	1,534,960	697,687
CCC	14,546	18,574
Unrated	718,999	680,543
	<u>6,952,654</u>	<u>5,461,707</u>

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39. Financial risk management (continued)

Credit risk (continued)

Concentration of risks of financial assets with credit risk exposure

Concentrations arise 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 Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to limit concentrations of exposures to counterparties, geographies and industries. Identified concentration of credit risk is controlled and managed accordingly.

Geographical risk concentration

The following table breaks down the Group's credit exposures at their carrying amounts, categorised by geographical region as of 31 December 2018 and 2017.

For this table, the Group has allocated exposures to regions based on the country of domicile of its counterparties:

On balance sheet items

	UAE AED'000	OECD AED'000	Others AED'000	Provision for credit loss AED'000	Total AED'000
31 December 2018					
Due from other banks, net	715,691	740,515	3,330,476	(31,140)	4,755,542
Loans and advances, net	29,680,320	699,300	4,447,654	(1,966,612)	32,860,662
Insurance contract assets, net	332,959	1,662	5,910	(45,605)	294,926
Customer acceptances	537,545	-	24,159	-	561,704
Investment securities, net	2,893,266	288,534	4,045,358	(38,025)	7,189,133
Other assets	499,459	-	-	-	499,459
Total	34,659,240	1,730,011	11,853,557	(2,081,382)	46,161,426
31 December 2017					
Due from other banks	220,742	925,317	2,653,180	-	3,799,239
Loans and advances - net	31,574,466	191,348	1,469,550	(995,171)	32,240,193
Insurance contract assets	314,523	-	30,602	-	345,125
Customer acceptances	170,290	-	1,017	-	171,307
Investment securities	2,372,040	321,377	2,875,332	-	5,568,749
Other assets	369,152	-	-	-	369,152
Total	35,021,213	1,438,042	7,029,681	(995,171)	42,493,765

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Credit risk (continued)

Concentration of risks of financial assets with credit risk exposure (continued)

Off balance sheet items:

	UAE AED'000	OECD AED'000	Others AED'000	Total AED'000
31 December 2018				
Credit commitments	1,830,479	-	189,925	2,020,404
Letter of credits and guarantees	1,413,717	8,467	109,249	1,531,433
	<u>3,244,196</u>	<u>8,467</u>	<u>299,174</u>	<u>3,551,837</u>
31 December 2017				
Credit commitments	531,959	-	1,174	533,133
Letter of credits and guarantees	1,102,234	24,992	155,864	1,283,090
	<u>1,634,193</u>	<u>24,992</u>	<u>157,038</u>	<u>1,816,223</u>

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

*Credit risk (continued)**Concentration of risks of financial assets with credit risk exposure (continued)**Geographical risk concentration*

The following table breaks down the Bank's credit exposures on loans and advances, investment securities, due from other banks and off balance sheet items categorised by industry as of 31 December 2018 and 2017:

	On balance sheet items						Total AED'000
	Loans and advances AED'000	Investment securities AED'000	Due from other banks AED'000	Total funded AED'000	Off balance sheet items AED'000	Total AED'000	
31 December 2018							
Agriculture, fishing & related activities	6,732	=	-	6,732	156	6,888	
Crude oil, gas, mining & quarrying	4,779	=	-	4,779	221,517	226,296	
Manufacturing	1,124,634	390,579	-	1,515,213	1,000	1,516,213	
Electricity & water	14,192	520,087	=	534,279	125	534,404	
Construction and real estate	1,905,946	661,087	=	2,567,033	691,514	3,258,547	
Trading	4,924,691	=	-	4,924,691	568,337	5,493,028	
Transport, storage & communication	905,915	589,169	-	1,495,084	20,116	1,515,200	
Financial institutions	1,164,144	1,863,935	4,786,682	7,814,761	695,811	8,510,572	
Services	3,661,688	456,244	=	4,117,932	15,749	4,133,681	
Government	2,644,447	2,746,057	-	5,390,504	377,105	5,767,609	
Retail and consumer banking	18,470,106	=	-	18,470,106	960,407	19,430,513	
Total exposures	34,827,274	7,227,158	4,786,682	46,841,114	3,551,837	50,392,951	
Provision for expected credit loss	(1,966,612)	(38,025)	(31,140)	(2,035,777)	(7,862)	(2,043,639)	
Net exposures	32,860,662	7,189,133	4,755,542	44,805,337	3,543,975	48,349,312	

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

*Credit risk (continued)**Concentration of risks of financial assets with credit risk exposure (continued)**Geographical risk concentration (continued)*

	On balance sheet items					Total AED'000
	Loans and advances AED'000	Investment securities AED'000	Due from other banks AED'000	Total funded AED'000	Off balance sheet items AED'000	
<i>31 December 2017</i>						
Agriculture, fishing & related activities	28	-	-	28	156	184
Crude oil, gas, mining & quarrying	7,656	-	-	7,656	192	7,848
Manufacturing	1,266,092	185,036	-	1,451,128	56,064	1,507,192
Electricity & water	12,871	423,891	-	436,762	1,218	437,980
Construction and real estate	1,392,633	484,934	-	1,877,567	191,977	2,069,544
Trading	5,441,298	-	-	5,441,298	234,589	5,675,887
Transport, storage & communication	1,010,054	503,954	-	1,514,008	16,519	1,530,527
Financial institutions	1,425,348	1,737,474	3,799,239	6,962,061	333,065	7,295,126
Services	3,399,992	556,748	-	3,956,740	205,110	4,161,850
Government	1,842,282	1,676,712	-	3,518,994	214,960	3,733,954
Retail and consumer banking	17,437,110	-	-	17,437,110	562,373	17,999,483
Total exposures.	33,235,364	5,568,749	3,799,239	42,603,352	1,816,223	44,419,575
Provision for credit loss	(995,171)	-	-	(995,171)	-	(995,171)
Net exposures	32,240,193	5,568,749	3,799,239	41,608,181	1,816,223	43,424,404

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Credit risk (continued)

Credit quality

The Group monitors credit risk per class of financial instrument. The table below outlines the classes identified, as well as the financial statement line item and the note that provides an analysis of the items included in the financial statement line for each class of financial instrument:

<i>Class of financial instrument</i>	<i>Notes</i>
Due from other banks	5
Loans and advances	6
Investment securities	7
Insurance contract assets and receivables	8

An analysis of the Group's credit risk exposure without taking into account the effects of any collateral or other credit enhancements is provided in the following tables. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively:

	2018			Total AED'000	2017 Total* AED'000
	Stage 1 12-month ECL AED'000	Stage 2 Lifetime ECL AED'000	Stage 3 Lifetime ECL AED'000		
Total					
Low to medium risk	43,136,398	3,437,346	37,885	46,611,629	40,641,698
Monitoring	178	1,783,247	3,362	1,786,787	1,831,134
Substandard	-	-	228,072	228,072	330,036
Doubtful	-	-	278,289	278,289	262,119
Loss	-	-	1,238,604	1,238,604	932,882
Total gross carrying amount	43,136,576	5,220,593	1,786,212	50,143,381	43,997,869
Loss allowance	(825,579)	(437,372)	(826,293)	(2,089,244)	(995,171)
Carrying amount	42,310,997	4,783,221	959,919	48,054,137	43,002,698

*This loss allowance represents the impairment provision as per IAS 39 (before restatement).

Expected credit loss allowance

A summary of the provision for credit loss and the net movement on financial instruments by category are as follows:

	1 January 2018 as restated AED 000	Net charge during the year AED 000	Other movement during the year AED 000	31 December 2018 AED 000
Due from other banks	19,693	11,447	-	31,140
Loans and advances	1,907,646	1,507,990	(1,449,024)	1,966,612
Investment securities	19,960	18,065	-	38,025
Insurance contract assets and receivables	51,945	(5,553)	(787)	45,605
Customer acceptances	1,226	(975)	-	251
Financial guarantees and letters of credit	1,643	5,968	-	7,611
Total	2,002,113	1,536,942	(1,449,811)	2,089,244

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Credit risk (continued)

Credit quality (continued)

Expected credit loss allowance (continued)

The tables below analyse the movement of the provision for credit loss during the year per class of financial assets:

▪ *Due from other banks*

	Stage 1 12-month ECL AED'000	Stage 2 Lifetime ECL AED'000	Stage 3 Lifetime ECL AED'000	Total AED'000
Loss allowance as at 31 December 2017	-	-	-	-
Restatement of the prior year	18,651	1,042	-	19,693
Loss allowance as at 1 January 2018	18,651	1,042	-	19,693
<i>Changes in the loss allowance:</i>				
- Transfer from stage 1	(238)	238	-	-
- Transfer from stage 2	-	-	-	-
- Transfer from stage 3	-	-	-	-
- Increases/(decreases) in provisions	4,834	510	-	5,344
Net change in financial assets originated, purchased and derecognised	5,616	487	-	6,103
Loss allowance as at 31 December 2018	28,863	2,277	-	31,140

▪ *Loans and advances*

	Stage 1 12-month ECL AED'000	Stage 2 Lifetime ECL AED'000	Stage 3 Lifetime ECL AED'000	Total AED'000
Loss allowance as at 1 January 2018, as restated	602,130	631,335	674,181	1,907,646
<i>Changes in the loss allowance:</i>				
- Transfer from stage 1	(34,190)	17,808	16,382	-
- Transfer from stage 2	57,209	(114,648)	57,439	-
- Transfer from stage 3	2,010	2,410	(4,420)	-
- Increases/(decrease) due to change in credit risk	(169,518)	140,061	415,726	386,269
Net change in financial assets originated and derecognised	131,295	(163,644)	(294,954)	(327,303)
Loss allowance as at 31 December 2018	588,936	513,322	864,354	1,966,612

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Credit risk (continued)

Credit quality (continued)

Expected credit loss allowance (continued)

▪ *Investment securities*

	Stage 1 12-month ECL AED'000	Stage 2 Lifetime ECL AED'000	Stage 3 Lifetime ECL AED'000	Total AED'000
Loss allowance as at 31 December 2017	-	-	-	-
Restatement of the prior year	10,391	9,569	-	19,960
Loss allowance as at 1 January 2018	10,391	9,569	-	19,960
<i>Changes in the loss allowance:</i>				
- Transfer from stage 1	(358)	358	-	-
- Transfer from stage 2	-	-	-	-
- Transfer from stage 3	-	-	-	-
- Increases due to change in credit risk	1,059	9,664	-	10,723
Net change in financial assets originated, purchased and derecognised	6,351	991	-	7,342
Loss allowance as at 31 December 2018	17,443	20,582	-	38,025

▪ *Insurance contracts and other receivables*

	Stage 1 12-month ECL AED'000	Stage 2 Lifetime ECL AED'000	Stage 3 Lifetime ECL AED'000	Total AED'000
Loss allowance as at 31 December 2017	-	-	-	-
Restatement of the prior year	51,945	-	-	51,945
Loss allowance as at 1 January 2018	51,945	-	-	51,945
<i>Changes in the loss allowance:</i>				
- Transfer from stage 1	-	-	-	-
- Transfer from stage 2	-	-	-	-
- Transfer from stage 3	-	-	-	-
- Decrease due to change in credit risk	(6,340)	-	-	(6,340)
Net change in financial assets originated, purchased and derecognised	-	-	-	-
Loss allowance as at 31 December 2018	45,605	-	-	45,605

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Credit risk (continued)

Credit quality (continued)

Expected credit loss allowance (continued)

▪ *Customer acceptances*

	Stage 1 12-month ECL AED'000	Stage 2 Lifetime ECL AED'000	Stage 3 Lifetime ECL AED'000	Total AED'000
Loss allowance as at 31 December 2017	-	-	-	-
Restatement of the prior year	1,121	105	-	1,226
Loss allowance as at 1 January 2018	1,121	105	-	1,226
<i>Changes in the loss allowance:</i>				
- Transfer from stage 1	-	-	-	-
- Transfer from stage 2	-	-	-	-
- Transfer from stage 3	-	-	-	-
- Decrease due to change in credit risk	(137)	6	-	(131)
Net change in financial assets originated, purchased and derecognised	(750)	(94)	-	(844)
Loss allowance as at 31 December 2018	234	17	-	251

▪ *Financial guarantees and letters of credit*

	Stage 1 12-month ECL AED'000	Stage 2 Lifetime ECL AED'000	Stage 3 Lifetime ECL AED'000	Total AED'000
Loss allowance as at 31 December 2017	-	-	-	-
Restatement of the prior year	1,437	146	60	1,643
Loss allowance as at 1 January 2018	1,437	146	60	1,643
<i>Changes in the loss allowance</i>				
- Transfer from stage 1	(81)	47	34	-
- Transfer from stage 2	-	(17)	17	-
- Transfer from stage 3	-	-	-	-
- Decrease due to change in credit risk	(497)	777	18	298
Net change in financial assets originated, purchased and derecognised	4,510	1,198	(38)	5,670
Loss allowance as at 31 December 2018	5,369	2,151	91	7,611

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39. Financial risk management (continued)

Credit risk (continued)

Credit quality (continued)

Restructured loans and advances

Restructuring activities include interest rate adjustments, extended payment arrangements and modification of payments. The majority of restructuring activity is undertaken to improve cash flow and is within the terms and conditions of the Group's product programme guideline. These policies are kept under continuous review. The Group has reviewed the entire portfolio and reported only restructured loans with financial difficulties under this note. The group has a full-fledged Collections and Recovery Unit that follow-up with overdue/delinquent customers for regularising the loan/advances. The table below presents loans restructured during the year 2018 and 2017.

Restructured loans during the year:

Product	2018		2017	
	No of accounts	Loan amount AED'000	No of accounts	Loan amount AED'000
Personal loans	715	325,597	1,275	694,061
Mortgage loans	10	28,790	10	19,706
Credit cards	4,503	170,758	7,826	323,643
Auto loans	425	26,613	1,122	91,247
Small and medium business banking loans	153	100,393	165	108,100
Wholesale banking loans	21	162,651	20	76,469
RAK finance business loans	671	418,687	716	356,028
Total	6,498	1,233,489	11,134	1,669,254

The table below presents restructured loan portfolio outstanding as at 31 December:

Product	2018		2017	
	No of accounts	Loan amount AED'000	No of accounts	Loan amount AED'000
Personal loans	2,157	1,009,500	2,209	1,073,681
Mortgage loans	75	173,814	67	154,258
Credit cards	9,526	284,288	9,657	317,345
Auto loans	1,549	78,488	2,123	131,790
Small and medium business loans	305	193,513	219	132,843
Wholesale banking loans	54	297,349	46	170,678
RAK finance business loans	1,185	601,085	1,175	526,756
Total	14,851	2,638,037	15,496	2,507,351

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39. Financial risk management (continued)

Credit risk (continued)

Collateral held as security and other credit enhancements

The Group holds collateral or other credit enhancements to mitigate credit risk associated with financial assets. The main types of collateral and the types of assets these are associated with are listed in the table below. The collateral presented relates to instruments that are measured at FVOCI, amortized cost and at FVTPL.

	<i>Type of collateral held</i>
Derivative asset	Fixed Deposit/Cash Margin
Loans and advances to banks	Letter of Comfort/Export Bills
Mortgage lending	Mortgage over Property
Corporate lending	Fixed Deposit/Cash Margin; Mortgage over Properties/Vehicles; Bank Guarantee/SBLC; Pledge of Shares; Stocks and Receivables etc.
Investment securities	Underlying investments

In addition to the collateral included in the table above, the Group holds other types of collateral and credit enhancements, such as second charges and floating charges for which specific values are not generally available.

There was no change in the Group's collateral policy during the year. More details with regards to collateral held for certain classes of financial assets can be found below.

Mortgage lending

The Group holds residential properties as collateral for the mortgage loans it grants to its customers. The Group monitors its exposure to retail mortgage lending using the LTV ratio, which is calculated as the ratio of the gross amount of the loan – or the amount committed for loan commitments – to the value of the collateral. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for residential mortgage loans is typically based on the collateral value at origination updated based on changes in house price indices. For credit-impaired loans the value of collateral is based on the most recent appraisals.

Personal lending

The Group's personal lending portfolio consists of secured loans, unsecured loans and credit cards.

Corporate lending

The Group requests collateral and guarantees for corporate lending. The most relevant indicator of corporate customers' creditworthiness is an analysis of their financial performance and their liquidity, advantage, management effectiveness and growth ratios. The valuation of collateral held against corporate lending, after initial approval, is updated once every two years for a performing asset. The valuation of such collateral is monitored more closely if the loan is put on "watch-list".

Repossessed collateral

The Group occasionally takes possession of mortgaged property which is held as collateral for loans. During the year 2018, the Group did not acquire of any mortgaged property. The Group had directly auctioned mortgaged properties without taking possession of the property, the realised amount of auctioned properties during the year 2018 was AED 20.5 million (2017 : AED 43.6 million). In the case of retail auto loans and wholesale banking asset based finance where the underlying asset is repossessed as a part of recovery process, these are disposed of in an auction by authorised third parties and the Bank does not carry any such assets in its books.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39. Financial risk management (continued)

Market risk

The Group takes on exposure to market risk, 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, currency and equity instruments, 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, foreign exchange rates and equity prices.

The Asset and Liability Committee (ALCO) is chaired by the Chief Executive Officer and comprises the Divisional heads of Finance, Treasury, Risk, Operations, Wholesale Banking, Business Banking and Retail Banking. It meets on a regular basis to monitor and manage market risk.

ALCO is responsible for formalising the Group's key financial indicators and ratios, sets the thresholds to manage and monitor the market risk and also analyses the sensitivity of the Group's interest rate and maturity mis-matches. ALCO also guides the Group's investment decisions and provides guidance in terms of interest rate and currency movements.

Market Risk and Treasury Mid Office functions with Risk Management are responsible for day to day monitoring of Market risk exposures within Board approved Policies and Market Risk Appetite.

The exposures to derivatives includes forward exchange contracts, Option Contracts and Interest Rate Swaps which are entered to meet customer needs and covered back to back in the interbank market. Further the Group has executed some interest rate swaps and a Cross Currency Swap for economic hedging purposes. Also, the Group has executed some derivatives on proprietary books within Board approved Risk Limits for Trading.

Group's proprietary Investments are managed according to the group's Investments Policy approved by the Investment Committee.

Price risk

The Group is exposed to price risk as a result of its holdings in debt securities classified as fair value through OCI in investment securities. The fair values of investments quoted in active markets are based on current mid prices. Senior Management meets regularly to discuss the return on investment and concentration across the Group's investment portfolio and manages the risk through diversification in terms of Counterparty, Country Industry and Rating.

The sensitivity analysis for price risk illustrates how changes in the fair value of securities held by the Group will fluctuate because of changes to market prices whether those changes are caused by factors specific to the individual issuer, or factors affecting all similar securities traded in the market.

Interest rate risk

Cash flow interest risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest. 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 Group takes on exposure 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 Group monitors interest rate risk through the use of a detailed Interest Reprice gap report and Net Interest Income (NII) and Economic Value of Equity (EVE) based sensitivity analysis to analyse the impact of anticipated movements in interest rates. The Group has a Risk Appetite limits for Interest rate risk shocks on the Group's Net Interest Income.

Financial assets that are not subject to any interest-rate risk mainly comprise investments in Subsidiaries, Equity investments, cash, balances with central banks excluding certificates of deposit.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Market risk (continued)

Interest rate risk (continued)

The Group is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The table below sets out the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates:

At 31 December 2018	Less than 3 months AED'000	3 months to 1 year AED'000	1 - 3 years AED'000	3 - 5 years AED'000	Over 5 years AED'000	Non-interest bearing AED'000	Total AED'000
Assets							
Cash and balances with the UAE Central Bank	450,000	100,000	-	-	-	4,397,996	4,947,996
Due from other banks, net	2,825,791	1,849,721	65,000	25,000	-	(9,970)	4,755,542
Loans and advances, net	17,327,706	5,406,828	7,136,267	2,205,456	3,018,261	(2,233,856)	32,860,662
Investment securities, net	455,205	531,231	1,046,102	1,813,618	3,106,498	236,479	7,189,133
Insurance contract assets and receivables, net	-	-	-	-	-	388,594	388,594
Goodwill, customer acceptances, property and equipment and other assets	-	-	-	-	-	2,542,013	2,542,013
Total	21,058,702	7,887,780	8,247,369	4,044,074	6,124,759	5,321,256	52,683,940
Liabilities and shareholders' equity							
Due to other banks	3,278,332	1,103,130	-	-	-	-	4,381,462
Deposits from customers	18,437,905	5,652,749	740,611	171	-	9,308,348	34,139,784
Debt securities in issued and other long term borrowings ¹	1,985,012	2,841,093	-	-	-	-	4,826,105
Insurance contract liabilities and payables	-	-	-	-	-	511,395	511,395
Other liabilities and customer acceptances	-	-	-	-	-	1,665,219	1,665,219
Shareholders' equity	-	-	-	-	-	7,159,975	7,159,975
Total	23,701,249	9,596,972	740,611	171	-	18,644,937	52,683,940
Interest rate sensitivity gap	(2,642,547)	(1,709,192)	7,506,758	4,043,903	6,124,759	(13,323,681)	-

¹The Group has converted the fixed rate debt securities issued into a floating rate using an interest rate swap.

Notes to the consolidated financial statements for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

*Market risk (continued)**Interest rate risk (continued)*

	Less than 3 months AED'000	3 months to 1 year AED'000	1 - 3 years AED'000	3 - 5 years AED'000	Over 5 years AED'000	Non -interest bearing AED'000	Total AED'000
<i>At 31 December 2017</i>							
Assets							
Cash and balances with the UAE Central Bank	500,000	-	-	-	-	4,240,566	4,740,566
Due from other banks	2,236,602	1,393,217	143,354	25,000	-	1,066	3,799,239
Loans and advances, net	14,440,336	5,715,377	7,198,804	2,384,005	3,687,788	(1,186,117)	32,240,193
Investment securities	171,387	301,029	792,221	1,211,155	2,985,915	107,042	5,568,749
Insurance contract assets and receivables	-	-	-	-	-	424,897	424,897
Goodwill, customer acceptances, property and equipment and other assets	-	-	-	-	-	1,763,514	1,763,514
Total	17,348,325	7,409,623	8,134,379	3,620,160	6,673,703	5,350,968	48,537,158
Liabilities and shareholders' equity							
Due to other banks	2,488,235	231,888	44,076	-	-	-	2,764,199
Deposits from customers	16,349,213	6,000,516	679,486	20	-	9,146,639	32,175,874
Debt securities issued and other long term borrowings	1,458,431	-	2,710,871	-	-	-	4,169,302
Insurance contract liabilities and payables	-	-	-	-	-	516,991	516,991
Other liabilities and customer acceptances	-	-	-	-	-	1,042,348	1,042,348
Shareholders' equity	-	-	-	-	-	7,868,444	7,868,444
Total	20,295,879	6,232,404	3,434,433	20	-	18,574,422	48,537,158
Interest rate sensitivity gap	(2,947,554)	1,177,219	4,699,946	3,620,140	6,673,703	(13,223,454)	-

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Market risk (continued)

Interest rate risk (continued)

Interest rate risk is assessed by measuring the impact of reasonable possible change in interest rate movements. The Group assumes a fluctuation in interest rates of 25 basis points (bps) and estimates the following impact on the net profit for the year and net assets at that date:

	2018 AED'000	2017 AED'000
Fluctuation in interest rates by 25 bps	<u>34,829</u>	<u>29,392</u>

The interest rate sensitivities set out above are worst case scenarios and employ simplified calculations. They are based on the gap between AED 28,946 million (2017: AED 24,758 million) of interest bearing assets with maturities within one year and AED 42,607 million (2017: AED 26,528 million) of interest bearing liabilities with maturities within one year. The sensitivity does not incorporate actions that could be taken by management to mitigate the effect of interest rate movements.

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. Positions are closely monitored and strategies are used to ensure positions are maintained within established limits.

The Group's assets are typically funded in the same currency as that of the business transacted in order to eliminate foreign exchange exposure. However, the Group does maintain a US dollar open position within limits approved by the Bank's ALCO.

At 31 December 2018, the Bank had the following net exposures denominated in AED and foreign currencies:

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Market risk (continued)

Currency risk (continued)

On balance sheet items

	AED AED'000	USD AED'000	Others AED'000	Total AED'000
At 31 December 2018				
Assets				
Cash and balances with the UAE Central Bank	4,222,931	724,223	842	4,947,996
Due from other banks	456,876	3,903,932	394,734	4,755,542
Loans and advances	27,568,227	5,281,679	10,756	32,860,662
Insurance contract assets	294,926	-	-	294,926
Investment securities	178,487	6,401,711	608,935	7,189,133
Customer acceptances	40,965	515,379	5,360	561,704
Other assets	382,576	115,404	1,479	499,459
Total assets	33,144,988	16,942,328	1,022,106	51,109,422
Liabilities				
Due to other banks	1,166,300	2,534,411	680,751	4,381,462
Deposits from customers	25,675,510	5,886,821	2,577,453	34,139,784
Debt securities in issue and other long term borrowings	-	4,826,105	-	4,826,105
Insurance contract liabilities and payables	511,395	-	-	511,395
Customer acceptances	40,965	515,379	5,360	561,704
Other liabilities	86,009	60,825	21,265	168,099
Total liabilities	27,480,179	13,823,541	3,284,829	44,588,549
Net position of financial instruments	5,664,809	3,118,787	(2,262,723)	6,520,873

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39. Financial risk management (continued)

Market risk (continued)

Currency risk (continued)

On balance sheet items (continued)

	AED AED'000	USD AED'000	Others AED'000	Total AED'000
At 31 December 2017				
Assets				
Cash and balances with the UAE Central Bank	4,186,749	552,793	1,024	4,740,566
Due from other banks	220,448	3,313,430	265,361	3,799,239
Loans and advances	27,228,751	4,819,105	192,337	32,240,193
Insurance contract assets	345,125	-	-	345,125
Investment securities	65,825	5,322,373	180,551	5,568,749
Customer acceptances	18,704	150,221	2,382	171,307
Other assets	288,129	79,588	1,435	369,152
Total assets	32,353,731	14,237,510	643,090	47,234,331
Liabilities				
Due to other banks	255,000	2,367,344	141,855	2,764,199
Deposits from customers	26,550,648	4,976,740	648,486	32,175,874
Debt securities in issue and other long term borrowings	-	4,169,302	-	4,169,302
Insurance contract liabilities and payables	516,991	-	-	516,991
Customer acceptances	18,704	150,221	2,382	171,307
Other liabilities	661,865	98,605	3,090	763,560
Total liabilities	28,003,208	11,762,212	795,813	40,561,233
Net position of financial instruments	4,350,523	2,475,298	(152,723)	6,673,098

The Group has no significant exposure to foreign currency risk as its functional currency is pegged to the USD, the currency in which the Bank has the largest net open position at 31 December 2018 and 2017. All currency positions are within limits laid down by ALCO.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Market risk (continued)

Currency risk (continued)

Off-balance sheet items

	AED AED'000	USD AED'000	Others AED'000	Total AED'000
<i>At 31 December 2018</i>				
Credit commitments	1,545,526	474,878	-	2,020,404
Letter of credit and guarantees	782,530	713,226	35,677	1,531,433
Total	2,328,056	1,188,104	35,677	3,551,837
<i>At 31 December 2017</i>				
Credit commitments	533,133	-	-	533,133
Letter of credit and guarantees	755,699	455,083	72,308	1,283,090
Total	1,288,832	455,083	72,308	1,816,223

Foreign exchange contracts

	AED AED'000	USD AED'000	Others AED'000	Total AED'000
<i>At 31 December 2018</i>				
Foreign exchange contracts	1,968,392	4,050,403	4,757,399	10,776,194
Interest rate swaps	755,903	5,316,961	-	6,072,864
Other derivatives	650,000	3,486,281	-	4,136,281
Total	3,374,295	12,853,645	4,757,399	20,985,339
<i>At 31 December 2017</i>				
Foreign exchange contracts	1,931,553	1,644,654	1,262,575	4,838,782
Interest rate swaps	-	3,856,482	-	3,856,482
Other derivatives	84,541	3,365,020	-	3,449,561
Total	2,016,094	8,866,156	1,262,575	12,144,825

Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its obligations when they fall due as a result of customer deposits being withdrawn, cash requirements from contractual commitments, or other cash outflows, such as debt maturities. Such outflows would deplete available cash resources for customer lending, trading activities and investments. In extreme circumstances, lack of liquidity could result in reductions in the balance sheet and sales of assets, or potentially an inability to fulfil lending commitments. The risk that the Group will be unable to do so is inherent in all banking operations and can be affected by a range of institution-specific and market-wide events including, but not limited to, credit events, systemic shocks and natural disasters.

Liquidity risk management process

The Group manages its liquidity in accordance with Central Bank of the U.A.E. requirements and the Group's internal guidelines mandated by ALCO. Based on the directives of the ALCO, the Treasury manages the liquidity of the Bank.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39. Financial risk management (continued)

Market risk (continued)

Liquidity risk (continued)

Liquidity risk management process (continued)

On the funding side, the Group has a large proportion of its funds in the form of own funds which reduces the requirement for external funds. The Group relies on deposits from its relationship based retail business banking and wholesale banking customers as its primary source of funding and only on a short term basis relies on interbank borrowings to fund its assets. The Group's debt securities typically are issued with maturities of greater than three years. Deposits from customers generally have shorter maturities and a large portion of them are repayable on demand as is endemic to these markets. The short term nature of these deposits increases the Group's liquidity risk and the bank manages this risk through maintaining competitive pricing and constant monitoring of market trends. Also, most of the deposit customers of the Group are relationship based and based on past trends. It is observed that these deposits are sticky in nature, thus reducing the liquidity risk to a large extent. The Group does not rely on large ticket deposits and its depositor profile is very diverse leading to a more stable deposit funding.

The Group raised USD 500 million under Euro Medium Term Notes under USD 1 billion EMTN programme launched in June 2014 which matures in June 2019. In March 2015 a second tranche of USD 300 million notes were issued under this programme. Subsequently the Group increased its EMTN programme to USD 2 billion. In July 2017, USD 50 million floating rate notes (FRN) were issued which matures on July 2021. Further in October 2017, Group arranged a three year syndicated borrowing of USD 350 million maturing in October 2020. The Group issued USD 145 million of bonds in September 2018 through a private placement which matures in September 2023. In September 2018 the Group borrowed USD 80 million which matures in September 2021. This helped the Group to achieve its long term funding requirements.

On the deployment side, the Group maintains a portfolio of highly liquid assets largely made up of balances with the UAE Central Bank, certificates of deposits issued by the Central Bank, inter-bank facilities and investment securities including investments in local government bonds which can be repaid to meet short term liquidity mismatches and be offloaded to meet longer term mismatches. The Central Bank of the U.A.E. has prescribed reserve requirements on deposits, 1% for time deposits and 14% on current, saving, call and similar accounts. As a contingency funding plan, the Group evaluates and keeps ready debt financing plans which can be quickly executed if required.

The table below analyses assets and liabilities of the Group into relevant maturity groupings based on the remaining years from the reporting date to the contractual cash flow date. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates and exchange rates.

The Central Bank of the U.A.E. also imposes mandatory 1:1 Loans to Stable Resources Ratio (LSRR) 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 U.A.E. ALCO monitors loans to stable resources ratios on a daily basis. The Group on a daily basis also monitors the liquid assets to total assets ratio and the eligible Liquid Asset Ratio (ELAR) and has set up internal management Action Triggers to take suitable corrective actions once the internal thresholds have been reached.

At 31 December 2018, 24.4% (2017: 23.4%) of the Group's total assets was in liquid assets. The LSRR as at 31 December 2018, stood at 94.5% (2017: 87.79%) which is significantly lower than the maximum requirement of 100%. Similarly, the Eligible Liquid Assets Ratio of the Group stood at 14.5% (2017: 15.0%) as at 31 December 2018, also reflecting a healthy liquidity position.

The Group has a large proportion of its liabilities as demand deposits which do not have a fixed maturity. Although behaviourally these deposits are stable, these have been grouped under up to 3 months category in accordance with the UAE Central Bank guideline.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

*Market risk (continued)**Liquidity risk (continued)*

	Up to 3 months AED'000	3 - 12 months AED'000	1 - 3 years AED'000	3 to 5 years AED'000	Over 5 years AED'000	Provision Credit loss AED'000	Total AED'000
At 31 December 2018							
<i>Assets</i>							
Cash and balances with the UAE Central Bank	4,847,996	100,000	-	-	-	-	4,947,996
Due from other banks	1,907,810	2,026,553	816,300	36,019	-	(31,140)	4,755,542
Loans and advances	7,320,202	5,650,059	8,652,011	6,391,836	6,813,166	(1,966,612)	32,860,662
Investment securities	729,709	531,231	1,046,102	1,870,380	3,049,736	(38,025)	7,189,133
Insurance contract assets and receivables	324,909	63,418	45,872	-	-	(45,605)	388,594
Customer acceptances	57,780	503,924	-	-	-	-	561,704
Goodwill and other intangible assets	-	-	-	-	167,723	-	167,723
Property and equipment and other assets	952,644	-	-	-	859,942	-	1,812,586
Total	16,141,050	8,875,185	10,560,285	8,298,235	10,890,567	(2,081,382)	52,683,940
<i>Liabilities and shareholders' equity</i>							
Due to other banks	1,897,449	2,019,724	464,289	-	-	-	4,381,462
Deposit from customers	27,746,253	5,652,749	740,611	171	-	-	34,139,784
Debts securities in issue and other long term borrowing	-	2,547,649	1,755,553	522,903	-	-	4,826,105
Insurance contract liabilities and payables	-	511,395	-	-	-	-	511,395
Customer acceptances	57,780	503,924	-	-	-	-	561,704
Other liabilities	1,061,315	34,338	-	-	-	7,862	1,103,515
Shareholders' equity	-	-	-	-	7,159,975	-	7,159,975
Total	30,762,797	11,269,779	2,960,453	523,074	7,159,975	7,862	52,683,940
Net cumulative liquidity gap							
	(14,621,747)	(17,016,341)	(9,416,509)	(1,641,348)	2,089,244	-	-
At 31 December 2017							
Total assets	14,592,338	7,695,284	9,613,494	4,874,883	11,761,159	-	48,537,158
Total liabilities and equity	28,802,471	6,973,358	4,710,248	182,637	7,868,444	-	48,537,158
Net cumulative liquidity gap	(14,210,133)	(13,488,207)	(8,584,961)	(3,892,715)	-	-	-

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Derivative cash flows

The Group's derivatives that will be settled on a gross basis comprise foreign exchange contracts.

The table below analyses the Group's derivative financial instruments grouped into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows related to foreign exchange and derivative contracts:

	Up to 1 month AED'000	1-3 months AED'000	3-12 months AED'000	1-5 years AED'000	Over 5 years AED'000	Total AED'000
At 31 December 2018						
<i>Foreign exchange contracts and other derivative:</i>						
- Outflow	865,744	3,251,961	9,611,382	1,793,667	901,600	16,424,354
- Inflow	868,882	3,243,439	9,602,965	1,772,406	894,827	16,382,519

At 31 December 2017

Foreign exchange contracts and other derivative:

- Outflow	1,078,805	20,206	3,856,863	594,795	28,009	5,578,678
- Inflow	1,079,529	9,765	3,863,234	588,416	29,502	5,570,446

Off-balance sheet items

	No later than 1 year AED'000	1-5 years AED'000	Over 5 years AED'000	Total AED'000
At 31 December 2018				
Credit commitments	2,020,404	-	-	2,020,404
Letter of credits and guarantees	1,306,235	224,598	600	1,531,433
Total	3,326,639	224,598	600	3,551,837
At 31 December 2017				
Credit commitments	528,303	4,830	-	533,133
Letter of credits and guarantees	1,065,612	216,629	849	1,283,090
Total	1,593,915	221,459	849	1,816,223

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

*Financial instruments**Categories of financial instruments*

The following tables analyse the Group's financial assets and financial liabilities in accordance with categories of financial instruments under IFRS 9:

<i>At 31 December 2018</i>	At amortised cost AED'000	Fair value through comprehensive income AED'000	Hedging derivatives AED'000	Fair value through profit or loss AED'000	Total AED'000
<i>Assets</i>					
Investment securities	4,718,248	2,409,917	-	60,968	7,189,133
Derivative financial instruments	4,947,996	-	7,344	50,161	57,505
Cash and balances with the UAE central Bank	4,755,542	-	-	-	4,947,996
Due from other banks	32,860,662	-	-	-	4,755,542
Loans and advances	294,926	-	-	-	32,860,662
Insurance contract assets and receivables	561,704	-	-	-	294,926
Customer acceptances	499,459	-	-	-	561,704
Other assets	48,638,537	2,409,917	7,344	111,129	499,459
Total financial assets		2,409,917	7,344	111,129	51,166,927
<i>Liabilities</i>					
Due to other banks	4,381,462	-	-	-	4,381,462
Deposits from customers	34,139,784	-	-	-	34,139,784
Debt securities issued and other long term borrowings	4,826,105	-	-	-	4,826,105
Insurance contract liabilities and payables	511,395	-	-	-	511,395
Derivative financial instruments	561,704	-	56,881	43,599	100,480
Customer acceptances	168,098	-	-	-	561,704
Other liabilities	44,588,548	-	56,881	43,599	168,098
Total financial liabilities			56,881	43,599	44,689,028

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Financial instruments (continued)

Categories of financial instruments (continued)

The following tables analyse the Group's financial assets and financial liabilities in accordance with categories of financial instruments under IAS 39:

	At amortised cost AED'000	Fair value through comprehensive income AED'000	Hedging derivatives AED'000	Fair value through profit or loss AED'000	Total AED'000
<i>At 31 December 2017</i>					
<i>Assets</i>					
Investment securities	-	5,564,475	-	4,274	5,568,749
Derivative financial instruments	-	-	6,111	19,429	25,540
Cash and balances with the UAE central Bank	4,740,566	-	-	-	4,740,566
Due from other banks	3,799,239	-	-	-	3,799,239
Loans and advances	32,240,193	-	-	-	32,240,193
Insurance contract assets and receivables	345,125	-	-	-	345,125
Customer acceptances	171,307	-	-	-	171,307
Other assets	369,152	-	-	-	369,152
Total financial assets	41,665,582	5,564,475	6,111	23,703	47,259,871
<i>Liabilities</i>					
Due to other banks	2,764,199	-	-	-	2,764,199
Deposits from customers	32,175,874	-	-	-	32,175,874
Debt securities issued and other long term borrowings	4,169,302	-	-	-	4,169,302
Insurance contract liabilities and payables	516,991	-	-	-	516,991
Derivative financial instruments	-	-	13,249	9,987	23,236
Customer acceptances	171,307	-	-	-	171,307
Other liabilities	93,850	-	-	-	93,850
Total financial liabilities	39,891,523	-	13,249	9,987	39,914,759

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Fair value hierarchy

The fair value measurements are categorised into different levels in the fair value hierarchy based on the inputs to valuation techniques used. The different levels are defined as follows:

Quoted market prices - Level 1

Financial instruments are classified as Level 1 if their values are observable in an active market. Such instruments are valued by reference to unadjusted quoted prices for identical assets or liabilities in active markets where the quoted price is readily available, and the price represents actual and regularly occurring market transactions.

Valuation techniques using observable inputs - Level 2

Financial instruments classified as Level 2 have been valued using models whose inputs are observable in an active market. Valuation based on observable inputs include financial instruments such as forwards foreign exchange contracts which are valued using market standard pricing techniques.

Valuation techniques using significant unobservable inputs - Level 3

Financial instruments are classified as Level 3 if their valuation incorporates significant inputs that are not based on observable market data (unobservable inputs). A valuation input is considered observable if it can be directly observed from a transaction in an active market.

Unobservable input levels are generally determined based on observable inputs of a similar nature, historical observations or other analytical techniques.

This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible. The table below analyses recurring fair value measurements for assets and liabilities.

The assets measured at fair value as per the hierarchy are disclosed in the table below:

	Quoted market prices Level 1 AED'000	Observable inputs Level 2 AED'000	Significant unobservable inputs Level 3 AED'000	Total AED'000
31 Decemeber 2018				
<i>Asset at fair value</i>				
<i>(Through other comprehensive income)</i>				
Investment securities - debt	2,196,564	-	-	2,196,564
Investment securities - equity	210,924	-	2,612	213,536
Foreign exchange contracts	-	35,838	-	35,838
Derivative financial instruments	-	21,667	-	21,667
<i>(Through profit and loss)</i>				
Investment market fund	22,964	-	38,004	60,968
<i>(Held at amortised cost)</i>				
Investment securities - debt	4,209,013	-	336,702	4,545,715
	<u>6,639,465</u>	<u>57,505</u>	<u>377,318</u>	<u>7,074,288</u>
<i>Liabilities at fair value</i>				
Foreign exchange contracts	-	45,986	-	45,986
Derivative financial instruments	-	54,494	-	54,494
	<u>-</u>	<u>100,480</u>	<u>-</u>	<u>100,480</u>

There are no transfers between levels during the period.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Fair value hierarchy (continued)

	Quoted market prices Level 1 AED'000	Observable inputs Level 2 AED'000	Significant unobservable Inputs Level 3 AED'000	Total AED'000
<i>31 December 2017</i>				
<i>Asset at fair value</i>				
<i>(Available-for-sale financial assets)</i>				
Investment securities - debt	5,185,470	-	276,237	5,461,707
Investment securities - equity	61,068	-	1,694	62,762
Investment securities - funds	20,853	-	19,153	40,006
Foreign exchange contracts	-	13,065	-	13,065
Derivative financial instruments	-	12,475	-	12,475
<i>(Held-for-trading)</i>				
Investment mutual fund	4,274	-	-	4,274
	<u>5,271,665</u>	<u>25,540</u>	<u>297,084</u>	<u>5,594,289</u>
<i>Liabilities at fair value</i>				
Foreign exchange contracts	-	3,023	-	3,023
Derivative financial instruments	-	20,213	-	20,213
	<u>-</u>	<u>23,236</u>	<u>-</u>	<u>23,236</u>

There are no transfers between levels during the period.

Fair values of financial assets and liabilities

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction. Consequently, differences can arise between the carrying values and fair value estimates of financial assets and liabilities. At 31 December 2018, the carrying value of the Group's financial assets and liabilities approximate their fair values, except for the below mentioned financial assets and liabilities:

	Fair value		Carrying value	
	31 December 2018 AED'000	31 December 2017 AED'000	31 December 2018 AED'000	31 December 2017 AED'000
<i>Assets</i>				
Loans and advances	33,050,411	32,442,793	32,860,662	32,240,193
Investment securities	7,016,783	5,568,749	7,189,133	5,568,749
Cash and balances with the UAE central Bank	4,948,723	4,740,350	4,947,996	4,740,566
Due from other banks	4,725,694	3,786,951	4,755,542	3,799,239
Total financial assets	<u>49,741,611</u>	<u>46,538,843</u>	<u>49,753,333</u>	<u>46,348,747</u>

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Fair values of financial assets and liabilities (continued)

	Fair value		Carrying value	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	AED'000	AED'000	AED'000	AED'000
<i>Liabilities</i>				
Due to other banks	4,418,479	2,771,387	4,381,462	2,764,199
Deposits from customers	34,102,734	32,170,844	34,139,784	32,175,874
Debt securities issued and other long term borrowings	4,821,560	4,167,772	4,826,105	4,169,302
Total financial liabilities	43,342,773	39,110,003	43,347,351	39,109,375

Capital Management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on the face of statement of financial position, are:

- to comply with the capital requirements set by the Central Bank of United Arab Emirates;
- to safeguard the Bank's ability to continue as a going concern and increase the returns for the shareholders; and
- to maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored on a regular basis by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and the Central Bank of United Arab Emirates. The required information is filed with the regulators on a regular basis as required under Basel II standards.

The Bank's capital management is driven by short and long-term strategies and organisational requirements with due consideration to the regulatory, economic and commercial environment in which the Bank operates.

The Bank seeks to optimise returns on capital, and its objective has always been to maintain a strong capital base to support business development and to meet regulatory capital requirements at all times.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

39. Financial risk management (continued)

Capital management (continued)

Capital structure and capital adequacy as per Basel III requirement as at 31 December 2018

The Bank is required to report capital resources and risk-weighted assets under the Basel III from January 2018. Capital structure and capital adequacy as per Basel III requirement as at 31 December 2018 and 31 December 2017 is given below:

	31 December 2018 AED'000	31 December 2017 AED'000
<i>Tier 1 capital</i>		
Ordinary share capital	1,676,245	1,676,245
Legal and other reserves	3,953,624	4,020,612
Retained earnings	542,158	1,278,986
Current year profit	910,239	774,143
Dividend	(502,874)	(502,874)
Tier 1 capital base	6,579,392	7,247,112
Tier 2 capital base	476,626	-
Total capital base	7,056,018	7,247,112
<i>Risk weighted assets</i>		
Credit risk	38,130,054	32,733,601
Market risk	464,985	18,056
Operational risk	2,451,565	2,276,146
Total risk weighted assets	41,046,604	35,027,803
Capital adequacy ratio on Tier 1 capital	16.03%	20.69%
Capital adequacy ratio on Tier 2 capital	1.16%	-
Total Capital adequacy ratio	17.19%	20.69%

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

40. Insurance risk

The Group accepts insurance risk through its written insurance contracts. The Group is exposed to uncertainty surrounding the timing, frequency and severity of claims under these contracts.

The principal risk the Group faces under insurance contracts is that the actual claims and benefit payments or the timing thereof, differ from expectations. This is influenced by the frequency of claims, severity of claims, actual benefits paid and subsequent development of long-term claims. Therefore, the objective of the Group is to ensure that sufficient reserves are available to cover these liabilities.

The above risk exposure is mitigated by diversification across a large portfolio of insurance contracts. The variability of risks is also improved by careful selection and implementation of underwriting strategy guidelines, as well as the use of reinsurance arrangements. The Group mainly issues short term insurance contracts in connection with property, motor, marine and casualty risks.

Two key elements of the Group's insurance risk management framework are its underwriting strategy and reinsurance strategy, as discussed below.

Underwriting strategy

The Group's underwriting strategy is to build balanced portfolios based on a large number of similar risks. This reduces the variability of the portfolios outcome.

The underwriting strategy is set out by the Group that establishes the classes of business to be written, the territories in which business is to be written and the industry sectors in which the Group is prepared to underwrite. This strategy is cascaded by the business units to individual underwriters through detailed underwriting authorities that set out the limits that any one underwriter can write by line size, class of business, territory and industry in order to ensure appropriate risk selection within the portfolio. All general insurance contracts except marine, are annual in nature and the underwriters have the right to refuse renewal or to change the terms and conditions of the contract at renewal.

Frequency and amounts of claims

The Group has developed their underwriting strategy to diversify the type of insurance risks accepted and within each of the categories to achieve sufficiently large populations of risk to reduce the variability of the expected outcome. The frequency and amounts of claims can be affected by several factors. The Group underwrites mainly property, motor, casualty, medical and marine risks. These are regarded as short-term insurance contracts as claims are normally advised and settled within one year of the insured event taking place.

Property

Property insurance covers a diverse collection of risks and therefore property insurance contracts are subdivided into four risks groups, fire, business interruption, weather damage and theft. These contracts are underwritten by reference to the commercial replacement value of the properties and contents insured. The cost of rebuilding properties, of replacement or indemnity for contents and time taken to restart operations for business interruptions are the key factors that influence the level of claims under these policies. The greatest likelihood of significant losses on these contracts arises from storm, flood damage or other weather related incidents.

Motor

Motor insurance contracts are designed to compensate policies holders for damage suffered to vehicles, disability to third parties arising through accidents and fire or theft of their vehicles.

Underwriting limits and guidelines are in place to enforce appropriate risk selection criteria.

The level of court awards for deaths and to injured parties and the replacement costs of motor vehicles are the key factors that influence the level of claims.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

40. Insurance risk (continued)

Frequency and amounts of claims (continued)

Marine

Marine insurance is designed to compensate contract holders for damage and liability arising through loss or damage to marine craft and accidents at sea resulting in the total or partial loss of cargoes. For marine insurance, the main risks are loss or damage to marine craft and accidents resulting in the total or partial loss of cargoes.

The underwriting strategy for the marine class of business is to ensure that policies are well diversified in terms of vessels and shipping routes covered.

Casualty

For casualty class of business, such as workmen's compensation, personal accident, general third party liability and loss of money, the extent of loss or damage and the potential court awards are the main factors that influence the level of claims.

The Group manage these risks through their underwriting strategy, adequate reinsurance arrangements and proactive claims handling. The underwriting strategy attempts to ensure that the underwritten risks are well diversified in terms of type and amount of risk. Underwriting limits are in place to enforce appropriate risk selections.

The Group proactively manage and pursue early settlement of claims to reduce their exposure to unpredictable developments.

The Group has adequate reinsurance arrangements to protect their financial viability against such claims for all classes of business.

The Group has obtained adequate non-proportionate reinsurance cover for all classes of an amount considered appropriate by the management.

Medical

Medical selection is part of the Group's underwriting procedures, whereby contributions are charged to reflect the health condition and family medical history of the applicants. Pricing is based on assumptions, such as mortality and persistency, which consider past experience and current trends. Contracts including specific risks and guarantees are tested for profitability according to predefined procedures before approval.

Products are reviewed by the business units on an annual basis to confirm, or otherwise, that pricing assumptions remain appropriate. Analysis is performed on earnings and liability movements to understand the source of any material variation in actual results from what was expected. This confirms the appropriateness of assumptions used in underwriting and pricing.

Concentration of insurance risk

The insurance risk arising from insurance contracts is concentrated mainly in the United Arab Emirates.

The geographical risk profile is similar to last year.

Assumptions and sensitivities

Process used to determine the assumptions

The method used by the Group for provision of IBNR takes into account historical data, past estimates and details of the reinsurance programme, to assess the expected size of reinsurance recoveries.

The assumptions that have the greatest effect on the measurement of insurance contract provisions are the expected loss ratios for the most recent accident years.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

40. Insurance risk (continued)

Reinsurance strategy

The Group reinsures a portion of the insurance risks it underwrites in order to control its exposure to losses and protect capital resources.

Ceded reinsurance contains credit risk, as discussed in the financial risk management note. The Group has a Reinsurance department that is responsible for setting the minimum security criteria for acceptable reinsurance and monitoring the purchase of reinsurance by the business units against those criteria. The department monitors developments in the reinsurance programme and its ongoing adequacy.

The Group buys a combination of proportionate and non-proportionate reinsurance treaties to reduce the net exposure to the Group. In addition, underwriters are allowed to buy facultative reinsurance in certain specified circumstances. All purchases of facultative reinsurance are subject to business unit pre-approval and the total expenditure on facultative reinsurance is monitored regularly by reinsurance department.

41. Critical accounting estimates and judgments in applying accounting policies

The Group's consolidated financial statements and its financial results are influenced by accounting policies, assumptions, estimates and management judgement, which necessarily have to be made in the course of preparation of the consolidated financial statements. The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. All estimates and assumptions required in conformity with IFRS are best estimates undertaken in accordance with applicable standards. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Accounting policies and management judgement for certain items are especially critical for the Group's results and financial situation due to their materiality.

(a) Critical judgments in applying the group's accounting policies introduced on adoption of IFRS 9

The following are the critical judgments, apart from those involving estimations, that the management has made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in financial statements:

▪ *Business model assessment*

Classification and measurement of financial assets depends on the results of the "solely payments of principal and interest" and the business model test. The Group determines the business model at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. This assessment includes judgment reflecting all relevant evidence including how the performance of the assets is evaluated and their performance measured, the risks that affect the performance of the assets and how these are managed and how the managers of the assets are compensated. The Group monitors financial assets measured at amortised cost or fair value through other comprehensive income that are derecognised prior to their maturity to understand the reason for their disposal and whether the reasons are consistent with the objective of the business for which the asset was held. Monitoring is part of the Group's continuous assessment of whether the business model for which the remaining financial assets are held continues to be appropriate and if it is not appropriate whether there has been a change in business model and so a prospective change to the classification of those assets.

▪ *Significant increase of credit risk*

ECL are measured as an allowance equal to 12-month ECL for stage 1 assets, or lifetime ECL assets for stage 2 or stage 3 assets. An asset moves to stage 2 when its credit risk has increased significantly since initial recognition. IFRS 9 does not define what constitutes a significant increase in credit risk. In assessing whether the credit risk of an asset has significantly increased, the Group takes into account qualitative and quantitative reasonable and supportable forward-looking information, a significant increase in credit risk is presumed if a customer is more than 30 days past due in making a contractual payment.

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

41. Critical accounting estimates and judgements in applying accounting policies (continued)

(a) *Critical judgments in applying the group's accounting policies introduced on adoption of IFRS 9 (continued)*

▪ *Establishing groups of assets with similar credit risk characteristics*

When ECLs are measured on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics according to product. The Group monitors the appropriateness of the credit risk characteristics on an ongoing basis to assess whether they continue to be similar. This is required in order to ensure that should credit risk characteristics change there is appropriate re-segmentation of the assets. This may result in new portfolios being created or assets moving to an existing portfolio that better reflects the similar credit risk characteristics of that group of assets. Re-segmentation of portfolios and movement between portfolios is more common when there is a significant increase in credit risk (or when that significant increase reverses) and so assets move from 12-month to lifetime ECLs, or vice versa, but it can also occur within portfolios that continue to be measured on the same basis of 12-month or lifetime ECLs but the amount of ECL changes because the credit risk of the portfolios differ.

▪ *Models and assumptions used*

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

b) Classification of and measurement of financial assets and liabilities

The Group classifies financial instruments, or its component parts, at initial recognition as a financial asset, a financial liability or an equity instrument in accordance with the substance of the contractual agreement and the definitions of the instruments. The substance of the financial instrument, rather than the legal form, governs its reclassification in the statement of financial position.

The Group determines the classification at initial recognition and, when allowed and appropriate, re-evaluates this designation at every statement of financial position date.

In measuring financial assets and liabilities, some of the Group's assets and liabilities are measured at a fair value for financial reporting purposes. In estimating the fair value of an asset or a liability, the Group uses market-observable data to the extent it is available. Where Level 1 inputs are not available, the Group engages independent professionally qualified valuers to perform the valuation. The Bank works closely with the qualified external valuers to establish the appropriate valuation techniques and inputs to the model.

c) Fair value measurement

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

Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)

41. Critical accounting estimates and judgements in applying accounting policies (continued)

d) Derivative financial instruments

Subsequent to initial recognition, the fair values of derivative financial instruments measured at fair value are generally obtained by reference to quoted market prices, discounted cash flow models and recognised pricing models as appropriate. When prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. The main factors which management considers when applying a model are:

- (i) The likelihood and expected timing of future cash flows on the instrument. These cash flows are usually governed by the terms of the instrument, although management judgment may be required in situations where the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt; and
- (ii) An appropriate discount rate of the instrument. Management determines this rate, based on its assessment of the appropriate spread of the rate for the instrument over the risk-free rate. When valuing instruments by reference to comparable instruments, management takes into account the maturity, structure and rating of the instrument with which the position held is being compared. When valuing instruments on a model basis using the fair value of underlying components, management considers, in addition, the need for adjustments to take account of a number of factors such as bid-offer spread, credit profile, servicing costs of portfolios and model uncertainty.

e) Provision for outstanding claims, whether reported or not

Considerable judgment by the management is required in the estimation of amounts due to the contract holders arising from claims made under insurance contracts. Such estimates are necessarily based on significant assumptions about several factors involving varying, and possible significant, degrees of judgment and uncertainty and actual results may differ from management's estimates resulting in future changes in estimated liabilities.

In particular, estimates have to be made both for the expected ultimate cost of claims reported at the date of statement of financial position and for the expected ultimate cost of claims incurred but not reported ("IBNR") at the date of statement of financial position. Claims requiring court or arbitration decisions are estimated individually. Independent loss adjusters normally estimate property claims. Management reviews its provisions for claims incurred and IBNR claims regularly.

f) Useful lives of property and equipment

The management determines the useful lives of property and equipment and the related depreciation charge. The depreciation charge for the year will change significantly if the actual life is different from the estimated useful life of the asset. The review carried out by management in the current year did not indicate any necessity for changes in the useful lives of property and equipment.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

41. Critical accounting estimates and judgements in applying accounting policies (continued)

g) Impairment of goodwill

The calculation of value-in-use is sensitive to the following assumptions:

(i) Growth rate

Growth rates are based on the management's assessment of the market share having regard to the forecasted growth and demand for the products offered. Growth rate of 3% per annum have been applied in the calculation.

(ii) Profit margins

Profit margins are based on the management's assessment of achieving a stabilized level of performance based on the approved business plan of the cash generating unit for the next five years.

(iii) Discount rates

Management has used the discount rate of 10% per annum throughout the assessment period, reflecting the estimated weighted average cost of capital of the Group and specific market risk profile.

Key sources of estimation uncertainty introduced on adoption of IFRS 9

The following are key estimations that the management has used in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in financial statements:

- *Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and determining the forward looking information relevant to each scenario:* When measuring ECL the Group uses reasonable and supportable forward looking information, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other.
- *Probability of default:* PD constitutes a key input in measuring ECL. PD is an estimate of the likelihood of default over a given time horizon, the calculation of which includes historical data, assumptions and expectations of future conditions.
- *Loss Given Default:* LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from collateral and integral credit enhancements.

42. Social contributions

The social contributions made (including donations and charity) during the year to various beneficiaries amounted to AED 1.1 million (2017: AED 1.45 million).

43. Approval of the consolidated financial statements

The consolidated financial statements were approved on 30 January 2019.