

Habib Bank Limited – UAE Branches

Financial Statements
for the year ended 31 December 2018

TABLE OF CONTENTS

INDEPENDENT AUDITORS' REPORTS	1
STATEMENT OF FINANCIAL POSITION	4
INCOME STATEMENT	5
STATEMENT OF OTHER COMPREHENSIVE INCOME	6
STATEMENT OF CASH FLOWS	7
STATEMENT OF CHANGES IN EQUITY	8
NOTES TO THE FINANCIAL STATEMENTS	9



KPMG Lower Gulf Limited
Level 13, Boulevard Plaza Tower One
Mohammed Bin Rashid Boulevard, Downtown Dubai, UAE
Tel. +971 (4) 403 0300, Fax +971 (4) 330 1515

Independent Auditors' Report

To the Regional General Manager of Habib Bank Limited, United Arab Emirates
Branches

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Habib Bank Limited, United Arab Emirates Branches ("the Bank"), which comprise the statement of financial position as at 31 December 2018, the income statement, statement of other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

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

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 Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Bank in accordance with International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in the United Arab Emirates, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Matter

The financial statements for the year ended 31 December 2017 were audited respectively by another auditor who expressed an unqualified audit opinion on the financial statements for the year ended 31 December 2017 on 27 March 2018.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and their preparation in compliance with the 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 financial statements that are free from material misstatement, whether due to fraud or error.

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

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

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



Auditors' Responsibilities for the Audit of the Financial Statements (continued)

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with 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.

Report on Other Legal and Regulatory Requirements

Further, as required by 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.

KPMG Lower Gulf Limited

Emilio Pera
Registration No.: 1146
Dubai, United Arab Emirates
Date: 25 MAR 2019

Habib Bank Limited - UAE Branches
STATEMENT OF FINANCIAL POSITION
As at 31 December 2018

	Notes	2018 AED '000	2017 AED '000
ASSETS			
Cash and balances with the UAE Central Bank	5	276,956	787,439
Due from other banks	6	142,432	367,785
Due from the Head Office and other branches	7	141,900	272,784
Loans and advances	8	1,403,261	1,416,897
Investment securities	9	299,130	100,000
Customer acceptances		10,336	2,835
Deferred tax asset	28	36,347	23,067
Other assets	10	64,211	57,437
Property and equipment	11	14,935	15,153
TOTAL ASSETS		2,389,508	3,043,397
LIABILITIES AND EQUITY			
LIABILITIES			
Due to other banks	12	130	-
Due to the Head Office and other branches	13	46,387	232,061
Customer deposits	14	1,854,250	2,191,550
Customer acceptances		10,336	2,835
Other liabilities	15	45,888	103,824
TOTAL LIABILITIES		1,956,991	2,530,270
EQUITY			
Allocated capital	17	373,072	373,072
Statutory reserve	18	20,532	20,532
Retained earnings		38,049	119,523
Fair value and other reserve	19	864	-
TOTAL EQUITY		432,517	513,127
TOTAL LIABILITIES AND EQUITY		2,389,508	3,043,397

These financial statements were authorised for issue on March 25, 2019 by:


Regional General Manager


Regional Head - Finance

The independent auditors' report is set out on pages 1 to 3.
The attached notes 1 to 31 form part of these financial statements.

Habib Bank Limited - UAE Branches

INCOME STATEMENT

For the year ended 31 December 2018

	<i>Notes</i>	2018 AED '000	2017 AED '000
Interest income	22	64,510	107,681
Interest expense	23	(10,373)	(18,758)
Net interest income		54,137	88,923
Fee and commission income	24	18,451	27,508
Other income	25	11,148	25,663
Net operating income		83,736	142,094
Operating expenses	26	(85,478)	(80,328)
Impairment allowance on loans and advances	8.3	(67,921)	(44,917)
Impairment reversal on off-balance sheet obligations		341	-
Impairment allowance on investments	19	(1,903)	-
Total operating expenses		(154,961)	(125,245)
Net (loss) / profit for the year before tax		(71,225)	16,849
Taxation	28	770	(4,335)
NET (LOSS) / PROFIT FOR THE YEAR		(70,455)	12,514

The independent auditors' report is set out on pages 1 to 3.
The attached notes 1 to 31 form part of these financial statements.

Habib Bank Limited - UAE Branches

STATEMENT OF OTHER COMPREHENSIVE INCOME

For the year ended 31 December 2018

	Notes	2018 AED '000	2017 AED '000
NET (LOSS)/PROFIT FOR THE YEAR		(70,455)	12,514
Other comprehensive income / (loss)			
<i>Other comprehensive income to be reclassified to income statement in subsequent periods</i>			
Net unrealised loss on fair value through OCI/available-for-sale investment securities	19	(1,049)	(2,889)
Impairment on investments under IFRS 9	19	1,913	-
Other comprehensive income / (loss) for the year		864	(2,889)
TOTAL COMPREHENSIVE (LOSS) / INCOME FOR THE YEAR		(69,591)	9,625

The independent auditors' report is set out on pages 1 to 3.
The attached notes 1 to 31 form part of these financial statements.

Habib Bank Limited - UAE Branches

STATEMENT OF CASH FLOWS

For the year ended 31 December 2018

	Notes	2018 AED '000	2017 AED '000
OPERATING ACTIVITIES			
Net (loss)/profit before taxation		(71,225)	16,849
Adjustment for:			
Depreciation/Amortisation	26	3,453	2,606
Impairment loss on credit losses - net		69,483	44,917
Loss on sale of property and equipment		64	252
Gain on sale of available-for-sale securities		-	(1,549)
Provision for employees' end of service benefits	16	1,044	1,298
Operational provision		-	506
Cash generated from operations before changes in operating assets and liabilities		2,819	64,879
Changes in operating assets and liabilities:			
Reserves with the UAE Central Bank		280,454	(45,640)
Due from the Head Office and other branches		9,217	7,346
Loans and advances		(55,847)	1,015,398
Other assets		(6,774)	4,821
Due to the Head Office and other branches		(35,797)	-
Customer deposits		(337,300)	(2,173,969)
Other liabilities		(56,457)	44,375
		(199,685)	(1,082,790)
Payments for employees' end of service benefits	16	(1,413)	(955)
Income tax paid		(13,620)	(8,610)
Net cash used in operating activities		(214,718)	(1,092,355)
INVESTING ACTIVITIES			
Proceeds from sale of investment securities		-	586,018
Purchase of investment securities		(198,266)	(143,449)
Purchase of property and equipment	11	(3,299)	(4,657)
Proceeds from sale of property and equipment		-	11
Net cash generated (used in) / from investing activities		(201,565)	437,923
FINANCING ACTIVITY			
Repatriation of profit to head office		(11,019)	-
Net cash used in financing activity		(11,019)	-
NET DECREASE IN CASH AND CASH EQUIVALENTS		(427,302)	(654,432)
Cash and cash equivalents at 1 January		697,596	1,352,028
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	29	270,294	697,596

The independent auditors' report is set out on pages 1 to 3.
The attached notes 1 to 31 form part of these financial statements.

Habib Bank Limited - UAE Branches
STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2018

	<i>Allocated capital AED'000</i>	<i>Statutory reserve AED'000</i>	<i>Retained earnings AED'000</i>	<i>Fair value and other reserve AED'000</i>	<i>Total AED'000</i>
As at 1 January 2018	373,072	20,532	119,523	-	513,127
Loss for the year	-	-	(70,455)	-	(70,455)
Other comprehensive income for the year	-	-	-	864	864
Total comprehensive loss for the year	-	-	(70,455)	864	(69,591)
Profit repatriated during the year	-	-	(11,019)	-	(11,019)
As at 31 December 2018	<u>373,072</u>	<u>20,532</u>	<u>38,049</u>	<u>864</u>	<u>432,517</u>
As at 1 January 2017	373,072	19,281	108,260	2,889	503,502
Profit for the year	-	-	12,514	-	12,514
Other comprehensive loss for the year	-	-	-	(2,889)	(2,889)
Total comprehensive income/(loss) for the year	-	-	12,514	(2,889)	9,625
Transfer to statutory reserve	-	1,251	(1,251)	-	-
As at 31 December 2017	<u>373,072</u>	<u>20,532</u>	<u>119,523</u>	<u>-</u>	<u>513,127</u>

The independent auditors' report is set out on pages 1 to 3.
The attached notes 1 to 31 form part of these financial statements.

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

1 ESTABLISHMENT AND OPERATIONS

Habib Bank Limited operates as a branch of Habib Bank Limited with its Head Office ("Head Office") in Pakistan. In the United Arab Emirates ("UAE"), it operates through its eight branches (2017: eight branches) located in the emirates of Abu Dhabi, Dubai and Sharjah under a license issued by the Central Bank of the UAE ("UAE Central Bank"). Habib Bank Limited, is listed on the Pakistan Stock Exchange.

The principal activities of Habib Bank Limited - UAE Branches (hereafter these branches are referred to as the "Bank") are to provide retail and corporate banking services in the UAE. These financial statements represent the combined statement of financial position and results of the eight branches (2017: eight branches) of the Bank in the UAE. The registered address of the Bank is P.O. Box 888, Dubai, UAE.

2 ACCOUNTING POLICIES

2.1 Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and comply with relevant laws of the U.A.E including UAE Federal Law No. 2 of 2015 ("Companies Law").

The financial statements have been prepared on the historical cost basis except for the following:

- derivative financial instruments are measured at fair value;
- financial assets at fair value through other comprehensive income (applicable from 1 January 2018);

The preparation of financial statements in conformity with IFRS as issued by the International Accounting Standard Board (IASB) requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 4.

Certain comparative figures have been reclassified where appropriate to conform to the presentation and accounting policies adopted in these financial statements.

2.2 Changes in accounting policies

The accounting policies set out below have been applied consistently to all the years presented in these financial statements, except changes in accounting policies resulting from the adoption of IFRS 9 and IFRS 15 as described below:

Standards, amendments and interpretations that are effective for the Bank's accounting period beginning on 01 January 2018

New standards and significant amendments to standards applicable to the Bank effective from January 01, 2018

The Bank initially applied IFRS 15 and IFRS 9 on 1 January 2018 retrospectively in accordance with IAS 8 without any practical expedients. The adoption of IFRS 15 did not materially impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Bank. Accordingly, the impact on the comparative information due to adoption of IFRS 15 is limited only to new disclosure requirements.

However, changes in accounting policies resulting from the adoption of IFRS 9 have been applied as follows:

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

2 ACCOUNTING POLICIES (continued)

2.2 Changes in accounting policies (continued)

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

- The determination of the business model within which a financial asset is held;
- The designation and revocation or previous designations of certain financial assets and financial liabilities measured at FVTPL; and
- The designation of certain investments in equity instruments not held for trading as FVOCI.

IFRS 7 Financial Instruments - Disclosures

IFRS 7 Financial Instruments: Disclosures, which was updated to reflect the differences between IFRS 9 and IAS 39, was also adopted by the Bank together with IFRS 9, for the year beginning 1 January 2018. Refer note 3.8 for the transition disclosures.

2.3 Summary of significant accounting policies

Financial Instruments

a) Recognition and initial measurement

A financial instrument is any contract that gives rise to both a financial asset for the Bank and a financial liability or equity instrument for another party or vice versa.

All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

Recognised financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at FVTPL) are added to or deducted from the fair value of the financial assets or financial liabilities respectively, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVTPL are recognised immediately in statement of profit or loss.

If the transaction price differs from fair value at initial recognition, the Bank will account for such difference as follows:

- if fair value is evidenced by a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only data from observable markets, then the difference is recognised in income statement on initial recognition (i.e. day 1 profit or loss);
- in all other cases, the fair value will be adjusted to bring it in line with the transaction price (i.e. day 1 profit or loss will be deferred by including it in the initial carrying amount of the asset or liability).

After initial recognition, the deferred gain or loss will be released to statement of profit or loss on a rational basis, only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

b) Fair value measurement

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

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

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

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Instruments (continued)

b) Fair value measurement (continued)

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

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

Fair value hierarchy

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, which reflects the significance of inputs used in making the measurements:

Level 1: Quoted market price (unadjusted) in an active market for an identical instrument. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry, group, pricing service or regulatory agency, and those prices represent actual and regularly recurring market transactions on an arm's length basis.

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

Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs based on unobservable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The Bank determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

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

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

Financial Assets

a) Classification

Applicable from 1 January 2018:

The Bank classifies financial assets on initial recognition in the following categories:

- i) Amortised cost; and
- ii) Fair value through other comprehensive income (FVOCI)
- iii) Fair value through profit or loss (FVTPL)

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

a) Classification (continued)

Applicable from 1 January 2018 (continued)

Business model assessment

The Bank makes an assessment of the objective of a business model in which a financial asset is held at portfolio level, because this reflects the way the business is managed and information is provided to the management. The assessment is not determined by a single factor or activity. Instead, the Bank considers all relevant information available at the date of the assessment. The information considered includes:

- The stated policies and objectives for the business 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 and the financial asset held within the portfolio is evaluated and reported to the management;
- The risks that affect the performance of the portfolio and, in particular, the way in which those risks are managed;
- How the managers of the business are compensated; 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.

Assessment whether contractual cash flows is solely payments of principal and interest

In assessing whether the contractual cash flows are solely payments of principal and interest (SPPI), the Bank considers the contractual terms of the instrument.

For the purpose 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.

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 Bank considers:

- contingent events that would change the amount and timing of cashflows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash from specified assets; and
- features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

a) Classification (continued)

Applicable from 1 January 2018 (continued)

i) Financial assets at amortised cost

A debt instrument, including loans and advances is classified as being measured at amortised cost 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 to hold financial assets in order 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.

ii) Financial assets at fair value through other comprehensive income (FVOCI)

A debt instrument is classified as being measured at FVOCI if it meets the following two conditions and the debt instrument is not designated at FVTPL:

- the asset is held within a business model whose objective is to hold financial assets in order 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.

Applicable before 1 January 2018

Loans and receivables:

Loans and receivables are non-derivative financial assets with fixed and determinable payments that are not quoted in an active market. These arise when the Bank provides money directly to the borrower with no intention of trading the receivable.

Available-for-sale (AFS)

Available-for-sale investments are those non-derivative financial assets that are designated as available-for-sale or not classified as (i) financial assets at fair value through profit or loss, (ii) loans and receivables or (iii) held-to-maturity investments. AFS assets are carried at fair value, with fair value changes recognised in other comprehensive income (OCI). These assets may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Interest income is recognised in profit or loss using the effective interest method. Foreign exchange gains or losses on available-for-sale debt security investments are recognised in the income statement. Impairment losses are recognised in the statement of profit or loss.

Other fair value changes, other than impairment losses, are recognised in OCI and presented in the fair value reserve within equity. When the investment is sold, the gain or loss accumulated in equity is reclassified to the income statement.

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

Applicable before 1 January 2018 (continued)

Classification (continued)

b) Subsequent measurement

Applicable from 1 January 2018

The Bank measures financial instruments, such as derivatives and certain fixed income instruments, at fair value at each reporting date.

Financial asset classified as at FVOCI or FVTPL are subsequently measured at fair value. Financial assets not carried at fair value are subsequently measured at amortised cost using the effective interest method, less expected credit allowances.

Applicable before 1 January 2018

Financial asset classified as at available-for-sale or fair value through profit or loss are subsequently measured at fair value. Financial assets not carried at fair value are subsequently measured at amortised cost using the effective interest method, less expected credit allowances.

c) Reclassifications

Applicable from 1 January 2018

Financial assets are not reclassified subsequent to their initial recognition except in the period after the Bank changes its business model for managing financial assets. If the business model under which the Bank holds financial assets changes, the financial assets affected are reclassified. The classification and measurement requirements related to the new category apply prospectively from the first day of the first reporting period following the change in business model that results in reclassifying the Bank's financial assets. During the current and previous financial year there was no change in the business model under which the Bank holds financial assets and therefore no reclassifications were made. Changes in contractual cash flows are considered under the accounting policy on 'Modification of financial assets' and 'Derecognition of financial assets' described in note 2.3 (g) and 2.3 (h) respectively.

Applicable before 1 January 2018

In cases where available-for-sale investments with a fixed maturity are reclassified as held-to-maturity investments, the fair value gains or losses until the date of the reclassification are held in OCI and amortised over the remaining life of the held-to-maturity investments using the effective interest rate method.

d) Foreign exchange gains and losses

The carrying amount of financial assets that are denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the end of each reporting period.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

e) Impairment

Applicable from 1 January 2018

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

- Loans and advances
- Debt investment securities
- Unfunded exposure

The Bank considers a debt investment security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Bank does not apply the low credit risk exemption to any other financial instruments.

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

Stage 1: When loans are first recognised, the Bank recognises an allowance based on 12 months ECLs. 12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Stage 2: When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the life time expected credit losses (LTECL). LTECL are the ECL that result from all possible default events over the expected life of the financial instrument.

Stage 3: Loans considered credit-impaired. The Bank records an allowance for the LTECLs.

ECLs are an unbiased probability-weighted estimate of the present value of credit losses that is determined by evaluating a range of possible outcomes. For funded exposures, ECL is measured as follows:

- for financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive;
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;

However, for unfunded exposures, ECL is measured as follows:

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

The Bank measures ECL on an individual basis, or on a collective basis for portfolios of loans that share similar economic and credit 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 Effective Interest Rate (EIR), regardless of whether it is measured on an individual basis or a collective basis.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

e) Impairment (continued)

Applicable from 1 January 2018 (continued)

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

- Probability of Default (PD);
- Exposure at Default (EAD); and
- Loss Given Default (LGD).

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

Details of these statistical parameters / inputs are as follows:

- PD – PD is the estimate of likelihood of default over a given time horizon, which is calculated based on statistical rating models currently used by the Bank and assessed using rating tools tailored to the various categories of counterparties and exposures.
- EAD – EAD represents the expected exposure in the event of a default. The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default. For lending commitments, the EADs are potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts. For financial guarantees, the EAD represents the amount of the guaranteed exposure when the financial guarantee becomes payable. EAD is determined by the exposure at reporting date.
- LGD – 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

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 that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

e) Impairment (continued)

Applicable from 1 January 2018 (continued)

Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt securities carried at FVOCI are credit-impaired.

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

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the lender of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession that the lender would not otherwise consider;
- the disappearance of an active market for a security because of financial difficulties; or

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 Bank 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 Bank considers the following factors:

- The market's assessment of creditworthiness as reflected in the bond yields;
- The rating agencies' assessments of creditworthiness;
- The country's ability to access the capital markets for new debt issuance; and
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.

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 includes unlikelihood to pay indicators and a backstop if amounts are overdue for 90 days or more.

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

e) Impairment (continued)

Applicable from 1 January 2018 (continued)

Default definition

Critical to the determination of ECL is the definition of default. The definition of default is used in measuring the amount of ECL and in the determination of whether the loss allowance is based on 12-month or lifetime ECL, as default is a component of the probability of default (PD) which affects both the measurement of ECLs and the identification of a significant increase in credit risk.

The Bank considers a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Bank in full without recourse by the Bank to actions such as realising security (if any is held); or
- the borrower is past due more than 90 days on any material credit obligation to the Bank.

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

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

Non-retail portfolio

The non-retail portfolio comprises of loans which are managed individually by the Relationship Managers (RMs) with oversight from the Credit Risk team of the Bank. These loans are appraised at least annually based on the financial information, other qualitative information and account conduct of the customer.

A non-retail customer is identified as at default if the customer is materially delinquent for more than 90 days on any of its credit obligation.

Retail portfolio

The retail portfolio comprises of loans that are managed at a product level, and based on approved product programs. A retail account is identified as default if the customer is delinquent for more than 90 days. The default rate analysis for the retail portfolio is performed at the account level.

Assessment of significant increase in credit risk

The Bank monitors all financial assets, issued loan commitments, letters of credit and financial guarantee contracts that are subject to the 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 Bank will measure the loss allowance based on lifetime rather than 12-month ECL. The assessment is performed on at least quarterly basis for each individual exposure.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

e) Impairment (continued)

Applicable from 1 January 2018 (continued)

Quantitative thresholds are established for the significant increase in the credit based on the movement in credit rating. In addition to quantitative criteria the Bank has a proactive Early Warning Indicator (EWI) framework, based on which the Credit Risk team performs a portfolio quality review on a monthly basis. The objective of the same is to identify potentially higher risk customers within the performing customers.

Multiple macro economic scenarios form the basis of determining the probability of default at initial recognition and at subsequent reporting dates. Different macro economic scenarios will lead to a different probability of default. It is the weighting of these different scenarios that forms the basis of a weighted average probability of default that is used to determine whether credit risk has significantly increased.

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, the Bank compares the probability of a default occurring on the financial instrument at the reporting date based on the remaining maturity of the instrument with the probability of a default occurring that was anticipated for the remaining maturity at the current reporting date when the financial instrument was first recognised.

In making this assessment, the Bank considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort, based on the Bank's historical experience and expert credit assessment. The following indicators are incorporated:

- internal risk grade;
- external credit rating (as far as available);
- actual or expected significant adverse changes in business, financial or economic conditions that are expected to cause a significant change to the borrower's ability to meet its obligations;
- actual or expected significant changes in the operating results of the borrower;
- significant increases in credit risk on other financial instruments of the same borrower;
- significant changes in the value of the collateral supporting the obligation;
- significant changes in the actual or expected performance and behaviour of the borrower, including changes in the payment status of borrowers in the group and changes in the operating results of the borrower; and
- macroeconomic information is incorporated as part of the internal rating model.

The quantitative factors that indicate significant increase in credit risk are reflected in PD models on a timely basis. However the Bank still considers separately some qualitative factors to assess if credit risk has increased significantly. For corporate lending there is particular focus on assets that are included on a 'watch list' given an exposure is on a watch list once there is a concern that the creditworthiness of the specific counterparty has deteriorated.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

c) Impairment (continued)

Applicable from 1 January 2018 (continued)

Improvement in credit risk profile

If there is evidence that there is no longer a significant increase in credit risk relative to initial recognition, then the loss allowance on an instrument returns to being measured as 12-month ECL.

The Bank has defined below criteria in accordance with regulatory guidelines to assess any improvement in the credit risk profile which will result into upgrading of customers moving from Stage 3 to Stage 2 and from Stage 2 to Stage 1.

- Significant decrease in credit risk will be upgraded stage-wise (one stage at a time) from Stage 3 to Stage 2 after and from Stage 2 to Stage 1 after meeting the curing period of at least 12 months.
- Restructured cases will be upgraded if repayments of 3 installments (for quarterly installments) have been made or 12 months (for installments longer than quarterly) curing period is met.

Incorporation of forward-looking information

The Bank incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. The Bank relies on GDP growth rates as an economic input.

The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses.

Presentation of allowance for ECL in the statement of financial position

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

- for financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- for debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve;
- for loan commitments and financial guarantee contracts: generally, as a provision in other liabilities; and
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component.

Applicable before 1 January 2018

Identification and measurement of impairment

At each reporting date the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the assets, and that the loss event has an impact on the future cash flows of the assets that can be estimated reliably.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

The Bank considers evidence of impairment for loans and advances at both a specific asset and collective level.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

e) Impairment (continued)

Applicable from 1 January 2018 (continued)

Individually assessed loans

At each reporting date, the Bank assesses on a case-by-case basis whether there is any objective evidence that a loan is impaired. Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. This procedure is applied to all accounts that are considered individually significant.

In determining impairment losses on these loans, the following factors are considered:

- the Bank's aggregate exposure to the customer;
- the viability of the customer's business model and capability to trade successfully out of financial difficulties and generate sufficient cash flow to service its debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors' commitments ranking ahead of, or pari passu with, the Bank and the likelihood of other creditors continuing to support the company;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding; and
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not local currency.
- when available, the secondary market price of debt.

Impairment losses are recognised in income statement and reflected in an allowance account against loans and advances. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Collectively assessed loans

Impairment is determined on a collective basis in two different scenarios:

- for loans subject to individual assessment to cover losses which have been incurred but have not yet been identified; and
- for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been identified (performing loans) are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss.

This arises from individual loan impairment at the reporting date which will only be specifically identified in the future. The collective impairment loss is determined after taking into account:

- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate specific allowance against the individual loan; and
- management's judgment as to whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by the management for each portfolio grouping.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

e) Impairment (continued)

Applicable before 1 January 2018 (continued)

Impairment on investments classified as available-for-sale

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in OCI to income statement as a recycle adjustment. The cumulative loss that is recycled from OCI to income statement is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in income statement.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in statement of profit or loss, the impairment loss is reversed through statement of profit or loss to the extent of amount earlier recognised as impairment loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is not reversed through the statement of profit or loss and is recognised directly in other comprehensive income.

f) Write-off

Loans and advances and debt securities are written-off when the Bank has no reasonable expectations of recovering the financial asset (either partially or in full). This is the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level. A write-off constitutes a derecognition event. The Bank may apply enforcement activities to financial assets written-off.

Recoveries of amounts previously written-off are included in 'recoveries' in the income statement and statement of other comprehensive income.

g) Modification of financial assets

Applicable from 1 January 2018

A modification of a financial asset occurs when the contractual terms governing the cash flows of a financial asset are renegotiated or otherwise modified between initial recognition and maturity of the financial asset. A modification affects the amount and / or timing of the contractual cash flows either immediately or at a future date.

When a financial asset is modified, the Bank assesses whether this modification results in derecognition. In accordance with the Bank's policy a modification results in derecognition when it gives rise to substantially different terms. To determine if the modified terms are substantially different from the original contractual terms the Bank considers the following:

- Qualitative factors, such as contractual cash flows after modification are no longer SPPI, change in currency or change of counterparty, the extent of change in interest rates, maturity, covenants. If these do not clearly indicate a substantial modification, then;
- A quantitative assessment is performed to compare the present value of the remaining contractual cash flows under the original terms with the contractual cash flows under the revised terms, both amounts discounted at the original effective interest. If the difference in present value is material, the Bank deems the arrangement is substantially different leading to derecognition.

When the contractual terms of a financial asset are modified and the modification does not result in derecognition, the Bank determines if the financial asset's credit risk has increased significantly since initial recognition by comparing:

- the remaining lifetime PD estimated based on data at initial recognition and the original contractual terms; with
- the remaining lifetime PD at the reporting date based on the modified terms.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

g) Modification of financial assets (continued)

Applicable from 1 January 2018

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants.

If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place. This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases.

If the credit risk remains significantly higher than what was expected at initial recognition, the loss allowance will continue to be measured at an amount equal to lifetime ECL. The loss allowance on forbore loans will generally only be measured based on 12-month ECL when there is evidence of the borrower's improved repayment behaviour following modification leading to a reversal of the previous significant increase in credit risk.

If the modification of a financial asset measured at amortised cost or FVOCI does not result in derecognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in the statement of profit or loss. Then the Bank measures ECL for the modified asset, where the expected cash flows arising from the modified financial asset are included in calculating the expected cash shortfalls from the original asset. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

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

Applicable before 1 January 2018

Financial assets

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

If the terms of a financial asset were modified because of financial difficulties of the borrower and the asset was not derecognised, then impairment of the asset was measured using the premodification interest rate.

Financial liabilities

The Bank derecognised a financial liability when its terms were modified and the cash flows of the modified liability were substantially different. In this case, a new financial liability based on the modified terms was recognised at fair value. The difference between the carrying amount of the financial liability extinguished and consideration paid was recognised in profit or loss. Consideration paid included non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability was not accounted for as derecognition, then any costs and fees incurred were recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial Assets (continued)

h) Derecognition of financial assets

The Bank derecognises a financial asset only when the contractual rights to the asset's cash flows expire (including expiry arising from a modification with substantially different terms), or when the financial asset and substantially all the risks and rewards of ownership of the asset are transferred to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

In the case where the financial asset is derecognised, the loss allowance for ECL is remeasured at the date of derecognition to determine the net carrying amount of the asset at that date. The difference between this revised carrying amount and the fair value of the new financial asset with the new terms will lead to a gain or loss on derecognition. The new financial asset will have a loss allowance measured based on 12-month ECL except in the rare occasions where the new loan is considered to be originated credit impaired. This applies only in the case where the fair value of the new loan is recognised at a significant discount to its revised par amount because there remains a high risk of default which has not been reduced by the modification. The Bank monitors credit risk of modified financial assets by evaluating qualitative and quantitative information, such as if the borrower is in past due status under the new terms.

On derecognition of a financial asset in its entirety, the difference between the carrying amount allocated to the part that is no longer recognised and the sum of the consideration received for the part no longer recognised and any cumulative gain / loss allocated to it that had been recognised in OCI is recognised in statement of profit or loss.

Financial liabilities

a) Classification

The Bank classifies its financial liabilities in amortised cost.

Financial liabilities at amortised cost

Financial liabilities, including deposits and borrowings, are initially measured at fair value, net of transaction costs. These financial liabilities are subsequently measured at amortised cost using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The EIR is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

b) Modification of financial liabilities

The Bank accounts for substantial modification of terms of an existing liability or part of it as an extinguishment of the original financial liability and the recognition of a new liability. It is assumed that the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective rate is materially different from the discounted present value of the remaining cash flows of the original financial liability.

In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and consideration paid is recognised in the income statement. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Financial liabilities (continued)

b) Modification of financial liabilities (continued)

Applicable from 1 January 2018:

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in the statement of profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification.

Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

c) Derecognition of financial liabilities

The Bank derecognises financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or have expired. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in the income statement.

Guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties, and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment.

Derivative financial instruments

a) Classification

The Bank enters into derivative financial instruments including forwards and swaps in the foreign exchange markets.

b) Initial and subsequent measurement

In the normal course of business, the fair value of a derivative on initial recognition is the transaction price. Subsequent to initial recognition, derivative financial instruments are stated at fair values. Fair values are generally obtained by reference to quoted market prices in active markets, or by using valuation techniques when an active market does not exist.

The positive mark to market values (unrealised gains) of derivative financial instruments is included in other assets. The negative mark to market values (unrealised losses) of derivative financial instruments is included in other liabilities.

Due from banks

Amounts due from banks are initially recognised at fair value and subsequently measured at amortised cost less allowance for expected credit loss, if any.

Loans and advances

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

The effective interest rate is the rate that exactly discounts estimated future cash flow through the expected life of the financial asset or liability.

Investment securities

The 'investment securities' caption in the statement of financial position includes debt securities measured at FVOCI. For debt securities measured at FVOCI, gains and losses are recognised in OCI.

Applicable before 1 January 2018:

Investment securities were initially measured at fair value and classified as available-for-sale securities.

Habib Bank Limited - UAE Branches
 NOTES TO THE FINANCIAL STATEMENTS
 As at 31 December 2018

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and impairment losses, if any. Cost includes expenditure that is directly attributable to the acquisition of the items plus their incidental costs. Depreciation is computed on the straight line method at rates calculated to reduce the cost of assets to their estimated residual values over their expected useful life.

During the year, the Bank has reviewed the useful lives of its furniture and fixtures, electrical, office and computer equipment and intangible assets as required by IAS 16 and IAS 38. This review has resulted in a change in the useful lives of these assets. This revision has been accounted for as a change in accounting estimate in accordance with the requirements of IAS 8. Accordingly, the effect of this change in accounting estimate has been recognised prospectively in the profit and loss account from the current year. The impact of this change is disclosed in note 11 to these financial statements.

	Years
Leasehold improvements	5
Furniture, fixtures, and office equipment	5-10
Motor vehicles	10
Computers and accessories	3-10

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These are included in other income in the income statement.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount being the higher of the net selling price and value in use.

The assets' residual values, useful lives and methods of depreciation are reviewed at each financial year end, and adjusted prospectively, if required.

Taxation

Provision for taxation is made in respect of the Bank's operations in the Emirates of Sharjah, Abu Dhabi and Dubai whereby tax is payable at the rate of 20% of the adjusted net profit generated during the year in each of the Emirates, in accordance with the relevant legislation of the Emirate.

Deferred tax

Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised except:

- Where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.
- In respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

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

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

Deferred tax relating to items recognised directly in equity are also recognised in equity and not in the income statement.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Borrowings, customer deposits and due to other banks

Borrowings are recognised initially at fair value, being their issue proceeds (fair value of consideration received), net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the EIR.

Employees' end of service benefits

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

The Bank provides end of service benefits to its expatriate employees. The entitlement to these benefits is usually based upon the employees' length of service and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment and are not less than the liability arising under the UAE Labour Laws.

Provisions

A provision is recognised if as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Operating lease

The leases entered into by the Bank are primarily operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease. Contingent rental payable is recognised as an expense in the period in which they are incurred.

Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, therefore, the related assets and liabilities are presented gross in the statement of financial position.

Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include cash on hand, balance in current and call accounts and placements with original maturity of less than three months with insignificant credit risk excluding the statutory deposit required to be maintained with the UAE Central Bank and deposits under lien.

Revenue recognition

Interest income and expense

Applicable from 1 January 2018:

Interest income and expense for all interest bearing financial instruments except at FVTPL, are presented in 'interest income' and 'interest expense' in the income statement on an accrual basis using the effective interest rates of the financial assets or financial liabilities to which they relate.

Applicable before 1 January 2018:

Interest income and expense are recognised in profit or loss using the effective interest method.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Revenue recognition (continued)

Interest income and expense (continued)

Applicable before 1 January 2018 (continued)

Amortised cost and gross carrying amount

Loans and advances are carried at amortised cost using the effective interest method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate (EIR). The effective interest rate is the rate that discounts estimated future cash receipts and payments earned or paid on a financial asset or a liability through its expected life or, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

Fees and commission

Fee income, which is not an integral part of the effective interest rate of a financial instrument, is earned from a diverse range of services provided by the Bank to its customers, and are accounted for in accordance with IFRS 15 'Revenue from Contracts with Customers'. Under the IFRS 15, fee income is measured by the Bank based on the consideration specified in a contract with a customer and excludes amounts collected on behalf of third parties. The Bank recognises revenue when it transfers control over a product or service to a customer.

A contract with a customer that results in a recognised financial instrument in the Bank's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

Fee income is accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of a transaction for a third-party, such as an arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognised as revenue as the services are provided; and
- other fees and commission income and expense are recognised as the related services are performed or received.

Fee income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate and recorded in 'Interest income'.

Foreign currency translation

(a) Functional and presentation currency

The financial statements are presented in United Arab Emirates Dirhams (AED), which is the Bank's functional and presentation currency, rounded to the nearest thousands, unless otherwise stated.

(b) Transactions and balances

Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to AED at the foreign exchange rates ruling at the dates that the fair values were determined.

Fiduciary activities

The Bank acts as a trustee/manager and in other capacities that results in holding or placing of assets in a fiduciary capacity on behalf of customers.

These assets and income arising from these assets are not included in the Bank's financial statements as the risk and rewards incidental to ownership of these assets lie with the client.

Acceptances

Acceptances arise when the Bank 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 Bank and is therefore recognised as a financial liability in the 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 (before 1 January 2018: IAS 39 Financial Instruments - Recognition and Measurement) and continued to be recognised as a financial liability in the statement of financial position with a contractual right of reimbursement from the customer as a financial asset.

2 ACCOUNTING POLICIES (continued)

2.3 Summary of significant accounting policies (continued)

Derivative product types

A derivative is a financial instrument whose value changes in response to an underlying variable, that requires little or no initial investment and that is settled at a future date. The Bank enters into a variety of derivative financial instruments to manage the exposure to profit and foreign exchange rate risks, including unilateral promise to buy/sell currencies and interest rate swap.

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 when these are quoted instruments or else by reference to recent market transactions, other valuation techniques including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Forwards

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

Swaps

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

Impairment of non-financial assets

At the end of each reporting period, the Bank reviews the carrying amounts of their non-financial assets to determine whether there is any indication of an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Bank estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in statement of profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in income statement.

3 FINANCIAL RISK MANAGEMENT

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

The Bank's risk management policies as approved by the Head Office are designed to identify and analyse 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 Bank regularly reviews its risk management policies and systems. These policies provide written principles for overall risk management, as well as specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments. In addition, internal audit is responsible for the independent review of risk management and the control environment.

The most important types of risk are credit risk, market risk, liquidity risk, and other operational risk. Market risk includes currency risk, interest rate and other price risk.

3.1 Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counter party will cause financial loss to the Bank by failing to discharge an obligation. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the Bank's portfolio, could result in losses that are different from those provided for at the reporting date. Management therefore carefully manages its exposure to credit risk. Credit exposures arise principally in loans and advances, due from other banks, investment securities and other receivables. There is also credit risk in financial arrangements not reflected on the statement of financial position such as credit commitments.

Internal credit risk ratings

In order to minimise credit risk, the Bank maintains the Bank's credit risk grading to categorise exposures according to their degree of risk of default. The Bank's credit risk grading framework comprises various 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 Bank measures credit risk of loans and advances to customers and to financial institutions at a counterparty level by using an internally developed technique named "Obligor Risk Rating" (ORR) considering various factors over a scale of 1 to 12 points. The better the customer credit strength the lower is the grade. This credit risk measurement technique is embedded in the Bank's daily operational management.

Classification	Grades	Risk significance
Performing	1 - 9	Exceptional to Watchlist
Non-performing	10 - 12	Substandard, Doubtful and Loss.

Measurement of ECL

As explained in note 2.3 (e), the Bank measures ECL considering the risk of default over the maximum contractual period over which the entity is exposed to credit risk. However, for financial instruments such as overdraft facilities that include both a loan and an undrawn commitment component, the Bank's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Bank's exposure to credit losses to the contractual notice period. For such financial instruments the Bank measures ECL over the period that it is exposed to credit risk and ECL would not be mitigated by credit risk management actions. These financial instruments do not have a fixed term or repayment structure and have a short contractual cancellation period. However, the Bank 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 canceled only when the Bank becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Bank expects to take to mitigate ECL, e.g. reduction in limits or cancellation of the loan commitment. The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee.

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 Credit risk (continued)

Restructured and renegotiated loans

Loans with renegotiated terms are defined as loans that have been restructured due to a deterioration in the borrower's financial position, for which the Bank has made concessions by agreeing to terms and conditions that are more favourable for the borrower than the Bank had provided initially and that it would not otherwise consider. A loan continues to be presented as part of loans with renegotiated terms until maturity, early repayment or write-off. Management continuously monitors the progress on renegotiated loans to ensure compliance with the terms at all times.

Exposure to credit risk

The Bank measures its exposure to credit risk by reference to gross carrying amount of financial assets less interest suspended and expected credit allowances, if any.

2018

Loans and advances

Performing

Non-performing

Allowance for impairment losses

Net carrying amount

Stage 1	Stage 2	Stage 3	Total
AED'000			
924,735	496,468	-	1,421,203
-	-	326,904	326,904
(9,007)	(13,629)	(322,210)	(344,846)
915,728	482,839	4,694	1,403,261

Unfunded advances

Performing

Allowance for impairment losses

Net carrying amount

Stage 1	Stage 2	Stage 3	Total
AED'000			
219,331	148,504	-	367,835
(597)	(219)	-	(816)
218,734	148,285	-	367,019

Debt securities

Performing

Allowance for impairment losses

Stage 1	Stage 2	Stage 3	Total
AED'000			
299,130	-	-	299,130
(1,913)	-	-	(1,913)

Ageing wise classification of loans and advances, amounts due from other banks and amounts due from the Head Office and other branches

Ageing of loans and advances, amounts due from other banks and amounts due from the Head Office and other branches are summarised as follows:

2017

	Loans and advances to customers AED '000	Amounts due from other banks AED '000	Amounts due from the Head Office and other branches AED '000
Neither past due nor impaired	1,374,852	367,785	272,784
Past due but not impaired	45,135	-	-
Impaired	312,584	-	-
Gross	1,732,571	367,785	272,784
Less: Specific and collective allowance for impairment	(315,674)	-	-
Net	1,416,897	367,785	272,784

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 Credit risk (continued)

- (a) Loans and advances, amounts due from other banks and amounts due from the Head Office and other branches neither past due nor impaired:

The credit quality of the portfolio of loans and advances amounts due from other banks and amounts due from the Head Office and other branches that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by the Bank.

2017

	<i>Loans and advances to customers AED '000</i>	<i>Amounts due from other banks AED '000</i>	<i>Amounts due from the Head Office and other branches AED '000</i>
Loans and advances			
- Corporate loans	1,362,166	-	-
- Retail loans	12,686	-	-
Due from other banks	-	367,785	-
Due from the Head office and other branches	-	-	272,784
Gross	<u>1,374,852</u>	<u>367,785</u>	<u>272,784</u>

- (b) Loans and advances, amounts due from other banks and amounts due from the Head Office and other branches past due but not impaired:

Loans and advances, amounts due from other banks and amounts due from the Head Office and other branches less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary. Gross amount of loans and advances by class to customers that were past due but not impaired along with cash collateral held by the Bank, were as follows:

2017

	<i>Corporate loans AED '000</i>	<i>Retail loans AED '000</i>	<i>Total AED '000</i>
Past due 0-59 days	35,545	3	35,548
Past due 60-89 days	327	-	327
More than 90 days	9,260	-	9,260
Total	<u>45,132</u>	<u>3</u>	<u>45,135</u>
Estimated fair value of collateral	4,152	-	4,152

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 Credit risk (continued)

The breakdown of the gross amount of individually impaired loans and advances by class, along with the fair value of related cash collateral held by the Bank as security, are as follows:

(c) *Loans and advances individually impaired*

2017

	<i>Corporate loans AED '000</i>	<i>Retail loans AED '000</i>	<i>Total AED '000</i>
Individually impaired	312,584	-	312,584
Estimated fair value of collateral	4,415	-	4,415

(d) *Loans and advances renegotiated*

The breakdown of the gross carrying amount of renegotiated financial assets, along with the fair value of related collateral held by the Bank as security, are as follows:

	<i>2018</i>			<i>2017</i>		
	<i>Corporate loans AED '000</i>	<i>Retail loans AED '000</i>	<i>Total AED '000</i>	<i>Corporate loans AED '000</i>	<i>Retail loans AED '000</i>	<i>Total AED '000</i>
Renegotiated financial assets	96,580	-	96,580	99,946	-	99,946
Estimated fair value of collateral	4,184	-	4,184	8,707	-	8,707

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 Credit risk (continued)

Risk limit control and mitigation policies

The Bank manages limits and controls concentrations of credit risk wherever they are identified in particular, to individual counterparties and groups, and to industries and countries.

The credit risk is primarily managed by placing limits on the amount of risk accepted in relation to one borrower or groups of borrowers and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review.

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing the lending limits where appropriate. Some other specific control and mitigation measures are outlined below.

(a) Collateral

As part of the Bank's credit risk management policies and practices, it obtains security where deemed necessary for loans and advances. The principal collateral types include:

- Mortgages over residential and commercial properties;
- Charges over business assets such as premises, inventory and accounts receivable;
- Charges over financial instruments such as debt securities and equities; and
- Personal and corporate guarantees.

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured. In addition, in order to minimise the credit loss the Bank obtains additional collaterals from the counterparty as soon as impairment indicators are observed for the relevant loans and advances.

Collaterals held as security for financial assets other than loans and advances are determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured.

The Bank seeks to use collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. The fair value of collateral is generally assessed, at a minimum, at inception and based on the Bank's reporting schedule, however, some collateral, for example, cash or securities relating to margining requirements, is valued daily. To the extent possible, the Bank uses active market data for valuing financial assets, held as collateral. Other financial assets which do not have a readily determinable market value are valued using models. Non-financial collateral, such as real estate, is valued based on data provided by third parties such as mortgage brokers, housing price indices, audited financial statements, and other independent sources.

Analysis of collateral by type is presented in the following table:

	<i>2018</i>	<i>2017</i>
	<i>AED '000</i>	<i>AED '000</i>
Cash Margin and Liens	140,751	160,256
Guarantee	7,573	34,088
Mortgage	9,116	20,326
	<u>157,440</u>	<u>214,670</u>

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 Credit risk (continued)

Risk limit control and mitigation policies (continued)

(b) Derivatives

At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favorable to the Bank, which in relation to derivatives is only a small fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements and entering into forward contracts with other banks, which forms as a back to back commitment to purchase and sell a contract, resulting in limited credit exposure to the Bank.

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

	<i>Maximum exposure</i>	
	<i>2018</i>	<i>2017</i>
	<i>AED '000</i>	<i>AED '000</i>
Credit risk exposures relating to assets reflected on and off statement of financial position are as follows:		
Balances with the UAE Central Bank	252,158	747,772
Due from other banks	142,432	367,785
Due from the Head Office and other branches	141,900	272,784
Loans and advances (gross):		
Corporate loans	1,736,679	1,719,885
Retail loans	11,428	12,686
Investment securities	299,130	100,000
Customer acceptances	10,336	2,835
Other assets	59,923	59,840
	2,653,986	3,283,587
Contingent liabilities	357,499	296,336
Undrawn credit commitments	500,592	576,846
	858,091	873,182
At 31 December	3,512,077	4,156,769

The above table represents a worst case scenario of credit risk exposure to the Bank, without taking account of any collateral held or other credit enhancements attached. For assets reflected on the statement of financial position, the exposures set out above are based on gross amounts.

Management is confident in its ability to continue to control and sustain minimal exposure of credit risk to the Bank resulting from both its loans and advances portfolio and debt securities.

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 Credit risk (continued)

Reposessed assets

The Bank's policy is to determine whether a reposessed asset is best used for its internal operations or should be sold. Assets determined to be useful for the internal operations are transferred to their relevant asset category at the lower of their reposessed value or the carrying value of the original secured asset. Assets that are determined to be sold are immediately transferred to assets held for sale at their fair value at the repossession date in line with the Bank's policy.

Reposessed collateral

During 2018, the Bank has not taken possession of any collateral held as security other than bank deposits most of which has been utilised in settlement of credit facilities (2017: Nil).

Investment securities

Investment securities mainly comprise of debt securities issued by various governments and local / foreign reputable organisations.

The table below presents an analysis of investment securities by rating agency designation, based on Moody's ratings or equivalent:

	2018 AED '000	2017 AED '000
AAA to A-	152,915	100,000
BBB to B-	146,215	-
Total	299,130	100,000

Impairment reserve under the Central Bank of UAE (CBUAE) guidance

The CBUAE has issued its IFRS 9 guidance 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
Allowances for impairment losses: General	
General provisions under Circular 28/2010 of CBUAE	25,365
Less: Stage 1 and Stage 2 provisions under IFRS 9	25,365
General provision transferred to the impairment reserve	-
Allowances for impairment losses: Specific	
Specific provisions under Circular 28/2010 of CBUAE	322,210
Less: Stage 3 provisions under IFRS 9	322,210
Specific provision transferred to the impairment reserve	-
Total provision transferred to the impairment reserve	-

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 Credit risk (continued)

Concentration of risks of financial assets with credit risk exposure

The following tables summarise the Bank's main credit exposure at their carrying amounts as categorised by the industry sectors of its counterparties.

2018	Financial institutions AED '000	Textile AED '000	Construction & real estate AED '000	Public sector AED '000	Wholesale & retail trade AED '000	Other industries AED '000	Individuals AED '000	Total AED '000
Balances with the UAE Central Bank	252,158	-	-	-	-	-	-	252,158
Due from other banks	142,432	-	-	-	-	-	-	142,432
Due from the Head Office and other branches	141,900	-	-	-	-	-	-	141,900
Loans and advances								
- Corporate loans	909,442	15,837	48,967	-	464,873	275,760	21,800	1,736,679
- Retail loans	-	-	-	-	-	-	11,428	11,428
Investment securities	299,130	-	-	-	-	-	-	299,130
Customer acceptances	-	-	-	-	6,718	3,618	-	10,336
Other assets	36,484	-	-	-	-	23,439	-	59,923
As at 31 December 2018	1,781,546	15,837	48,967	-	471,591	302,817	33,228	2,653,986

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 Credit risk (continued)

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

2017	Financial institutions AED '000	Textile AED '000	Construction & real estate AED '000	Public sector AED '000	Wholesale & retail trade AED '000	Other industries AED '000	Individuals AED '000	Total AED '000
Balances with the UAE Central Bank	747,772	-	-	-	-	-	-	747,772
Due from other banks	367,785	-	-	-	-	-	-	367,785
Due from the Head Office and other branches	272,784	-	-	-	-	-	-	272,784
Loans and advances	568,441	30,293	27,772	36,730	551,842	477,433	27,374	1,719,885
- Corporate loans	-	-	-	-	-	-	12,686	12,686
- Retail loans	-	-	-	-	-	-	-	100,000
Investment securities	100,000	-	-	-	-	-	-	100,000
Customer acceptances	-	-	1,684	-	-	1,151	-	2,835
Other assets	35,308	-	-	-	-	24,532	-	59,840
As at 31 December 2017	2,092,090	30,293	29,456	36,730	551,842	503,116	40,060	3,283,587

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 Credit risk (continued)

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

The following table breaks down the Bank's main credit exposure at their carrying amounts, as categorised by geographical region as of the year-end.

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

	<i>UAE</i> <i>AED'000</i>	<i>OECD</i> <i>AED'000</i>	<i>Other Asian</i> <i>countries</i> <i>AED '000</i>	<i>Others</i> <i>AED'000</i>	<i>Total</i> <i>AED'000</i>
31 December 2018					
Balances with the UAE Central Bank	252,158	-	-	-	252,158
Due from other banks	-	105,377	37,055	-	142,432
Due from the Head Office and other branches	-	6,324	135,576	-	141,900
Loans and advances:					
- Corporate loans	882,429	192,741	647,057	14,480	1,736,707
- Retail loans	11,400	-	-	-	11,400
Investment securities	118,492	43,518	118,689	18,431	299,130
Customer acceptances	10,336	-	-	-	10,336
Other assets	59,923	-	-	-	59,923
	1,334,738	347,960	938,377	32,911	2,653,986
	<i>UAE</i> <i>AED'000</i>	<i>OECD</i> <i>AED'000</i>	<i>Other Asian</i> <i>countries</i> <i>AED '000</i>	<i>Others</i> <i>AED'000</i>	<i>Total</i> <i>AED'000</i>
31 December 2017					
Balances with the UAE Central Bank	747,772	-	-	-	747,772
Due from other banks	35,000	223,485	45,862	63,438	367,785
Due from the Head Office and other branches	-	120,468	152,316	-	272,784
Loans and advances:					
- Corporate loans	983,951	300,479	249,850	185,605	1,719,885
- Retail loans	12,686	-	-	-	12,686
Investment securities	100,000	-	-	-	100,000
Customer acceptances	2,835	-	-	-	2,835
Other assets	59,840	-	-	-	59,840
	1,942,084	644,432	448,028	249,043	3,283,587

OECD represents Organisation for Economic Corporation and Development. This includes United States, Canada, Australia, Japan, United Kingdom, Turkey and other European countries.

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.2 Market risk

The Bank takes exposure on market risks, which is the risk that the fair value of 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 Bank's Assets and Liability Committee (ALCO) is responsible for formalising the key financial indicators and ratios, setting the thresholds to manage and monitor the market risk and also analysing the sensitivity of the Bank's interest rate and maturity mismatches. ALCO also guides the Bank's investment decisions and provides guidance in terms of interest rate and currency movements.

Foreign exchange risk

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

	<i>AED AED '000</i>	<i>USD AED '000</i>	<i>Euro AED '000</i>	<i>GBP AED '000</i>	<i>Other AED '000</i>	<i>Total AED '000</i>
As at 31 December 2018						
Assets						
Cash and balances with the UAE Central Bank	221,133	55,823	-	-	-	276,956
Due from other banks	-	81,709	17,426	42,117	1,180	142,432
Due from the Head Office and other branches	-	134,663	91	6,092	1,054	141,900
Loans and advances	459,489	767,928	175,844	-	-	1,403,261
Investment securities	100,000	155,612	-	43,518	-	299,130
Customer acceptances	4,187	6,149	-	-	-	10,336
Other assets	61,550	52,879	360	704	-	115,493
	<u>846,359</u>	<u>1,254,763</u>	<u>193,721</u>	<u>92,431</u>	<u>2,234</u>	<u>2,389,508</u>
Liabilities						
Due to other banks	130	-	-	-	-	130
Due to the Head Office and other branches	2,994	43,393	-	-	-	46,387
Customer deposits	1,143,473	473,042	142,057	94,383	1,295	1,854,250
Customer acceptances	4,187	6,149	-	-	-	10,336
Other liabilities	35,242	10,534	5	99	8	45,888
	<u>1,186,026</u>	<u>533,118</u>	<u>142,062</u>	<u>94,482</u>	<u>1,303</u>	<u>1,956,991</u>
Net financial position	<u>(339,667)</u>	<u>721,645</u>	<u>51,659</u>	<u>(2,051)</u>	<u>931</u>	<u>432,517</u>

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.2 Market risk (continued)

Foreign exchange risk (continued)

	<i>AED AED '000</i>	<i>USD AED '000</i>	<i>Euro AED '000</i>	<i>GBP AED '000</i>	<i>Other AED '000</i>	<i>Total AED '000</i>
As at 31 December 2017						
Assets						
Cash and balances with the						
UAE Central Bank	517,621	269,818	-	-	-	787,439
Due from other banks	35,000	227,742	33,747	-	71,296	367,785
Due from the Head Office						
and other branches	-	199,022	6,702	66,878	182	272,784
Loans and advances	682,221	461,112	209,411	64,153	-	1,416,897
Investment securities	100,000	-	-	-	-	100,000
Customer acceptances	1,174	1,661	-	-	-	2,835
Other assets	79,615	11,847	259	570	3,366	95,657
	<u>1,415,631</u>	<u>1,171,202</u>	<u>250,119</u>	<u>131,601</u>	<u>74,844</u>	<u>3,043,397</u>
Liabilities						
Due to the Head Office						
and other branches	5,305	224,052	-	-	2,704	232,061
Customer deposits	1,415,191	361,317	214,319	129,782	70,941	2,191,550
Customer acceptances	1,174	1,661	-	-	-	2,835
Other liabilities	89,326	12,063	2,328	99	8	103,824
	<u>1,510,996</u>	<u>599,093</u>	<u>216,647</u>	<u>129,881</u>	<u>73,653</u>	<u>2,530,270</u>
Net financial position	<u>(95,365)</u>	<u>572,109</u>	<u>33,472</u>	<u>1,720</u>	<u>1,191</u>	<u>513,127</u>

The tables below indicate the currencies to which the Bank has exposure on assets and liabilities. The analysis calculates the effect of a reasonably possible increase in the currency rate against the AED, with all other variables held constant (a possible equal decrease in the currency rate against the AED will have an equal and opposite effect). A negative amount in the table reflects a potential net reduction in profit and loss, while a positive amount reflects a net potential increase in profit and loss.

Currency	2018		2017	
	<i>Change in currency rate in %</i>	<i>Effect on profit and loss AED'000</i>	<i>Change in currency rate in %</i>	<i>Effect on profit and loss AED'000</i>
Euro	±10	5,166	±10	3,347
GBP	±10	(205)	±10	172
Others	±10	93	±10	119

Price risk

The Bank mainly holds debt securities, issued by various governments and local / foreign reputable organisations, which are carried at fair value. The Bank's exposure to price risk is dependent on the economical and political factors of these respective countries. The Bank manages the price risk through diversification and placing limits on individual and total debt securities portfolio. Reports on the debt securities portfolio are submitted to the Bank's senior management on a regular basis. The Head Office Investment Committee reviews and approves all debt securities investment decisions. A 10% increase / decrease in value of Bank's financial assets measured at fair value through OCI will result in an increase / decrease in the Bank's equity by AED 29,913 thousand (2017: AED 10,000 thousand).

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.2 Market risk (continued)

Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a floating rate assets/liabilities will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the fair value of fixed rate assets/liabilities will fluctuate because of changes in market interest rates. The Bank 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 ALCO sets limits on the level of mismatch of interest rate re-pricing that may be undertaken, which is monitored daily by Treasury.

The table below summarises the Bank's exposure to interest rate risks. It includes the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	Upto 3 months AED'000	3 months to 1 year AED'000	1 year to 5 years AED'000	Over 5 years AED'000	Non interest bearing AED'000	Total AED'000	Effective interest rate (%)
At 31 December 2018							
Assets							
Cash and balances with the UAE Central Bank	-	-	-	-	276,956	276,956	-
Due from other banks	130,295	-	-	-	12,137	142,432	1.22
Due from the Head Office and other branches	51,973	82,690	-	-	7,237	141,900	4.05
Loans and advances	289,724	914,051	210,123	7,305	(17,942)	1,403,261	3.93
Investment securities	-	-	200,853	98,277	-	299,130	3.10
Customer acceptances	-	-	-	-	10,336	10,336	-
Other assets	-	-	-	-	115,493	115,493	-
Total financial assets	471,992	996,741	410,976	105,582	404,217	2,389,508	
Liabilities							
Due to other banks	-	-	-	-	130	130	-
Due to the Head Office and other branches	-	35,797	-	-	10,590	46,387	1.01
Customer deposits	434,029	586,966	-	-	833,255	1,854,250	0.53
Customer acceptances	-	-	723	-	9,613	10,336	-
Other liabilities	-	-	-	-	45,888	45,888	-
Total liabilities	434,029	622,763	723	-	899,476	1,956,991	
Interest sensitivity gap	37,963	373,978	410,253	105,582	(495,259)	432,517	

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.2 Market risk (continued)

Interest rate risk (continued)

	Upto 3 months AED'000	3 months to 1 year AED'000	1 year to 5 years AED'000	Over 5 years AED'000	Non interest bearing AED'000	Total AED'000	Effective interest rate (%)
At 31 December 2017							
Assets							
Cash and balances with the UAE Central Bank	-	-	-	-	787,439	787,439	-
Due from other banks	71,730	-	-	-	296,055	367,785	0.51
Due from the Head Office and other branches	51,422	91,907	-	-	129,455	272,784	2.09
Loans and advances	192,404	915,333	312,250	-	(3,090)	1,416,897	3.14
Investment securities	-	-	100,000	-	-	100,000	3.17
Customer acceptances	-	-	-	-	2,835	2,835	-
Other assets	-	-	-	-	95,657	95,657	-
Total financial assets	315,556	1,007,240	412,250	-	1,308,351	3,043,397	
Liabilities							
Due to the Head Office and other branches	151,732	35,797	-	-	44,532	232,061	0.30
Customer deposits	574,929	476,048	-	-	1,140,573	2,191,550	0.44
Customer acceptances	-	-	-	-	2,835	2,835	-
Other liabilities	-	-	-	-	103,824	103,824	-
Total liabilities	726,661	511,845	-	-	1,291,764	2,530,270	
Interest sensitivity gap	(411,105)	495,395	412,250	-	16,587	513,127	

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.2 Market risk (continued)

Interest rate risk (continued)

Interest rate risk is also assessed by measuring the impact of a reasonably possible change in interest rate movements. The Bank 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:

	<i>Interest income AED '000</i>	<i>Interest expense AED '000</i>
As at 31 December 2018		
Fluctuation in yield by 25 bps	4,668	2,442
As at 31 December 2017		
Fluctuation in yield by 25 bps	9,332	5,609

The interest rate sensitivities set out above are illustrative only and employ simplified scenarios. The sensitivity does not incorporate actions that could be taken by management to mitigate the effect of interest

3.3 Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfill commitments to lend.

The Bank manages its liquidity in accordance with UAE Central Bank requirements and the Bank's internal guidelines mandated by ALCO. The UAE Central Bank has prescribed reserve requirements on deposits at 1% and 14% on time and demand deposits respectively. The UAE Central Bank also imposes mandatory 1:1 lending to stable resources ratio whereby loans and advances (combined with financial guarantees and inter-bank placements having a remaining term of greater than three months) should not exceed stable funds as defined by the UAE Central Bank. ALCO of the Bank monitors liquidity ratios on a regular basis.

The table below presents the cash flows payable by the Bank under non-derivative financial liabilities by remaining contractual maturities at the reporting date. The amounts disclosed in the table are the contractual undiscounted cash outflows based on the current applicable interest rates.

	<i>Up to 3 months AED '000</i>	<i>3 months to 1 year AED '000</i>	<i>1 – 5 years AED '000</i>	<i>Over 5 years AED '000</i>	<i>Total AED '000</i>
At 31 December 2018					
Due to other banks	130	-	-	-	130
Due to the Head Office and other branches	46,387	-	-	-	46,387
Customer deposits	1,270,450	586,962	-	-	1,857,412
Other liabilities	45,888	-	-	-	45,888
	1,362,855	586,962	-	-	1,949,817

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.3 Liquidity risk (continued)

<i>At 31 December 2017</i>	<i>Up to 3 months AED '000</i>	<i>3 months to 1 year AED '000</i>	<i>1 – 5 years AED '000</i>	<i>Over 5 years AED '000</i>	<i>Total AED '000</i>
Due to other banks	-	-	-	-	-
Due to the Head Office and other branches	196,264	35,797	-	-	232,061
Customer deposits	1,720,161	473,924	-	-	2,194,085
Other liabilities	103,824	-	-	-	103,824
	<u>2,020,249</u>	<u>509,721</u>	<u>-</u>	<u>-</u>	<u>2,529,970</u>

3.4 Operational risk

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

3.5 Fair value of financial assets and liabilities

Financial assets consist of cash and balances with the UAE Central Bank, due from other banks, due from the Head Office and other branches, loans and advances, investment securities, accrued interest, other receivables and customer acceptances. Financial liabilities consist of due to other banks, due to the Head Office and other branches, customer deposits, customer acceptances, accrued income and other payables.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at measurement date.

The fair values of financial instruments are not materially different from their carrying values.

Analysis of financial instruments recorded at fair value by level of the fair value hierarchy

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments which are carried at fair value by the following valuation techniques:

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

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.

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

As at year end, investment securities classified as FVOCI amounted to AED 299,130 thousand (2017: Classified as AFS amounted to AED 100,000 thousand) as mentioned in note 9, of which investment securities amounting to AED 199,130 thousand (2017: Nil) were falling under level 1 category and investment securities amounting to AED 100,000 thousand (2017: 100,000) were falling under level 3.

During the year, there was no movement between the level 1 and level 2 of the fair value hierarchy. During current or prior year, bank has not classified any financial instrument in level 3 of the fair value hierarchy.

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.6 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 UAE Central Bank;
- 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 UAE Central Bank. The required information is filed with the regulators on a quarterly and annual basis.

The UAE Central Bank issued Basel III capital regulation which came into effect from December 31, 2017, introducing minimum capital requirement at three level: common equity tier 1 (CET1, Tier 1 (T1) and Total Capital.

Minimum transitional arrangements as per CBUAE are as follows:

Capital element

Minimum common equity tier 1 ratio	7.00%
Minimum tier 1 capital ratio	8.50%
Minimum capital adequacy ratio	10.50%
Capital conservation buffer	1.88%

The capital adequacy ratio as per Basel III framework is given below:

	2018 AED '000	2017 AED '000
Tier 1 capital		
Allocated capital	373,072	373,072
Statutory reserves	20,532	20,532
Retained earnings	38,049	119,523
Fair value and other reserves	864	-
Regulatory adjustment	(102)	(65)
Total Tier 1 capital	432,415	513,062
Tier 2 capital		
Collective impairment provision	21,137	22,981
Total Tier 2 capital	21,137	22,981
Total capital base	453,552	536,043
Risk Weighted Assets		
Credit risk	1,690,940	1,838,477
Market risk	880	68,764
Operational risk	273,788	276,819
Total risk weighted assets	1,965,608	2,184,060
Capital Adequacy Ratio (%)	23.07	24.54
Tier 1 capital to risk weighted assets ratio (%)	22.00	23.49

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.7 Credit Quality Analysis

As of 31 December 2018

	Stage 1		Stage 2		Stage 3		Total	
	Exposure AED '000	ECL AED '000	Exposure AED '000	ECL AED '000	Exposure AED '000	ECL AED '000	Exposure AED '000	ECL AED '000
Cash and balances with the UAE Central Bank	276,956	-	-	-	-	-	276,956	-
Due from other banks	142,432	-	-	-	-	-	142,432	-
Due from the Head Office and other branches	141,900	-	-	-	-	-	141,900	-
Loans and advances	924,735	9,007	496,468	13,629	326,904	322,210	1,748,107	344,846
Investment securities	299,130	1,913	-	-	-	-	299,130	1,913
Other assets	59,923	-	-	-	-	-	59,923	-
Unfunded exposure	219,331	597	148,504	219	-	-	367,835	816
	<u>2,064,407</u>	<u>11,517</u>	<u>644,972</u>	<u>13,848</u>	<u>326,904</u>	<u>322,210</u>	<u>3,036,283</u>	<u>347,575</u>

The impairment allowance against financial instruments classified as FVOCI is routed through other comprehensive income and not deducted from carrying value in the statement of financial position.

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.7 Credit Quality Analysis (continued)

As of 1 January 2018

	Stage 1		Stage 2		Stage 3		Total	
	Exposure AED '000	ECL AED '000	Exposure AED '000	ECL AED '000	Exposure AED '000	ECL AED '000	Exposure AED '000	ECL AED '000
Cash and balances with the UAE Central Bank	787,439	-	-	-	-	-	787,439	-
Due from other banks	367,785	-	-	-	-	-	367,785	-
Due from the Head Office and other branches	272,784	-	-	-	-	-	272,784	-
Loans and advances	1,140,826	5,932	279,161	20,484	312,584	288,091	1,732,571	314,507
Investment securities	100,000	10	-	-	-	-	100,000	10
Other assets	59,840	-	-	-	-	-	59,840	-
Unfunded exposure	235,858	888	63,313	269	-	-	299,171	1,157
	2,964,532	6,830	342,474	20,753	312,584	288,091	3,619,590	315,674

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

3 FINANCIAL RISK MANAGEMENT (continued)

3.8 Transition impact

The following tables 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 Bank's financial assets and financial liabilities as at 1 January 2018

Financial assets

	IAS 39 classification	IFRS 9 classification	IAS 39 carrying amount AED '000	Impact of ECL* AED '000	IFRS 9 carrying amount AED '000
Cash and balances with the UAE Central Bank	Amortised cost	Amortised cost	787,439	-	787,439
Due from other banks	Amortised cost	Amortised cost	367,785	-	367,785
Due from the Head Office and other branches	Amortised cost	Amortised cost	272,784	-	272,784
Loans and advances	Loans and receivables	Amortised cost	1,416,897	1,167	1,418,064
Investment securities	Available for sale - debt	FVOCI	100,000	-	100,000
Other assets	Amortised cost	Amortised cost	59,840	-	59,840
			<u>3,004,745</u>	<u>1,167</u>	<u>3,005,912</u>

Financial liabilities

	IAS 39 classification	IFRS 9 classification	IAS 39 carrying amount AED '000	Impact of ECL* AED '000	IFRS 9 carrying amount AED '000
Due to other banks	Amortised cost	Amortised cost	-	-	-
Due to the Head Office and other branches	Amortised cost	Amortised cost	232,061	-	232,061
Customer deposits	Amortised cost	Amortised cost	2,191,550	-	2,191,550
Customer acceptances	Amortised cost	Amortised cost	2,835	-	2,835
Other liabilities	Amortised cost	Amortised cost	95,332	(1,157)	94,175
			<u>5,526,523</u>	<u>10</u>	<u>5,526,533</u>

* Note: Collective provisioning as at 1 January 2018 was reclassified to other liabilities for unfunded exposure amounting to AED 1,157 thousand and AED 10 thousand to OCI due to adoption of IFRS 9 from 1 January 2018.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of the financial statements requires management to make estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty and actual results may therefore differ, resulting in future changes in these estimates.

In particular, considerable management judgment is required in respect of the following issues:

Going concern

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

Impairment of non-financial assets

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or CGU's fair value less costs to sell and its value in use.

In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by other available fair value indicators.

Applicable from 1 January 2018:

Financial asset classification

Assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding.

Significant increase in credit risk

As explained in note 2.3 (c), 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 Bank takes into account qualitative and quantitative reasonable and supportable forward looking information.

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. Refer to note 2.3 (c) for details of the characteristics considered in this judgement. 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 Bank 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. See note 2.3 (c) for more details on ECL.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Applicable before 1 January 2018:

Impairment losses on loans and advances

The Bank reviews its loan portfolios to assess impairment at each reporting date. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio.

This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows (excluding future expected credit losses that have not yet been incurred). The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Impairment of available-for-sale investments

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment. In making this judgment, the Bank evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology or operational and financing cash flows.

Key sources of estimation uncertainty

The following are key estimations that have been used in the process of applying the Bank's accounting policies:

Applicable from 1 January 2018:

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 Bank 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.

Applicable before 1 January 2018:

Fair value measurement and valuation process: In estimating the fair value of a financial asset or a liability, the Bank uses market-observable data to the extent it is available. Where such Level 1 inputs are not available the Bank uses valuation models to determine the fair value of its financial instruments. Refer to note 3.1 (b) for more details on fair value measurement.

Income taxes

The Bank is subject to income taxes in the United Arab Emirates. Significant estimates are required to determine the provision for income taxes. The Bank recognises liabilities for anticipated tax based on significant estimates of the amount of tax that will be due. Where the final outcome is different from the amounts that were initially recorded, such differences will impact the provision for income tax.

Deferred tax

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

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

5 CASH AND BALANCES WITH THE UAE CENTRAL BANK

	<i>2018</i> <i>AED '000</i>	<i>2017</i> <i>AED '000</i>
Cash in hand	24,798	39,667
With the UAE Central Bank in:		
Statutory deposits	161,787	442,241
Current accounts	<u>90,371</u>	<u>305,531</u>
	<u>276,956</u>	<u>787,439</u>

The statutory deposits with the UAE Central Bank are not available to finance the day to day operations of the Bank.

6 DUE FROM OTHER BANKS

	<i>2018</i> <i>AED '000</i>	<i>2017</i> <i>AED '000</i>
Placements with original maturity equal to / less than 3 months	130,295	71,730
Current accounts	<u>12,137</u>	<u>296,055</u>
	<u>142,432</u>	<u>367,785</u>

Placements with other banks are at rates 0.75% to 3.0% per annum (2017: 1.35% to 1.5%).

7 DUE FROM THE HEAD OFFICE AND OTHER BRANCHES

	<i>2018</i> <i>AED '000</i>	<i>2017</i> <i>AED '000</i>
Placements with original maturity over 3 months	82,690	91,907
Placements with original maturity equal to / less than 3 months	51,973	51,422
Current accounts	<u>7,237</u>	<u>129,455</u>
	<u>141,900</u>	<u>272,784</u>

Placements with head office and other branches are at rates 3.5% to 8.9% per annum (2017: 1.25% to 7.62%).

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

8 LOANS AND ADVANCES

	2018 AED '000	2017 AED '000
Corporate loans	1,736,679	1,719,885
Retail loans	11,428	12,686
Total	1,748,107	1,732,571
Less:		
Allowance for impairment	(344,846)	(315,674)
Net loans and advances	1,403,261	1,416,897

8.1 Analysis of gross loans and advances

	2018 AED '000	2017 AED '000
Loans	683,629	885,157
Overdrafts	124,751	103,866
Loans against trust receipts	266,567	408,898
Bills discounted	673,160	334,650
Total	1,748,107	1,732,571

8.2 An analysis of changes in the gross carrying amount and the corresponding ECL allowances is as follows

	Stage 1	Stage 2	Stage 3	Total
	AED'000			
Gross exposure at 1 January 2018	1,140,826	279,161	312,584	1,732,571
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	(339,385)	339,385	-	-
Transfer to Stage 3	(49,676)	(8,356)	58,032	-
Net additions / (repayments)	172,970	(113,722)	(6,021)	53,227
Amounts written off	-	-	(37,691)	(37,691)
At 31 December 2018	924,735	496,468	326,904	1,748,107

8.3 Allowance for impairment

	Stage 1	Stage 2	Stage 3	Total
	AED'000			
ECL allowance at 31 December 2017	6,830	20,753	288,091	315,674
Impact of adopting IFRS 9	(898)	(269)	-	(1,167)
ECL allowance at 1 January 2018	5,932	20,484	288,091	314,507
Net impairment charge / (reversals)	3,075	(6,855)	71,701	67,921
Bad debts recovery	-	-	109	109
Amounts written off	-	-	(37,691)	(37,691)
At 31 December 2018	9,007	13,629	322,210	344,846

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

8 LOANS AND ADVANCES (continued)

8.3 Allowance for impairment (continued)

	<i>Specific impairment provision AED '000</i>	<i>Collective impairment provision AED '000</i>	<i>Total AED '000</i>
1 January 2017	229,398	41,359	270,757
Net addition / (reversal) for the year	58,693	(13,776)	44,917
31 December 2017	288,091	27,583	315,674

9 INVESTMENT SECURITIES

	<i>2018 AED '000</i>	<i>2017 AED '000</i>
Fair value through OCI /Available-for-sale investments securities valued at fair value	299,130	100,000
Allowances for impairment losses	1,913	-

As at 31 December 2018, the Bank held bonds with a market value of AED 7.45 million in a fiduciary capacity on behalf of customers' without recourse to itself. Accordingly, these bonds are not included as part of the bank's own portfolio.

10 OTHER ASSETS

	<i>2018 AED '000</i>	<i>2017 AED '000</i>
Interest receivable	20,511	20,460
Prepayments	10,427	5,632
Others	41,332	39,404
Less: Provision held against other assets	(8,059)	(8,059)
	64,211	57,437

During 2012, the Bank acquired a property collateralised against loans and advances as a result of a settlement agreement with its customer. Last year, the property had been transferred to Head Office and receivable of AED 33.083 million was recognised in consideration for the transfer of the property. Total receivable from Head Office as at December 31, 2018 is AED 36.484 million (2017: AED 35.308 million).

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

11 PROPERTY AND EQUIPMENT

	2018	2017
Capital work in process	1,442	7,731
Tangible fixed assets	13,391	7,357
Intangible assets	102	65
	<u>14,935</u>	<u>15,153</u>

	<i>Leasehold improvements</i> <i>AED'000</i>	<i>Furniture, fixture and office equipment</i> <i>AED'000</i>	<i>Computer and accessories</i> <i>AED'000</i>	<i>Motor vehicles</i> <i>AED'000</i>	<i>Total</i> <i>AED'000</i>
Cost:					
1 January 2018	9,010	6,563	5,792	742	22,107
Additions during the year	4,696	4,609	243	-	9,548
Disposals during the year	(3,955)	(757)	(1,355)	-	(6,067)
31 December 2018	<u>9,751</u>	<u>10,415</u>	<u>4,680</u>	<u>742</u>	<u>25,588</u>
Accumulated depreciation:					
1 January 2018	6,653	3,668	4,139	290	14,750
Depreciation charge for the year (note 26)	1,520	1,399	461	70	3,450
Relating to disposals during the year	(3,950)	(698)	(1,355)	-	(6,003)
31 December 2018	<u>4,223</u>	<u>4,369</u>	<u>3,245</u>	<u>360</u>	<u>12,197</u>
Net book value:					
31 December 2018	<u>5,528</u>	<u>6,046</u>	<u>1,435</u>	<u>382</u>	<u>13,391</u>

	<i>Leasehold improvements</i> <i>AED'000</i>	<i>Furniture, fixture and office equipment</i> <i>AED'000</i>	<i>Computer and accessories</i> <i>AED'000</i>	<i>Motor vehicles</i> <i>AED'000</i>	<i>Total</i> <i>AED'000</i>
Cost:					
1 January 2017	8,958	6,546	5,949	805	22,258
Additions during the year	52	816	1,071	-	1,939
Disposals during the year	-	(799)	(1,228)	(63)	(2,090)
31 December 2017	<u>9,010</u>	<u>6,563</u>	<u>5,792</u>	<u>742</u>	<u>22,107</u>
Accumulated depreciation:					
1 January 2017	5,756	3,253	4,686	283	13,978
Depreciation charge for the year (note 26)	897	1,032	600	70	2,599
Relating to disposals during the year	-	(617)	(1,147)	(63)	(1,827)
31 December 2017	<u>6,653</u>	<u>3,668</u>	<u>4,139</u>	<u>290</u>	<u>14,750</u>
Net book value:					
31 December 2017	<u>2,357</u>	<u>2,895</u>	<u>1,653</u>	<u>452</u>	<u>7,357</u>

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

11 PROPERTY AND EQUIPMENT (continued)

With effect from January 2018, the estimated useful lives of certain items of furniture and fixtures and electrical, office and computer equipment have been revised to make them more reflective of the consumption pattern of the assets. The effect of these changes is resulting in reduction in depreciation expense which is as follows:

	<i>2018</i>
	<i>AED '000</i>
Electrical Eqpt.	53
Furniture & Fixture	139
Computer and accessories	118
	<u>310</u>

12 DUE TO OTHER BANKS

	<i>2018</i>	<i>2017</i>
	<i>AED '000</i>	<i>AED '000</i>
Current accounts	130	-
	<u>130</u>	<u>-</u>

13 DUE TO THE HEAD OFFICE AND OTHER BRANCHES

	<i>2018</i>	<i>2017</i>
	<i>AED '000</i>	<i>AED '000</i>
Current accounts	10,590	44,532
Borrowings with original maturity equal to / less than 3 months	35,797	151,732
Borrowings with original maturity over 3 months	-	35,797
	<u>46,387</u>	<u>232,061</u>

Borrowings are obtained at interest rate of 0% per annum (2017: 0% to 2.10%).

14 CUSTOMER DEPOSITS

	<i>2018</i>	<i>2017</i>
	<i>AED '000</i>	<i>AED '000</i>
Current deposits	788,899	1,085,883
Time deposits	637,132	520,523
Savings deposits	383,863	530,454
Others	44,356	54,690
	<u>1,854,250</u>	<u>2,191,550</u>

At 31 December 2018, 12 customers accounted for 20% (2017: 19%) of total customer deposits. At 31 December 2018, deposits amounting to AED 141 million (2017: AED 160 million) were held as cash collateral for loans and advances to customers.

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

15 OTHER LIABILITIES

	2018 AED '000	2017 AED '000
Manager's cheques	18,878	65,793
Accrued interest payable	5,508	5,433
Provision for employees' end of service benefits (note 16)	6,214	6,583
Income tax payable	1,278	2,388
Others	13,194	23,627
Impairment allowance against unfunded exposure	816	-
	<u>45,888</u>	<u>103,824</u>

16 PROVISION FOR EMPLOYEES' END OF SERVICE BENEFITS

	2018 AED '000	2017 AED '000
Balance as at 1 January	6,583	6,240
Charge for the year (note 27)	1,044	1,298
Paid during the year	(1,413)	(955)
At 31 December	<u>6,214</u>	<u>6,583</u>

Provision is also made for the full amount of end of service benefit due to non-UAE national employees in accordance with the UAE Labour Law, for their period of service up to the end of the year. The provision relating to end of service benefit is included in other liabilities.

U.A.E. National employees in the United Arab Emirates are members of the Government-managed retirement pension and social security benefit scheme. As per Federal Labour Law No. 7 of 1999, the Bank is required to contribute between 12.5% - 15% of the "contribution calculation salary" of U.A.E. payroll costs to the retirement benefit scheme to fund the benefits. The employees are also required to contribute 5% of the "contribution calculation salary" to the scheme. The only obligation of the Bank with respect to the retirement pension and social security scheme is to make the specified contributions. The contributions are charged to the income statement.

The Bank provides for staff terminal benefits based on an estimation of the amount of future benefit that employees have earned in return for their service until their retirement. This calculation is performed based on a projected unit credit method.

17 ALLOCATED CAPITAL

The assigned capital of the Bank is AED 373,072 thousand (2017: AED 373,072 thousand) and is provided by the Head Office.

18 STATUTORY RESERVE

In accordance with Article 82 of the UAE Union Law Number 10 of 1980, as amended, 10% of the profit for the year is required to be transferred to a statutory reserve which is non-distributable. Allocations to this reserve are required to be made until such time as the balance in this reserve equals 50% of the allocated capital.

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

19 FAIR VALUE AND OTHER RESERVES

	<i>2018</i> <i>AED '000</i>	<i>2017</i> <i>AED '000</i>
Fair value through OCI investment securities / available-for-sale investment securities		
At 1 January	-	2,889
Net unrealised loss on Fair value through OCI securities / available-for-sale investment securities	(1,049)	(2,889)
Impairment on investments under IFRS 9	1,913	-
At 31 December	<u>864</u>	<u>-</u>

Amount of AED 10 thousand pertains to the adoption of IFRS 9 as at 1 January 2018.

20 DERIVATIVE FINANCIAL INSTRUMENTS

The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are indicative of neither the market risk nor the credit risk. All such derivatives are due less than one year.

	<i>Assets</i> <i>2018</i> <i>AED '000</i>	<i>Liabilities</i> <i>2018</i> <i>AED '000</i>	<i>Notional</i> <i>amount</i> <i>2018</i> <i>AED '000</i>	<i>Assets</i> <i>2017</i> <i>AED '000</i>	<i>Liabilities</i> <i>2017</i> <i>AED '000</i>	<i>Notional</i> <i>amount</i> <i>2017</i> <i>AED '000</i>
Derivatives held for trading:						
Forward foreign exchange contracts	503	-	863,972	407	-	677,733
Interest rate swaps	-	-	1,603	-	-	5,908
	<u>503</u>	<u>-</u>	<u>865,575</u>	<u>407</u>	<u>-</u>	<u>683,641</u>

21 CONTINGENCIES AND COMMITMENTS

	<i>2018</i> <i>AED '000</i>	<i>2017</i> <i>AED '000</i>
Letters of credit	<u>148,350</u>	<u>43,079</u>
Letters of guarantee	<u>209,149</u>	<u>253,257</u>
Forward foreign exchange contracts	<u>863,972</u>	<u>677,733</u>
Undrawn credit commitments	<u>500,592</u>	<u>576,846</u>

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

21 CONTINGENCIES AND COMMITMENTS (continued)

Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet his obligations to third parties. Documentary and commercial letters of credit, which 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, are collateralised by the underlying shipments of goods to which they relate and therefore have significantly less risk. Cash requirements under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement.

Forward foreign exchange contracts comprise commitments to purchase or sell foreign currencies on behalf of customers and in respect of the Bank's proprietary activity.

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

22 INTEREST INCOME

	2018 AED '000	2017 AED '000
Interest income on:		
- loans and advances	48,193	81,913
- due from the Head Office, branches and other banks	11,002	9,725
- investment securities	5,315	16,043
	<u>64,510</u>	<u>107,681</u>

23 INTEREST EXPENSE

	2018 AED '000	2017 AED '000
Interest expense on:		
- customer deposits	9,711	18,483
- due to the Head Office, branches and other banks	662	275
	<u>10,373</u>	<u>18,758</u>

24 FEE AND COMMISSION INCOME

	2018 AED '000	2017 AED '000
Letters of credit / guarantees	6,531	9,969
Loan Processing fee	1,860	2,942
Interbank fund transfer	740	4,018
Incidental charges	4,069	3,202
Basic Banking charges	1,596	2,319
Remittance income	1,593	2,526
Others	2,062	2,532
	<u>18,451</u>	<u>27,508</u>

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

25 OTHER INCOME

	<i>2018</i> <i>AED '000</i>	<i>2017</i> <i>AED '000</i>
Foreign exchange income	9,954	23,002
Gain on sale of investment	-	1,549
Miscellaneous income	1,194	1,112
	<u>11,148</u>	<u>25,663</u>

26 OPERATING EXPENSES

	<i>2018</i> <i>AED '000</i>	<i>2017</i> <i>AED '000</i>
Staff costs (note 27)	44,457	53,138
Professional consultancy	15,045	1,152
Rent and insurance	9,648	8,905
Communication costs	1,088	1,231
Depreciation (note 11)	3,450	2,599
Amortisation	3	7
Branch license fee	2,116	2,073
Others	9,671	11,223
	<u>85,478</u>	<u>80,328</u>

No social contributions were made during the year ended 31 December 2018 (2017: Nil).

27 STAFF COSTS

	<i>2018</i> <i>AED '000</i>	<i>2017</i> <i>AED '000</i>
Salaries and allowances	40,665	49,413
Charge for employees' end of service benefits (note 16)	1,044	1,298
Medical expenses	2,748	2,427
	<u>44,457</u>	<u>53,138</u>

28 TAXATION

The taxable income is calculated after making certain adjustments to the net profit before tax for the year and is based on management's best estimate. The components of income tax expense for the year are:

	<i>2018</i> <i>AED '000</i>	<i>2017</i> <i>AED '000</i>
Current tax:		
- current income tax	-	2,384
- adjustment in respect of current income tax of prior years	12,510	7,622
	<u>12,510</u>	<u>10,006</u>
Deferred tax :		
- Relating to origination and reversal of temporary differences	(13,280)	(5,671)
	<u>(770)</u>	<u>4,335</u>

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

28 TAXATION (continued)

28.1 Reconciliation between taxation (benefit) / expense and accounting profit

	2018 AED '000	2017 AED '000
Net profit for the year before taxation	(71,225)	16,849
Tax on income @ 20% (2017: 20%)	-	3,370
- Prior year current tax	12,510	7,622
- Disallowed provisions	(13,280)	(6,802)
- Tax losses for which no deferred tax has been recognised	-	145
Income tax (benefit)/expense for the year	<u>(770)</u>	<u>4,335</u>

28.2 Prior year taxation

Tax assessed by the tax authorities for the prior assessment years was in excess of the tax provision maintained by the Bank by AED 12,510 thousand (2017: AED 7,622 thousand). Such shortfall was charged to income statement by the Bank and has been settled during the year.

28.3 Deferred tax asset

Deferred taxes are calculated on all temporary differences using an effective tax rate of 20%.
The movement on the deferred tax account on provision is as follows:

	2018 AED '000	2017 AED '000
At 1 January	23,067	17,395
Additions during the year	13,280	5,672
At 31 December	<u>36,347</u>	<u>23,067</u>

29 CASH AND CASH EQUIVALENTS

	2018 AED '000	2017 AED '000
Cash and balances with the UAE Central Bank (excluding statutory deposits)	115,169	345,198
Due from other banks	142,432	367,785
Due from the Head Office and other branches	59,210	180,877
	<u>316,811</u>	<u>893,860</u>
Due to other banks	(130)	-
Due to the Head Office and other branches	(46,387)	(196,264)
	<u>270,294</u>	<u>697,596</u>

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

30 MATURITY PROFILE OF ASSETS AND LIABILITIES

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 Bank and its exposure to changes in interest rates and exchange rates.

The table below analyses assets and liabilities of the Bank at the reporting date into relevant maturity groupings based on the remaining period to the contractual maturity

	At 31 December 2018							
	Up to 3 months AED '000	3 months to 1 year AED '000	Up to 1 year		Over		More than	
			Subtotal AED '000	1 – 5 years AED '000	5 years AED '000	1 year Subtotal AED '000	No fixed maturity AED '000	Total AED '000
Assets								
Cash and balances with the UAE Central Bank	276,956	-	276,956	-	-	-	-	276,956
Due from other banks	142,432	-	142,432	-	-	-	-	142,432
Due from the Head Office and other branches	77,575	64,325	141,900	-	-	-	-	141,900
Loans and advances	634,734	640,286	1,275,020	123,775	4,466	128,241	-	1,403,261
Investment securities	50,000	195,343	245,343	53,787	-	53,787	-	299,130
Customer acceptances	9,613	723	10,336	-	-	-	-	10,336
Deferred tax asset	-	-	-	-	-	-	36,347	36,347
Other assets	-	-	-	-	-	-	64,211	64,211
Property and equipment	-	-	-	-	-	-	14,935	14,935
Total Assets	1,191,310	900,677	2,091,987	177,562	4,466	182,028	115,493	2,389,508

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

30 MATURITY PROFILE OF ASSETS AND LIABILITIES (continued)

	Up to 3 months AED '000	3 months to 1 year AED '000	Up to 1 year Subtotal AED '000	1 – 5 years AED '000	Over 5 years AED '000	More than 1 year Subtotal AED '000	No fixed maturity AED '000	Total AED '000
Liabilities								
Borrowings from other banks	130	-	130	-	-	-	-	130
Due to the Head Office and other branches	46,387	-	46,387	-	-	-	-	46,387
Customer deposits	1,420,794	433,456	1,854,250	-	-	-	-	1,854,250
Customer acceptances	9,613	723	10,336	-	-	-	-	10,336
Other liabilities	-	-	-	-	6,796	6,796	39,092	45,888
Total liabilities	1,476,924	434,179	1,911,103	-	6,796	6,796	39,092	1,956,991
Net liquidity gap	(285,614)	466,498	180,884	177,562	(2,330)	175,232	76,401	432,517
Capital and reserves								
Allocated capital								373,072
Statutory reserve								20,532
Retained earnings								38,049
Fair value reserve								864
Total								432,517

Habib Bank Limited - UAE Branches

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2018

30 MATURITY PROFILE OF ASSETS AND LIABILITIES

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 Bank and its exposure to changes in interest rates and exchange rates.

The table below analyses assets and liabilities of the Bank at the reporting date into relevant maturity groupings based on the remaining period to the contractual maturity

	At 31 December 2017	Assets						Liabilities			
		Up to 3 months		3 months to 1 year		Up to 1 year		Over 5 years		More than 1 year	
		AED '000	AED '000	AED '000	AED '000	Subtotal AED '000	AED '000	Subtotal AED '000	AED '000	Subtotal AED '000	No fixed maturity AED '000
Cash and balances with the UAE Central Bank	787,439	-	-	-	-	787,439	-	-	-	-	-
Due from other banks	367,785	-	-	-	-	367,785	-	-	-	-	-
Due from the Head Office and other branches	199,242	73,542	-	-	-	272,784	-	-	-	-	-
Loans and advances	762,131	320,676	-	319,756	14,334	1,082,807	334,090	-	-	-	-
Investment securities	-	-	-	100,000	-	-	100,000	-	-	-	-
Customer acceptances	1,848	987	-	-	-	2,835	-	-	-	-	-
Deferred tax asset	-	-	-	-	-	-	-	-	-	-	-
Other assets	-	-	-	-	-	-	-	-	-	-	-
Property and equipment	-	-	-	-	-	-	-	-	-	-	-
Total Assets	2,118,445	395,205	419,756	14,334	434,090	2,513,650	95,657	3,043,397			

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

30 MATURITY PROFILE OF ASSETS AND LIABILITIES (continued)

	Up to 3 months AED '000	3 months to 1 year AED '000	Up to 1 year Subtotal AED '000	1 - 5 years AED '000	Over 5 years AED '000	More than 1 year Subtotal AED '000	No fixed maturity AED '000	Total AED '000
Liabilities								
Due to the Head Office and other branches								
Customer deposits	196,264	35,797	232,061	-	-	-	-	232,061
Customer acceptances	1,826,420	365,130	2,191,550	-	-	-	-	2,191,550
Other liabilities	1,848	987	2,835	-	-	-	-	2,835
	-	-	-	-	8,095	8,095	95,729	103,824
Total liabilities	2,024,532	401,914	2,426,446	-	8,095	8,095	95,729	2,530,270
Net liquidity gap	93,913	(6,709)	87,204	419,756	6,239	425,995	(72)	513,127
Capital and reserves								
Allocated capital								373,072
Statutory reserve								20,532
Retained earnings								119,523
Total								513,127

In the above table, all current account and saving account balances have been classified as maturing in upto 3 months column. However, in normal course of events, and based on historical trend all of them are not withdrawn within three months.

Habib Bank Limited - UAE Branches
NOTES TO THE FINANCIAL STATEMENTS
As at 31 December 2018

31 RELATED PARTIES

Related parties include the Head Office, key management personnel and entities controlled, jointly controlled or significantly influenced by such parties. A number of banking transactions are entered into with the Head Office and other branches in the normal course of business. All the transactions with the related parties were carried out on commercial terms and conditions and were duly approved by management of the Bank.

	<i>2018</i> <i>AED'000</i>	<i>2017</i> <i>AED'000</i>
Related party balances		
<i>Advances</i>		
Head office and other branches	44,284	41,574
Key management personnel	-	-
Other related parties	49,731	84,528
	<u>94,015</u>	<u>126,102</u>
<i>Deposits</i>		
Key management personnel	<u>330</u>	<u>707</u>
<i>Current accounts due from related parties</i>		
Head office and other branches	<u>7,237</u>	<u>129,455</u>
<i>Outstanding placements due from related parties</i>		
Head office and other branches	<u>134,663</u>	<u>143,329</u>
<i>Due to related parties</i>		
Head office and other branches	<u>46,387</u>	<u>232,061</u>
<i>Other assets</i>		
Receivable from Head office (Please refer note no. 10)		
Interest receivable	<u>392</u>	<u>112</u>
<i>Other contingencies</i>	<u>-</u>	<u>3,869</u>
Transactions during the year		
Mark-up / return / interest earned	<u>10,001</u>	<u>9,635</u>
Mark-up / return / interest expensed	<u>400</u>	<u>271</u>
Other expenses	<u>30</u>	<u>30</u>
Remuneration paid to key management personnel	<u>1,578</u>	<u>2,504</u>

During the year, the Bank has not recorded any impairment of the amounts due from related parties.