

# Consolidated Financial Statements

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National Bank of Kuwait Group  
**CONSOLIDATED STATEMENT OF INCOME**  
For the year ended 31 December 2017

|  | <i>Notes</i> | <b>2017</b><br><b>KD 000's</b> | <b>2016</b><br><b>KD 000's</b> |
|--|--------------|--------------------------------|--------------------------------|
| Interest income  | 4            | <b>742,616</b>                 | 665,263                        |
| Interest expense   | 5            | <b>223,762</b>                 | 189,653                        |
| <b>Net interest income</b>   |              | <b>518,854</b>                 | 475,610                        |
| Murabaha and other Islamic financing income                                      |              | <b>155,903</b>                 | 128,000                        |
| Finance cost and Distribution to depositors                                      |              | <b>45,793</b>                  | 33,873                         |
| <b>Net income from Islamic financing</b>   |              | <b>110,110</b>                 | 94,127                         |
| <b>Net interest income and net income from Islamic financing</b>                 |              | <b>628,964</b>                 | 569,737                        |
| Net fees and commissions   | 6            | <b>138,556</b>                 | 132,826                        |
| Net investment income  | 7            | <b>19,818</b>                  | 6,398                          |
| Net gains from dealing in foreign currencies                                     |              | <b>33,735</b>                  | 35,391                         |
| Other operating income   |              | <b>1,600</b>                   | 957                            |
| <b>Non-interest income</b>   |              | <b>193,709</b>                 | 175,572                        |
| <b>Net operating income</b>  |              | <b>822,673</b>                 | 745,309                        |
| Staff expenses   |              | <b>154,472</b>                 | 143,844                        |
| Other administrative expenses  |              | <b>92,731</b>                  | 87,435                         |
| Depreciation of premises and equipment   |              | <b>15,121</b>                  | 16,380                         |
| Amortisation of intangible assets  | 15           | <b>3,121</b>                   | 4,362                          |
| <b>Operating expenses</b>  |              | <b>265,445</b>                 | 252,021                        |
| <b>Operating profit before provision for credit losses and impairment losses</b> |              | <b>557,228</b>                 | 493,288                        |
| <b>Provision charge for credit losses and impairment losses</b>                  | 8            | <b>188,219</b>                 | 152,317                        |
| <b>Operating profit before taxation</b>  |              | <b>369,009</b>                 | 340,971                        |
| Taxation   | 9            | <b>26,704</b>                  | 28,811                         |
| <b>Profit for the year</b>   |              | <b>342,305</b>                 | 312,160                        |
| Attributable to:   |              |                                |                                |
| Shareholders of the Bank   |              | <b>322,362</b>                 | 295,178                        |
| Non-controlling interests  |              | <b>19,943</b>                  | 16,982                         |
|  |              | <b>342,305</b>                 | 312,160                        |
| <b>Basic earnings per share attributable to shareholders of the Bank</b>         | 10           | <b>53 fils</b>                 | 49 fils                        |

The attached notes 1 to 32 form part of these consolidated financial statements.

National Bank of Kuwait Group

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2017

|  | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|--|--------------------------------|--------------------------------|
| <b>Profit for the year</b>   | <b>342,305</b>                 | 312,160                        |
| <b>Other comprehensive income:</b>   |                                |                                |
| Investments available for sale:  |                                |                                |
| Net change in fair value   | <b>13,633</b>                  | 14,689                         |
| Net transfer to consolidated statement of income   | <b>(13,450)</b>                | 4,713                          |
|  | <b>183</b>                     | 19,402                         |
| Share of other comprehensive income of associates  | <b>246</b>                     | 7                              |
| Exchange differences on translation of foreign operations  | <b>2,919</b>                   | (159,012)                      |
| <b>Other comprehensive income (loss) for the year reclassifiable to consolidated statement of income in subsequent years</b> | <b>3,348</b>                   | (139,603)                      |
| <b>Total comprehensive income for the year</b>   | <b>345,653</b>                 | 172,557                        |
| <b>Attributable to:</b>  |                                |                                |
| Shareholders of the Bank   | <b>326,144</b>                 | 156,661                        |
| Non-controlling interests  | <b>19,509</b>                  | 15,896                         |
|  | <b>345,653</b>                 | 172,557                        |

The attached notes 1 to 32 form part of these consolidated financial statements.

# National Bank of Kuwait Group

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2017

|  | <i>Notes</i> | <b>2017</b><br><b>KD 000's</b> | <b>2016</b><br><b>KD 000's</b> |
|--|--------------|--------------------------------|--------------------------------|
| <b>Assets</b>                                      |              |                                |                                |
| Cash and short term funds                          | 11           | <b>2,743,640</b>               | 2,686,963                      |
| Central Bank of Kuwait bonds                       | 13           | <b>655,591</b>                 | 748,889                        |
| Kuwait Government treasury bonds                   | 13           | <b>1,076,211</b>               | 493,101                        |
| Deposits with banks                                |              | <b>2,488,188</b>               | 2,407,915                      |
| Loans, advances and Islamic financing to customers | 12           | <b>14,502,609</b>              | 13,611,491                     |
| Investment securities                              | 13           | <b>3,348,996</b>               | 3,178,450                      |
| Investment in associates                           | 14           | <b>63,187</b>                  | 73,644                         |
| Land, premises and equipment                       |              | <b>324,277</b>                 | 255,086                        |
| Goodwill and other intangible assets               | 15           | <b>581,906</b>                 | 581,840                        |
| Other assets                                       | 16           | <b>249,996</b>                 | 201,415                        |
| <b>Total assets</b>                                |              | <b>26,034,601</b>              | 24,238,794                     |
| <b>Liabilities</b>                                 |              |                                |                                |
| Due to banks and other financial institutions      |              | <b>7,469,303</b>               | 7,347,803                      |
| Customer deposits                                  |              | <b>13,779,607</b>              | 12,608,092                     |
| Certificates of deposit issued                     |              | <b>490,835</b>                 | 415,989                        |
| Global medium term notes                           | 17           | <b>221,173</b>                 | -                              |
| Subordinated Tier 2 bonds                          | 18           | <b>124,734</b>                 | 124,700                        |
| Other liabilities                                  | 19           | <b>387,848</b>                 | 337,478                        |
| <b>Total liabilities</b>                           |              | <b>22,473,500</b>              | 20,834,062                     |
| <b>Equity</b>                                      |              |                                |                                |
| Share capital                                      | 20           | <b>591,744</b>                 | 563,566                        |
| Proposed bonus shares                              | 21           | <b>29,588</b>                  | 28,178                         |
| Statutory reserve                                  | 20           | <b>295,872</b>                 | 281,783                        |
| Share premium account                              | 20           | <b>803,028</b>                 | 803,028                        |
| Treasury shares                                    | 20           | <b>(77,799)</b>                | (77,799)                       |
| Treasury share reserve                             | 20           | <b>13,994</b>                  | 13,994                         |
| Other reserves                                     | 20           | <b>1,372,964</b>               | 1,271,813                      |
| Equity attributable to shareholders of the Bank    |              | <b>3,029,391</b>               | 2,884,563                      |
| Perpetual Tier 1 Capital Securities                | 22           | <b>210,700</b>                 | 210,700                        |
| Non-controlling interests                          | 23           | <b>321,010</b>                 | 309,469                        |
| <b>Total equity</b>                                |              | <b>3,561,101</b>               | 3,404,732                      |
| <b>Total liabilities and equity</b>                |              | <b>26,034,601</b>              | 24,238,794                     |

Nasser Musaed Abdullah Al-Sayer  
Chairman

Isam J. Al Sager  
Group Chief Executive Officer

The attached notes 1 to 32 form part of these consolidated financial statements.

# National Bank of Kuwait Group

## CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2017

|   | <i>Notes</i> | <b>2017</b><br><b>KD 000's</b> | <b>2016</b><br><b>KD 000's</b> |
|---|--------------|--------------------------------|--------------------------------|
| <b>Operating activities</b>   |              |                                |                                |
| Profit for the year   |              | <b>342,305</b>                 | 312,160                        |
| Adjustments for:  |              |                                |                                |
| Net investment income   | 7            | <b>(19,818)</b>                | (6,398)                        |
| Depreciation of premises and equipment                              |              | <b>15,121</b>                  | 16,380                         |
| Amortisation of intangible assets                                   | 15           | <b>3,121</b>                   | 4,362                          |
| Provision charge for credit losses and impairment losses            | 8            | <b>188,219</b>                 | 152,317                        |
| Share based payment reserve   |              | <b>358</b>                     | 491                            |
| Taxation  | 9            | <b>26,704</b>                  | 28,811                         |
|   |              | <hr/>                          | <hr/>                          |
| Operating profit before changes in operating assets and liabilities |              | <b>556,010</b>                 | 508,123                        |
| Changes in operating assets and liabilities:                        |              |                                |                                |
| Central Bank of Kuwait bonds  |              | <b>93,298</b>                  | 55,041                         |
| Kuwait Government treasury bonds                                    |              | <b>(583,110)</b>               | (113,049)                      |
| Deposits with banks   |              | <b>(80,273)</b>                | (1,026,578)                    |
| Loans, advances and Islamic financing to customers                  |              | <b>(1,065,748)</b>             | (349,165)                      |
| Other assets  |              | <b>(48,581)</b>                | (7,390)                        |
| Due to banks and other financial institutions                       |              | <b>121,500</b>                 | 107,697                        |
| Customer deposits   |              | <b>1,171,515</b>               | 911,541                        |
| Certificates of deposit issued                                      |              | <b>74,846</b>                  | (239,268)                      |
| Other liabilities   |              | <b>45,472</b>                  | 31,467                         |
| Tax paid  |              | <b>(28,133)</b>                | (28,775)                       |
|   |              | <hr/>                          | <hr/>                          |
| Net cash from (used in) operating activities                        |              | <b>256,796</b>                 | (150,356)                      |
| <b>Investing activities</b>   |              |                                |                                |
| Purchase of investment securities                                   |              | <b>(1,782,370)</b>             | (2,110,056)                    |
| Proceeds from sale/redemption of investment securities              |              | <b>1,627,148</b>               | 1,467,493                      |
| Dividend income   | 7            | <b>3,143</b>                   | 3,065                          |
| Dividend from associates  |              | <b>34</b>                      | 414                            |
| Proceeds from sale of land, premises and equipment                  |              | <b>4,970</b>                   | 4,188                          |
| Purchase of land, premises and equipment                            |              | <b>(89,282)</b>                | (54,021)                       |
| Change in effective holding in subsidiaries                         |              | <b>(707)</b>                   | -                              |
|   |              | <hr/>                          | <hr/>                          |
| Net cash used in investing activities                               |              | <b>(237,064)</b>               | (688,917)                      |
| <b>Financing activities</b>   |              |                                |                                |
| Net proceeds from issuance of Global medium term notes              | 17           | <b>225,880</b>                 | -                              |
| Proceeds from issuance of right shares                              | 20(a)        | -                              | 137,584                        |
| Net proceeds from issue of Perpetual Tier 1 Sukuk by a subsidiary   | 23           | -                              | 74,738                         |
| Dividends paid  |              | <b>(166,184)</b>               | (148,443)                      |
| Interest paid on Perpetual Tier 1 Capital Securities                |              | <b>(12,232)</b>                | (12,146)                       |
| Profit distribution on Perpetual Tier 1 Sukuk by a subsidiary       |              | <b>(5,119)</b>                 | (2,573)                        |
| Dividends paid by a subsidiary to non-controlling interests         |              | <b>(5,400)</b>                 | (4,295)                        |
|   |              | <hr/>                          | <hr/>                          |
| Net cash from financing activities                                  |              | <b>36,945</b>                  | 44,865                         |
|   |              | <hr/>                          | <hr/>                          |
| <b>Increase (decrease) in cash and short term funds</b>             |              | <b>56,677</b>                  | (794,408)                      |
| Cash and short term funds at the beginning of the year              |              | <b>2,686,963</b>               | 3,481,371                      |
|   |              | <hr/>                          | <hr/>                          |
| <b>Cash and short term funds at the end of the year</b>             | 11           | <b>2,743,640</b>               | 2,686,963                      |
|   |              | <hr/> <hr/>                    | <hr/> <hr/>                    |

The attached notes 1 to 32 form part of these consolidated financial statements.

# National Bank of Kuwait Group

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017

KD 000's

|   | <i>Equity attributable to shareholders of the Bank</i> |                                      |                              |                                      |                            |                                       | <i>Other reserves<br/>(Note 20e)</i> | <i>Total</i>     | <i>Perpetual<br/>Tier 1 Capital<br/>Securities</i> | <i>Non -<br/>controlling<br/>interests</i> | <i>Total<br/>equity</i> |
|---|--|--------------------------------------|------------------------------|--------------------------------------|----------------------------|---------------------------------------|--------------------------------------|------------------|--|--|-------------------------|
|   | <i>Share<br/>capital</i>                               | <i>Proposed<br/>bonus<br/>shares</i> | <i>Statutory<br/>reserve</i> | <i>Share<br/>premium<br/>account</i> | <i>Treasury<br/>shares</i> | <i>Treasury<br/>share<br/>reserve</i> |                                      |                  |  |  |                         |
| At 1 January 2017   | 563,566  | 28,178                               | 281,783                      | 803,028                              | (77,799)                   | 13,994                                | 1,271,813                            | <b>2,884,563</b> | 210,700  | 309,469                                    | <b>3,404,732</b>        |
| Profit for the year   | -  | -                                    | -                            | -                                    | -                          | -                                     | 322,362                              | <b>322,362</b>   | -  | 19,943                                     | <b>342,305</b>          |
| Other comprehensive income (loss)                             | -  | -                                    | -                            | -                                    | -                          | -                                     | 3,782                                | <b>3,782</b>     | -  | (434)                                      | <b>3,348</b>            |
| Total comprehensive income                                    | -  | -                                    | -                            | -                                    | -                          | -                                     | <b>326,144</b>                       | <b>326,144</b>   | -  | <b>19,509</b>                              | <b>345,653</b>          |
| Transfer to statutory reserve (Note 20b)                      | -  | -                                    | 14,089                       | -                                    | -                          | -                                     | (14,089)                             | -                | -  | -  | -                       |
| Issue of bonus shares (Note 20a)                              | 28,178   | (28,178)                             | -                            | -                                    | -                          | -                                     | -                                    | -                | -  | -  | -                       |
| Dividends paid  | -  | -                                    | -                            | -                                    | -                          | -                                     | (166,184)                            | <b>(166,184)</b> | -  | -  | <b>(166,184)</b>        |
| Interest paid on perpetual Tier 1 Capital Securities          | -  | -                                    | -                            | -                                    | -                          | -                                     | (12,232)                             | <b>(12,232)</b>  | -  | -  | <b>(12,232)</b>         |
| Share based payment in a subsidiary                           | -  | -                                    | -                            | -                                    | -                          | -                                     | 209                                  | <b>209</b>       | -  | 149  | <b>358</b>              |
| Dividend paid by a subsidiary to non-controlling interests    | -  | -                                    | -                            | -                                    | -                          | -                                     | -                                    | -                | -  | (5,400)                                    | <b>(5,400)</b>          |
| Profit distribution on Perpetual Tier 1 Sukuk by a subsidiary | -  | -                                    | -                            | -                                    | -                          | -                                     | (2,989)                              | <b>(2,989)</b>   | -  | (2,130)                                    | <b>(5,119)</b>          |
| Proposed bonus shares (Note 21)                               | -  | 29,588                               | -                            | -                                    | -                          | -                                     | (29,588)                             | -                | -  | -  | -                       |
| Change in effective holding in subsidiaries                   | -  | -                                    | -                            | -                                    | -                          | -                                     | (120)                                | <b>(120)</b>     | -  | (587)                                      | <b>(707)</b>            |
| <b>At 31 December 2017</b>                                    | <b>591,744</b>   | <b>29,588</b>                        | <b>295,872</b>               | <b>803,028</b>                       | <b>(77,799)</b>            | <b>13,994</b>                         | <b>1,372,964</b>                     | <b>3,029,391</b> | <b>210,700</b>                                     | <b>321,010</b>                             | <b>3,561,101</b>        |

The attached notes 1 to 32 form part of these consolidated financial statements.

# National Bank of Kuwait Group

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017

KD 000's

|  | <i>Equity attributable to shareholders of the Bank</i> |                              |                          |                              |                        |                               |                                  | <i>Total</i> | <i>Perpetual Tier 1 Capital Securities</i> | <i>Non - controlling interests</i> | <i>Total equity</i> |
|--|--|------------------------------|--------------------------|------------------------------|------------------------|-------------------------------|----------------------------------|--------------|--|------------------------------------|---------------------|
|  | <i>Share capital</i>                                   | <i>Proposed bonus shares</i> | <i>Statutory reserve</i> | <i>Share premium account</i> | <i>Treasury shares</i> | <i>Treasury share reserve</i> | <i>Other reserves (Note 20e)</i> |              |  |                                    |                     |
| At 1 January 2016  | 503,972  | 25,198                       | 251,986                  | 699,840                      | (77,799)               | 13,994                        | 1,338,748                        | 2,755,939    | 210,700                                    | 224,485                            | 3,191,124           |
| Profit for the year  | -  | -                            | -                        | -                            | -                      | -                             | 295,178                          | 295,178      | -  | 16,982                             | 312,160             |
| Other comprehensive loss   | -  | -                            | -                        | -                            | -                      | -                             | (138,517)                        | (138,517)    | -  | (1,086)                            | (139,603)           |
| Total comprehensive income   | -  | -                            | -                        | -                            | -                      | -                             | 156,661                          | 156,661      | -  | 15,896                             | 172,557             |
| Transfer to statutory reserve (Note 20b)                             | -  | -                            | 29,797                   | -                            | -                      | -                             | (29,797)                         | -            | -  | -                                  | -                   |
| Issue of bonus shares (Note 20a)                                     | 25,198   | (25,198)                     | -                        | -                            | -                      | -                             | -                                | -            | -  | -                                  | -                   |
| Issue of rights shares (Note 20a)                                    | 34,396   | -                            | -                        | 103,188                      | -                      | -                             | -                                | 137,584      | -  | -                                  | 137,584             |
| Dividends paid   | -  | -                            | -                        | -                            | -                      | -                             | (148,443)                        | (148,443)    | -  | -                                  | (148,443)           |
| Interest paid on perpetual Tier 1 Capital Securities                 | -  | -                            | -                        | -                            | -                      | -                             | (12,146)                         | (12,146)     | -  | -                                  | (12,146)            |
| Transfer to cash settled share based compensation                    | -  | -                            | -                        | -                            | -                      | -                             | (2,418)                          | (2,418)      | -  | -                                  | (2,418)             |
| Share based payment in a subsidiary                                  | -  | -                            | -                        | -                            | -                      | -                             | 287                              | 287          | -  | 204                                | 491                 |
| Dividend paid by a subsidiary to non-controlling interests           | -  | -                            | -                        | -                            | -                      | -                             | -                                | -            | -  | (4,295)                            | (4,295)             |
| Issue of Perpetual Tier 1 Sukuk by a subsidiary (Note 23)            | -  | -                            | -                        | -                            | -                      | -                             | -                                | -            | -  | 75,388                             | 75,388              |
| Transaction costs on issue of Perpetual Tier 1 Sukuk by a subsidiary | -  | -                            | -                        | -                            | -                      | -                             | (379)                            | (379)        | -  | (271)                              | (650)               |
| Profit distribution on Perpetual Tier 1 Sukuk by a subsidiary        | -  | -                            | -                        | -                            | -                      | -                             | (1,503)                          | (1,503)      | -  | (1,070)                            | (2,573)             |
| Proposed bonus shares (Note 21)                                      | -  | 28,178                       | -                        | -                            | -                      | -                             | (28,178)                         | -            | -  | -                                  | -                   |
| Other movements  | -  | -                            | -                        | -                            | -                      | -                             | (1,019)                          | (1,019)      | -  | (868)                              | (1,887)             |
| At 31 December 2016  | 563,566  | 28,178                       | 281,783                  | 803,028                      | (77,799)               | 13,994                        | 1,271,813                        | 2,884,563    | 210,700                                    | 309,469                            | 3,404,732           |

The attached notes 1 to 32 form part of these consolidated financial statements.

## 1 INCORPORATION AND REGISTRATION

The consolidated financial statements of National Bank of Kuwait S.A.K.P. (the “Bank”) and its subsidiaries (collectively the “Group”) for the year ended 31 December 2017 were authorised for issue in accordance with a resolution of the directors on 8 January 2018. The Annual General Assembly of the Shareholders has the power to amend these consolidated financial statements after issuance. The Bank is a public shareholding company incorporated in Kuwait in 1952 and is registered as a bank (commercial registration number - 8490) with the Central Bank of Kuwait. The Bank’s registered office is at Abdullah Al Ahmed Street, P.O. Box 95, Safat 13001, Kuwait. The principal activities of the Bank are described in Note 3.

## 2 SIGNIFICANT ACCOUNTING POLICIES

### 2.1 Basis of preparation

The consolidated financial statements have been prepared in accordance with the regulations of the State of Kuwait for financial services institutions regulated by the Central Bank of Kuwait. These regulations require adoption of all International Financial Reporting Standards (IFRS) as issued by International Accounting Standards Board (IASB) except for International Accounting Standard (IAS) 39, ‘Financial Instruments: Recognition and Measurement’, requirement for a collective provision, which has been replaced by the Central Bank of Kuwait’s requirement for a minimum general provision as described under the accounting policy for impairment of financial assets.

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

### 2.2 Changes in accounting policies

The accounting policies applied are consistent with those used in the previous year. Amendments to IFRSs which are effective for annual accounting period starting from 1 January 2017 did not have any material impact on the accounting policies, financial position or performance of the Group.

#### **Standards issued but not yet effective:**

A number of new standards, amendments to standards and interpretations which are effective for annual periods beginning on or after 1 January 2018 have not been early adopted in the preparation of the Group’s consolidated financial statements. None of these are expected to have a significant impact on the consolidated financial statements of the Group except the following:

#### *IFRS 9: Financial Instruments*

The IASB issued IFRS 9 ‘Financial Instruments’ in its final form in July 2014 and is effective for annual periods beginning on or after 1 January 2018. IFRS 9 sets out the requirements for recognizing and measuring financial assets and financial liabilities, impairment of financial assets and hedge accounting. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement.

The Group has determined the Date of Initial Application for IFRS 9 to be 1 January 2018. The classification, measurement and impairment requirements are applied retrospectively by adjusting the opening consolidated statement of financial position at 1 January 2018. The Group will not restate the comparatives as permitted by IFRS 9.

#### a. Classification and measurement

The classification and measurement of financial assets will depend on how these are managed (the entity’s business model) and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income or fair value through statement of income.

Equity instruments are measured at fair value through profit or loss. However, the Group may, at initial recognition of a non-trading equity instrument, irrevocably elect to designate the instrument as fair value through other comprehensive income, with no subsequent recycling to consolidated statement of income. This designation is also available to non-trading equity instrument holdings on date of transition.

The adoption of this standard will have an impact on the classification and measurement of Group’s financial assets but is not expected to have a significant impact on the classification and measurement of financial liabilities.

#### b. Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks. The Group will adopt accounting requirements of hedge accounting requirements as per IFRS 9 and does not expect any significant impact on its financial position.



## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.2 Changes in accounting policies (continued)

#### c. Impairment of financial assets

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

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

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

The Group has completed the development and testing of operating models and methodologies for the calculation of ECL. The Group has also performed parallel runs during the year to gain a better understanding of the potential effect of the new standard and for the governance framework to gain experience. The Group continues to revise, refine and validate the impairment models and related process controls in advance of 31 March 2018 reporting.

#### d. Transition impact:

Upon adoption of IFRS 9 the Group expects certain changes in classification of financial assets and related reclassifications between retained earnings and fair value reserve. The Group does not expect a material impact on equity due to changes in classification of financial assets.

The Group will be in a position to determine the potential impact of the ECL provision during the period ending 31 March 2018 after the CBK advises the basis on which the IFRS 9 ECL provision will be calculated. The Group shall abide by CBK regulations in this regard.

#### e. Financial instruments: disclosures (IFRS 7)

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

#### *IFRS 15: Revenue from Contracts with customers*

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

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

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.2 Changes in accounting policies (continued)

#### *IFRS 16: Leases*

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

### 2.3 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank as at 31 December each year and its subsidiaries as at the same date or a date not earlier than three months from 31 December. The financial statements of subsidiaries and associates are prepared using consistent accounting policies and are adjusted, where necessary, to bring the accounting policies in line with those of the Group. All intercompany balances and transactions, including unrealised profits arising from intra-group transactions have been eliminated on consolidation.

#### *a. Subsidiaries*

Subsidiaries are all entities over which the Bank has control. The control is achieved when the Bank is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Refer note 26 for the list of major subsidiaries, their principal businesses and the Group's effective holding.

#### *b. Non-controlling interest*

Interest in the equity of subsidiaries not attributable to the Group is reported as non-controlling interest in the consolidated statement of financial position. Non-controlling interest in the acquiree is measured at the proportionate share in the recognised amounts of the acquiree's identifiable net assets. Losses are allocated to the non-controlling interest even if they exceed the non-controlling interest's share of equity in the subsidiary. Transactions with non-controlling interests are treated as transactions with equity owners of the Group. Gains or losses on changes in non-controlling interests without loss of control are recorded in equity.

#### *c. Associates*

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investment in an associate is initially recognised at cost and subsequently accounted for by the equity method of accounting. The Group's investment in associates includes goodwill identified on acquisition. The Group's share of its associates' post-acquisition profits or losses is recognised in the consolidated statement of income, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.

The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount in the consolidated statement of income. Upon loss of significant influence over the associate, the Group measures and recognises any retained investment at its fair value. Gain or loss on this transaction is computed by comparing the carrying amount of the associate at the time of loss of significant influence with the aggregate of fair value of the retained investment and proceeds from disposal. This is recognised in the consolidated statement of income.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.4 Foreign currencies

The consolidated financial statements are presented in Kuwaiti Dinars (thousands) which is also the Bank's functional currency.

#### *a. Translation of foreign currency transactions*

Transactions in foreign currencies are initially recorded in the functional currency rate of exchange ruling at the date of the transaction. Monetary assets and monetary liabilities in foreign currencies (other than monetary items that form part of the net investment in a foreign operation) are translated into functional currency at rates of exchange prevailing at the reporting date. Any gains or losses are taken to the consolidated statement of income. Exchange differences arising on monetary items that form part of the net investment in a foreign operation are determined using closing rates and recognised in other comprehensive income and presented in the foreign currency translation reserve in equity. When a foreign operation is disposed of, the cumulative amount in foreign currency translation reserve relating to that foreign operation is recognised in the consolidated statement of income. Goodwill, intangible assets and any fair value adjustments to the carrying value of assets and liabilities are recorded at the functional currency of the foreign operation and are translated to the presentation currency at the rate of exchange prevailing at the reporting date. All resulting exchange differences are recognised in other comprehensive income and accumulated in foreign currency translation reserve within equity.

Translation gains or losses on non-monetary items carried at fair value are recognised in other comprehensive income as part of the fair value adjustment on investment securities available for sale, unless the non-monetary item is part of an effective hedging strategy.

#### *b. Translation of financial statements of foreign entities*

The results and financial position of all the Group entities that have a functional currency different from the presentation currency are translated to presentation currency as follows:

The assets and liabilities are translated at rates of exchange ruling at the reporting date. Income and expense items are translated at average exchange rates for the year. All resulting exchange differences are recognised in other comprehensive income and accumulated in foreign currency translation reserve within equity and duly recognised in the consolidated statement of income on disposal of the foreign operation.

### 2.5 Interest income and expenses

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

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

### 2.6 Murabaha and other Islamic financing income

Income from Murabaha, Wakala and Leased assets is recognized on a pattern reflecting a constant periodic return on the outstanding net investment.

### 2.7 Fees and commissions income

Fees income earned from services provided over a period of time is recognised over the period of service. Fees and commissions arising from providing a transaction service are recognised on completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis. Asset management fees related to investment funds are recognised over the period in which the service is provided. The same principle is applied for wealth management and custody services that are continuously provided over an extended period of time.

### 2.8 Dividend income

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

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.9 Impairment of financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if and only if there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. If such evidence exists, any impairment loss is recognised in the consolidated statement of income.

#### *a. Assets carried at amortised cost*

The amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the consolidated statement of income. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the consolidated statement of income. In addition, in accordance with Central Bank of Kuwait instructions, a minimum general provision is made on all applicable credit facilities (net of certain categories of collateral) that are not provided for specifically.

#### *b. Assets classified as available for sale*

The amount of impairment loss is measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the consolidated statement of income. This amount is recognised in the consolidated statement of income. If, in a subsequent period, the amount of the impairment loss decreases for an equity instrument, the previously recognised losses are not reversed through the consolidated statement of income, instead, recorded as increase in the cumulative changes in fair value reserve. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

### 2.10 Impairment of non-financial assets

Goodwill and intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Other non-financial assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. If previously recognised impairment losses have decreased, such excess impairment provision is reversed for non-financial assets other than goodwill.

### 2.11 Share based compensation

#### *Equity settled share based compensation*

The fair value of the employee services received in exchange for the grant of options or shares is recognised as an expense, together with a corresponding increase in equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options or shares on the date of grant using the Black Scholes model. At each reporting date, the Group revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the consolidated statement of income, with a corresponding adjustment to equity.

#### *Cash settled share based compensation*

The fair value of the employee services received in exchange for the cash settled share based payment is recognised as an expense, together with a corresponding increase in liability. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options determined using the Black Scholes model. The liability is remeasured to fair value at each reporting date up to and including the settlement date, with changes in fair value recognised in the consolidated statement of income.

### 2.12 Post employment benefits

The Group is liable to make defined contributions to State plans and lump sum payments under defined benefit plans to employees at cessation of employment, in accordance with the laws of the place they are employed. The defined benefit plan is unfunded. The present value of the defined benefit obligation is determined annually by actuarial valuations using the projected unit credit method. An actuarial valuation involves making various assumptions such as determination of the discount rate, future salary increases and mortality rates. These assumptions are reviewed at each reporting date.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.13 Taxation

Income tax payable on taxable profit ('current tax') is recognised as an expense in the period in which the profits arise in accordance with the fiscal regulations of the respective countries in which the Group operates. Deferred tax assets are recognised for deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent it is probable that taxable profit will be available to utilise these. Deferred tax liabilities are recognised for taxable temporary differences. Deferred tax assets and liabilities are measured using tax rates and applicable legislation enacted at the reporting date.

### 2.14 Recognition of financial assets and financial liabilities

Financial assets and financial liabilities are recognised when the Group becomes party to contractual provisions of the instrument and are initially measured at fair value. Transaction costs are included only for those financial instruments that are not measured at fair value through statement of income.

### 2.15 Cash and short term funds

Cash and short term funds consist of cash in hand, current account and money at call with other banks and deposits with banks maturing within seven days.

### 2.16 Deposits with banks

Deposits with banks are stated at amortised cost using the effective interest method less any amounts written off and provision for impairment. The carrying values of such assets which are being effectively hedged for changes in fair value are adjusted to the extent of the changes in fair value attributable to the risk being hedged.

### 2.17 Loans and advances to customers

Loans and advances are financial assets with fixed or determinable payments that are not quoted in an active market.

#### *Carrying value*

Loans and advances are stated at amortised cost using the effective interest method less any amounts written off and provision for impairment. The carrying values of such assets which are being effectively hedged for changes in fair value are adjusted to the extent of the changes in fair value attributable to the risk being hedged.

#### *Renegotiated loans*

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

### 2.18 Islamic financing to customers

Islamic financing to customers are financial assets with fixed or determinable payments that are not quoted in an active market.

#### *a. Murabaha*

Murabaha is an agreement relating to the sale of commodities at cost plus an agreed upon profit margin, whereby the seller informs the buyer of the price at which the deal will be completed and also the amount of profit to be recognized. Murabaha is a financial asset originated by the Group and is stated at amortised cost net of provision for impairment.

#### *b. Wakala*

Wakala is an agreement involving Al-Muwakkil (the Principal) who wishes to appoint Al-Wakil (the Agent) to be his agent with respect to the investment of Al-Muwakkil's fund, in accordance with regulations of the Islamic Sharia'a. Wakala is a financial asset originated by the Group and stated at amortised cost net of provision for impairment.

#### *c. Leased assets - the Group as a lessor*

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating lease. Leased assets are stated at amortised cost net of provision for impairment.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.19 Financial investments

The Group classifies its financial investments in the following categories:

- Held to maturity
- Available for sale
- Investments carried at fair value through statement of income

All investments with the exception of investments at fair value through statement of income are initially recognised at cost, being the fair value of the consideration given including directly attributable transaction costs. Premiums and discounts on financial investments (excluding those carried at fair value through statement of income) are amortised using the effective yield method and taken to interest income.

#### *Held to maturity*

Held to maturity investments are investments with fixed or determinable payments and fixed maturity that the Group has the intention and ability to hold to maturity. Held to maturity investments are measured at amortised cost, less provision for impairment in value, if any. The losses arising from impairment of such investments are recognised in the consolidated statement of income. The interest income from debt securities classified as held to maturity is recorded in interest income.

#### *Available for sale*

Available for sale investments are those investments which are designated as available for sale or investments that do not qualify to be classified as fair value through statement of income, held to maturity, or loans and advances. After initial recognition, investments which are classified as "available for sale" are normally remeasured at fair value, unless fair value cannot be reliably determined in which case they are measured at cost less impairment. Fair value changes which are not part of an effective hedging relationship are recognised in other comprehensive income and presented in the cumulative changes in fair values in equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as "cumulative changes in fair values" within equity, is included in the consolidated statement of income for the period. In case of a reversal of previously recognised impairment losses for equity investments, such changes will not be recognised in the current consolidated statement of income but will be recorded as an increase in the reserve for cumulative changes in fair values. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed through consolidated statement of income. The portion of any fair value changes relating to an effective hedging relationship is recognised directly in the consolidated statement of income. The interest income from debt securities classified as available for sale is recorded in interest income and the dividend income from equities is recorded in dividend income.

#### *Investments carried at fair value through statement of income*

Investments are classified as "investments carried at fair value through statement of income" if they are held for trading or, upon initial recognition, are designated as fair value through statement of income. Investments are classified as held for trading when they are acquired for the purpose of selling or repurchase in the near term with the intention of generating short-term profits, or are derivatives which are not designated as part of effective hedges. Investments are designated as fair value through statement of income if the fair value of the investment can be reliably measured and the classification as fair value through statement of income is as per the documented strategy of the Group. Investments classified as "investments carried at fair value through statement of income" are remeasured at fair value with all changes in fair value being recorded in the consolidated statement of income. Any dividend income of equities classified as 'investments carried at fair value through the statement of income' is recorded as part of 'dividend income'.

#### *Reclassification of financial investments*

Available for sale investments are reclassified to held to maturity investments only in certain limited circumstances as a result of change in intention when there is an ability to hold till maturity. Upon such reclassification, the fair value on the date of reclassification becomes the new amortised cost of such investments. Any difference between the new amortised cost and the maturity amount are amortised to consolidated statement of income over the remaining life of the investments using effective interest method. The amount of gain or loss previously recognised in other comprehensive income are also amortised to consolidated statement of income over the remaining life of the investments using effective interest method.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.20 Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, in the most advantageous market to which the Group has access at that date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique.

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

If there is no quoted price in an active market, then the Group uses valuation techniques that include the use of valuation models that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction. The inputs to these models are taken from observable markets where possible, but where this is not feasible, estimation is required in establishing fair values. Judgements and estimates include considerations of liquidity and model inputs related to items such as credit risk (both own and counterparty), funding value adjustments, correlation and volatility.

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

Fair values of investment properties are determined by appraisers having an appropriate recognised professional qualification and recent experience in the location and category of the property being valued and also considering the ability to generate economic benefits by using the property in its highest and best use.

### 2.21 Repurchase and resale agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date at an agreed price (repos) are not derecognised in the consolidated statement of financial position. Amounts received under these agreements are treated as interest bearing liabilities and the difference between the sale and repurchase price treated as interest expense using the effective yield method. Assets purchased with a corresponding commitment to resell at a specified future date at an agreed price (reverse repos) are not recognised in the consolidated statement of financial position. Amounts paid under these agreements are treated as interest earning assets and the difference between the purchase and resale price treated as interest income using the effective yield method.

### 2.22 Offsetting of financial assets and liabilities

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

### 2.23 Derecognition of financial assets and financial liabilities

#### Financial assets

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

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

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

#### Financial liabilities

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

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.24 Derivative financial instruments

The Group deals in interest rate swaps to manage its interest rate risk on interest bearing assets and liabilities. Similarly the Group deals in forward foreign exchange contracts for customers and to manage its foreign currency positions and cash flows. All derivative financial instruments of the Group are recorded in the consolidated statement of financial position at fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Positive and negative fair values are reported as assets and liabilities respectively and are offset when there is both an intention to settle net and a legal right to offset exists.

For the purposes of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability and (b) cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised financial asset or liability or a highly probable forecast transaction.

In relation to fair value hedges which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument is recognised immediately in the consolidated statement of income. The carrying amounts of hedged items are adjusted for fair value changes attributable to the risk being hedged and the difference is recognised in the consolidated statement of income.

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

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

### 2.25 Trade and settlement date accounting

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

### 2.26 Investment properties

Investment properties are properties held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the production or supply of goods or services or for administrative purposes. Investment property is measured at cost on initial recognition and subsequently at fair value with any change therein recognised in consolidated statement of income. Cost includes expenditure that is directly attributable to the acquisition of the investment property. Fair values of investment properties are determined by appraisers having an appropriate recognised professional qualification and recent experience in the location and category of the property being valued. Any gain or loss on disposal of an investment property (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in consolidated statement of income. When the use of a property changes such that it is reclassified as Land, premises and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.



**2 SIGNIFICANT ACCOUNTING POLICIES (continued)****2.27 Land, premises and equipment**

Land and premises comprise mainly branches and offices. All premises and equipment are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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

Land is not depreciated. Depreciation is provided on the depreciable amount of other items of premises and equipments on a straight line basis over their estimated useful life. The depreciable amount is the gross carrying value, less the estimated residual value at the end of its useful life. The estimated useful life of premises and equipments are as follows:

|                            |                                  |
|----------------------------|----------------------------------|
| Building on leasehold land | term of lease (maximum 20 years) |
| Building on freehold land  | 50 years                         |
| IT systems and equipment   | 3-10 years                       |

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

**2.28 Business combinations**

Business combinations are accounted for using the acquisition method of accounting. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. Non-controlling interest in the acquiree is measured at the proportionate share in the recognised amounts of the acquiree's identifiable net assets. Other acquisition related costs incurred are expensed and included in other administrative expenses.

If the business combination is achieved in stages, the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date and included in cost of acquisition. Any resulting gain or loss is recognised in consolidated statement of income. Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the consolidated statement of income.

**2.29 Goodwill and intangible assets***a. Goodwill*

Goodwill acquired in a business combination is initially measured at cost, being the excess of the cost of the acquisition over the net fair value of the identifiable assets and liabilities acquired. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Goodwill is recorded in the functional currency of the foreign operation and is translated to the presentation currency at the rate of exchange prevailing at the reporting date. When subsidiaries are sold, the difference between the selling price and the net assets plus cumulative translation differences and goodwill is recognised in the consolidated statement of income.

**2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.29 Goodwill and intangible assets (continued)**

*b. Intangible assets*

Intangible assets comprise separately identifiable intangible items arising from business combinations. An intangible asset is recognised only when its cost can be measured reliably and it is probable that the expected future economic benefit will flow to the Group. Intangible assets are initially measured at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of the intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised on a straight line basis over the useful economic life of 5 to 15 years and tested for impairment whenever there is an indication that the intangible asset may be impaired. Intangible assets with indefinite useful lives are not amortised but tested for impairment annually or whenever there is an indication that the intangible asset may be impaired. If the carrying value of the intangible asset is more than the recoverable amount, the intangible asset is considered impaired and is written down to its recoverable amount. The excess of carrying value over the recoverable amount is recognised in the consolidated statement of income. Impairment losses on intangible assets recognised in the consolidated statement of income in previous periods, are reversed when there is an increase in the recoverable amount.

**2.30 Property acquired on settlement of debt**

Property acquired on settlement of debt is stated at the lower of the related loans and advances and the current fair value of such assets. Gains or losses on disposal and revaluation losses are recognised in the consolidated statement of income.

**2.31 Due to Banks and Financial Institutions, Customer deposits & Certificates of deposit issued**

Due to Banks and Financial Institutions, Customer Deposits & Certificates of deposit issued are stated at amortised cost using effective interest method. The carrying values of such liabilities which are being effectively hedged for changes in fair value are adjusted to the extent of the changes in fair value being hedged.

**2.32 Islamic customer deposits**

Islamic customer deposits comprise of Investment accounts and Non-investment accounts.

*Investment accounts*

Investment accounts may take the form of investment deposits, which are valid for specified periods of time, and are automatically renewable on maturity for the same period, unless the concerned depositors give written notice to the contrary, or take the form of investment saving accounts for unspecified periods. In all cases, investment accounts receive a proportion of the profit, bear a share of loss and are carried at cost plus profit payable.

*Non-investment accounts*

Non-investment accounts represent, in accordance with Islamic Sharia'a, Qard Hasan from depositors to the Group. These accounts are neither entitled to profit nor do they bear any risk of loss, as the Group guarantees to pay the related balance. Investing Qard Hasan is made at the discretion of the Group and the results of such investments are attributable to the shareholders of the Group. Non-investment accounts are carried at cost.

**2.33 Subordinated Tier 2 Bonds and Global Medium Term Notes**

These are financial liabilities and are initially recognised at their fair value being the issue proceeds net of transaction costs and are subsequently measured at their amortised cost using the effective interest rate method. The carrying values of such liabilities which are being effectively hedged for changes in fair value are adjusted to the extent of the changes in fair value being hedged.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.34 Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the consolidated financial statements at fair value, being the premium received, in other liabilities. The premium received is recognised in the consolidated statement of income in 'net fees and commissions' on a straight line basis over the life of the guarantee. The guarantee liability is subsequently carried at initial measurement less amortisation. When a payment under the guarantee is likely to become payable, the present value of the expected net payments less the unamortised premium is charged to the consolidated statement of income.

### 2.35 Treasury shares

The Bank's holding of its own shares are accounted for as treasury shares and are stated at purchase consideration including directly attributable costs. When the treasury shares are sold, gains are credited to a separate account in equity (treasury share reserve) which is non distributable. Any realised losses are charged to the same account to the extent of the credit balance on that account. Any excess losses are charged to retained earnings then to reserves. Gains realised subsequently on the sale of treasury shares are first used to offset any previously recorded losses in the order of reserves, retained earnings and the treasury share reserve amount. No cash dividends are distributed on these shares. The issue of bonus shares increases the number of shares proportionately and reduces the average cost per share without affecting the total cost of treasury shares.

### 2.36 Fiduciary assets

Assets and related deposits held in trust or in a fiduciary capacity are not treated as assets or liabilities of the Group and accordingly are not included in the consolidated statement of financial position.

### 2.37 Significant accounting judgements and estimates

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

#### *Accounting Judgements*

##### *Impairment of available for sale equity investments*

The Group treats equity financial assets available for sale as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgment.

##### *Classification of investments*

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, available for sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial assets at initial recognition.

##### *Estimation uncertainty and assumptions*

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

##### *Impairment of goodwill*

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

##### *Impairment of investment in associates*

The Group calculates the amount of impairment as the difference between the recoverable amount and its carrying value if there is any objective evidence that the investment in associates are impaired. The estimation of recoverable amount requires the Group to make an estimate of the expected future cashflows and selection of appropriate inputs for valuation.

**2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.37 Significant accounting judgements and estimates (continued)**

*Estimation uncertainty and assumptions (continued)*

*Provision for credit losses*

The Group reviews its Loans, advances and Islamic financing to customers on a quarterly basis to assess whether a provision for credit losses should be recorded in the consolidated statement of income. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

*Fair values of assets and liabilities including intangibles*

Considerable judgment by management is required in the estimation of the fair value of the assets including intangibles with definite and indefinite useful life, liabilities and contingent liabilities acquired as a result of business combination.

*Share based payments*

The Group measures the share based payments to employees by reference to the fair value of the relevant equity instruments. Estimating fair value for share based payment transactions requires determination of the most appropriate valuation model. This estimate also requires determination of the most appropriate inputs to the valuation model including the expected life of the share option, volatility and dividend yield and making assumptions about them. The assumptions and models used for estimating fair value for share based payment transactions are disclosed in Note 24.

*Valuation of unquoted financial assets*

Fair value of unquoted financial assets is determined using valuation techniques including the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments. The determination of the cash flows and discount factors requires significant estimation.

**3 SEGMENTAL ANALYSIS**

The Group organises and manages its operations by geographic territory in the first instance, primarily Domestic and International. Within its Domestic operations, the Group segments its business into Consumer and Private Banking, Corporate Banking, Investment Banking and Asset Management, Islamic Banking and Group Centre. All operations outside Kuwait are classified as International. Management treats the operations of these segments separately for the purposes of decision making, resource allocation and performance assessment.

**Consumer and Private Banking**

Consumer Banking provides a diversified range of products and services to individuals. The range includes consumer loans, credit cards, deposits, foreign exchange and other branch related services. Private Banking provides a comprehensive range of customised and innovative banking services to high net worth individuals and to institutional clients.

**Corporate Banking**

Corporate Banking provides a comprehensive product and service offering to business and corporate customers, including lending, deposits, trade finance, foreign exchange and advisory services.

**Investment Banking and Asset Management**

Investment Banking provides a full range of capital market advisory and execution services. The activities of Asset Management include wealth management, asset management, custody, brokerage and research.

**Islamic Banking**

Islamic banking represents the financial results of Boubyan Bank K.S.C.P., the Islamic banking subsidiary of the Group.

**Group Centre**

Group Centre includes treasury, investments, and other defined Group activities. Treasury provides a comprehensive range of treasury services and products to its clients, and is also responsible for the Bank's liquidity and market risk management. Group Centre includes any residual in respect of transfer pricing and inter segment allocations.

**International**

International includes all branches, subsidiaries and associates outside the State of Kuwait.

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**3 SEGMENTAL ANALYSIS (continued)**

The following table shows net interest income and net income from Islamic financing, net operating income, profit for the year, total assets and total liabilities information in respect of the Group's business segments:

**2017**

|  | <i>Consumer<br/>and Private<br/>Banking<br/>KD 000's</i> | <i>Corporate<br/>Banking<br/>KD 000's</i> | <i>Investment<br/>Banking<br/>and Asset<br/>Management<br/>KD 000's</i> | <i>Islamic<br/>Banking<br/>KD 000's</i> | <i>Group<br/>Centre<br/>KD 000's</i> | <i>International<br/>KD 000's</i> | <i>Total<br/>KD 000's</i> |
|--|--|---|---|---|--------------------------------------|-----------------------------------|---------------------------|
| <b>Net interest income and net income from Islamic financing</b> | <b>194,710</b>   | <b>143,346</b>                            | <b>352</b>  | <b>110,110</b>                          | <b>36,635</b>                        | <b>143,811</b>                    | <b>628,964</b>            |
| <b>Net operating income</b>                                      | <b>259,192</b>   | <b>189,278</b>                            | <b>27,300</b>   | <b>129,928</b>                          | <b>36,387</b>                        | <b>180,588</b>                    | <b>822,673</b>            |
| <b>Profit (loss) for the year</b>                                | <b>149,360</b>   | <b>110,605</b>                            | <b>14,662</b>   | <b>47,672</b>                           | <b>(74,689)</b>                      | <b>94,695</b>                     | <b>342,305</b>            |
| <b>Total assets</b>  | <b>4,398,466</b>   | <b>5,199,932</b>                          | <b>125,946</b>  | <b>3,970,396</b>                        | <b>3,251,132</b>                     | <b>9,088,729</b>                  | <b>26,034,601</b>         |
| <b>Total liabilities</b>   | <b>4,603,968</b>   | <b>2,526,691</b>                          | <b>73,609</b>   | <b>3,518,039</b>                        | <b>1,620,005</b>                     | <b>10,131,188</b>                 | <b>22,473,500</b>         |

**2016**

|  | <i>Consumer<br/>and Private<br/>Banking<br/>KD 000's</i> | <i>Corporate<br/>Banking<br/>KD 000's</i> | <i>Investment<br/>Banking<br/>and Asset<br/>Management<br/>KD 000's</i> | <i>Islamic<br/>Banking<br/>KD 000's</i> | <i>Group<br/>Centre<br/>KD 000's</i> | <i>International<br/>KD 000's</i> | <i>Total<br/>KD 000's</i> |
|--|--|---|---|---|--------------------------------------|-----------------------------------|---------------------------|
| <b>Net interest income and net income from Islamic financing</b> | <b>181,803</b>   | <b>126,768</b>                            | <b>162</b>  | <b>94,127</b>                           | <b>17,958</b>                        | <b>148,919</b>                    | <b>569,737</b>            |
| <b>Net operating income</b>                                      | <b>242,059</b>   | <b>170,785</b>                            | <b>23,339</b>   | <b>106,997</b>                          | <b>15,414</b>                        | <b>186,715</b>                    | <b>745,309</b>            |
| <b>Profit (loss) for the year</b>                                | <b>139,493</b>   | <b>137,400</b>                            | <b>12,146</b>   | <b>41,301</b>                           | <b>(118,138)</b>                     | <b>99,958</b>                     | <b>312,160</b>            |
| <b>Total assets</b>  | <b>4,218,253</b>   | <b>5,380,784</b>                          | <b>107,767</b>  | <b>3,481,807</b>                        | <b>2,754,535</b>                     | <b>8,295,648</b>                  | <b>24,238,794</b>         |
| <b>Total liabilities</b>   | <b>4,171,318</b>   | <b>2,287,130</b>                          | <b>47,754</b>   | <b>3,058,654</b>                        | <b>2,048,908</b>                     | <b>9,220,298</b>                  | <b>20,834,062</b>         |

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**3 SEGMENTAL ANALYSIS (continued)****Geographic information:**

The following table shows the geographic distribution of the Group's operating income based on the location of the operating entities.

| <b>Net operating income</b>        | <b>2017</b><br><i>KD 000's</i> | <b>2016</b><br><i>KD 000's</i> |
|------------------------------------|--------------------------------|--------------------------------|
| Kuwait                             | <b>642,085</b>                 | 558,594                        |
| Other Middle East and North Africa | <b>129,582</b>                 | 138,474                        |
| Europe                             | <b>28,710</b>                  | 25,398                         |
| Others                             | <b>22,296</b>                  | 22,843                         |
|                                    | <b>822,673</b>                 | 745,309                        |

The following table shows the geographic distribution of the Group's non-current assets based on the location of the operating entities.

| <b>Non-current assets</b>          | <b>2017</b><br><i>KD 000's</i> | <b>2016</b><br><i>KD 000's</i> |
|------------------------------------|--------------------------------|--------------------------------|
| Kuwait                             | <b>960,011</b>                 | 857,613                        |
| Other Middle East and North Africa | <b>23,397</b>                  | 24,269                         |
| Europe                             | <b>9,586</b>                   | 1,112                          |
| Others                             | <b>623</b>                     | 444                            |
|                                    | <b>993,617</b>                 | 883,438                        |

Non-current assets consist of land, premises and equipment, goodwill and other intangible assets, investment properties and property acquired on settlement of debts.

**4 INTEREST INCOME**

|  | <b>2017</b><br><i>KD 000's</i> | <b>2016</b><br><i>KD 000's</i> |
|--|--------------------------------|--------------------------------|
| Deposits with banks                            | <b>57,624</b>                  | 38,910                         |
| Loans and advances to customers                | <b>534,490</b>                 | 490,903                        |
| Debt investment securities                     | <b>122,481</b>                 | 121,705                        |
| Kuwait Government treasury bonds and CBK bonds | <b>28,021</b>                  | 13,745                         |
|  | <b>742,616</b>                 | 665,263                        |

**5 INTEREST EXPENSE**

|   | <b>2017</b><br><i>KD 000's</i> | <b>2016</b><br><i>KD 000's</i> |
|---|--------------------------------|--------------------------------|
| Due to banks and other financial institutions | <b>86,576</b>                  | 68,320                         |
| Customer deposits                             | <b>120,738</b>                 | 110,782                        |
| Certificates of deposit issued                | <b>7,103</b>                   | 4,637                          |
| Global Medium Term Notes                      | <b>3,180</b>                   | -                              |
| Subordinated Tier 2 bonds                     | <b>6,165</b>                   | 5,914                          |
|   | <b>223,762</b>                 | 189,653                        |

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**6 NET FEES AND COMMISSIONS**

|                                       | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|---------------------------------------|--------------------------------|--------------------------------|
| Fees and commissions income           | <b>167,697</b>                 | 159,584                        |
| Fees and commissions related expenses | <b>(29,141)</b>                | (26,758)                       |
| Net fees and commissions              | <b>138,556</b>                 | 132,826                        |

Fees and commissions income includes asset management fees of KD 30,926 thousand (2016: KD 29,551 thousand) earned on trust and fiduciary activities where the Group holds or invests assets on behalf of its customers.

**7 NET INVESTMENT INCOME**

|  | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|--|--------------------------------|--------------------------------|
| Net realised gains on available for sale investments                         | <b>13,968</b>                  | 4,314                          |
| Net gains from investments carried at fair value through statement of income | <b>1,050</b>                   | 822                            |
| Dividend income  | <b>3,143</b>                   | 3,065                          |
| Share of results of associates   | <b>1,016</b>                   | (1,289)                        |
| Net gains (losses) from investment properties                                | <b>641</b>                     | (514)                          |
|  | <b>19,818</b>                  | 6,398                          |

**8 PROVISION CHARGE FOR CREDIT LOSSES AND IMPAIRMENT LOSSES**

|  | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|--|--------------------------------|--------------------------------|
| Provision charge for credit losses (Note 12)     | <b>174,951</b>                 | 125,683                        |
| Impairment losses on investment securities       | <b>518</b>                     | 9,027                          |
| Impairment losses on associates (Note 14)        | <b>12,750</b>                  | 12,165                         |
| Impairment losses on intangible assets (Note 15) | <b>-</b>                       | 5,442                          |
|  | <b>188,219</b>                 | 152,317                        |

**9 TAXATION**

|   | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|---|--------------------------------|--------------------------------|
| National labour support tax                                       | <b>8,176</b>                   | 7,263                          |
| Zakat   | <b>3,566</b>                   | 3,243                          |
| Contribution to Kuwait Foundation for the Advancement of Sciences | <b>2,955</b>                   | 2,520                          |
| Overseas tax  | <b>12,007</b>                  | 15,785                         |
|   | <b>26,704</b>                  | 28,811                         |

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**10 EARNINGS PER SHARE**

Basic earnings per share is calculated by dividing the profit for the year attributable to shareholders of the Bank (adjusted for interest and profit paid on Perpetual Tier I Capital Securities) by the weighted average number of shares outstanding during the year net of treasury shares. There are no dilutive potential shares that are convertible into shares.

|  | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|--|--------------------------------|--------------------------------|
| Profit for the year attributable to shareholders of the Bank   | <b>322,362</b>                 | 295,178                        |
| Less: Interest paid on Perpetual Tier 1 Capital Securities   | <b>(12,232)</b>                | (12,146)                       |
| Less: Profit distribution on Perpetual Tier 1 Sukuk by a subsidiary attributable to shareholders of the Bank | <b>(2,989)</b>                 | (1,503)                        |
|  | <u><b>307,141</b></u>          | <u>281,529</u>                 |
| Weighted average number of shares outstanding during the year net of treasury shares (thousands)             | <u><b>5,816,429</b></u>        | <u>5,717,886</u>               |
| Basic earnings per share   | <u><b>53 fils</b></u>          | <u>49 fils</u>                 |

Earnings per share calculations for 2016 have been adjusted to take account of the bonus shares issued in 2017.

**11 CASH AND SHORT TERM FUNDS**

|   | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|---|--------------------------------|--------------------------------|
| Cash on hand  | <b>195,249</b>                 | 179,298                        |
| Current account with other banks                            | <b>1,264,834</b>               | 1,140,983                      |
| Money at call   | <b>183,985</b>                 | 260,366                        |
| Balances with the Central Bank of Kuwait                    | <b>84,207</b>                  | 190,830                        |
| Deposits and Murabaha with banks maturing within seven days | <b>1,015,365</b>               | 915,486                        |
|   | <u><b>2,743,640</b></u>        | <u>2,686,963</u>               |

**12 LOANS, ADVANCES AND ISLAMIC FINANCING TO CUSTOMERS**

| <b>2017</b>  | <i>Middle<br/>East and<br/>North<br/>Africa</i><br><i>KD 000's</i> | <i>North<br/>America</i><br><i>KD 000's</i> | <i>Europe</i><br><i>KD 000's</i> | <i>Asia</i><br><i>KD 000's</i> | <i>Others</i><br><i>KD 000's</i> | <i>Total</i><br><i>KD 000's</i> |
|--|--|---|----------------------------------|--------------------------------|----------------------------------|---------------------------------|
| Corporate  | <b>9,006,588</b>   | <b>294,887</b>                              | <b>409,750</b>                   | <b>170,231</b>                 | <b>244,556</b>                   | <b>10,126,012</b>               |
| Retail   | <b>4,989,797</b>   | <b>134</b>                                  | <b>2,179</b>                     | <b>-</b>                       | <b>-</b>                         | <b>4,992,110</b>                |
| Loans, advances and Islamic financing to customers | <u><b>13,996,385</b></u>   | <u><b>295,021</b></u>                       | <u><b>411,929</b></u>            | <u><b>170,231</b></u>          | <u><b>244,556</b></u>            | <u><b>15,118,122</b></u>        |
| Provision for credit losses                        |  |   |                                  |                                |                                  | <u><b>(615,513)</b></u>         |
|  |  |   |                                  |                                |                                  | <u><u><b>14,502,609</b></u></u> |



**12 LOANS, ADVANCES AND ISLAMIC FINANCING TO CUSTOMERS (continued)**

|   | <i>Middle<br/>East and<br/>North<br/>Africa</i><br>KD 000's | <i>North<br/>America</i><br>KD 000's | <i>Europe</i><br>KD 000's | <i>Asia</i><br>KD 000's | <i>Others</i><br>KD 000's | <i>Total</i><br>KD 000's |
|---|---|--------------------------------------|---------------------------|-------------------------|---------------------------|--------------------------|
| 2016  |   |                                      |                           |                         |                           |                          |
| Corporate   | 8,572,654   | 271,989                              | 344,561                   | 179,112                 | 294,360                   | 9,662,676                |
| Retail  | 4,613,908   | 119                                  | 3,042                     | -                       | -                         | 4,617,069                |
| Loans, advances and Islamic<br>financing to customers | 13,186,562  | 272,108                              | 347,603                   | 179,112                 | 294,360                   | 14,279,745               |
| Provision for credit losses                           |   |                                      |                           |                         |                           | (668,254)                |
|   |   |                                      |                           |                         |                           | <u>13,611,491</u>        |

Provisions for credit losses on cash facilities are as follows:

|  | <i>Specific</i>         |                         | <i>General</i>          |                         | <i>Total</i>            |                         |
|--|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
|  | <i>2017</i><br>KD 000's | <i>2016</i><br>KD 000's | <i>2017</i><br>KD 000's | <i>2016</i><br>KD 000's | <i>2017</i><br>KD 000's | <i>2016</i><br>KD 000's |
| Balance at beginning of the year                 | <b>101,386</b>          | 142,972                 | <b>566,868</b>          | 469,917                 | <b>668,254</b>          | 612,889                 |
| Provided during the year                         | <b>89,809</b>           | 30,398                  | <b>84,821</b>           | 96,951                  | <b>174,630</b>          | 127,349                 |
| Transfer   | <b>145,800</b>          | -                       | <b>(145,800)</b>        | -                       | -                       | -                       |
| Amounts written off net of<br>exchange movements | <b>(227,369)</b>        | (71,984)                | <b>(2)</b>              | -                       | <b>(227,371)</b>        | (71,984)                |
| Balance at end of the year                       | <u><b>109,626</b></u>   | <u>101,386</u>          | <u><b>505,887</b></u>   | <u>566,868</u>          | <u><b>615,513</b></u>   | <u>668,254</u>          |

Further analysis of specific provision based on class of financial asset is given below:

|  | <i>Corporate</i>        |                         | <i>Retail</i>           |                         | <i>Total</i>            |                         |
|--|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
|  | <i>2017</i><br>KD 000's | <i>2016</i><br>KD 000's | <i>2017</i><br>KD 000's | <i>2016</i><br>KD 000's | <i>2017</i><br>KD 000's | <i>2016</i><br>KD 000's |
| Balance at beginning of the year                 | <b>44,248</b>           | 60,431                  | <b>57,138</b>           | 82,541                  | <b>101,386</b>          | 142,972                 |
| Provided during the year                         | <b>69,495</b>           | 14,153                  | <b>20,314</b>           | 16,245                  | <b>89,809</b>           | 30,398                  |
| Transfer   | <b>145,800</b>          | -                       | -                       | -                       | <b>145,800</b>          | -                       |
| Amounts written off net of<br>exchange movements | <b>(216,055)</b>        | (30,336)                | <b>(11,314)</b>         | (41,648)                | <b>(227,369)</b>        | (71,984)                |
| Balance at end of the year                       | <u><b>43,488</b></u>    | <u>44,248</u>           | <u><b>66,138</b></u>    | <u>57,138</u>           | <u><b>109,626</b></u>   | <u>101,386</u>          |

Analysis of total provision charge for credit losses is given below:

|                                    | <i>Specific</i>         |                         | <i>General</i>          |                         | <i>Total</i>            |                         |
|------------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
|                                    | <i>2017</i><br>KD 000's | <i>2016</i><br>KD 000's | <i>2017</i><br>KD 000's | <i>2016</i><br>KD 000's | <i>2017</i><br>KD 000's | <i>2016</i><br>KD 000's |
| Cash facilities                    | <b>89,809</b>           | 30,398                  | <b>84,821</b>           | 96,951                  | <b>174,630</b>          | 127,349                 |
| Non cash facilities                | <b>20</b>               | (1,763)                 | <b>301</b>              | 97                      | <b>321</b>              | (1,666)                 |
| Provision charge for credit losses | <u><b>89,829</b></u>    | <u>28,635</u>           | <u><b>85,122</b></u>    | <u>97,048</u>           | <u><b>174,951</b></u>   | <u>125,683</u>          |

**12 LOANS, ADVANCES AND ISLAMIC FINANCING TO CUSTOMERS (continued)**

The available provision on non-cash facilities of KD 29,591 thousand (2016: KD 29,270 thousand) is included under other liabilities (Note 19).

The impairment provision for finance facilities complies in all material respects with the specific provision requirements of the Central Bank of Kuwait and IFRS. In March 2007, the Central Bank of Kuwait issued a circular amending the basis of making general provisions on facilities changing the minimum rate from 2% to 1% for cash facilities and 0.5% for non cash facilities. The required rates were effective from 1 January 2007 on the net increase in facilities, net of certain restricted categories of collateral, during the reporting period. Pending further directive from the Central Bank of Kuwait, the general provision in excess of 1% for cash facilities and 0.5% for non-cash facilities was retained as general provision.

Non-performing loans, advances and Islamic financing to customers and related specific provisions are as follows:

|  | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|--|--------------------------------|--------------------------------|
| Loans, advances and Islamic financing to customers | <b>214,092</b>                 | 183,005                        |
| Provisions   | <b>104,476</b>                 | 95,383                         |

The fair value of collateral that the Group holds relating to loans, advances and Islamic financing to customers individually determined to be non-performing at 31 December 2017 amounts to KD 85,643 thousand (2016: KD 63,838 thousand). The collateral consists of cash, securities, bank guarantees and properties.

**13 FINANCIAL INVESTMENTS**

The table below provides the details of the categorisation of financial investments:

| <i>2017</i>                               | <i>Held to maturity</i><br><i>KD 000's</i> | <i>Available for sale</i><br><i>KD 000's</i> | <i>Fair value through statement of income</i><br><i>KD 000's</i> | <i>Total</i><br><i>KD 000's</i> |
|---|--|--|--|---------------------------------|
| <b>Investment securities</b>              |  |  |  |                                 |
| Debt securities - Government (Non Kuwait) | <b>138,493</b>                             | <b>1,745,472</b>                             | -  | <b>1,883,965</b>                |
| Debt securities - Non Government          | -  | <b>1,217,376</b>                             | -  | <b>1,217,376</b>                |
| Equities                                  | -  | <b>62,458</b>                                | <b>3,477</b>   | <b>65,935</b>                   |
| Other investments                         | -  | <b>145,789</b>                               | <b>35,931</b>  | <b>181,720</b>                  |
|   | <b>138,493</b>                             | <b>3,171,095</b>                             | <b>39,408</b>  | <b>3,348,996</b>                |
| <b>Central Bank of Kuwait bonds</b>       | <b>655,591</b>                             | -  | -  | <b>655,591</b>                  |
| <b>Kuwait Government treasury bonds</b>   | <b>919,218</b>                             | <b>156,993</b>                               | -  | <b>1,076,211</b>                |
|   | <b>1,713,302</b>                           | <b>3,328,088</b>                             | <b>39,408</b>  | <b>5,080,798</b>                |

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**13 FINANCIAL INVESTMENTS (continued)**

| 2016                                      | <i>Held to<br/>maturity<br/>KD 000's</i> | <i>Available<br/>for sale<br/>KD 000's</i> | <i>Fair value<br/>through<br/>statement of<br/>income</i> | <i>Total</i>     |
|---|--|--|---|------------------|
|   |  |  | <i>KD 000's</i>   | <i>KD 000's</i>  |
| Investment securities                     |  |  |   |                  |
| Debt securities - Government (Non Kuwait) | 170,958                                  | 1,538,535                                  | -   | 1,709,493        |
| Debt securities - Non Government          | -  | 1,172,713                                  | -   | 1,172,713        |
| Equities                                  | -  | 85,354                                     | 2,987   | 88,341           |
| Other investments                         | -  | 159,288                                    | 48,615  | 207,903          |
|   | <u>170,958</u>                           | <u>2,955,890</u>                           | <u>51,602</u>   | <u>3,178,450</u> |
| Central Bank of Kuwait bonds              | 748,889                                  | -  | -   | 748,889          |
| Kuwait Government treasury bonds          | 493,101                                  | -  | -   | 493,101          |
|   | <u>1,412,948</u>                         | <u>2,955,890</u>                           | <u>51,602</u>   | <u>4,420,440</u> |

All unquoted available for sale equities are recorded at fair value except for investments with a carrying value of KD 495 thousand (2016: KD 563 thousand), which are recorded at cost since fair value cannot be reliably estimated.

An impairment loss of KD 518 thousand (2016: KD 9,027 thousand) has been made against investments classified as available for sale on which there has been a significant or prolonged decline in value.

**14 INVESTMENT IN ASSOCIATES**

Associates of the Group:

|  | <i>Carrying value</i>    |                          |
|--|--------------------------|--------------------------|
|  | <i>2017<br/>KD 000's</i> | <i>2016<br/>KD 000's</i> |
| Bank Syariah Muamalat Indonesia T.B.K. | <b>20,326</b>            | 31,150                   |
| Bank of London and the Middle East     | <b>31,777</b>            | 29,564                   |
| Turkish Bank A.S.                      | <b>4,762</b>             | 4,884                    |
| United Capital Bank                    | <b>2,784</b>             | 4,581                    |
| Others                                 | <b>3,538</b>             | 3,465                    |
|  | <u><b>63,187</b></u>     | <u>73,644</u>            |

|  | <i>Country of<br/>incorporation</i> | <i>Principal<br/>business</i> | <i>% Effective ownership</i> |             |
|--|-------------------------------------|-------------------------------|------------------------------|-------------|
|  |                                     |                               | <i>2017</i>                  | <i>2016</i> |
| Bank Syariah Muamalat Indonesia T.B.K. | Indonesia                           | Banking                       | <b>30.5</b>                  | 30.5        |
| Bank of London and the Middle East     | United Kingdom                      | Banking                       | <b>26.4</b>                  | 26.4        |
| Turkish Bank A.S.                      | Turkey                              | Banking                       | <b>34.3</b>                  | 34.3        |
| United Capital Bank                    | Sudan                               | Banking                       | <b>21.7</b>                  | 21.7        |

During the year the Group received dividend amounting to KD 34 thousand from associates (2016: KD 414 thousand).

During the year the Group provided KD 12,750 thousand (2016: KD 12,165 thousand) by way of impairment in respect of its associates, primarily consisting of KD 10,836 thousand (2016: KD 12,165 thousand) in respect of Bank Syariah Muamalat Indonesia T.B.K. The impairment in respect of Bank Syariah Muamalat Indonesia T.B.K is calculated as the difference between fair value less cost of disposal and the carrying value. Fair value less cost of disposal is determined using market multiples.

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**15 GOODWILL AND OTHER INTANGIBLE ASSETS**

|  | <i>Goodwill</i><br><i>KD 000's</i> | <i>Intangible</i><br><i>Assets</i><br><i>KD 000's</i> | <i>Total</i><br><i>KD 000's</i> |
|--|------------------------------------|---|---------------------------------|
| <b>Cost</b>                                      |                                    |   |                                 |
| At 1 January 2017                                | 394,814                            | 217,659   | 612,473                         |
| Exchange rate adjustments                        | 3,089                              | 766   | 3,855                           |
| At 31 December 2017                              | <u>397,903</u>                     | <u>218,425</u>  | <u>616,328</u>                  |
| <b>Accumulated amortisation &amp; impairment</b> |                                    |   |                                 |
| At 1 January 2017                                | -                                  | 30,633  | 30,633                          |
| Amortisation charge for the year                 | -                                  | 3,121   | 3,121                           |
| Exchange rate adjustments                        | -                                  | 668   | 668                             |
| At 31 December 2017                              | <u>-</u>                           | <u>34,422</u>   | <u>34,422</u>                   |
| <b>Net book value</b>                            |                                    |   |                                 |
| At 31 December 2017                              | <u>397,903</u>                     | <u>184,003</u>  | <u>581,906</u>                  |

|  | <i>Goodwill</i><br><i>KD 000's</i> | <i>Intangible</i><br><i>assets</i><br><i>KD 000's</i> | <i>Total</i><br><i>KD 000's</i> |
|--|------------------------------------|---|---------------------------------|
| <b>Cost</b>                                      |                                    |   |                                 |
| At 1 January 2016                                | 474,174                            | 241,326   | 715,500                         |
| Exchange rate adjustments                        | (79,360)                           | (23,667)  | (103,027)                       |
| At 31 December 2016                              | <u>394,814</u>                     | <u>217,659</u>  | <u>612,473</u>                  |
| <b>Accumulated amortisation &amp; impairment</b> |                                    |   |                                 |
| At 1 January 2016                                | -                                  | 37,906  | 37,906                          |
| Amortisation charge for the year                 | -                                  | 4,362   | 4,362                           |
| Impairment charge for the year                   | -                                  | 5,442   | 5,442                           |
| Exchange rate adjustments                        | -                                  | (17,077)  | (17,077)                        |
| At 31 December 2016                              | <u>-</u>                           | <u>30,633</u>   | <u>30,633</u>                   |
| <b>Net book value</b>                            |                                    |   |                                 |
| At 31 December 2016                              | <u>394,814</u>                     | <u>187,026</u>  | <u>581,840</u>                  |

Net book value of goodwill as at 31 December 2017 includes KD 334,531 thousand (2016: KD 334,531 thousand) in respect of Boubyan Bank K.S.C.P., KD 60,483 thousand (2016: KD 57,341 thousand) in respect of National Bank of Kuwait - Egypt S.A.E. and KD 2,889 thousand (2016: KD 2,942 thousand) in respect of Credit Bank of Iraq S.A.

Net book value of intangible assets as at 31 December 2017 includes banking licences and brand amounting to KD 161,163 thousand (2016: KD 162,232 thousand), customer relationships and core deposits amounting to KD 16,130 thousand (2016: KD 17,923 thousand) and brokerage licences amounting to KD 6,710 thousand (2016: KD 6,871 thousand). Intangible assets with indefinite useful life amounts to KD 165,333 thousand (2016: KD 165,494 thousand). Intangible assets with definite useful life amounting to KD 18,670 thousand (2016: KD 21,532 thousand) are amortised over a period of 5 to 15 years.

**15 GOODWILL AND OTHER INTANGIBLE ASSETS (continued)****Impairment testing for goodwill and intangible assets with indefinite useful life**

The carrying value of goodwill and intangible assets with indefinite useful life are tested for impairment on an annual basis (or more frequently if evidence exists that goodwill or intangible assets might be impaired) by estimating the recoverable amount of the cash generating unit (CGU) to which these items are allocated using value-in-use calculations unless fair value based on an active market price is higher than the carrying value of the CGU. The value in use calculations use pre-tax cash flow projections based on financial budgets approved by management over a five years period and a relevant terminal growth rate. These cash flows are then discounted to derive a net present value which is compared to the carrying value. The discount rate used is pre-tax and reflects specific risks relating to the relevant cash generating unit.

Recoverable amount of goodwill and other intangible assets with indefinite useful life is calculated using value-in-use method based on following inputs. The goodwill in respect of Boubyan Bank K.S.C.P. is allocated to a single CGU which consists of identifiable net assets including intangible assets of Boubyan Bank K.S.C.P. A discount rate of 8.75% (2016: 9.25%) and a terminal growth rate of 3.25% (2016: 3.25%) are used to estimate the recoverable amount of this cash generating unit. The goodwill in respect of National Bank of Kuwait - Egypt S.A.E. is allocated to a single CGU which consists of identifiable net assets including intangible assets of National Bank of Kuwait - Egypt S.A.E. A discount rate of 17% (2016: 18%) and a terminal growth rate of 5% (2016: 5%) are used to estimate the recoverable amount of this cash generating unit. A discount rate of 9.25% (2016: 10%) and terminal growth rate of 3% (2016: 3%) are used to estimate the recoverable amount of the brokerage licence in Kuwait. The Group has also performed a sensitivity analysis by varying these input factors by a reasonable margin. Based on such analysis, there are no indications that goodwill or intangible assets with indefinite useful life are impaired.

**16 OTHER ASSETS**

|  | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|--|--------------------------------|--------------------------------|
| Interest receivable                          | <b>78,303</b>                  | 56,683                         |
| Positive fair value of derivatives (Note 28) | <b>27,680</b>                  | 45,183                         |
| Sundry debtors and prepayments               | <b>39,586</b>                  | 41,675                         |
| Investment properties                        | <b>53,572</b>                  | 24,680                         |
| Properties acquired on settlement of debts   | <b>33,862</b>                  | 21,832                         |
| Others                                       | <b>16,993</b>                  | 11,362                         |
|  | <b>249,996</b>                 | 201,415                        |

**17 GLOBAL MEDIUM TERM NOTES**

During the year, the Bank established a USD 3 billion Global medium term note programme ("GMTN programme"). On 30 May 2017, the Bank issued senior unsecured notes amounting to USD 750,000 thousand due in May 2022 under the GMTN programme through a wholly owned special purpose vehicle. These notes were issued at 99.491 per cent of nominal value and carry a fixed interest rate of 2.75% per annum payable semi-annually in arrears.

**18 SUBORDINATED TIER 2 BONDS**

On 18 November 2015, the Bank issued Kuwaiti Dinar denominated subordinated Tier 2 bonds amounting to KD 125,000 thousand with a tenor of up to 10 years, comprising equal tranches of fixed rate bonds and floating rate bonds. Fixed rate bonds carry an interest rate of 4.75% per annum, payable semi-annually in arrears, for the first five years and will be reset for the subsequent period at the rate of 2.75% over the CBK Discount Rate (on the fifth year anniversary of date of issuance). Floating rate bonds carry an interest rate of 2.50% per annum over the Central Bank of Kuwait discount rate, reset semi-annually, subject to a maximum of 1% over the prevailing rate for the fixed rate bonds and payable semi-annually in arrears. These bonds are unsecured and callable in whole or in part at the option of the Bank after 5 years from the date of issuance, subject to certain conditions and regulatory approvals.

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**19 OTHER LIABILITIES**

|  | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|--|--------------------------------|--------------------------------|
| Interest payable                             | 97,852                         | 74,144                         |
| Income received in advance                   | 35,082                         | 28,808                         |
| Taxation                                     | 19,176                         | 20,605                         |
| Provision on non-cash facilities (Note 12)   | 29,591                         | 29,270                         |
| Accrued expenses                             | 36,645                         | 32,367                         |
| Negative fair value of derivatives (Note 28) | 54,123                         | 42,550                         |
| Post employment benefit                      | 34,114                         | 30,653                         |
| Others                                       | 81,265                         | 79,081                         |
|  | <u>387,848</u>                 | <u>337,478</u>                 |

**Post Employment Benefit**

The present value of defined benefit obligation was determined by actuarial valuations using the projected unit credit method. The significant inputs used in the actuarial valuation are a discount rate of 5%, future salary increases in line with expected consumer price inflation and appropriate mortality and disability rates.

**20 SHARE CAPITAL AND RESERVES**

## a) Share capital

The authorised share capital of the Bank comprises of 6,000,000,000 (2016: 6,000,000,000) shares of KD 0.100 each.

|  | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|--|--------------------------------|--------------------------------|
| Issued and fully paid in cash:                               |                                |                                |
| 5,917,447,518 (2016 : 5,635,664,303) shares of KD 0.100 each | <u>591,744</u>                 | <u>563,566</u>                 |

Annual General Assembly meeting of the shareholders held on 11 March 2017 approved an increase of KD 28,178,321.500 in the issued and fully paid share capital of the Bank by issuing 281,783,215 bonus shares representing 5% of the share capital. The issued and fully paid up share capital increased from KD 563,566,430.300 to KD 591,744,751.800 and the change in share capital was recorded in the commercial register on 19 March 2017.

The movement in ordinary shares in issue during the year was as follows:

|   | <i>2017</i>          | <i>2016</i>          |
|---|----------------------|----------------------|
| Number of shares in issue as at 1 January   | 5,635,664,303        | 5,039,717,687        |
| Bonus issue                                 | 281,783,215          | 251,985,884          |
| Rights issue                                | -                    | 343,960,732          |
| Number of shares in issue as at 31 December | <u>5,917,447,518</u> | <u>5,635,664,303</u> |

## b) Statutory reserve

The Board of Directors recommended a transfer of KD 14,089 thousand (2016: KD 29,797 thousand) to the statutory reserve. This is in compliance with the Bank's Articles of Association and the Companies Law, as amended, which require a minimum of 10% of profit for the year attributable to the shareholders of the Bank before KFAS, NLST and Zakat to be transferred to a non distributable statutory reserve until such time as this reserve equals 50% of the Bank's issued capital. Accordingly, the transfer to statutory reserve, which is less than 10% of the profit for the year, is that amount required to make the statutory reserve 50% of the Bank's issued capital.

Distribution of this reserve is limited to the amount required to enable payment of a dividend of 5% of share capital in years when accumulated profits are not sufficient for the payment of a dividend of that amount.

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**20 SHARE CAPITAL AND RESERVES (continued)**

## c) Share premium account

The balance in the share premium account is not available for distribution.

## d) Treasury shares and Treasury share reserve

The Bank held the following treasury shares at the year end:

|  | <i>2017</i>        | <i>2016</i> |
|--|--------------------|-------------|
| Number of treasury shares                                | <b>101,018,981</b> | 96,208,554  |
| Treasury shares as a percentage of total shares in issue | <b>1.7%</b>        | 1.7%        |
| Cost of treasury shares (KD thousand)                    | <b>77,799</b>      | 77,799      |
| Market value of treasury shares (KD thousand)            | <b>73,542</b>      | 62,536      |
| Weighted average market value per treasury share (fils)  | <b>718</b>         | 643         |

Movement in treasury shares was as follows:

|                           | <i>No. of shares</i> |             |
|---------------------------|----------------------|-------------|
|                           | <i>2017</i>          | <i>2016</i> |
| Balance as at 1 January   | <b>96,208,554</b>    | 91,626,899  |
| Bonus issue               | <b>4,810,427</b>     | 4,581,344   |
| Purchases                 | -                    | 311         |
| Balance as at 31 December | <b>101,018,981</b>   | 96,208,554  |

The balance in the treasury share reserve account is not available for distribution. Further, an amount equal to the cost of treasury shares is not available for distribution from general reserve throughout the holding period of these treasury shares.

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**20 SHARE CAPITAL AND RESERVES (continued)**

e) Other reserves

|   | <i>KD 000's</i>            |                              |   |  |  |                                       |                                     |
|---|----------------------------|------------------------------|---|--|--|---------------------------------------|-------------------------------------|
|   | <i>General<br/>reserve</i> | <i>Retained<br/>earnings</i> | <i>Foreign<br/>currency<br/>translation<br/>reserve</i> | <i>Cumulative<br/>changes in<br/>fair values</i> | <i>Share based<br/>payment<br/>reserve</i> | <i>Proposed<br/>cash<br/>dividend</i> | <i>Total<br/>other<br/>reserves</i> |
| At 1 January 2017   | 117,058                    | 1,163,193                    | (237,915)   | 49,121   | 14,172                                     | 166,184                               | <b>1,271,813</b>                    |
| Profit for the year   | -                          | 322,362                      | -   | -  | -  | -                                     | <b>322,362</b>                      |
| Other comprehensive income                                    | -                          | -                            | 3,424   | 358  | -  | -                                     | <b>3,782</b>                        |
| <b>Total comprehensive income</b>                             | <b>-</b>                   | <b>322,362</b>               | <b>3,424</b>  | <b>358</b>                                       | <b>-</b>                                   | <b>-</b>                              | <b>326,144</b>                      |
| Transfer to statutory reserve (Note 20b)                      | -                          | (14,089)                     | -   | -  | -  | -                                     | <b>(14,089)</b>                     |
| Dividends paid  | -                          | -                            | -   | -  | -  | (166,184)                             | <b>(166,184)</b>                    |
| Interest paid on perpetual Tier 1 Capital Securities          | -                          | (12,232)                     | -   | -  | -  | -                                     | <b>(12,232)</b>                     |
| Share based payment in a subsidiary                           | -                          | -                            | -   | -  | 209  | -                                     | <b>209</b>                          |
| Profit distribution on perpetual Tier 1 Sukuk by a subsidiary | -                          | (2,989)                      | -   | -  | -  | -                                     | <b>(2,989)</b>                      |
| Proposed bonus shares (Note 21)                               | -                          | (29,588)                     | -   | -  | -  | -                                     | <b>(29,588)</b>                     |
| Proposed cash dividend 30 fils per share (Note 21)            | -                          | (174,493)                    | -   | -  | -  | 174,493                               | <b>-</b>                            |
| Change in effective holding in subsidiaries                   | -                          | (120)                        | -   | -  | -  | -                                     | <b>(120)</b>                        |
| <b>At 31 December 2017</b>                                    | <b>117,058</b>             | <b>1,252,044</b>             | <b>(234,491)</b>  | <b>49,479</b>                                    | <b>14,381</b>                              | <b>174,493</b>                        | <b>1,372,964</b>                    |



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**20 SHARE CAPITAL AND RESERVES (continued)**

e) Other reserves (continued)

|  | <i>KD 000's</i>        |                          |   |  |                                    |                               |                             |
|--|------------------------|--------------------------|---|--|------------------------------------|-------------------------------|-----------------------------|
|  | <i>General reserve</i> | <i>Retained earnings</i> | <i>Foreign currency translation reserve</i> | <i>Cumulative changes in fair values</i> | <i>Share based payment reserve</i> | <i>Proposed cash dividend</i> | <i>Total other reserves</i> |
| At 1 January 2016  | 117,058                | 1,107,221                | (79,749)                                    | 29,472                                   | 16,303                             | 148,443                       | 1,338,748                   |
| Profit for the year  | -                      | 295,178                  | -   | -  | -                                  | -                             | 295,178                     |
| Other comprehensive (loss) income                                    | -                      | -                        | (158,166)                                   | 19,649                                   | -                                  | -                             | (138,517)                   |
| <b>Total comprehensive income (loss)</b>                             | -                      | 295,178                  | (158,166)                                   | 19,649                                   | -                                  | -                             | 156,661                     |
| Transfer to statutory reserve (Note 20b)                             | -                      | (29,797)                 | -   | -  | -                                  | -                             | (29,797)                    |
| Dividends paid   | -                      | -                        | -   | -  | -                                  | (148,443)                     | (148,443)                   |
| Interest paid on perpetual Tier 1 Capital Securities                 | -                      | (12,146)                 | -   | -  | -                                  | -                             | (12,146)                    |
| Transfer to cash settled share based compensation                    | -                      | -                        | -   | -  | (2,418)                            | -                             | (2,418)                     |
| Share based payment in a subsidiary                                  | -                      | -                        | -   | -  | 287                                | -                             | 287                         |
| Transaction costs on issue of Perpetual Tier 1 Sukuk by a subsidiary | -                      | (379)                    | -   | -  | -                                  | -                             | (379)                       |
| Profit distribution on perpetual Tier 1 Sukuk by a subsidiary        | -                      | (1,503)                  | -   | -  | -                                  | -                             | (1,503)                     |
| Proposed bonus shares (Note 21)                                      | -                      | (28,178)                 | -   | -  | -                                  | -                             | (28,178)                    |
| Proposed cash dividend 30 fils per share (Note 21)                   | -                      | (166,184)                | -   | -  | -                                  | 166,184                       | -                           |
| Other movements  | -                      | (1,019)                  | -   | -  | -                                  | -                             | (1,019)                     |
| <b>At 31 December 2016</b>   | <b>117,058</b>         | <b>1,163,193</b>         | <b>(237,915)</b>                            | <b>49,121</b>                            | <b>14,172</b>                      | <b>166,184</b>                | <b>1,271,813</b>            |

**20 SHARE CAPITAL AND RESERVES (continued)**

e) Other reserves (continued)

The general reserve was created in accordance with Bank's Articles of Association and is freely distributable, except for the amount equivalent to the cost of treasury shares.

The foreign currency translation reserve includes the exchange differences on conversion of results and financial position of all group entities including goodwill, intangible assets and any fair value adjustments to the carrying value of assets and liabilities from their functional currency to the presentation currency.

**21 PROPOSED DIVIDEND**

The Board of Directors recommended distribution of a cash dividend of 30 fils per share (2016: 30 fils per share) and bonus shares of 5% (2016: 5%) on outstanding shares as at 31 December 2017. The cash dividend and bonus shares, if approved by the shareholders' general assembly, shall be payable to the shareholders after obtaining the necessary regulatory approvals.

**22 PERPETUAL TIER 1 CAPITAL SECURITIES**

In April 2015, the Bank issued Perpetual Tier 1 Capital Securities (the "Capital Securities"), through a wholly owned special purpose vehicle, amounting to USD 700,000 thousand which are eligible to be classified under equity in accordance with IAS 32: Financial Instruments – Presentation. The Capital Securities are subordinated, unsecured and carry an interest rate of 5.75% per annum, payable semi-annually in arrears, until the first call date in April 2021. Payments of interest in respect of the Capital Securities may be cancelled (in whole or in part) at the sole discretion of the Bank on a non-cumulative basis. Any such cancellation is not considered an event of default. Payments of interest are treated as a deduction from equity. The Capital Securities have no maturity date and are callable (in whole but not in part) at par at the option of the Bank on the first call date in April 2021 and on every interest payment date thereafter, subject to certain conditions.

**23 NON-CONTROLLING INTERESTS**

During 2015, Boubyan Bank K.S.C.P. (Boubyan Bank), a subsidiary of the Bank, issued "Tier 1 Sukuk", through a Sharia's compliant Sukuk arrangement amounting to USD 250,000 thousand. Tier 1 Sukuk is a perpetual security in respect of which there is no fixed redemption date and constitutes direct, unsecured, subordinated obligations (senior only to share capital) of the Boubyan Bank subject to the terms and conditions of the Mudaraba Agreement. The Tier 1 Sukuk is listed on the Irish Stock Exchange and NASDAQ Dubai and callable by the Boubyan Bank after five-year period ending May 2021 (the "First Call Date") or any profit payment date thereafter subject to certain redemption conditions. Tier 1 Sukuk bears an expected profit rate of 6.75% per annum to be paid semi-annually in arrears until the First Call Date. After that, the expected profit rate will be reset based on then prevailing 5 years U.S Dollar Mid Swap Rate plus initial margin of 5.588% per annum. At the issuer's sole discretion, it may elect not to make any Mudaraba distributions expected and in such event, the Mudaraba profit will not be accumulated and the event is not considered an event of default. The Group did not subscribe to the Tier 1 Sukuk issue and the total amount is included in non- controlling interest in the consolidated statement of financial position.

**24 SHARE BASED PAYMENT**

The Bank operates a cash settled share based compensation plan and granted options to its senior executives. These options vest if the employees remain in service for a period of three years and will be settled by cash payment determined based on the market value of the Bank's equity shares on vesting date.

The fair value of options granted during the year as determined using the Black-Scholes valuation model was KD 0.663 (2016: KD 0.612) as at the end of the year. The significant inputs into the model were a share price of KD 0.728 (2016: KD 0.660) at the measurement date, a standard deviation of expected share price returns of 25.27% (2016: 20.40%), option life disclosed above and annual risk free interest rate of 2.75% (2016: 2.5%). The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices over the last three years.

# National Bank of Kuwait Group

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### 24 SHARE BASED PAYMENT (continued)

The following table shows the movement in number of share options during the year:

|                            | <u>2017</u>                 | <u>2016</u>                 |
|----------------------------|-----------------------------|-----------------------------|
|                            | <u>No. of share options</u> | <u>No. of share options</u> |
| Outstanding at 1 January   | 6,051,992                   | 5,637,743                   |
| Granted during the year    | 3,237,108                   | 2,197,905                   |
| Exercised during the year  | (2,091,184)                 | (1,556,637)                 |
| Lapsed during the year     | (245,557)                   | (227,019)                   |
| Outstanding at 31 December | <u>6,952,359</u>            | <u>6,051,992</u>            |

Boubyan Bank K.S.C.P. operates an equity settled share based compensation plan and granted share options to its senior executives.

The expense accrued on account of share based compensation plans for the year amounts to KD 1,909 thousand (2016: KD 1,693 thousand) and is included under staff expenses.

### 25 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

Level 2: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using quoted prices for identical or similar instruments in market that are considered less than active or other valuation techniques in which all significant inputs are observable from market data. Debt securities under this category mainly include sovereign debt instruments in the Middle East & North Africa (MENA) region.

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

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

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

# National Bank of Kuwait Group

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 25 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

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

| <b>2017</b>                                | <i>Level 1<br/>KD 000's</i> | <i>Level 2<br/>KD 000's</i> | <i>Level 3<br/>KD 000's</i> | <i>Total<br/>KD 000's</i> |
|--|-----------------------------|-----------------------------|-----------------------------|---------------------------|
| Debt securities                            | 2,074,930                   | 1,030,534                   | 14,377                      | 3,119,841                 |
| Equities and other investments             | 58,829                      | 122,844                     | 65,487                      | 247,160                   |
|  | <u>2,133,759</u>            | <u>1,153,378</u>            | <u>79,864</u>               | <u>3,367,001</u>          |
| Derivative financial instruments (Note 28) | -                           | (26,443)                    | -                           | (26,443)                  |
|  | <u>-</u>                    | <u>(26,443)</u>             | <u>-</u>                    | <u>(26,443)</u>           |
| <b>2016</b>                                | <i>Level 1<br/>KD 000's</i> | <i>Level 2<br/>KD 000's</i> | <i>Level 3<br/>KD 000's</i> | <i>Total<br/>KD 000's</i> |
| Debt securities                            | 1,756,896                   | 939,587                     | 14,765                      | 2,711,248                 |
| Equities and other investments             | 91,489                      | 132,410                     | 71,782                      | 295,681                   |
|  | <u>1,848,385</u>            | <u>1,071,997</u>            | <u>86,547</u>               | <u>3,006,929</u>          |
| Derivative financial instruments (Note 28) | -                           | 2,633                       | -                           | 2,633                     |
|  | <u>-</u>                    | <u>2,633</u>                | <u>-</u>                    | <u>2,633</u>              |

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

|                                   | <i>At 1<br/>January<br/>2017<br/>KD 000's</i> | <i>Change in<br/>fair value<br/>KD 000's</i> | <i>Additions<br/>KD 000's</i> | <i>Sale/<br/>redemption<br/>KD 000's</i> | <i>Exchange<br/>rate<br/>movements<br/>KD 000's</i> | <i>At 31<br/>December<br/>2017<br/>KD 000's</i> | <i>Net gains<br/>in the<br/>consolidated<br/>statement of<br/>income<br/>KD 000's</i> |
|-----------------------------------|---|--|-------------------------------|--|---|---|---|
| Debt securities                   | 14,765  | -  | -                             | (377)                                    | (11)  | 14,377  | 999   |
| Equities and<br>other investments | 71,782  | 4,010  | 1,732                         | (11,420)                                 | (617)   | 65,487  | 6,679   |
|                                   | <u>86,547</u>                                 | <u>4,010</u>                                 | <u>1,732</u>                  | <u>(11,797)</u>                          | <u>(628)</u>  | <u>79,864</u>                                   | <u>7,678</u>  |
|                                   | <i>At 1<br/>January<br/>2016<br/>KD 000's</i> | <i>Change in<br/>fair value<br/>KD 000's</i> | <i>Additions<br/>KD 000's</i> | <i>Sale/<br/>redemption<br/>KD 000's</i> | <i>Exchange<br/>rate<br/>movements<br/>KD 000's</i> | <i>At 31<br/>December<br/>2016<br/>KD 000's</i> | <i>Net gains<br/>in the<br/>consolidated<br/>statement of<br/>income<br/>KD 000's</i> |
| Debt securities                   | 31,686  | -  | 14,000                        | (30,929)                                 | 8   | 14,765  | 989   |
| Equities and<br>other investments | 79,904  | (9,677)                                      | 9,950                         | (8,771)                                  | 376   | 71,782  | 4,616   |
|                                   | <u>111,590</u>                                | <u>(9,677)</u>                               | <u>23,950</u>                 | <u>(39,700)</u>                          | <u>384</u>  | <u>86,547</u>                                   | <u>5,605</u>  |

# National Bank of Kuwait Group

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 25 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Debt securities included in this category consists of unquoted corporate bonds issued by banks and financial institutions. The fair values of these bonds are estimated using discounted cash flow method using credit spread of 4% (2016: 4%). Equities and other securities included in this category mainly include strategic equity investments and private equity funds which are not traded in an active market. The fair values of these investments are estimated by using valuation techniques that are appropriate in the circumstances. Valuation techniques include discounted cash flow models, observable market information of comparable companies, recent transaction information and net asset values. Significant unobservable inputs used in valuation techniques mainly include discount rate, terminal growth rate, revenue, profit estimates and market multiples such as price to book and price to earnings. Given the diverse nature of these investments, it is not practical to disclose a range of significant unobservable inputs.

Other financial assets and liabilities are carried at amortised cost and the carrying values are not materially different from their fair values as most of these assets and liabilities are of short term maturities or are repriced immediately based on market movement in interest rates. Fair values of remaining financial assets and liabilities carried at amortised cost are estimated mainly using discounted cash flow models incorporating certain assumptions such as credit spreads that are appropriate in the circumstances.

Sensitivity analysis on fair value estimations, by varying input assumptions by a reasonable margin, did not indicate any material impacts on consolidated statement of financial position or consolidated statement of income.

### 26 SUBSIDIARIES

Principal operating subsidiaries:

| <i>Name of entities</i>                            | <i>Country of incorporation</i> | <i>Principal business</i> | <i>% Effective ownership</i> |             |
|--|---------------------------------|---------------------------|------------------------------|-------------|
|  |                                 |                           | <i>2017</i>                  | <i>2016</i> |
| Boubyan Bank K.S.C.P.                              | Kuwait                          | Islamic Banking           | <b>58.4</b>                  | 58.4        |
| National Bank of Kuwait - Egypt S.A.E.             | Egypt                           | Banking                   | <b>98.5</b>                  | 98.5        |
| Watani Investment Company K.S.C.(Closed)           | Kuwait                          | Investment Company        | <b>99.9</b>                  | 99.9        |
| National Bank of Kuwait (International) plc        | United Kingdom                  | Banking                   | <b>100.0</b>                 | 100.0       |
| NBK Banque Privée (Suisse) S.A.                    | Switzerland                     | Investment Management     | <b>100.0</b>                 | 100.0       |
| National Bank of Kuwait (Lebanon) S.A.L.           | Lebanon                         | Banking                   | <b>85.5</b>                  | 85.5        |
| Credit Bank of Iraq S.A.                           | Iraq                            | Banking                   | <b>84.3</b>                  | 84.3        |
| National Investors Group Holdings Limited          | Cayman Islands                  | Investment Company        | <b>100.0</b>                 | 100.0       |
| Watani Financial Brokerage Company K.S.C. (Closed) | Kuwait                          | Brokerage                 | <b>93.3</b>                  | 93.3        |

At 31 December 2017, 38.1% (2016: 38.1%) of the Group's interest in National Bank of Kuwait (Lebanon) S.A.L. was held by an intermediate holding company, NBK Holding (Liban) S.A.L.

The Bank also holds voting capital in certain special purpose entities which have been established to manage funds and fiduciary assets on behalf of the Bank's customers. The Bank does not have a beneficial interest in the underlying assets of these companies. Information about the Group's fund management activities is set out in note 32.

Significant non-controlling interest exists in Boubyan Bank K.S.C.P. as follows:

|  | <i>2017</i>     | <i>2016</i>     |
|--|-----------------|-----------------|
|  | <i>KD 000's</i> | <i>KD 000's</i> |
| Accumulated balances of non-controlling interest | <b>304,112</b>  | 293,211         |
| Profit attributable to non-controlling interest  | <b>19,137</b>   | 16,527          |

# National Bank of Kuwait Group

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 26 SUBSIDIARIES (continued)

Summarised financial information of Boubyan Bank K.S.C.P. is as follows:

| <i>Summarised financial information</i> | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|---|--------------------------------|--------------------------------|
| Assets                                  | <b>3,970,396</b>               | 3,481,807                      |
| Liabilities                             | <b>3,518,039</b>               | 3,058,654                      |
| Net operating income                    | <b>125,567</b>                 | 103,303                        |
| Results for the year                    | <b>47,672</b>                  | 41,301                         |
| Other comprehensive loss for the year   | <b>(17)</b>                    | (297)                          |

  

| <i>Summarised cash flow information</i> | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|---|--------------------------------|--------------------------------|
| Operating cash flow                     | <b>175,392</b>                 | (390,909)                      |
| Investing cash flow                     | <b>(112,571)</b>               | (47,840)                       |
| Financing cash flow                     | <b>(18,824)</b>                | 60,870                         |

### 27 COMMITMENTS AND CONTINGENT LIABILITIES

|  | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|--|--------------------------------|--------------------------------|
| Commitments on behalf of customers for which there are corresponding liabilities by the customers concerned: |                                |                                |
| Acceptances  | <b>144,001</b>                 | 115,668                        |
| Letters of credit  | <b>328,943</b>                 | 319,459                        |
| Guarantees   | <b>3,755,718</b>               | 3,638,537                      |
|  | <b><u>4,228,662</u></b>        | <b><u>4,073,664</u></b>        |

Irrevocable commitments to extend credit amount to KD 713,129 thousand (31 December 2016: KD 786,888 thousand). This includes commitments to extend credit which are irrevocable over the life of the facility or are revocable only in response to a material adverse change.

In the normal course of business, the Group has exposure to various indirect credit commitments which, though not reflected in the consolidated statement of financial position, are subject to normal credit standards, financial controls and monitoring procedures.

These credit commitments do not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded. Credit losses, if any, which may result from exposure to such commitments are not expected to be significant.

The Group has commitments in respect of capital expenditure amounting to KD 60,019 thousand (31 December 2016: KD 105,426 thousand).

**28 DERIVATIVE FINANCIAL INSTRUMENTS**

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

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

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

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

**Interest rate swaps**

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

**Forward foreign exchange**

Forward foreign exchange contracts are agreements to buy or sell currencies at a specified rate and at a future date.

The fair value of derivative financial instruments included in the financial records, together with their notional amounts is summarised as follows:

|   | 2017  |   |                              | 2016  |   |                              |
|---|---|---|------------------------------|---|---|------------------------------|
|   | <i>Positive<br/>fair value<br/>KD 000's</i> | <i>Negative<br/>fair value<br/>KD 000's</i> | <i>Notional<br/>KD 000's</i> | <i>Positive<br/>fair value<br/>KD 000's</i> | <i>Negative<br/>fair value<br/>KD 000's</i> | <i>Notional<br/>KD 000's</i> |
| Interest rate swaps (held as fair value hedges) | 20,989                                      | 37,845                                      | 1,947,427                    | 25,992                                      | 30,117                                      | 1,376,449                    |
| Interest rate swaps (others)                    | 962   | 926   | 91,050                       | 1,450                                       | 1,404                                       | 84,811                       |
| Forward foreign exchange contracts              | 5,729                                       | 15,352                                      | 2,171,714                    | 17,741                                      | 11,029                                      | 2,094,223                    |
|   | <b>27,680</b>                               | <b>54,123</b>                               | <b>4,210,191</b>             | <b>45,183</b>                               | <b>42,550</b>                               | <b>3,555,483</b>             |

The net fair value of interest rate swaps held as fair value hedges as at 31 December 2017 is negative KD 16,856 thousand (2016: negative KD 4,125 thousand). Gain on the hedged fixed income financial assets amounted to KD 41,534 thousand (2016: KD 26,805 thousand).

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### 29 RELATED PARTY TRANSACTIONS

Related parties comprise board members and executive officers of the Bank, their close family members, companies controlled by them or close family members and associates of the Group. Certain related parties were customers of the Group in the ordinary course of business. Transactions with related parties were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with unrelated parties and did not involve more than a normal amount of risk. Lending to Board Members and their related parties is secured by tangible collateral in accordance with regulations of Central Bank of Kuwait.

Details of the interests of related parties are as follows:

|  | <i>Number of<br/>Board Members<br/>or Executive<br/>Officers</i> |             | <i>Number of<br/>related parties</i> |             | <i>2017<br/>KD 000's</i> | <i>2016<br/>KD 000's</i> |
|--|--|-------------|--------------------------------------|-------------|--------------------------|--------------------------|
|  | <i>2017</i>  | <i>2016</i> | <i>2017</i>                          | <i>2016</i> |                          |                          |
| <b>Board Members</b>                     |  |             |                                      |             |                          |                          |
| Loans (secured)                          | 3  | 4           | 15                                   | 16          | 125,328                  | 155,598                  |
| Contingent liabilities                   | -  | -           | 12                                   | 13          | 21,508                   | 20,981                   |
| Credit cards                             | 7  | 6           | 12                                   | 10          | 66                       | 99                       |
| Deposits                                 | 9  | 8           | 69                                   | 67          | 37,184                   | 32,090                   |
| Collateral against credit facilities     | 3  | 4           | 14                                   | 14          | 278,512                  | 288,898                  |
| Interest and fee income                  |  |             |                                      |             | 5,864                    | 7,586                    |
| Interest expense                         |  |             |                                      |             | 100                      | 43                       |
| Purchase of equipment and other expenses |  |             |                                      |             | 23                       | 23                       |
| <b>Executive Officers</b>                |  |             |                                      |             |                          |                          |
| Loans                                    | 4  | 3           | 6                                    | 3           | 2,795                    | 2,702                    |
| Contingent liabilities                   | 4  | 5           | -                                    | -           | 2                        | 2                        |
| Credit cards                             | 12   | 12          | 2                                    | 2           | 47                       | 38                       |
| Deposits                                 | 13   | 13          | 31                                   | 33          | 3,782                    | 2,910                    |
| Interest and fee income                  |  |             |                                      |             | 100                      | 90                       |
| Interest expense                         |  |             |                                      |             | 5                        | -                        |

Details of compensation to key management personnel are as follows:

|  | <i>2017<br/>KD 000's</i> | <i>2016<br/>KD 000's</i> |
|--|--------------------------|--------------------------|
| Salaries and other short term benefits | 10,048                   | 9,462                    |
| Post-employment benefits               | 517                      | 514                      |
| Share based compensation               | 707                      | 475                      |
|  | <u>11,272</u>            | <u>10,451</u>            |

Board members do not receive any emoluments in the form of fees, salaries or bonuses for their services rendered to the Bank.



### 30 RISK MANAGEMENT

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

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

In accordance with the Central Bank of Kuwait's directives, the Group has implemented a comprehensive system for the measurement and management of risk. This methodology helps in reflecting both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. Information compiled from all internal business groups are closely examined and analysed to identify and control risks.

Transactions and outstanding risk exposures are quantified and compared against authorised limits, whereas non-quantifiable risks are monitored against policy guidelines and key risk and control indicators. Any discrepancies, excesses or deviation are escalated to management for appropriate action.

As part of its overall risk management, the Group uses interest rate swaps, forward foreign exchange contracts and other instruments to manage exposures resulting from changes in interest rates, foreign exchange, equity risks, credit risks and exposures arising from forecast transactions. Collaterals are used to reduce the Group's credit risks.

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

#### 30.1 CREDIT RISK

Credit risk is the risk that counterparty will cause a financial loss to the Group by failing to discharge an obligation. Credit risk arises in the Group's normal course of business.

All significant policies relating to credit risks are reviewed and approved by the Board of Directors.

Credit limits are established for all customers after a careful assessment of their creditworthiness. Standing procedures, outlined in the Group's Credit Policy Manual, require that all credit proposals be subjected to detailed screening by the domestic or international credit control divisions pending submission to the appropriate credit committee. Whenever necessary, all loans are secured by acceptable forms of collateral to mitigate the related credit risks.

In accordance with the instructions of the Central Bank of Kuwait dated 18 December 1996, setting out the rules and regulations regarding the classification of credit facilities, the Group has formed an internal committee comprising competent professional staff and having as its purpose the study and evaluation of the existing credit facilities of each customer of the Group. This committee is required to identify any abnormal situations and difficulties associated with a customer's position which might cause the debt to be classified as irregular, and to determine an appropriate provisioning level. The committee, which meets regularly throughout the year, also studies the positions of those customers whose irregular balances exceed 25% of their total debt, in order to determine whether further provisions are required.

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

31 December 2017

**30 RISK MANAGEMENT (continued)****30.1 CREDIT RISK (continued)****30.1.1 MAXIMUM EXPOSURE TO CREDIT RISK**

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

|  | 2017                                     |  | 2016                                     |  |
|--|--|--|--|--|
|  | <i>Gross exposure</i><br><i>KD 000's</i> | <i>Net exposure</i><br><i>KD 000's</i> | <i>Gross exposure</i><br><i>KD 000's</i> | <i>Net exposure</i><br><i>KD 000's</i> |
| Loans, advances and Islamic financing to customers | <b>14,502,609</b>                        | <b>9,815,314</b>                       | 13,611,491                               | 9,063,108                              |
| Contingent liabilities                             | <b>4,228,662</b>                         | <b>4,020,092</b>                       | 4,073,664                                | 3,939,330                              |

**Collateral and other credit enhancements**

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

**30.1.2 RISK CONCENTRATION OF THE MAXIMUM EXPOSURE TO CREDIT RISK**

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

Credit risk can also arise due to a significant concentration of Group's assets to any single counterparty. This risk is managed by diversification of the portfolio. The 20 largest loans, advances and Islamic financing to customers outstanding as a percentage of gross loans, advances and Islamic financing to customers as at 31 December 2017 is 17% (2016: 16%).

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

| 2017   | <i>Middle East and North Africa</i> |                  |                  |                  |                 | <i>North America</i> | <i>Europe</i>   | <i>Asia</i>     | <i>Others</i>   | <i>Total</i>      |
|--|-------------------------------------|------------------|------------------|------------------|-----------------|----------------------|-----------------|-----------------|-----------------|-------------------|
|  | <i>Africa</i>                       | <i>America</i>   | <i>Europe</i>    | <i>Asia</i>      | <i>Others</i>   |                      |                 |                 |                 |                   |
| <b>Geographic region</b>                           | <i>KD 000's</i>                     | <i>KD 000's</i>  | <i>KD 000's</i>  | <i>KD 000's</i>  | <i>KD 000's</i> | <i>KD 000's</i>      | <i>KD 000's</i> | <i>KD 000's</i> | <i>KD 000's</i> | <i>KD 000's</i>   |
| Balances and deposits with banks                   | 2,674,244                           | 1,085,400        | 992,856          | 284,079          | -               | -                    | -               | -               | -               | 5,036,579         |
| Central Bank of Kuwait bonds                       | 655,591                             | -                | -                | -                | -               | -                    | -               | -               | -               | 655,591           |
| Kuwait Government treasury bonds                   | 1,076,211                           | -                | -                | -                | -               | -                    | -               | -               | -               | 1,076,211         |
| Loans, advances and Islamic financing to customers | 13,394,320                          | 291,674          | 405,990          | 168,554          | 242,071         | -                    | -               | -               | -               | 14,502,609        |
| Held to maturity investments                       | 123,234                             | -                | -                | 15,259           | -               | -                    | -               | -               | -               | 138,493           |
| Available for sale investments                     | 2,287,985                           | 44,212           | 107,725          | 502,753          | 20,173          | -                    | -               | -               | -               | 2,962,848         |
| Other assets                                       | 123,877                             | 2,486            | 31,569           | 3,227            | 1,403           | -                    | -               | -               | -               | 162,562           |
|  | <b>20,335,462</b>                   | <b>1,423,772</b> | <b>1,538,140</b> | <b>973,872</b>   | <b>263,647</b>  | <b>-</b>             | <b>-</b>        | <b>-</b>        | <b>-</b>        | <b>24,534,893</b> |
| Commitments and contingent liabilities (Note 27)   | 2,458,973                           | 307,776          | 1,358,135        | 767,990          | 48,917          | -                    | -               | -               | -               | 4,941,791         |
|  | <b>22,794,435</b>                   | <b>1,731,548</b> | <b>2,896,275</b> | <b>1,741,862</b> | <b>312,564</b>  | <b>-</b>             | <b>-</b>        | <b>-</b>        | <b>-</b>        | <b>29,476,684</b> |

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### 30 RISK MANAGEMENT (continued)

#### 30.1 CREDIT RISK (continued)

##### 30.1.2 RISK CONCENTRATION OF THE MAXIMUM EXPOSURE TO CREDIT RISK (continued)

| 2016   | Middle<br>East and<br>North<br>Africa<br>KD 000's | North<br>America<br>KD 000's | Europe<br>KD 000's | Asia<br>KD 000's | Others<br>KD 000's | Total<br>KD 000's |
|--|---|------------------------------|--------------------|------------------|--------------------|-------------------|
| Balances and deposits with banks                   | 2,770,929   | 1,087,006                    | 656,737            | 400,908          | -                  | 4,915,580         |
| Central Bank of Kuwait bonds                       | 748,889   | -                            | -                  | -                | -                  | 748,889           |
| Kuwait Government treasury bonds                   | 493,101   | -                            | -                  | -                | -                  | 493,101           |
| Loans, advances and Islamic financing to customers | 12,533,231  | 269,013                      | 343,165            | 174,628          | 291,454            | 13,611,491        |
| Held to maturity investments                       | 158,504   | -                            | -                  | 12,454           | -                  | 170,958           |
| Available for sale investments                     | 1,890,777   | 52,668                       | 175,575            | 555,225          | 37,003             | 2,711,248         |
| Other assets                                       | 104,006   | 6,836                        | 40,895             | 1,978            | 1,188              | 154,903           |
|  | <u>18,699,437</u>                                 | <u>1,415,523</u>             | <u>1,216,372</u>   | <u>1,145,193</u> | <u>329,645</u>     | <u>22,806,170</u> |
| Commitments and contingent liabilities (Note 27)   | 2,432,241   | 256,158                      | 1,256,892          | 900,991          | 14,270             | 4,860,552         |
|  | <u>21,131,678</u>                                 | <u>1,671,681</u>             | <u>2,473,264</u>   | <u>2,046,184</u> | <u>343,915</u>     | <u>27,666,722</u> |

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

| Industry sector                        | 2017<br>KD 000's  | 2016<br>KD 000's  |
|--|-------------------|-------------------|
| Trading                                | 2,300,304         | 2,267,746         |
| Manufacturing                          | 2,224,598         | 1,748,147         |
| Banks and other financial institutions | 9,224,294         | 9,137,352         |
| Construction                           | 1,308,088         | 1,304,291         |
| Real Estate                            | 3,078,956         | 2,947,829         |
| Retail                                 | 4,869,811         | 4,507,414         |
| Government                             | 3,318,470         | 2,485,983         |
| Others                                 | 3,152,163         | 3,267,960         |
|  | <u>29,476,684</u> | <u>27,666,722</u> |

**30 RISK MANAGEMENT (continued)****30.1 CREDIT RISK (continued)****30.1.3 CREDIT QUALITY PER CLASS OF FINANCIAL ASSETS**

In managing its portfolio, the Group utilises ratings and other measures and techniques which seek to take account of all aspects of perceived risk. Credit exposures classified as 'High' quality are those where the ultimate risk of financial loss from the obligor's failure to discharge its obligation is assessed to be low. These include facilities to corporate entities with financial condition, risk indicators and capacity to repay which are considered to be good to excellent. Credit exposures classified as 'Standard' quality comprise all other facilities whose payment performance is fully compliant with contractual conditions and which are not 'impaired'. The ultimate risk of possible financial loss on 'Standard' quality is assessed to be higher than that for the exposures classified within the 'High' quality range.

The table below shows the credit quality by class of financial assets for statement of financial position lines, based on the Group's credit rating system.

|  | <i>Neither past due nor impaired</i> |                  | <i>Past due</i>    | <i>Total</i>      |
|--|--------------------------------------|------------------|--------------------|-------------------|
|  | <i>High</i>                          | <i>Standard</i>  | <i>or impaired</i> |                   |
|  | <i>KD 000's</i>                      | <i>KD 000's</i>  | <i>KD 000's</i>    | <i>KD 000's</i>   |
| <b>2017</b>  |                                      |                  |                    |                   |
| Balances and short term deposits with banks        | <b>2,548,391</b>                     | -                | -                  | <b>2,548,391</b>  |
| Central Bank of Kuwait bonds                       | <b>655,591</b>                       | -                | -                  | <b>655,591</b>    |
| Kuwait Government treasury bonds                   | <b>1,076,211</b>                     | -                | -                  | <b>1,076,211</b>  |
| Deposits with banks                                | <b>2,299,426</b>                     | <b>188,762</b>   | -                  | <b>2,488,188</b>  |
| Loans, advances and Islamic financing to customers | <b>13,154,016</b>                    | <b>1,644,268</b> | <b>319,838</b>     | <b>15,118,122</b> |
| Held to maturity investments                       | <b>15,258</b>                        | <b>123,235</b>   | -                  | <b>138,493</b>    |
| Available for sale investments                     | <b>1,822,560</b>                     | <b>1,140,288</b> | -                  | <b>2,962,848</b>  |
|  | <b>21,571,453</b>                    | <b>3,096,553</b> | <b>319,838</b>     | <b>24,987,844</b> |
| <b>2016</b>  |                                      |                  |                    |                   |
| Balances and short term deposits with banks        | 2,507,665                            | -                | -                  | 2,507,665         |
| Central Bank of Kuwait bonds                       | 748,889                              | -                | -                  | 748,889           |
| Kuwait Government treasury bonds                   | 493,101                              | -                | -                  | 493,101           |
| Deposits with banks                                | 2,230,960                            | 176,955          | -                  | 2,407,915         |
| Loans, advances and Islamic financing to customers | 11,626,334                           | 2,381,425        | 271,986            | 14,279,745        |
| Held to maturity investments                       | 12,454                               | 158,504          | -                  | 170,958           |
| Available for sale investments                     | 2,255,252                            | 455,996          | -                  | 2,711,248         |
|  | 19,874,655                           | 3,172,880        | 271,986            | 23,319,521        |

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**30 RISK MANAGEMENT (continued)****30.1 CREDIT RISK (continued)****30.1.4 AGEING ANALYSIS OF PAST DUE OR IMPAIRED LOANS, ADVANCES AND ISLAMIC FINANCING TO CUSTOMERS**

|                    | <i>Corporate</i>                              |   | <i>Retail</i>                                 |   | <i>Total</i>                                  |   |
|--------------------|---|---|---|---|---|---|
|                    | <i>Past due and not impaired<br/>KD 000's</i> | <i>Past due and impaired<br/>KD 000's</i> | <i>Past due and not impaired<br/>KD 000's</i> | <i>Past due and impaired<br/>KD 000's</i> | <i>Past due and not impaired<br/>KD 000's</i> | <i>Past due and impaired<br/>KD 000's</i> |
| <b>2017</b>        |   |   |   |   |   |   |
| Up to 30 days      | <b>30,092</b>                                 | <b>1,678</b>                              | <b>41,061</b>                                 | -   | <b>71,153</b>                                 | <b>1,678</b>                              |
| 31 - 60 days       | <b>6,551</b>                                  | <b>158</b>                                | <b>18,252</b>                                 | -   | <b>24,803</b>                                 | <b>158</b>                                |
| 61 - 90 days       | <b>7,018</b>                                  | -   | <b>2,772</b>                                  | -   | <b>9,790</b>                                  | -   |
| 91-180 days        | -   | <b>42,882</b>                             | -   | <b>23,794</b>                             | -   | <b>66,676</b>                             |
| More than 180 days | -   | <b>73,915</b>                             | -   | <b>71,665</b>                             | -   | <b>145,580</b>                            |
|                    | <b>43,661</b>                                 | <b>118,633</b>                            | <b>62,085</b>                                 | <b>95,459</b>                             | <b>105,746</b>                                | <b>214,092</b>                            |
| <b>2016</b>        |   |   |   |   |   |   |
| Up to 30 days      | 4,500   | 2,793                                     | 36,541  | -   | 41,041  | 2,793                                     |
| 31 - 60 days       | 13,261  | -   | 16,983  | -   | 30,244  | -   |
| 61 - 90 days       | 15,078  | -   | 2,618   | -   | 17,696  | -   |
| 91-180 days        | -   | 37,984                                    | -   | 20,138                                    | -   | 58,122                                    |
| More than 180 days | -   | 58,673                                    | -   | 63,417                                    | -   | 122,090                                   |
|                    | 32,839  | 99,450                                    | 56,142  | 83,555                                    | 88,981  | 183,005                                   |

Of the aggregate amount of gross past due or impaired loans, advances and Islamic financing to customers, the fair value of collateral that the Group held as at 31 December 2017 was KD 91,283 thousand (2016: KD 75,586 thousand).

**30 RISK MANAGEMENT (continued)****30.2 LIQUIDITY RISK**

Liquidity risk is the risk that the Group will be unable to meet its financial liabilities when they fall due. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind and monitors liquidity on a daily basis.

The table below summarises the maturity profile of Group's assets, liabilities and equity based on contractual cash flows and maturity dates. This does not necessarily take account of the effective maturities.

|   | <i>Up to 3<br/>months<br/>KD 000's</i> | <i>3 to 12<br/>months<br/>KD 000's</i> | <i>Over 1<br/>year<br/>KD 000's</i> | <i>Total<br/>KD 000's</i> |
|---|--|--|-------------------------------------|---------------------------|
| <b>2017</b>   |  |  |                                     |                           |
| <b>Assets</b>   |  |  |                                     |                           |
| Cash and deposits with banks                                  | 5,007,709                              | 169,660                                | 54,459                              | 5,231,828                 |
| Central Bank of Kuwait bonds                                  | 429,162                                | 226,429                                | -                                   | 655,591                   |
| Kuwait Government treasury bonds                              | 54,833                                 | 145,648                                | 875,730                             | 1,076,211                 |
| Loans, advances and Islamic financing to customers            | 4,490,941                              | 1,775,826                              | 8,235,842                           | 14,502,609                |
| Held to maturity investments                                  | 43,812                                 | 56,556                                 | 38,125                              | 138,493                   |
| Available for sale investments                                | 603,357                                | 211,760                                | 2,355,978                           | 3,171,095                 |
| Investments carried at fair value through statement of income | 39,408                                 | -                                      | -                                   | 39,408                    |
| Investment in associates                                      | -                                      | -                                      | 63,187                              | 63,187                    |
| Land, premises and equipment                                  | -                                      | -                                      | 324,277                             | 324,277                   |
| Goodwill and other intangible assets                          | -                                      | -                                      | 581,906                             | 581,906                   |
| Other assets  | 104,922                                | 35,773                                 | 109,301                             | 249,996                   |
|   | <u>10,774,144</u>                      | <u>2,621,652</u>                       | <u>12,638,805</u>                   | <u>26,034,601</u>         |
| <b>Liabilities and equity</b>                                 |  |  |                                     |                           |
| Due to banks and other financial institutions                 | 5,158,633                              | 1,604,734                              | 705,936                             | 7,469,303                 |
| Customer deposits   | 11,338,972                             | 1,936,062                              | 504,573                             | 13,779,607                |
| Certificates of deposit issued                                | 394,749                                | 91,559                                 | 4,527                               | 490,835                   |
| Global medium term notes                                      | -                                      | -                                      | 221,173                             | 221,173                   |
| Subordinated Tier 2 bonds                                     | -                                      | -                                      | 124,734                             | 124,734                   |
| Other liabilities   | 285,280                                | 449                                    | 102,119                             | 387,848                   |
| Share capital and reserves                                    | -                                      | -                                      | 2,854,898                           | 2,854,898                 |
| Proposed cash dividend  | 174,493                                | -                                      | -                                   | 174,493                   |
| Perpetual Tier 1 Capital Securities                           | -                                      | -                                      | 210,700                             | 210,700                   |
| Non-controlling interests                                     | -                                      | -                                      | 321,010                             | 321,010                   |
|   | <u>17,352,127</u>                      | <u>3,632,804</u>                       | <u>5,049,670</u>                    | <u>26,034,601</u>         |

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 30 RISK MANAGEMENT (continued)

#### 30.2 LIQUIDITY RISK (continued)

| 2016  | <i>Up to 3<br/>months<br/>KD 000's</i> | <i>3 to 12<br/>months<br/>KD 000's</i> | <i>Over 1<br/>year<br/>KD 000's</i> | <i>Total<br/>KD 000's</i> |
|---|--|--|-------------------------------------|---------------------------|
| <b>Assets</b>   |  |  |                                     |                           |
| Cash and deposits with banks                                  | 4,782,330                              | 258,957                                | 53,591                              | 5,094,878                 |
| Central Bank of Kuwait bonds                                  | 544,722                                | 204,167                                | -                                   | 748,889                   |
| Kuwait Government treasury bonds                              | 66,871                                 | 144,012                                | 282,218                             | 493,101                   |
| Loans, advances and Islamic financing to customers            | 4,489,373                              | 1,567,813                              | 7,554,305                           | 13,611,491                |
| Held to maturity investments                                  | 23,184                                 | 86,692                                 | 61,082                              | 170,958                   |
| Available for sale investments                                | 456,395                                | 412,713                                | 2,086,782                           | 2,955,890                 |
| Investments carried at fair value through statement of income | 51,602                                 | -                                      | -                                   | 51,602                    |
| Investment in associates                                      | -                                      | -                                      | 73,644                              | 73,644                    |
| Land, premises and equipment                                  | -                                      | -                                      | 255,086                             | 255,086                   |
| Goodwill and other intangible assets                          | -                                      | -                                      | 581,840                             | 581,840                   |
| Other assets  | 91,726                                 | 35,682                                 | 74,007                              | 201,415                   |
|   | <u>10,506,203</u>                      | <u>2,710,036</u>                       | <u>11,022,555</u>                   | <u>24,238,794</u>         |
| <b>Liabilities and equity</b>                                 |  |  |                                     |                           |
| Due to banks and other financial institutions                 | 4,985,624                              | 1,509,419                              | 852,760                             | 7,347,803                 |
| Customer deposits   | 10,420,857                             | 1,810,620                              | 376,615                             | 12,608,092                |
| Certificates of deposit issued                                | 281,566                                | 134,423                                | -                                   | 415,989                   |
| Subordinated Tier 2 bonds                                     | -                                      | -                                      | 124,700                             | 124,700                   |
| Other liabilities   | 244,557                                | 1,834                                  | 91,087                              | 337,478                   |
| Share capital and reserves                                    | -                                      | -                                      | 2,718,379                           | 2,718,379                 |
| Proposed cash dividend  | 166,184                                | -                                      | -                                   | 166,184                   |
| Perpetual Tier 1 Capital Securities                           | -                                      | -                                      | 210,700                             | 210,700                   |
| Non-controlling interests                                     | -                                      | -                                      | 309,469                             | 309,469                   |
|   | <u>16,098,788</u>                      | <u>3,456,296</u>                       | <u>4,683,710</u>                    | <u>24,238,794</u>         |

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 30 RISK MANAGEMENT (continued)

#### 30.2 LIQUIDITY RISK (continued)

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

|  | <i>Up to 3<br/>months<br/>KD 000's</i> | <i>3 to 12<br/>months<br/>KD 000's</i> | <i>Over 1<br/>year<br/>KD 000's</i> | <i>Total<br/>KD 000's</i> |
|--|--|--|-------------------------------------|---------------------------|
| <b>2017</b>  |  |  |                                     |                           |
| <b>Financial Liabilities</b>   |  |  |                                     |                           |
| Due to banks and other financial institutions                        | 5,159,461                              | 1,620,848                              | 738,165                             | 7,518,474                 |
| Customer deposits  | 11,354,114                             | 1,973,989                              | 561,704                             | 13,889,807                |
| Certificates of deposit issued                                       | 395,310                                | 92,708                                 | 4,742                               | 492,760                   |
| Global medium term notes   | -                                      | 6,224                                  | 247,939                             | 254,163                   |
| Subordinated Tier 2 bonds  | -                                      | 6,250                                  | 168,048                             | 174,298                   |
|  | <u>16,908,885</u>                      | <u>3,700,019</u>                       | <u>1,720,598</u>                    | <u>22,329,502</u>         |
| <b>Contingent liabilities and commitments</b>                        |  |  |                                     |                           |
| Contingent liabilities   | 870,969                                | 1,130,897                              | 2,226,796                           | 4,228,662                 |
| Irrevocable commitments  | 118,216                                | 140,253                                | 454,660                             | 713,129                   |
|  | <u>989,185</u>                         | <u>1,271,150</u>                       | <u>2,681,456</u>                    | <u>4,941,791</u>          |
| <b>Derivative financial instruments<br/>settled on a gross basis</b> |  |  |                                     |                           |
| Contractual amounts payable  | <u>1,595,679</u>                       | <u>460,016</u>                         | <u>197,832</u>                      | <u>2,253,527</u>          |
| Contractual amounts receivable                                       | <u>1,597,771</u>                       | <u>458,247</u>                         | <u>196,146</u>                      | <u>2,252,164</u>          |
|  |  |  |                                     |                           |
|  | <i>Up to 3<br/>months<br/>KD 000's</i> | <i>3 to 12<br/>months<br/>KD 000's</i> | <i>Over 1<br/>year<br/>KD 000's</i> | <i>Total<br/>KD 000's</i> |
| <b>2016</b>  |  |  |                                     |                           |
| <b>Financial Liabilities</b>   |  |  |                                     |                           |
| Due to banks and other financial institutions                        | 4,998,573                              | 1,527,916                              | 886,416                             | 7,412,905                 |
| Customer deposits  | 10,431,268                             | 1,837,137                              | 408,186                             | 12,676,591                |
| Certificates of deposit issued                                       | 282,388                                | 134,913                                | -                                   | 417,301                   |
| Subordinated Tier 2 bonds  | -                                      | 6,035                                  | 173,065                             | 179,100                   |
|  | <u>15,712,229</u>                      | <u>3,506,001</u>                       | <u>1,467,667</u>                    | <u>20,685,897</u>         |
| <b>Contingent liabilities and commitments</b>                        |  |  |                                     |                           |
| Contingent liabilities   | 817,517                                | 1,065,384                              | 2,190,763                           | 4,073,664                 |
| Irrevocable commitments  | 82,921                                 | 309,724                                | 394,243                             | 786,888                   |
|  | <u>900,438</u>                         | <u>1,375,108</u>                       | <u>2,585,006</u>                    | <u>4,860,552</u>          |
| <b>Derivative financial instruments<br/>settled on a gross basis</b> |  |  |                                     |                           |
| Contractual amounts payable  | <u>1,807,064</u>                       | <u>235,010</u>                         | <u>135,040</u>                      | <u>2,177,114</u>          |
| Contractual amounts receivable                                       | <u>1,804,471</u>                       | <u>235,471</u>                         | <u>145,539</u>                      | <u>2,185,481</u>          |



**30 RISK MANAGEMENT (continued)****30.3 MARKET RISK**

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

**30.3.1 INTEREST RATE RISK**

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

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

**Interest rate sensitivity**

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

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

|                 |                                 | 2017                                     |  | 2016                                     |  |
|-----------------|---------------------------------|--|--|--|--|
|                 |                                 | <i>Effect on<br/>profit<br/>KD 000's</i> | <i>Effect on<br/>equity<br/>KD 000's</i> | <i>Effect on<br/>profit<br/>KD 000's</i> | <i>Effect on<br/>equity<br/>KD 000's</i> |
| <b>Currency</b> | <b>Movement in Basis points</b> |  |  |  |  |
| KWD             | +25                             | 7,729                                    | -  | 7,534                                    | -  |
| USD             | +25                             | 728                                      | (69)                                     | 632                                      | (114)                                    |
| EUR             | +25                             | 1,930                                    | -  | 915                                      | (5)                                      |
| GBP             | +25                             | 1,029                                    | -  | 827                                      | -  |
| EGP             | +25                             | 328                                      | -  | 298                                      | -  |

**30.3.2 FOREIGN EXCHANGE RISK**

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

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

**30 RISK MANAGEMENT (continued)****30.3 MARKET RISK (continued)****30.3.2 FOREIGN EXCHANGE RISK (continued)**

The table below analyses the effect on profit of an assumed 5% strengthening in value of the currency rate against the Kuwaiti Dinar from levels applicable at the year end, with all other variables held constant. A negative amount in the table reflects a potential net reduction in profit, whereas a positive amount reflects a net potential increase.

| <i>Currency</i> | <i>% Change in<br/>currency rate</i> | <i>2017</i>                          | <i>2016</i>                          |
|-----------------|--------------------------------------|--------------------------------------|--------------------------------------|
|                 |                                      | <i>Effect on profit<br/>KD 000's</i> | <i>Effect on profit<br/>KD 000's</i> |
| USD             | +5                                   | <b>181</b>                           | (412)                                |
| GBP             | +5                                   | <b>(2)</b>                           | 40                                   |
| EUR             | +5                                   | <b>34</b>                            | 214                                  |
| EGP             | +5                                   | <b>(181)</b>                         | (127)                                |
| Other           | +5                                   | <b>(53)</b>                          | (42)                                 |

**30.3.3 EQUITY PRICE RISK**

Equity price risk is the risk that the fair values of equities will fluctuate as a result of changes in the level of equity indices or the value of individual share prices. Equity price risk arises from the change in fair values of equity investments. The Group manages the risk through diversification of investments in terms of geographic distribution and industry concentration. The table below analyses the effect of equity price risk on profit (as a result of change in the fair value of equity investments held as fair value through statement of income) and on equity (as a result of change in the fair value of equity investments held as available for sale) at the year end due to an assumed 5% change in market indices, with all other variables held constant.

| <i>Market indices</i> | <i>% Change in<br/>equity price</i> | <i>2017</i>                              |  | <i>2016</i>                              |  |
|-----------------------|-------------------------------------|--|--|--|--|
|                       |                                     | <i>Effect on<br/>profit<br/>KD 000's</i> | <i>Effect on<br/>equity<br/>KD 000's</i> | <i>Effect on<br/>profit<br/>KD 000's</i> | <i>Effect on<br/>equity<br/>KD 000's</i> |
| Kuwait stock exchange | +5                                  | -  | <b>219</b>                               | -  | 949                                      |
| Saudi stock exchange  | +5                                  | -  | <b>512</b>                               | -  | 475                                      |
| UAE stock indices     | +5                                  | -  | <b>264</b>                               | -  | 309                                      |

**30.4 OPERATIONAL RISK**

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

The Operational Risk function of the Group is in line with the Central Bank of Kuwait instructions dated 14 November 1996, concerning the general guidelines for internal controls and the instructions dated 13 October 2003, regarding the sound practices for managing and supervising operational risks in banks.

# National Bank of Kuwait Group

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2017

### 31 CAPITAL

A key objective of the Group is to maximise shareholders' value with optimal levels of risk, whilst maintaining a strong capital base to support the development of its business and comply with the externally-imposed capital requirements.

The disclosures relating to the capital adequacy regulations issued by Central Bank of Kuwait (CBK) as stipulated in CBK Circular number 2/RB, RBA/A336/2014 dated 24 June 2014 (Basel III) and the Leverage regulations as stipulated in CBK Circular number 2/BS/ 342/2014 dated 21 October 2014 under the Basel Committee framework are included under the 'Risk Management' section of the Annual Report.

Capital adequacy, financial leverage and the use of various levels of regulatory capital are monitored regularly by the Group's management and are, also, governed by guidelines of Basel Committee on Banking Supervision as adopted by the CBK.

The Group's regulatory capital and capital adequacy ratios (Basel III) are shown below:

|   | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|---|--------------------------------|--------------------------------|
| Risk Weighted Assets                        | <b>16,591,706</b>              | 15,631,316                     |
| Capital required                            | <b>2,488,756</b>               | 2,344,697                      |
| Capital available                           |                                |                                |
| Common Equity Tier 1 capital                | <b>2,362,174</b>               | 2,202,176                      |
| Additional Tier 1 capital                   | <b>253,048</b>                 | 247,904                        |
| Tier 1 capital                              | <b>2,615,222</b>               | 2,450,080                      |
| Tier 2 capital                              | <b>337,052</b>                 | 323,472                        |
| Total capital                               | <b>2,952,274</b>               | 2,773,552                      |
| Common Equity Tier 1 capital adequacy ratio | <b>14.2%</b>                   | 14.1%                          |
| Tier 1 capital adequacy ratio               | <b>15.8%</b>                   | 15.7%                          |
| Total capital adequacy ratio                | <b>17.8%</b>                   | 17.7%                          |

The calculations include Boubyan Bank K.S.C.P., an Islamic Banking subsidiary. For purposes of determining risk-weighted assets and capital required, exposures and assets at Boubyan Bank K.S.C.P. are risk weighted, and capital charge calculated, in accordance with Central Bank of Kuwait regulations applicable to banks providing banking services compliant with Codes of Islamic Sharia'a. Those figures are then added to corresponding figures pertaining to all the rest of the Group, identical with the treatment in relevant reports submitted to the Central Bank of Kuwait.

The Group's financial leverage ratio is calculated in accordance with CBK circular number 2/BS/ 342/2014 dated 21 October 2014 is shown below:

|                 | <i>2017</i><br><i>KD 000's</i> | <i>2016</i><br><i>KD 000's</i> |
|-----------------|--------------------------------|--------------------------------|
| Tier 1 capital  | <b>2,615,222</b>               | 2,450,080                      |
| Total exposures | <b>28,394,001</b>              | 26,510,797                     |
| Leverage ratio  | <b>9.2%</b>                    | 9.2%                           |

### 32 FUNDS UNDER MANAGEMENT

The Group manages a number of funds, some of which are managed in association with other professional fund managers. The funds have no recourse to the general assets of the Group and the Group has no recourse to the assets of the funds. Accordingly, the assets of these funds are not included in the consolidated statement of financial position. As at 31 December 2017, funds under management were KD 3,892 million (2016: KD 3,614 million).

**NATIONAL BANK OF KUWAIT GROUP**

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