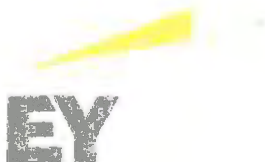


WARBA BANK K.S.C.P.

**CONSOLIDATED
FINANCIAL STATEMENTS**

31 DECEMBER 2020



**Building a better
working world**

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF WARBA BANK K.S.C.P.

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of Warba Bank K.S.C.P. (the "Bank") and its subsidiaries (collectively "the Group"), which comprise the consolidated statement of financial position as at 31 December 2020, and the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2020, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS"), as adopted by the Central Bank of Kuwait (CBK) for use by the State of Kuwait.

Basis for Opinion

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current year. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For the matter below, our description of how our audit addressed the matter is provided in that context.

Credit losses on Islamic financing to customers

The recognition of credit losses on cash and non-cash Islamic financing to customers ("financing facilities") is the higher of Expected Credit Loss determined under International Financial Reporting Standard 9: *Financial Instruments* ("IFRS 9"), according to Central Bank of Kuwait (the "CBK") guidelines ("ECL"), and the provision required by the CBK rules on classification of financing facilities and calculation of their provision (the "CBK rules") as disclosed in the accounting policies in Note 2.5.1 and in Note 4 to the consolidated financial statements.



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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF WARBA BANK K.S.C.P. (continued)

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

Key Audit Matters (continued)

Credit losses on Islamic financing to customers (continued)

Recognition of ECL, is a complex accounting policy, which requires considerable judgement in its implementation. ECL is dependent on management's judgement in assessing the level of credit risk on initial recognition and significant increase in credit risk subsequently on the reporting date relative to its initial recognition, and classification into three stages. Furthermore, as disclosed by management, inherently judgmental modelling techniques are used to estimate ECLs which involves determining Probability of Default ("PD"), Loss Given Default ("LGD") and Exposure at Default ("EAD") which are modelled based on macroeconomic variables, and discounted to the reporting date. As disclosed in Note 25, the COVID-19 global pandemic significantly impacted management's determination of the ECL and required the application of heightened judgment. As a result, the ECL has a higher than usual degree of uncertainty and the inputs used are inherently subject to change, which may materially change the estimate in future periods.

On the other hand, recognition of specific provision on impaired financing facility under the CBK rules is based on the instructions prescribed by the CBK on the minimum provision to be recognised, together with any additional provision to be recognised based on management's estimate of expected cash flows related to that financing facility.

We determined that '*Credit losses on Islamic financing to customers*' is a key audit matter due to the significance of financing facilities and the related estimation uncertainty and judgement applied by management in the identification of significant increase in credit risk and consequent staging of customers; the significant judgment required by management when designing future macroeconomic scenarios; forecasting macroeconomic variables and probability-weighting scenarios. This is further heightened by the high degree of estimation uncertainty due to the economic impacts of COVID-19 that led to a high degree of judgment, including determination of whether rescheduling of profit or principal for certain financing facilities resulted in temporary or permanent liquidity issues of the customers.

Our audit procedures include testing the design and implementation of controls over the assessment and calculation of material significant increase in credit risk (SICR) indicators and staging of customers accordingly. We also tested the effectiveness of controls over the PD, LGD and EAD models and the design of multiple future macroeconomic scenarios, the forecasting of macroeconomic variables, and the probability-weighting of these scenarios. The procedures also covered the impact of ECL caused by the economic disruption arising from the COVID 19 pandemic, including ones focused on rescheduled financing facilities.

With respect to the ECL, we have selected samples of financing facilities outstanding, included rescheduled financing facilities, and checked the appropriateness of the Group's determination of significant increase in credit risk and the resultant basis for classification of the financing facilities into various stages. We involved our specialists to review the ECL model in terms of key data, methods and assumptions used to ensure they are in line with IFRS 9 requirements, determined in accordance with CBK guidelines. For a sample of financing facilities, we have checked the appropriateness of the Group's staging criteria, EAD, PD and LGD including the eligibility and value of collateral considered in the ECL models used by the Group and the overlays considered by the management in view of the ongoing COVID-19 pandemic, in order to determine ECL taking into consideration CBK guidelines. We have also checked the consistency of various inputs and assumptions used by the Group's management to determine ECL.



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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF WARBA BANK K.S.C.P. (continued)

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

Key Audit Matters (continued)

Credit losses on Islamic financing to customers (continued)

Further, for the CBK rules provision requirements, we have assessed the criteria for determining whether there is a requirement to calculate any credit loss in accordance with the related regulations and, if required, it has been computed accordingly. For the samples selected, which included rescheduled financing facilities, we have verified whether all impairment events have been identified by the Group's management. For the selected samples which also included impaired financing facilities, we have assessed the valuation of collateral and checked the resultant provision calculations.

Other information included in the Group's 2020 Annual Report

Management is responsible for the other information. Other information consists of the information included in the Group's 2020 Annual Report, other than the consolidated financial statements and our auditors' report thereon. We obtained the report of the Bank's Board of Directors, prior to the date of our auditors' report, and we expect to obtain the remaining sections of the Group's 2020 Annual Report after the date of our auditors' report.

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

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

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

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs as adopted by CBK for use by the State of Kuwait, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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



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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF WARBA BANK K.S.C.P. (continued)

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

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

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

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

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

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

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

**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF
WARBA BANK K.S.C.P. (continued)**

Report on Other Legal and Regulatory Requirements

Furthermore, in our opinion proper books of account have been kept by the Bank and the consolidated financial statements, together with the contents of the report of the Bank's Board of Directors relating to these consolidated financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the consolidated financial statements incorporate all information that is required by the Capital Adequacy Regulations and Financial Leverage Ratio Regulations issued by the CBK as stipulated in CBK Circular Nos. 2/RB, RBA/336/2014 dated 24 June 2014 and its amendments, and 2/I.B.S. 343/2014 dated 21 October 2014 and its amendments, respectively, the Companies Law No 1 of 2016, as amended, and its executive regulations, as amended, and by the Bank's Memorandum of Incorporation and Articles of Association, as amended, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of the Capital Adequacy Regulations and Financial Leverage Ratio Regulations issued by the CBK as stipulated in CBK Circular Nos. 2/RB, RBA /336/2014 dated 24 June 2014 and its amendments, and 2/I.B.S. 343/2014 dated 21 October 2014 and its amendments, respectively, the Companies Law No 1 of 2016, as amended, and its executive regulations, as amended, or of the Bank's Memorandum of Incorporation and Articles of Association, as amended, have occurred during the year ended 31 December 2020 that might have had a material effect on the business of the Bank or on its financial position.

We further report that, during the course of our audit, we have not become aware of any violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the CBK and the organisation of banking business, and its related regulations during the year ended 31 December 2020 that might have had a material effect on the business of the Bank or on its financial position.



BADER A. AL-ABDULJADER
LICENCE NO. 207-A
EY
(AL AIBAN, AL OSAIMI & PARTNERS)



DR. RASHEED M. AL - QENAE
LICENSE NO. 130-A
OF KPMG SAFI AL-MUTAWA & PARTNERS
MEMBER FIRM OF KPMG INTERNATIONAL


22 February 2021
Kuwait

Warba Bank K.S.C.P.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2020

	Notes	2020 KD'000	2019 KD'000
ASSETS			
Cash and bank balances	3	110,999	102,544
Placements with banks and the CBK		357,897	225,703
Financing receivables	4	2,497,366	2,261,974
Financial assets at fair value through profit or loss	5	90,929	55,895
Financial assets at fair value through other comprehensive income	6	237,050	323,062
Investment in joint ventures	7	108,240	91,007
Investment properties	8	30,039	20,798
Other assets		23,074	39,885
Property and equipment		19,660	22,803
TOTAL ASSETS		3,475,254	3,143,671
LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks and other financial institutions	9	494,355	953,303
Depositors' accounts	10	2,353,454	1,705,811
Sukuk issued	11	302,429	152,179
Other liabilities		44,922	38,018
TOTAL LIABILITIES		3,195,160	2,849,311
EQUITY			
Share capital	12	157,500	150,000
Share premium		40,000	40,000
Statutory reserve	12	3,098	3,098
Fair value reserve		1,676	7,211
Foreign currency translation reserve		1,469	127
(Accumulated losses) retained earnings		(12)	10,061
		203,731	210,497
Proposed distributions	12	-	7,500
EQUITY ATTRIBUTABLE TO SHAREHOLDERS OF THE BANK		203,731	217,997
Perpetual Tier 1 Sukuk	13	76,363	76,363
TOTAL EQUITY		280,094	294,360
TOTAL LIABILITIES AND EQUITY		3,475,254	3,143,671


Abdulwahab A. Al Houti
Chairman


Shaheen H. Al Ghanem
Chief Executive Officer

The accompanying notes 1 to 25 form an integral part of these consolidated financial statements.



Warba Bank K.S.C.P.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2020

	<i>Notes</i>	2020 KD'000	2019 KD'000
Placements and finance income		109,282	109,570
Finance costs and distribution to depositors		(62,826)	(64,081)
Net finance income		46,456	45,489
Net investment income	14	26,252	7,884
Net fee and commission income	15	3,228	5,070
Other income	16	3,765	296
Foreign exchange (loss) gain		(907)	1,023
Net operating income		78,794	59,762
Staff costs		(17,669)	(14,807)
General and administrative expenses		(3,936)	(4,426)
Depreciation expense		(4,623)	(3,174)
Net operating expenses		(26,228)	(22,407)
Net operating profit before provision for impairment and credit losses		52,566	37,355
Provision for impairment and credit losses	17	(46,638)	(19,908)
Profit before tax and board of directors' remuneration		5,928	17,447
Contribution to Kuwait Foundation for the Advancement of Sciences (KFAS)		-	(157)
National Labour Support Tax (NLST)		(166)	(452)
Zakat		(65)	(175)
Board of directors' remuneration		(63)	(125)
NET PROFIT FOR THE YEAR		5,634	16,538
BASIC AND DILUTED EARNINGS PER SHARE (EPS)	18	0.41 fils	7.36 fils

The accompanying notes 1 to 25 form an integral part of these consolidated financial statements.

Warba Bank K.S.C.P.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2020

	Note	2020 KD'000	2019 KD'000
Net profit for the year		5,634	16,538
Other comprehensive (loss) income			
<i>Other comprehensive (loss) income that will be reclassified to profit or loss:</i>			
<i><u>Debt instruments at fair value through other comprehensive income:</u></i>			
Net change in fair value		3,314	11,434
Changes in allowance for expected credit losses	17	(979)	682
Reclassification adjustment on derecognition	14	(7,903)	(215)
Net (losses) gains on debt instruments at fair value through other comprehensive income		(5,568)	11,901
<i><u>Cash flow hedges:</u></i>			
Hedging net losses		-	(1,266)
Less: reclassification adjustment on discontinuation of the hedging relationship		-	1,209
Movement on cash flow hedges		-	(57)
<i><u>Foreign currency translation:</u></i>			
Exchange differences on translation of foreign operations		1,342	48
Total items that are or may be reclassified to profit or loss		(4,226)	11,892
<i>Other comprehensive income that will not be reclassified to profit or loss</i>			
Net change in fair value of equity investments at fair value through other comprehensive income		33	13
Total items that will not be reclassified to profit or loss		33	13
OTHER COMPREHENSIVE (LOSS) INCOME FOR THE YEAR		(4,193)	11,905
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		1,441	28,443

The accompanying notes 1 to 25 form an integral part of these consolidated financial statements.

Warba Bank K.S.C.P.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2020

	Share capital KD'000	Share premium KD'000	Statutory reserve KD'000	Fair value reserve KD'000	Foreign currency translation reserve KD'000	(Accumulated losses) retained earnings KD'000	Sub-total KD'000	Proposed distributions KD'000	Equity attributable to shareholders of the Bank KD'000	Perpetual Tier 1 Sukuk KD'000	Total equity KD'000
As at 1 January 2020	150,000	40,000	3,098	7,211	127	10,061	210,497	7,500	217,997	76,363	294,360
Net profit for the year	-	-	-	-	-	5,634	5,634	-	5,634	-	5,634
Other comprehensive (loss) income	-	-	-	(5,535)	1,342	-	(4,193)	-	(4,193)	-	(4,193)
Total comprehensive (loss) income for the year	-	-	-	(5,535)	1,342	5,634	1,441	-	1,441	-	1,441
Transferred to the statutory reserve	-	-	-	-	-	-	-	-	-	-	-
Issue of bonus shares (Note 12)	7,500	-	-	-	-	-	7,500	(7,500)	-	-	-
Profit paid on Perpetual Tier 1 Sukuk (Note 13)	-	-	-	-	-	(4,981)	(4,981)	-	(4,981)	-	(4,981)
Modification loss on payment deferral program (Note 25)	-	-	-	-	-	(10,726)	(10,726)	-	(10,726)	-	(10,726)
At 31 December 2020	157,500	40,000	3,098	1,676	1,469	(12)	203,731	-	203,731	76,363	280,094
As at 1 January 2019 as previously reported (audited)	150,000	40,000	1,353	(4,646)	79	7,779	194,565	-	194,565	76,363	270,928
Impact of adopting IFRS 16 at 1 January 2019	-	-	-	-	-	(68)	(68)	-	(68)	-	(68)
Restated opening balance under IFRS 16	150,000	40,000	1,353	(4,646)	79	7,711	194,497	-	194,497	76,363	270,860
Net profit for the year	-	-	-	-	-	16,538	16,538	-	16,538	-	16,538
Other comprehensive income	-	-	-	11,857	48	-	11,905	-	11,905	-	11,905
Total comprehensive income for the year	-	-	-	11,857	48	16,538	28,443	-	28,443	-	28,443
Transferred to the statutory reserve	-	-	1,745	-	-	(1,745)	-	-	-	-	-
Proposed distributions (Note 12)	-	-	-	-	-	-	-	-	-	-	-
Proposed bonus shares	-	-	-	-	-	(7,500)	(7,500)	7,500	-	-	-
Profit paid on Perpetual Tier 1 Sukuk (Note 13)	-	-	-	-	-	(4,943)	(4,943)	-	(4,943)	-	(4,943)
At 31 December 2019	150,000	40,000	3,098	7,211	127	10,061	210,497	7,500	217,997	76,363	294,360

The accompanying notes 1 to 25 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2020

	Notes	2020 KD'000	2019 KD'000
OPERATING ACTIVITIES			
Profit before tax and board of directors' remuneration		5,928	17,447
<i>Adjustments for:</i>			
Net investment income	14	(26,252)	(7,884)
Provision for employees' end of service benefits		904	779
Gain on sale of property and equipment		(795)	-
Depreciation expense		4,623	3,174
Provision for impairment and credit losses		46,638	19,908
		<u>31,046</u>	<u>33,424</u>
<i>Changes in operating assets and liabilities:</i>			
Placements with banks and the CBK		18,811	1,973
Financing receivables		(294,393)	(672,864)
Other assets		16,584	(13,913)
Due to banks and other financial institutions		(459,005)	118,074
Depositors' accounts		647,643	652,633
Other liabilities		(4,981)	(1,332)
Taxes paid		(627)	(569)
		<u>(44,922)</u>	<u>117,426</u>
Net cash flows (used in) from operating activities			
INVESTING ACTIVITIES			
Purchase/ capital contributions of financial assets at FVPL		(44,508)	(19,339)
Proceeds from sale/ redemption of financial assets at FVPL		12,685	2,634
Purchase of financial assets at FVOCI		(157,759)	(228,810)
Proceeds from sale of financial assets at FVOCI		251,252	65,877
Additions to investment in joint ventures	7	(13,084)	(35,550)
Proceeds from sale of investment property		7,278	2,259
Purchase of property and equipment		(6,248)	(3,298)
Proceeds from sale of property and equipment		2,924	-
Dividends received from financial assets		2,175	2,151
Other investment income received		580	937
Amounts paid on discontinuation of the hedging relationship		-	(1,209)
Distributions received from joint ventures		5,388	4,159
Rental income received		1,064	1,425
		<u>61,747</u>	<u>(208,764)</u>
Net cash flows from (used in) investing activities			
FINANCING ACTIVITIES			
Profit paid to holders of Perpetual Tier 1 Sukuk	13	(4,981)	(4,943)
Net movement on Sukuk issued		150,250	152,179
Payment of lease liabilities		(2,698)	(2,187)
		<u>142,571</u>	<u>145,049</u>
Net cash flows from financing activities			
NET INCREASE IN CASH AND CASH EQUIVALENTS		<u>159,396</u>	<u>53,711</u>
Cash and cash equivalents at 1 January		<u>283,637</u>	<u>229,926</u>
CASH AND CASH EQUIVALENTS AT 31 DECEMBER		<u><u>443,033</u></u>	<u><u>283,637</u></u>

The accompanying notes 1 to 25 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

1 CORPORATE INFORMATION

Warba Bank K.S.C.P. (the “Bank”) is a Kuwaiti public shareholding company, incorporated on 17 February 2010 in the State of Kuwait by virtue of Amiri Decree No. 289/2009. The Bank is registered as an Islamic banking institution in accordance with the rules and regulations of the Central Bank of Kuwait (the “CBK”) on 7 April 2010 and its shares are publicly traded on the Boursa Kuwait. The Bank’s head office is located at Al-Raya Tower, Mezzanine floor 1, Omar Ibn Al-Khattab Street and its registered postal address is P.O. Box 1220, Safat 13013, State of Kuwait.

The Bank is primarily involved in investment, corporate and retail banking activities in accordance with the principles of Islamic Shari’a, as approved by the Bank’s Shari’a Supervisory Board.

The annual general assembly meeting (“AGM”) of the shareholders of the Bank held on 20 April 2020 approved the consolidated financial statements for the year ended 31 December 2019. Distributions proposed and approved by the Bank for the year then ended are provided in Note 12.

The consolidated financial statements of the Bank and its wholly owned special purpose vehicles (collectively, the “Group”) for the year ended 31 December 2020 were authorised for issue in accordance with a resolution of the Board of Directors on 12 January 2021. The shareholders of the Bank have the power to amend these consolidated financial statements in the AGM.

2.1 BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with the regulations for financial services institutions as issued by the Central Bank of Kuwait (CBK) in the State of Kuwait. These regulations, including the recently issued CBK circulars on regulatory measures in response to COVID-19 and related CBK communications, require banks and other financial institutions regulated by CBK to adopt the International Financial Reporting Standards with the following amendments:

- (a) expected credit loss (“ECL”) to be measured at the higher of ECL on financing facilities computed under IFRS 9 in accordance with the CBK guidelines or the provisions as required by CBK instructions along with its consequent impact on related disclosures; and
- (b) recognition of modification losses on financial assets arising from payment holidays to customers in response to Covid-19 to be recognized in retained earnings instead of profit or loss as required by IFRS 9.

The above framework is hereinafter referred to as ‘IFRS as adopted by CBK for use by the State of Kuwait’.

The consolidated financial statements have been prepared on a historical cost basis except for financial assets designated at fair value through profit or loss (FVTPL), debt and equity instruments at fair value through other comprehensive income (FVOCI) and investment properties all of which have been measured at fair value.

The Bank presents its statement of financial position in order of liquidity based on the Bank’s intention and perceived ability to recover/settle the majority of assets/liabilities of the corresponding financial statement line item. An analysis regarding recovery or settlement within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in Note 21.

The consolidated financial statements are presented in Kuwaiti Dinars (KD) and all values are rounded to the nearest thousand (KD ‘000), except when otherwise indicated.

The consolidated financial statements provide comparative information in respect of the previous period. Certain comparative information has been reclassified and represented to conform to classification in the current period. Such reclassification has been made to improve the quality of information presented.

2.2 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

The accounting policies adopted in the preparation of these consolidated financial statements are consistent with those used in the previous financial year, except for the adoption of new standards effective as of 1 January 2020. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

2.2 CHANGES IN ACCOUNTING POLICIES (continued)

2.2.1 New standards, interpretations, and amendments adopted by the Group

Several amendments and interpretations apply for the first time in 2020, but do not have an impact on the consolidated financial statements of the Group.

Amendments to IFRS 3: *Definition of a Business*

The amendment to IFRS 3 clarifies that to be considered a business, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output. Furthermore, it clarified that a business can exist without including all of the inputs and processes needed to create outputs. These amendments had no impact on the consolidated financial statements of the Group, but may impact future periods should the Group enter into any business combinations.

Adoption of profit rate benchmark reform (IBOR reform Phase 1)

The Group has adopted profit rate benchmark reform – Amendments to IFRS 9, IAS 39 and IFRS 7 (IBOR reform Phase 1) with effect from 1 January 2020. IBOR reform Phase 1 includes a number of reliefs, which apply to all hedging relationships that are directly affected by profit rate benchmark reform. A hedging relationship is affected if the reform gives rise to uncertainties about the timing and or amount of benchmark-based cash flows of the hedged item or the hedging instrument during the period before the replacement of an existing interest rate benchmark with an alternative nearly risk-free interest rate (RFR). This may lead to uncertainty whether a forecast transaction is highly probable and whether prospectively the hedging relationship is expected to be highly effective. IBOR reform Phase 1 provides reliefs which require the Group to assume that hedging relationships are unaffected by the uncertainties caused by IBOR reform. This includes assuming that hedged cash flows are not altered as a result of IBOR reform. Also, the reliefs allow the Group to not discontinue hedging relationships as a result of retrospective or prospective ineffectiveness. These amendments did not have a material impact on the consolidated financial statements of the Group.

Amendments to IAS 1 and IAS 8: *Definition of Material*

The amendments provide a new definition of material that states “information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.”

The amendments clarify that materiality will depend on the nature or magnitude of information, either individually or in combination with other information, in the context of the financial statements. A misstatement of information is material if it could reasonably be expected to influence decisions made by the primary users. These amendments had no impact on the consolidated financial statements of, nor is there expected to be any future impact to the Group.

Conceptual Framework for Financial Reporting issued on 29 March 2018

The Conceptual Framework is not a standard, and none of the concepts contained therein override the concepts or requirements in any standard. The purpose of the Conceptual Framework is to assist the IASB in developing standards, to help preparers develop consistent accounting policies where there is no applicable standard in place and to assist all parties to understand and interpret the standards.

The revised Conceptual Framework includes some new concepts, provides updated definitions and recognition criteria for assets and liabilities and clarifies some important concepts.

These amendments had no impact on the consolidated financial statements of the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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2.2 CHANGES IN ACCOUNTING POLICIES (continued)

2.2.1 New standards, interpretations, and amendments adopted by the Group (continued)

Amendments to IFRS 16 Covid-19 Related Rent Concessions

On 28 May 2020, the IASB issued Covid-19-Related Rent Concessions - amendment to IFRS 16 Leases. The amendments provide relief to lessees from applying IFRS 16 guidance on lease modification accounting for rent concessions arising as a direct consequence of the Covid-19 pandemic. As a practical expedient, a lessee may elect not to assess whether a Covid-19 related rent concession from a lessor is a lease modification. A lessee that makes this election accounts for any change in lease payments resulting from the Covid-19 related rent concession the same way it would account for the change under IFRS 16, if the change were not a lease modification.

The amendment applies to annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted. This amendment had no material impact on the consolidated financial statements of the Group.

2.2.2 Summary of accounting policies for new transactions and events

Government grants

Government grants are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognised as income on a systematic basis over the periods that the related costs, for which it is intended to compensate, are expensed. When the grant relates to an asset, it is recognised as income in equal amounts over the expected useful life of the related asset.

When the Group receives grants of non-monetary assets, the asset and the grant are recorded at nominal amounts and released to profit or loss over the expected useful life of the asset, based on the pattern of consumption of the benefits of the underlying asset by equal annual instalments.

2.3 STANDARDS ISSUED BUT NOT YET EFFECTIVE

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

Reference to the Conceptual Framework – Amendments to IFRS 3

In May 2020, the IASB issued Amendments to IFRS 3 *Business Combinations - Reference to the Conceptual Framework*. The amendments are intended to replace a reference to the *Framework for the Preparation and Presentation of Financial Statements*, issued in 1989, with a reference to the *Conceptual Framework for Financial Reporting* issued in March 2018 without significantly changing its requirements.

The Board also added an exception to the recognition principle of IFRS 3 to avoid the issue of potential 'day 2' gains or losses arising for liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 Levies, if incurred separately.

At the same time, the Board decided to clarify existing guidance in IFRS 3 for contingent assets that would not be affected by replacing the reference to the Framework for the Preparation and Presentation of Financial Statements.

The amendments are effective for annual reporting periods beginning on or after 1 January 2022 and apply prospectively.

The amendments are not expected to have a material impact on the Group.

Property, Plant and Equipment: Proceeds before Intended Use – Amendments to IAS 16

In May 2020, the IASB issued Property, Plant and Equipment — Proceeds before Intended Use, which prohibits entities from deducting from the cost of an item of property, plant and equipment, any proceeds from selling items produced while bringing that asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Instead, an entity recognises the proceeds from selling such items, and the costs of producing those items, in profit or loss.

The amendment is effective for annual reporting periods beginning on or after 1 January 2022 and must be applied retrospectively to items of property, plant and equipment made available for use on or after the beginning of the earliest period presented when the entity first applies the amendment.

The amendments are not expected to have a material impact on the Group.

2.3 STANDARDS ISSUED BUT NOT YET EFFECTIVE (continued)

IFRS 9 Financial Instruments – Fees in the '10 per cent' test for derecognition of financial liabilities

As part of its 2018-2020 annual improvements to IFRS standards process the IASB issued amendment to IFRS 9. The amendment clarifies the fees that an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the terms of the original financial liability. These fees include only those paid or received by the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf. An entity applies the amendment to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.

The amendment is effective for annual reporting periods beginning on or after 1 January 2022 with earlier adoption permitted. The Group will apply the amendments to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.

The amendments are not expected to have a material impact on the Group.

Profit Rate Benchmark Reform (Phase 2)

On 27 August 2020 the International Accounting Standards Board (IASB or the Board) published 'Interest Rate Benchmark Reform – Phase 2, Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16' (IBOR reform Phase 2). IBOR reform Phase 2 provides temporary reliefs to address the accounting issues which arise upon the replacement of an Inter-Bank Offered Rate (an IBOR) with an alternative nearly risk-free profit rate (an RFR). The amendment is effective for annual reporting periods beginning on or after 1 January 2021 with earlier adoption permitted.

The impact of the replacement of interbank offered rates ('IBORs') with alternative risk-free rates on the Group's products and services remains a key area of focus. The Group has exposure to contracts referencing IBORs, such as Libor, extending past FY2021, when it is likely that these IBORs will cease being published. The Group is currently assessing the impact of the Group's transition to the new rate regimes after 2021 by considering changes in its products, services, systems and reporting and will continue to engage with internal and external stakeholders to support an orderly transition and to mitigate the risks resulting from the transition.

IFRS 17 – Insurance contracts

In May 2017, the IASB issued IFRS 17 *Insurance Contracts* (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 *Insurance Contracts* (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply. IFRS 17 introduces new accounting requirements for banking products with insurance features that may affect the determination of which instruments or which components thereof will be in the scope of IFRS 9 or IFRS 17.

Credit cards and similar products that provide insurance coverage: most issuers of these products will be able to continue with their existing accounting treatment as a financial instrument under IFRS 9. IFRS 17 excludes from its scope credit card contracts (and other similar contracts that provide credit or payment arrangements) that meet the definition of an insurance contract if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer. When the insurance coverage is provided as part of the contractual terms of the credit card, the issuer is required to:

- ▶ Separate the insurance coverage component and apply IFRS 17 to it
- ▶ Apply other applicable standards (such as IFRS 9, IFRS 15 *Revenue from Contracts with Customers* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) to the other components

Loan contracts that meet the definition of insurance but limit the compensation for insured events to the amount otherwise required to settle the policyholder's obligation created by the contract: Issuers of such loans – e.g. a loan with waiver on death – have an option to apply IFRS 9 or IFRS 17. The election would be made at a portfolio level and would be irrevocable.

IFRS 17 is effective for reporting periods beginning on or after 1 January 2023, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17.

The Group is currently in the process of assessing the impact of adopting IFRS 17 on its consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.4.1 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its wholly owned special purpose vehicles (investees which are controlled by the Bank) as at 31 December 2020. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Specifically, the Group controls an investee if, and only if, the Group has:

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

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- ▶ The contractual arrangement with the other vote holders of the investee
- ▶ Rights arising from other contractual arrangements
- ▶ The Group's voting rights and potential voting rights

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

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

A change in the ownership interest of a wholly owned special purpose vehicle, without a loss of control, is accounted for as an equity transaction.

If the Group loses control over a wholly owned special purpose vehicle, it derecognises the related assets (including goodwill), liabilities, non-controlling interest and other components of equity, while any resultant gain or loss is recognised in profit or loss. Any investment retained is recognised at fair value.

The consolidated financial statements include the financial statements of the Bank and its wholly owned special purpose vehicles. The wholly owned special purpose vehicles of the Bank are as follows:

<i>Name of subsidiary</i>	<i>Principal activities</i>	<i>Country of incorporation</i>	<i>Equity interest %</i>	
			<i>31 December 2020</i>	<i>31 December 2019</i>
Abyat Real Estate Company L.L.C.	Real estate	Sultanate of Oman	100	100
Themar Al Omania Company L.L.C.	Real estate	Sultanate of Oman	100	100
Al Kout Holdings Limited	Real estate	Jersey	100	100
Warba Tier 1 Sukuk Limited	Financial securities	Cayman Islands	100	100

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4.2 Financial instruments – initial recognition

2.4.2.1 Date of recognition

Financial assets and liabilities, with the exception of financing receivable and depositors' accounts, are initially recognised on the trade date, i.e., the date that the Group becomes a party to the contractual provisions of the instrument. This includes regular way trades: 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. Financing to customers are recognised when funds are transferred to the customers' accounts. The Group recognises depositors' accounts when funds are transferred to the Group.

2.4.2.2 Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value except in the case of financial assets and liabilities recorded at FVTPL, transaction costs are added to, or subtracted from, this amount.

2.4.2.3 Day 1 profit or loss

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

2.4.2.4 Determining the classification and measurement of financial assets and liabilities

The Group has determined the classification and measurement of its financial assets as follows:

➤ *Cash and cash equivalents*

Cash and cash equivalents as referred to in the cash flow statement comprises cash on hand, non-restricted current accounts with central banks and placements with banks on demand or with an original maturity of three months or less.

➤ *Placements with banks, Financing receivables, Financial investments at amortised cost*

The Bank only measures placements with banks, financing receivables and other financial investments at amortised cost if both of the following conditions are met:

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

The details of these conditions are outlined below.

Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective:

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

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

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4.2 Financial instruments – initial recognition (continued)

2.4.2.4 Determining the classification and measurement of financial assets and liabilities (continued)

The SPPP test

As a second step of its classification process the Bank assesses the contractual terms of the financial asset to identify whether they meet the SPPP test.

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

The most significant elements of profit within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPP assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the profit rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and profit on the amount outstanding. In such cases, the financial asset is required to be measured at FVTPL.

▸ *Debt instruments at FVOCI*

The Bank applies the new category under IFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets
- The contractual terms of the financial asset meet the SPPP test

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Profit returns and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost. The ECL calculation for Debt instruments at FVOCI is explained below. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the consolidated statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit and loss upon derecognition of the assets.

▸ *Equity instruments at FVOCI*

Upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of Equity under IAS 32 *Financial Instruments: Presentation* and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

Gains and losses on these equity instruments are never recycled to profit or loss. Dividends are recognised in profit or loss when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4.2 Financial instruments – initial recognition (continued)

2.4.2.4 Determining the classification and measurement of financial assets and liabilities (continued)

Financial assets and financial liabilities at fair value through profit or loss (FVTPL)

Financial assets and financial liabilities in this category are those that are not held for trading and have been either designated by management upon initial recognition or are mandatorily required to be measured at fair value under IFRS 9. Management only designates an instrument at FVTPL upon initial recognition when one of the following criteria are met. Such designation is determined on an instrument-by-instrument basis:

- ▶ The designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis; or
- ▶ The liabilities (and assets until 1 January 2018 under IAS 39) are part of a group of financial liabilities (or financial assets, or both under IAS 39), which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- ▶ The liabilities (and assets until 1 January 2018 under IAS 39) contain one or more embedded derivatives, unless they do not significantly modify the cash flows that would otherwise be required by the contract, or it is clear with little or no analysis when a similar instrument is first considered that separation of the embedded derivative(s) is prohibited

Financial liabilities other than at fair value through profit or loss

These financial liabilities are subsequently measured at amortised cost using the effective profit method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective profit rate.

Due to banks and other financial institutions, depositors' accounts, sukuk issued and other liabilities are classified as "financial liabilities other than at fair value through profit or loss".

Financial guarantees, letters of credit and undrawn loan commitments

The Bank issues financial guarantees, letters of credit and loan commitments.

Financial guarantees are initially recognised in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the statement of profit or loss, and from 1 January 2018 the higher of ECL under IFRS 9 according to the CBK guidelines, and the provisions required by the CBK.

The premium received is recognised in the statement of profit or loss in Net fees and commission income on a straight line basis over the life of the guarantee.

2.4.3 Financial instruments - Derecognition of financial assets and liabilities

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 has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset or (b) the Group 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 or has entered into a pass-through arrangement, it evaluates if and to what extent it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all of the risks and rewards of the asset, nor transferred control of the asset, the Group continues to recognise the transferred asset to the extent of the Group's continuing involvement. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4.3 Financial instruments - Derecognition of financial assets and liabilities (continued)

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.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same financier 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. The difference in the respective carrying amounts is recognised in the consolidated statement of profit or loss.

De-recognition due to substantial modification or terms and conditions

The Group derecognises a financial asset, such as financing receivables, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new finance, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised financing receivables are classified as Stage 1 for ECL measurement purposes, unless they are deemed to be credit impaired.

When assessing whether or not to derecognise a financing receivable, amongst others, the Group considers the following factors:

- ▶ Change in currency of the financing
- ▶ Introduction of an equity instrument feature
- ▶ Change in counterparty

If the modifications are such that, the instrument would no longer meet the SPPP criterion

De-recognition due to substantial modification or terms and conditions (continued)

If the modifications do not result in cash flows that are substantially different, they result in derecognition. Based on the change in cash flows discounted at original effective profit rate, the Group records a modification gain or loss, to the extent that an impairment loss has not already been recorded.

2.4.4 Impairment of financial assets

2.4.4.1 Expected credit loss of financial assets

The Expected credit loss (ECL) model applies to financial assets measured at amortised cost, contract assets and debt instruments at FVOCI. The credit losses are based on ECL associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since initial recognition. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the credit loss is based on the change in ECL over the life of the asset.

The Group measures ECL for financing receivables, non-cash credit facilities in the form of bank guarantees, letters of guarantee, documentary letters of credit, undrawn cash and non-cash credit facilities (revocable and irrevocable) (together "financing facilities"), placements with banks and investment in debt instruments measured at FVOCI.

The Group considers balances with the CBK and Sukuk issued by the CBK and the Government of Kuwait have low credit risk based on external credit ratings of the counterparties and hence ECL is considered negligible. Equity investments are not subject to ECL.

The Group considers that its cash and cash equivalents have low credit risk based on the external credit ratings of the counterparties and CBK guarantee of deposits placed with local banks.

The Group provides for credit losses on financing facilities according to the CBK guidelines and records the provision for impairment of financing facilities at the higher of ECL under IFRS 9 according to the CBK guidelines, and the provisions required by the CBK instructions.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4.4 Impairment of financial assets (continued)

2.4.4.1 Expected credit loss of financial assets (continued)

Expected Credit Losses

The Group applies a three-stage approach to measure the ECL as described below:

Stage 1: 12-month ECL

The Group measures loss allowances at an amount equal to 12-month ECL on financial assets where there has not been a significant increase in credit risk since their initial recognition or on exposures that are determined to have a low credit risk at the reporting date. The Group considers a financial asset to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'.

Stage 2: Lifetime ECL – not credit impaired

The Group measures loss allowances at an amount equal to lifetime ECL on financial assets where there has been a significant increase in credit risk since initial recognition but are not credit impaired.

Stage 3: Lifetime ECL – credit impaired

The Group measures loss allowances on financial assets determined as a credit impaired based on an objective evidence on impairment at an amount equal to lifetime ECL.

Lifetime ECL is ECL that result from all possible default events over the remaining expected life of a financial instrument. The 12 month ECL is the portion of lifetime expected credit loss that result from default events that are possible within the 12 months after the reporting date. Both lifetime ECL and 12 month ECL are calculated on either an individual basis or a collective basis depending on the nature of the underlying portfolio of financial instruments.

Determining the stage of impairment

At each reporting date, the Group assesses whether there has been significant increase in credit risk since initial recognition by comparing the risk of default occurring over the remaining expected life from the reporting date with the risk of default at the date of initial recognition. The quantitative criteria used to determine a significant increase in credit risk is a series of relative and absolute thresholds. All financial assets that are 30 days past due are deemed to have significant increase in credit risk since initial recognition and migrated to stage 2 even if other criteria do not indicate a significant increase in credit risk.

At each reporting date, the Group also assesses whether a financial asset or group of financial assets is credit impaired. The Group considers a financial asset to be credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred or when contractual payments are 90 days past due. All credit impaired financial assets are classified as stage 3 for ECL measurement purposes. Evidence of credit impairment includes observable data about the following:

- ▶ Significant financial difficulty of the borrower or issuer
- ▶ A breach of contract such as default or past due event
- ▶ The lender having granted to the borrower a concession, that the lender would otherwise not consider, for economic or contractual reasons relating to the borrower's financial difficulty
- ▶ The disappearance of an active market for a security because of financial difficulties
- ▶ Purchase of a financial asset at a deep discount that reflects the incurred credit loss

At the reporting date, if the credit risk of a financial asset or group of financial assets has not increased significantly since initial recognition or not credit impaired, these financial assets are classified as stage 1.

Measurement of ECL

ECL is the probability weighted estimate of credit losses and is measured as the present value of all cash shortfalls discounted at the effective profit rate of the financial instrument. Cash shortfall represents the difference between cash flows due to the Group in accordance with the contract and the cash flows that the Group expects to receive. The key elements in the measurement of ECL include probability of default ("PD"), loss given default ("LGD") and exposure at default ("EAD"). The Group estimates these elements using appropriate credit risk models taking into consideration the internal and external credit ratings of the assets, nature and value of collaterals, forward looking macroeconomic scenarios as well as other factors.

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**2.4.4 Impairment of financial assets (continued)****2.4.4.1 Expected credit loss of financial assets (continued)***Presentation of allowance for ECL in the consolidated statement of financial position*

Loss allowances for ECL are presented as a deduction from the gross carrying amount of the financial assets for financial assets carried at amortised cost. In the case of debt instruments measured at FVOCI, the Group recognises the ECL charge in the consolidated statement of profit or loss and a corresponding amount is recognised in other comprehensive income with no reduction in the carrying amount of the financial asset in the consolidated statement of financial position.

Incorporation of forward looking information

The Group incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. The Group has performed historical analysis and identified the key economic variables impacting credit risk and ECL. Relevant macro-economic adjustments are applied to capture variations from economic scenarios. These reflect reasonable and supportable forecasts of future macro-economic conditions that are not captured within the base ECL calculations. Macro-economic factors taken into consideration include, but are not limited to, gross domestic product, commodity price index and equity price index and require an evaluation of both the current and forecast direction of the macro-economic cycle. Incorporating forward-looking information increases the degree of judgement required as to how changes in these macro-economic factors will affect ECL. The methodologies and assumptions including any forecasts of future economic conditions are reviewed regularly.

Renegotiated financing receivables

In the event of a default, the Group seeks to restructure financing to customers rather than take possession of collateral. This may involve extending the payment arrangements and the agreement of new financing conditions. When the financing to customers has been renegotiated or modified but not derecognised, any impairment is measured using the original effective yield method as calculated before the modification of terms. Management continually reviews renegotiated financing to ensure that all criteria are met and that future payments are likely to occur. Management also assesses whether there has been significant increase in credit risk or the facility should be classified in stage 3.

2.4.4.2 Provisions for credit losses in accordance with the CBK instructions

The Group is required to calculate provisions for credit losses on financing receivables in accordance with the CBK instructions with respect to financing receivables and the calculation of provisions. Financing receivables are classified as past due when a payment has not been received on its contractual payment date or if the facility is in excess of pre-approved limits. A financing receivable is classified as past due and impaired when the profit or a principal instalment is past due for more than 90 days and if the carrying amount of the facility is greater than its estimated recoverable value. Past due and past due and impaired financing receivables are managed and monitored as irregular facilities and are classified into the following four categories which are then used to determine the provisions:

Category	Criteria	Specific provision
Watch list	Irregular for a period up to 90 days	—
Substandard	Irregular for a period of 91- 180 days	20%
Doubtful	Irregular for a period of 181- 365 days	50%
Bad	Irregular for a period exceeding 365 days	100%

The Group may also include a credit facility in one of the above categories based on management's judgement of a customer's financial and/or non-financial circumstances.

Minimum general provisions of 1% on cash facilities and 0.5% on non-cash facilities are made on all applicable financing receivables (net of certain restricted categories of collateral) which are not subject to specific provisioning.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4.5 Write-offs

Financial assets are written off either partially or in their entirety only when the Bank has no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to other income.

2.4.6 Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated financial position when there is a legally enforceable right to set off the recognised amounts and the Group intends to settle on a net basis so as to realise the assets and liabilities simultaneously.

2.4.7 Derivative financial instruments and hedge accounting

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge.

Beginning 1 January 2018, the documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the Group will assess whether the hedging relationship meets the hedge effectiveness requirements (including the analysis of sources of hedge effectiveness and how the hedge ratio is determined). A hedging relationship qualifies for hedge accounting if it meets all of the following effectiveness requirements:

- ▶ There is 'an economic relationship' between the hedge item and the hedging instrument.
- ▶ The effect of the credit risk does not 'dominate the value changes' that result from that economic relationship; and
- ▶ The hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the Group actually hedges and the quantity of the hedging instrument that the Group actually uses to hedge that quantity of hedged item.

Cash flow hedges

The cash flow hedges hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability, a highly probable transaction or foreign exchange risks within an unrecognised firm commitment.

In accordance with its wider risk management, it is the Group's strategy to apply cash flow hedge accounting to keep its profit rate and foreign currency revaluation fluctuations within its established limits. Applying cash flow hedge accounting enables the Group to reduce the cash flow fluctuations arising from foreign exchange and profit rate risk on an instrument or group of instruments, or to hedge profit rate mismatches on a portfolio level from its floating liabilities including future issuances.

From an accounting point of view, a cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability (such as all or some future profit payments on variable rate debt) or a highly probable forecast transaction and could affect profit or loss.

For designated and qualifying cash flow hedges, the effective portion of the cumulative gain or loss on the hedging instrument is initially recognised directly in OCI within equity. The ineffective portion of the gain or loss on the hedging instrument is recognised immediately in profit or loss.

When the hedged cash flow affects the statement of profit or loss, the effective portion of the gain or loss on the hedging instrument is recorded in the corresponding income or expense line of the statement of profit or loss.

When a hedging instrument expires, is sold, terminated, exercised, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss that has been recognised in OCI at that time remains in OCI and is recognised when the hedged forecast transaction is ultimately recognised in the statement of profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in OCI is immediately transferred to the statement of profit or loss.

To test the hedge effectiveness, the Group compares the changes in the fair value of the hedging instruments against the changes in fair value of the hedged items attributable to the hedged risk (e.g., changes in the forward exchange rates or profit rate risk).

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4.8 Investments in joint venture

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

The considerations made in determining joint control are similar to those necessary to determine control over subsidiaries. The Group's investment in its joint ventures are accounted for using the equity method.

Under the equity method, the investment in joint venture is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the joint venture since the acquisition date. Goodwill relating to the joint venture is included in the carrying amount of the investment and is not tested for impairment separately.

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

The financial statements of the joint ventures are prepared with three months gap from the reporting period of the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

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

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

2.4.9 Investment properties

Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the reporting date. Gains or losses arising from changes in the fair values of investment properties are included in profit or loss in the period in which they arise, including the corresponding tax effect. Fair values are determined based on an annual valuation performed by an accredited external independent valuer using appropriate valuation techniques.

Investment properties are derecognised either when they have been disposed of (i.e., at the date the recipient obtains control) or when they are permanently withdrawn from use and no future economic benefit is expected from their disposal. The difference between the net disposal proceeds and the carrying amount of the asset is recognised in profit or loss in the period of derecognition. In determining the amount of consideration from the derecognition of investment property the Group considers the effects of variable consideration, existence of a significant financing component, non-cash consideration, and consideration payable to the buyer (if any).

Transfers are made to (or from) investment property only when there is a change in use. For a transfer from investment property to owner-occupied property, the deemed cost for subsequent accounting is the fair value at the date of change in use. If owner-occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under property, plant and equipment up to the date of change in use.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4.10 Property and equipment

Property and equipment is stated at historical cost less accumulated depreciation and any impairment in value. 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 recognised in profit or loss as incurred.

Land is not depreciated. Depreciation of other property and equipment items is calculated using the straight-line method to allocate their cost, net of their residual values, over their estimated useful lives, as follows:

Buildings	20-40 years
Furniture, fixtures and equipment	3-5 years

An item of property, and equipment and any significant part initially recognised is derecognised upon disposal (i.e., at the date the recipient obtains control) or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of profit or loss when the asset is derecognised.

The residual values, useful lives and methods of depreciation of property and equipment are reviewed at each financial year end and adjusted prospectively, if appropriate.

2.4.11 Impairment of non-financial assets

The Group assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit (CGU) fair value less costs of disposal and its value in use. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. When the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs of disposal, recent market transactions are taken into account. If no such transactions can be identified, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded companies or other available fair value indicators.

The Group bases its impairment calculation on most recent budgets and forecast calculations, which are prepared separately for each of the Group's CGUs to which the individual assets are allocated. These budgets and forecast calculations generally cover a period of five years. A long-term growth rate is calculated and applied to project future cash flows after the fifth year.

For assets excluding goodwill, an assessment is made at each reporting date to determine whether there is an indication that previously recognised impairment losses no longer exist or have decreased. If such indication exists, the Group estimates the asset's or CGU's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the statement of profit or loss unless the asset is carried at a revalued amount, in which case, the reversal is treated as a revaluation increase.

Goodwill is tested for impairment annually as at the reporting date and when circumstances indicate that the carrying value may be impaired.

Impairment is determined for goodwill by assessing the recoverable amount of each CGU (or group of CGUs) to which the goodwill relates. When the recoverable amount of the CGU is less than its carrying amount, an impairment loss is recognised. Impairment losses relating to goodwill cannot be reversed in future periods.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4.12 End of service indemnity

The Group provides for end of service benefits to all of its employees as per the Kuwaiti Labor Law. The entitlement to the benefits is based upon the employee's final salary and length of service, subject to the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

2.4.13 Revenue recognition

Revenue is recognised either at a point in time or over time, when (or as) the Group satisfies performance obligations by transferring the promised goods or services to its customers.

Rental income

The Group is the lessor in operating leases. Rental income arising from operating leases on investment property is accounted for on a straight-line basis over the lease terms.

Fee and commission income

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income, and other management and advisory fees.

The Group earns fee and commission income from a diverse range of financial services it provides to its customers. Fee and commission income is recognised at an amount that reflects the consideration to which the Group expects to be entitled in exchange for providing the services.

The performance obligations, as well as the timing of their satisfaction, are identified, and determined, at the inception of the contract. The Group's revenue contracts do not typically include multiple performance obligations.

When the Group provides a service to its customers, consideration is invoiced and generally due immediately upon satisfaction of a service provided at a point in time or at the end of the contract period for a service provided over time.

The Group has generally concluded that it is the principal in its revenue arrangements because it typically controls the services before transferring them to the customer.

Finance and similar income

Finance and similar income includes income from Wakala, Murabaha and Ijara investments and is calculated using both the EIR method and other methods.

Dividend income

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

Net investment income

Net investment income includes all gains and losses from changes in fair value and dividends. This includes any ineffectiveness recorded on hedging transactions.

2.4.14 Foreign currency translation

Functional and presentational currency

The consolidated financial statements are presented in KD. For each entity in the group, the Bank determines the functional currency and items included in the financial statements of each entity are measured using that functional currency. The Group uses the direct method of consolidation.

Transactions and balances

Transactions in foreign currencies are initially recorded in the functional currency at the spot rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated into the functional currency at the spot rate of exchange at the reporting date. All foreign exchange differences arising on non-trading activities are taken to foreign exchange gain/(loss) in the consolidated statement of profit or loss.

Non-monetary items that are measured at historical cost in a foreign currency are translated using the spot exchange rates as at the date of recognition.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4.14 Foreign currency translation (continued)

Group companies

On consolidation, the assets and liabilities in foreign operations are translated into KD at the spot rate of exchange prevailing at the reporting date and their income statements are translated at spot exchange rates prevailing at the dates of the transactions. The exchange differences arising on translation for consolidation are recognised in OCI.

Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations, and are translated at the closing rate of exchange.

2.4.15 Taxation

National Labour Support Tax (NLST)

The Group calculates the NLST in accordance with Law No. 19/2000 and the Ministry of Finance resolution No. 24/2006 at 2.5% of taxable profit for the year. As per the law, cash dividends from listed companies which are subjected to NLST has to be deducted from the profit for the year.

Provision of Kuwait Foundation for the Advancement of Sciences (KFAS)

The Group calculates the contribution to KFAS at 1% of profit for the year in accordance with the modified calculation based on the Foundation's Board of Directors resolution, which states that the transfer to statutory reserve should be excluded from profit for the year when determining the contribution.

Zakat

Contribution to Zakat is calculated at 1% of the Group in accordance with the Ministry of Finance resolution No. 58/2007 effective from 10 December 2007.

2.4.16 Segment information

A segment is a distinguishable component of the Group that engages in business activities from which it earns revenue and incurs costs. The operating segments are used by the management of the Group to allocate resources and assess performance. Operating segments exhibiting similar economic characteristics, products and services, classes of customers where appropriate are aggregated and reported as reportable segments.

2.4.17 Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. When the effect of the time value of money is material, the Bank determines the level of provision by discounting the expected cash flows at a pre-tax rate reflecting the current rates specific to the liability. The expense relating to any provision is presented in the statement of profit or loss net of any reimbursement in provision for impairment and credit losses.

2.4.18 Contingent assets and liabilities

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

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

2.4.19 Fiduciary assets

The Group provides fiduciary services that result in the holding or investing of assets on behalf of its clients. Assets held in a fiduciary capacity, unless recognition criteria are met, are not reported in the financial statements, as they are not assets of the Group.

2.4.20 Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Group's shareholders. Interim dividends are deducted from equity when they are declared and are no longer at the discretion of the Group.

Dividends for the year that are approved after the reporting date are disclosed as an event after the reporting date.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4.21 Sukuk issued

Sukuk issued 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 profit rate method.

2.4.22 Leases

The Group assesses at contract inception whether a contract is, or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

2.4.22.1 Group as a lessee

The Group applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Group recognises lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

Right-of-use assets

The Group recognises right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Right-of-use assets are depreciated on a straight-line basis over the lease term.

The right-of-use assets are subject to impairment in line with the Group's policy as described in Note 2.4.11 – Impairment of non-financial assets.

Lease liabilities

At the commencement date of the lease, the Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (less any lease incentives receivable), variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Group and payments of penalties for terminating the lease, if the lease term reflects exercising the option to terminate. Variable lease payments that do not depend on an index or a rate are recognised as expenses in the period in which the event or condition that triggers the payment occurs.

2.4.22.2 Group as a lessor

Leases in which the Group does not transfer substantially all the risks and rewards incidental to ownership of an asset are classified as operating leases. Rental income arising is accounted for on a straight-line basis over the lease terms and is included in revenue in the statement of profit or loss due to its operating nature. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

2.5 SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the Group's consolidated financial statements requires management to make judgements, estimates and assumptions that affect the reported amount of revenues, expenses, assets and liabilities, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods. In the process of applying the Group's accounting policies, management has made the following judgements and 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.

Existing circumstances and assumptions about future developments may change due to circumstances beyond the Group's control and are reflected in the assumptions if and when they occur. Items with the most significant effect on the amounts recognised in the consolidated financial statements with substantial management judgement and/or estimates are collated below with respect to judgements/estimates involved.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

2.5 SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS (continued)

2.5.1 Judgments

Consolidation of wholly owned special purpose vehicles

A wholly owned special purpose vehicle is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. The Group consolidates the structured entities that it controls, as explained in Note 2.4.1. When making this judgement, the Group also considers voting and similar rights available to itself and other parties, who may limit the Group's ability to control, including rights to appoint, reassign or remove members of the structured entity's key management personnel who have the ability to direct the relevant activities.

Going concern

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

Fair value of financial instruments

The fair value of financial instruments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e., an exit price) regardless of whether that price is directly observable or estimated using another valuation technique. When the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of valuation models. 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. For further details about determination of fair value please see Note 24.

Hedge accounting

The Group's hedge accounting policies include an element of judgement and estimation. Estimates of future profit rates and the general economic environment will influence the availability and timing of suitable hedged items, with an impact on the effectiveness of the hedge relationships.

Classification of financial assets

The Group determines the classification of financial assets based on the assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and profit.

Classification of property

Management decides on acquisition of a real estate property whether it should be classified as investment property or property and equipment. The Group classifies property as investment property if it is acquired to generate rental income or for capital appreciation or for an undetermined future use.

Determining the lease term of contracts with renewal and termination options – Group as lessee

The Group determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

The Group has several lease contracts that include extension and termination options. The Group applies judgement in evaluating whether it is reasonably certain whether or not to exercise the option to renew or terminate the lease. That is, it considers all relevant factors that create an economic incentive for it to exercise either the renewal or termination. After the commencement date, the Group reassesses the lease term if there is a significant event or change in circumstances that is within its control and affects its ability to exercise or not to exercise the option to renew or to terminate (e.g., construction of significant leasehold improvements or significant customisation to the leased asset).

2.5 SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS (continued)

2.5.2 Estimation uncertainty

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 also described in the individual notes of the related financial statement line items below. The Group based its assumptions and estimates on parameters available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising that are beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

Impairment of investment in joint ventures

Investment in joint ventures are accounted for under the equity method of accounting for associates, whereby these investments are initially stated at cost, and are adjusted thereafter for the post-acquisition change in the Group's share of the net assets of the joint ventures less any impairment losses. The Group is required to assess, at each reporting date, whether there are indications of impairment. If such indications exist, the management estimates the recoverable amount of the joint venture in order to determine the extent of the impairment loss (if any). The identification of impairment indicators and determination of the recoverable amounts require management to make significant judgements, estimates and assumptions.

Expected credit losses of financial instruments – as per IFRS 9 according to the CBK guidelines

The Group's ECL calculations are outputs of complex model with a number of underlying assumptions regarding the choice of variable inputs and their dependencies. Elements of the ECL model that are considered accounting judgements and estimates include:

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

The Group has the policy to regularly review its model in the context of actual loss experience and adjust when necessary.

Impairment losses on financing receivables – as per CBK guidelines

The Group reviews its financing receivables on a regular basis to assess whether an impairment loss should be recorded in the consolidated statement of profit or loss. 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.

Valuation of investment properties

The fair value of investment properties is determined by real estate valuation experts using recognised valuation techniques and the principles of IFRS 13 *Fair Value Measurement*.

Investment properties under construction are measured based on estimates prepared by independent real estate valuation experts, except where such values cannot be reliably determined. The significant methods and assumptions used by valuers in estimating the fair value of investment properties are set out in Note 8.

Fair value measurement

Management uses valuation techniques to determine the fair value of financial instruments (where active market quotes are not available). This involves developing estimates and assumptions consistent with how market participants would price the instrument. Management bases its assumptions on observable data as far as possible but this is not always available. In that case, management uses the best information available. Estimated fair values may vary from the actual prices that would be achieved in an arm's length transaction at the reporting date.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

2.5 SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS (continued)**2.5.2 Estimation uncertainty (continued)*****Leases - Estimating the incremental borrowing rate***

The Group cannot readily determine the profit rate implicit in the lease, therefore, it uses its incremental borrowing rate (IBR) to measure lease liabilities. The IBR is the rate that the Group would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The IBR therefore reflects what the Group 'would have to pay', which requires estimation when no observable rates are available or when they need to be adjusted to reflect the terms and conditions of the lease.

The Group estimates the IBR using observable inputs (such as market profit rates) when available and is required to make certain entity-specific estimates.

3 CASH AND CASH EQUIVALENTS

For the purpose of the consolidated statement of cash flows, cash and cash equivalents comprise the following at 31 December:

	<i>2020</i> <i>KD'000</i>	<i>2019</i> <i>KD'000</i>
Cash	11,708	3,725
Current account with the CBK	90,396	10,615
Current accounts with commercial banks	8,895	88,204
Total cash and bank balances	110,999	102,544
Placements with the CBK whose original maturity is within 3 months	74,044	27,101
Placements with banks whose original maturity is within 3 months	257,990	153,992
Total cash and cash equivalents	443,033	283,637

Placements with banks represent placements with reputable financial institutions with appropriate credit-ratings assigned by international credit-rating agencies.

4 FINANCING RECEIVABLES

Financing receivables mainly comprise of facilities extended to the customers of the Group in the form of Murabaha and Ijara contracts. Wherever necessary, financing receivables are secured by acceptable forms of collateral to mitigate the related credit risk.

	<i>2020</i> <i>KD'000</i>	<i>2019</i> <i>KD'000</i>
Murabaha receivables	2,252,388	2,083,870
Ijara receivables	356,061	304,759
Wakala receivables	39,856	18,662
Others	14,631	14,976
Less: deferred profit	(123,394)	(117,138)
Financing receivables before provision for impairment	2,539,542	2,305,129
Less: Provision for impairment as per CBK guidelines	(42,176)	(43,155)
	2,497,366	2,261,974

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

4 FINANCING RECEIVABLES

Further analysis of financing receivables, net of deferred profit, based on customer type is given below:

	2020 KD'000	2019 KD'000
Corporate	1,576,475	1,443,639
Individuals	963,067	861,490
Financing receivables before provision for impairment	2,539,542	2,305,129
Less: Provision for impairment as per CBK guidelines	(42,176)	(43,155)
	2,497,366	2,261,974

Movement in provision for impairment as per CBK instructions is as follows:

	31 December 2020		
	<i>Specific provision KD'000</i>	<i>General provision KD'000</i>	<i>Total KD'000</i>
<i>Cash facilities</i>			
As at 1 January 2020	14,591	28,564	43,155
Provision charged during the year	37,102	11,169	48,271
Written off balances during the year	(48,797)	-	(48,797)
Foreign currency movement	(409)	(44)	(453)
At 31 December 2020	2,487	39,689	42,176
<i>Non-cash facilities</i>			
As at 1 January 2020	5,275	809	6,084
Provision charged during the year	(1,641)	-	(1,641)
Foreign currency movement	-	-	-
At 31 December 2020	3,634	809	4,443
<i>Total facilities</i>			
As at 1 January 2020	19,866	29,373	49,239
Provision charged during the year (Note 17)	35,461	11,169	46,630
Written off balances during the year	(48,797)	-	(48,797)
Foreign currency movement	(409)	(44)	(453)
At 31 December 2020	6,121	40,498	46,619

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

4 FINANCING RECEIVABLES (continued)

	31 December 2019		
	<i>Specific provision KD'000</i>	<i>General provision KD'000</i>	<i>Total KD'000</i>
<i>Cash facilities</i>			
As at 1 January 2019 calculated under IFRS 9 according to the CBK guidelines	9,173	21,165	30,338
Reclassification*	(1,403)	-	(1,403)
Balance after reclassification	7,770	21,165	28,935
Provision charged during the year	11,416	7,419	18,835
Written off balances during the year	(4,595)	-	(4,595)
Foreign currency movement	-	(20)	(20)
At 31 December 2019	<u>14,591</u>	<u>28,564</u>	<u>43,155</u>
<i>Non-cash facilities</i>			
As at 1 January 2019 calculated under IFRS 9 according to the CBK guidelines	3,700	603	4,303
Reclassification*	1,403	-	1,403
Balance after reclassification	5,103	603	5,706
Provision charged during the year	172	206	378
Foreign currency movement	-	-	-
At 31 December 2019	<u>5,275</u>	<u>809</u>	<u>6,084</u>
<i>Total facilities</i>			
As at 1 January 2019 calculated under IFRS 9 according to the CBK guidelines	12,873	21,768	34,641
Provision charged during the year (Note 17)	11,588	7,625	19,213
Written off balances during the year	(4,595)	-	(4,595)
Foreign currency movement	-	(20)	(20)
At 31 December 2019	<u>19,866</u>	<u>29,373</u>	<u>49,239</u>

- * During the prior year ended 31 December 2019, an amount of KD 1,403 thousand has been reclassified between cash and non-cash facilities provisions balances.

As at 31 December 2020, the expected credit losses calculated as per IFRS 9 according to the CBK guidelines amounted to KD 40,614 thousand, which is less than provisions computed as required by the CBK guidelines amounting to KD 46,619 thousand.

As at 31 December 2019, the expected credit losses calculated as per IFRS 9 according to the CBK guidelines amounted to KD 40,988 thousand, which is less than provisions computed as required by the CBK guidelines amounting to KD 49,239 thousand.

The available provision balance on non-cash facilities of KD 4,443 thousand (2019: KD 6,084 thousand) is included under other liabilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

5 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	<i>2020</i> <i>KD'000</i>	<i>2019</i> <i>KD'000</i>
Quoted equity instruments	15,580	7,536
Funds (unquoted)	57,792	35,267
Other securities (unquoted)	17,557	13,092
	<u>90,929</u>	<u>55,895</u>

The hierarchy for determining and disclosing the fair values of financial instruments by valuation techniques are presented in Note 24.

6 FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	<i>2020</i> <i>KD'000</i>	<i>2019</i> <i>KD'000</i>
Quoted Sukuk	225,209	311,159
Unquoted Sukuk	6,303	6,398
Unquoted equity instruments	5,538	5,505
	<u>237,050</u>	<u>323,062</u>

During the year ended 31 December 2020, the management has performed a review of the financial assets at fair value through other comprehensive income to assess the ECL. Based on the assessment, the management has recognised a reversal of ECL of KD 979 thousand (2019: ECL of KD 682 thousand) in the consolidated statement of profit or loss for the year (Note 17).

The hierarchy for determining and disclosing the fair values of financial instruments by valuation techniques are presented in Note 24.

Investments in debt instruments are subject to ECL. An analysis of changes in the gross carrying amount and the corresponding ECL in relation to investment in debt instruments is as follows:

	<i>31 December 2020</i>			
	<i>Stage 1</i> <i>KD'000</i>	<i>Stage 2</i> <i>KD'000</i>	<i>Stage 3</i> <i>KD'000</i>	<i>Total</i> <i>KD'000</i>
Gross carrying amount as at 1 January 2020	313,546	4,011	-	317,557
New assets purchased (payments and assets derecognised during the year), net	(89,563)	-	-	(89,563)
Transfer between stages	(5,280)	5,175	105	-
Foreign exchange adjustments	3,524	(6)	-	3,518
At 31 December 2020	<u>222,227</u>	<u>9,180</u>	<u>105</u>	<u>231,512</u>
	<i>31 December 2020</i>			
	<i>Stage 1</i> <i>KD'000</i>	<i>Stage 2</i> <i>KD'000</i>	<i>Stage 3</i> <i>KD'000</i>	<i>Total</i> <i>KD'000</i>
ECL allowance as at 1 January 2020	1,526	109	-	1,635
Impact due to purchase/de-recognition	(462)	(53)	-	(515)
Impact on year end ECL of exposures transferred between stages during the year	(48)	-	48	-
Re-measurement of ECL	(464)	-	-	(464)
At 31 December 2020	<u>552</u>	<u>56</u>	<u>48</u>	<u>656</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

6 FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (continued)

	<i>31 December 2019</i>			
	<i>Stage 1 KD'000</i>	<i>Stage 2 KD'000</i>	<i>Stage 3 KD'000</i>	<i>Total KD'000</i>
Gross carrying amount as at 1 January 2019	137,219	5,874	-	143,093
New assets purchased (payments and assets derecognised during the year), net	176,266	(1,865)	-	174,401
Transfer between stages	-	-	-	-
Foreign exchange adjustments	61	2	-	63
At 31 December 2019	<u>313,546</u>	<u>4,011</u>	<u>-</u>	<u>317,557</u>

	<i>31 December 2019</i>			
	<i>Stage 1 KD'000</i>	<i>Stage 2 KD'000</i>	<i>Stage 3 KD'000</i>	<i>Total KD'000</i>
ECL allowance as at 1 January 2019	759	194	-	953
Impact due to purchase/de-recognition	725	(58)	-	667
Impact on year end ECL of exposures transferred between stages during the year	-	-	-	-
Re-measurement of ECL	42	(27)	-	15
At 31 December 2019	<u>1,526</u>	<u>109</u>	<u>-</u>	<u>1,635</u>

7 INVESTMENT IN JOINT VENTURES

The Group's interest in joint ventures is accounted for using the equity method in the consolidated financial statements. Summarised financial information of the joint ventures, based on its IFRS financial statements, and reconciliation with the carrying amount of the investment in the consolidated financial statements are set out below:

	<i>2020 KD'000</i>	<i>2019 KD'000</i>
As at 1 January	91,007	52,498
Additions	13,084	35,550
Share of results (Note 14)	8,536	7,272
Distributions received	(5,388)	(4,159)
Foreign currency translation adjustment	1,001	(154)
As at 31 December	<u>108,240</u>	<u>91,007</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

7 INVESTMENT IN JOINT VENTURES (continued)

The following table illustrates summarised financial information of the Group's investment in the joint ventures:

	<i>2020</i> <i>KD'000</i>	<i>2019</i> <i>KD'000</i>
<i>Summarised statement of financial position of the joint ventures:</i>		
Current assets	4,389	33
Non-current assets	103,903	91,037
Current liabilities	(52)	(63)
Equity	108,240	91,007
Group's share in equity	108,240	91,007
Group's carrying amount of the investment	108,240	91,007
<i>Summarised statement of profit or loss of the joint ventures:</i>		
Revenue	8,682	7,523
Administrative and other expenses	(146)	(251)
Profit for the year (continuing operations)	8,536	7,272
Group's share of profit for the year	8,536	7,272

The joint ventures had no capital commitments as at 31 December 2020 (2019: KD 5,783 thousand) and no contingent liabilities as at 31 December 2020 and 2019.

8 INVESTMENT PROPERTIES

	<i>2020</i> <i>KD'000</i>	<i>2019</i> <i>KD'000</i>
Opening balance at 1 January	20,798	22,867
Reclassification from property and equipment	13,165	-
Sale during the year	(5,233)	(2,198)
Fair value adjustment to investment properties (Note 14)	941	(221)
Foreign currency translation adjustment	368	350
Closing balance at 31 December	30,039	20,798

The fair value of investment properties is determined based on valuations performed by independent and accredited valuers with recognised and relevant professional qualification and with recent experience in locations and categories of investment properties being valued. The valuation models applied are consistent with the principles in IFRS 13 and fair value is determined using a mix of the income capitalisation method and the market comparison approach considering the nature and usage of each property. Fair value using the income capitalisation method is estimated based on the normalised net operating income generated by the property, which is divided by the capitalisation (discount) rate. Under the market comparison approach, fair value is estimated based on comparable transactions. The unit of comparison applied by the Group is the price per square meter ('sqm'). Based on these valuations, the fair value of investment properties witnessed an increase of KD 941 thousand compared to its carrying values as at 31 December 2020 (2019: decrease of KD 221 thousand).

Significant increases (decreases) in estimated price per square metre in isolation would result in a significantly higher (lower) fair value on a linear basis.

Significant increases (decreases) in estimated rental value and rent growth per annum in isolation would result in a significantly higher (lower) fair value of the properties. Significant increases (decreases) in the long-term vacancy rate and discount rate (and exit yield) in isolation would result in a significantly lower (higher) fair value.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

8 INVESTMENT PROPERTIES (continued)

The fair value of the investment properties is classified as a level 2 fair value since no significant adjustments need to be made to the prices obtained from the local markets.

Generally, a change in the assumption made for the estimated rental value is accompanied by a directionally similar change in the rent growth per annum and discount rate (and exit yield), and an opposite change in the long term vacancy rate.

	<i>2020</i> <i>KD'000</i>	<i>2019</i> <i>KD'000</i>
Rental income derived from investment properties	1,082	1,377
Direct operating expenses	(221)	(389)
Net rental income arising from investment properties (Note 14)	861	988

The Group has no restrictions on the realisability of its investment properties and no contractual obligations to either purchase, construct or develop investment properties or for repairs, maintenance and enhancements.

9 DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

Due to banks and other financial institutions represents deposits received from banks and other financial institutions under Wakala and Murabaha contracts.

10 DEPOSITORS' ACCOUNTS

Depositors' accounts of the Group comprise of the following:

☒ *Non-investment deposits in the form of current accounts*

These deposits are not entitled to any profits nor do they bear any risk of loss as the Group guarantees to pay the related balances on demand. Accordingly, these deposits are considered Qard Hasan from depositors to the Group.

☒ *Investment deposits*

These include Mudaraba, Murabaha and Wakala deposits, which have fixed maturity as specified in the term of the contract except for investment saving accounts which are valid for an unlimited period.

11 SUKUK ISSUED

On 24 September 2019, the Bank completed the series 1 issue of unsecured Sukuk (senior debt) amounting to US\$ 500 million with a tenor of up to 5 years maturing on 24 September 2024. Such sukuk has a fixed coupon rate of 2.982% per annum, payable semi-annually in arrears. The Sukuk is listed on the Irish Stock Exchange (Euronext Dublin) and NASDAQ Dubai.

On 17 June 2020, the Bank completed the issuance of an unsecured Sukuk (senior debt) amounting to KD 150 million with a tenor of up to 5 years maturing on 17 June 2025. Such sukuk has a coupon rate of 1% per annum over the CBK discount rate, payable semi-annually in arrears. The Sukuk is listed on the Irish Stock Exchange (Euronext Dublin).

12 EQUITY

The authorised, issued, and fully paid share capital as at 31 December 2020 comprise of 1,575,000 thousand shares (2019: 1,500,000 thousand shares) of 100 fils each.

The ordinary general assembly meeting ("AGM") of the Bank's shareholders held on 20 April 2020 approved to a bonus shares issue of 5% of the authorised, issued, and fully paid share capital for the year ended 31 December 2019 (2018: Nil%). No cash dividends were declared for the year ended 31 December 2019 (2018: Nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

12 EQUITY (continued)

The extra-ordinary general assembly (“EGM”) of the Bank’s shareholders held on 27 April 2020 approved the increase of Bank’s authorised, issued, and fully paid share capital by issuing 75,000 thousand bonus shares at 5% of the authorised and paid-up share capital (i.e. 5 shares for each 100 shares) amounting to KD 7,500 thousand to the shareholders registered in the Bank’s records as at the end of the record date scheduled on 4 June 2020.

Statutory reserve

In accordance with the Companies’ Law, and the Bank’s Memorandum of Incorporation and Articles of Association, a minimum of 10% of the profit for the year before contribution to KFAS, NLST, Zakat and Directors’ remunerations shall be transferred to the statutory reserve. The Annual General Assembly of the Bank may resolve to discontinue such transfer when the reserve exceeds 50% of the issued share capital. The reserve may only be used to offset losses or enable the payment of a dividend up to 5% of paid-up share capital in years when profit is not sufficient for the payment of such dividend due to absence of distributable reserves. Any amounts deducted from the reserve shall be refunded when the profits in the following years suffice, unless such reserve exceeds 50% of the issued share capital.

No transfer has been made to the statutory reserve during the current year ended 31 December 2020 due to accumulated losses. An amount of KD 1,745 thousand was transferred to the statutory reserve during the prior year ended 31 December 2019.

Voluntary reserve

In accordance with the Bank’s Articles of Association and Memorandum of Incorporation, a percentage is deducted for voluntary reserve based on proposal of the Board of Directors and subject to approval of the Annual General Assembly. Such transfers may be discontinued by a resolution of the ordinary general assembly upon a proposal by the Board of Directors and the CBK approval.

In accordance with the Companies’ Law, a maximum of 10% of the profit for the year before contribution to KFAS, NLST, Zakat and Directors’ remuneration, is eligible to be transferred to the voluntary reserve by a resolution of the Annual General Assembly upon a proposal by the Board of Directors in order to accumulate a voluntary reserve allocated for purposes specified by the Annual General Assembly.

Based on the proposal of the Board of Directors, no transfers have been made to the voluntary reserve in the current and prior year.

Proposed distributions

	2020 KD’000	2019 KD’000
Proposed bonus shares:		
Proposed bonus shares for 2020: Nil shares for each Nil shares (2019: 5 shares for each 100 shares)	-	7,500
	<u> </u>	<u> </u>

13 PERPETUAL TIER 1 SUKUK

On 14 March 2017, the Bank, through a Shari’a compliant Sukuk arrangement, issued Tier 1 Sukuk amounting to USD 250 million. 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 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 Bank after five-year period ending 14 March 2022 (the “First Call Date”) or any profit payment date thereafter subject to certain redemption conditions.

The net proceeds of Tier 1 Sukuk are invested by way of Mudaraba with the Bank (as Mudareb), on an unrestricted co-mingling basis, by the Bank in its general business activities carried out through the general Mudaraba pool. Tier 1 Sukuk bears a profit rate of 6.5% 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 Mid Swap Rate plus initial margin of 4.374% per annum.

At the Bank’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 Bank made profit payments during the year on 12 March and 10 September 2020.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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14 NET INVESTMENT INCOME

	<i>2020</i> KD'000	<i>2019</i> KD'000
Realised gain on sale of debt instruments at fair value through other comprehensive income	7,903	215
Realised gain on sale of financial assets at fair value through profit or loss	2,100	23
Share of results of investment in joint ventures (Note 7)	8,536	7,272
Dividend income	2,132	2,176
Net rental income from investment properties (Note 8)	861	988
Gain on sale of investment property	2,045	61
Fair value adjustment to financial assets at fair value through profit or loss	1,154	(2,358)
Fair value adjustment to investment properties (Note 8)	941	(221)
Other investment income (loss)	580	(272)
	<u>26,252</u>	<u>7,884</u>

15 NET FEES AND COMMISSION INCOME

Net fees and commission income includes financing syndication fees earned on the successful completion of syndicated deals by the Group amounting to KD 1,491 thousand (2019: KD 2,531 thousand).

16 OTHER INCOME

In an attempt to mitigate the impact of the Covid-19 pandemic, the Government of Kuwait has introduced measures to aid private entities in response to the pandemic. These measures include government assistance made towards national workforce in the private sector for a period of up to six months effective from June 2020.

The financial support amounting to KD 1,486 thousand is accounted for in accordance with IAS 20 'Accounting for Government Grants and Disclosures of Government Assistance' and recognised in profit or loss as 'other income' on a systematic basis over the periods in which the Bank recognises expenses for the related staff costs.

17 PROVISION FOR IMPAIRMENT AND CREDIT LOSSES

	<i>2020</i> KD'000	<i>2019</i> KD'000
(Reversal of) provision for expected credit losses for investments in Sukuk (Note 6)	(979)	682
Reversal of expected credit losses for placements with banks	(64)	(8)
Provision for impairment as per CBK guidelines on credit facilities (Note 4)	46,630	19,213
Impairment on other assets	1,051	21
	<u>46,638</u>	<u>19,908</u>

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18 BASIC AND DILUTED EARNINGS PER SHARE (EPS)

Basic EPS amounts are calculated by dividing the profit for the year attributable to ordinary equity holders of the Bank adjusted for profit paid on Perpetual Tier 1 Sukuk by the weighted average number of ordinary shares outstanding during the year. Diluted EPS is calculated by dividing the profit attributable to ordinary equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on conversion of all the dilutive potential ordinary shares into ordinary shares. As there are no dilutive instruments outstanding, basic and diluted earnings per share are identical.

	2020	2019
Net profit for the year (KD'000)	5,634	16,538
Less: profit payment on Perpetual Tier 1 Sukuk (KD'000)	(4,981)	(4,943)
	<u>653</u>	<u>11,595</u>
Weighted average number of shares outstanding ('000)	<u>1,575,000</u>	<u>1,575,000</u>
Basic and diluted earnings per share (fils)	<u>0.41</u>	<u>7.36</u>

The comparative basic and diluted earnings per share have been restated to reflect the impact of bonus shares issued in 2020 (Note 12).

There have been no transactions involving ordinary shares between the reporting date and the date of authorisation of this consolidated financial statements which would require the restatement of EPS.

19 RELATED PARTY DISCLOSURES

Related parties comprise the major shareholders, board of directors, entities controlled by them or under their joint control, associates, key management personnel and their close family members. Balances with related parties arise from commercial transactions in the normal course of business on terms approved by the management.

19.1 Remuneration of the Bank's key management personnel:

Key management personnel are those individuals who have the authority and responsibility for planning and exercising power to directly or indirectly control the activities of the Bank and its employees. The Bank considers the members of the Board of Directors (and its sub-committees) and Executive Committee to be key management personnel for the purposes of IAS 24 *Related Party Disclosures*.

	2020 KD'000	2019 KD'000
Salaries and benefits	1,874	2,297
End of service benefits	196	153
Directors' remuneration*	94	259
	<u>2,164</u>	<u>2,709</u>

* Directors' remuneration includes special compensation for additional contributions related to participation in the executive committees in accordance with board of directors' decisions.

Board of directors' remuneration for the year ended 31 December 2020 is subject to the approval of the annual general assembly meeting (AGM).

The AGM of the shareholders of the Bank for the year ended 31 December 2019 held on 20 April 2020 approved the directors' fees proposed for the year ended 31 December 2019 of KD 125 thousand.

19.2 Transactions with Bank's key management personnel and board of directors' members:

The Bank enters into transactions, arrangements and agreements involving senior management, board of directors' members, and their controlled business, or close family members, in the ordinary course of business under the same commercial and market terms, profit and commission rates that apply to non-related parties.

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19 RELATED PARTY DISCLOSURES (continued)

19.2 Transactions with Bank's key management personnel and board of directors' members: (continued)

The following table shows the total amount of transactions, which have been entered into with key management personnel and board of directors' members for the relevant financial year which are included in the consolidated statement of financial position:

	<i>2020</i> <i>KD'000</i>	<i>2019</i> <i>KD'000</i>
Financing facilities	1,480	1,439
Credit cards	8	4
Depositors' accounts	1,613	6,810

The transactions with related parties included under the contingent liabilities are as follows:

	<i>2020</i> <i>KD'000</i>	<i>2019</i> <i>KD'000</i>
Letter of guarantees	4	4

The number of the board members and executive officers is, as follows:

	<i>2020</i>	<i>2019</i>
Financing facilities	6	6
Credit cards	8	5
Depositors' accounts	50	44
Letter of guarantees	1	1

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

	<i>2020</i> <i>KD'000</i>	<i>2019</i> <i>KD'000</i>
Placements and finance income	73	90
Finance costs and distributions to depositors	74	67

19.3 Transactions with major shareholders and other related parties:

In addition to transactions with key management personnel and board of directors' members, the Bank enters into transactions with major shareholders and other entities which the Bank has direct or indirect control, including common control, joint control and significant influence.

Balances recorded in the consolidated statement of financial position are as follows:

	<i>Outstanding balances as at</i>		
	<i>Major shareholders KD'000</i>	<i>Other related parties KD'000</i>	<i>Total 31 December 2020 KD'000</i>
Depositors' accounts	552,054	279	552,333

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As at and for the year ended 31 December 2020

19 RELATED PARTY DISCLOSURES (continued)

19.3 Transactions with major shareholders and other related parties (continued):

	<i>Outstanding balances as at</i>		
	<i>Major shareholders KD'000</i>	<i>Other related parties KD'000</i>	<i>Total 31 December 2019 KD'000</i>
Depositors' accounts	871,968	893	872,861

The number of major shareholders and other related parties is as follows:

	<i>No. of major shareholders</i>	<i>No. of other related parties</i>
2020		
Depositors' accounts	2	30
2019		
Depositors' accounts	2	30

Transactions with related parties recorded in the consolidated statement of profit or loss are as follows:

	<i>Transactions values during the year ended</i>		
	<i>Major shareholders KD'000</i>	<i>Other related parties KD'000</i>	<i>Total 31 December 2020 KD'000</i>
Finance costs and distributions to depositors	10,677	-	10,677

	<i>Transactions values during the year ended</i>		
	<i>Major shareholders KD'000</i>	<i>Other related parties KD'000</i>	<i>Total 31 December 2019 KD'000</i>
Finance costs and distributions to depositors	20,531	-	20,531

Outstanding balances at year-end are in the ordinary course of business. The profit rates charged to, and by, related parties are at normal commercial rates. Except for guarantees of KD 2,764 thousand received for related party receivables, there are no guarantees provided for related party payables during the year ended 31 December 2020 (2019: KD 2,995 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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20 COMMITMENTS AND CONTINGENT LIABILITIES

	<i>2020</i> <i>KD'000</i>	<i>2019</i> <i>KD'000</i>
Acceptances and letters of credit	38,751	52,210
Letter of guarantees	127,647	115,030
Contingent liabilities	166,398	167,240
Capital commitments	104,668	28,816

As at 31 December 2020, irrevocable commitments to extend credit amounted to KD 15,093 thousand (2019: KD 9,868 thousand). These include commitments to extend credit which are irrevocable over the life of the facility or are revocable only in response to a material adverse change.

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.

21 RISK MANAGEMENT

Risk is inherent in all activities of the Group and is managed through a process of ongoing identification, measurement, mitigation and monitoring, subject to risk appetite limits and other controls. This process of risk management is critical to the Group's financial health and continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Group has exposure to the following risks from financial instruments:

- ▶ Credit risk
- ▶ Market risk
- ▶ Liquidity risk
- ▶ Operational risk

In addition, there are other risk types that need to be monitored and controlled. This note presents information about the Group's exposure to each of the risks, the Group's framework of policies, models and quantification techniques and processes for identifying, measuring, mitigating, monitoring and managing risk, and the management of Group's capital.

This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to country risk and various operating and business risks.

21.1 Risk management structure***Board of Directors***

The Board of Directors (the 'Board') has overall responsibility for the establishment and oversight of Risk Management function. The Board has established a Board Risk Committee (the 'BRC') comprising of members from the Board, to set the framework and monitor the Bank's Risks and Control related requirements covering all risk types like credit, market, liquidity risks and operational risk. The Board Risk Committee is assisted in these functions by the Chief Risk Officer.

The Board has also established a Board Audit Committee (the 'BAC'), as required by the Central Bank of Kuwait, which, amongst other functions, is also required to monitor adherence with the Group's Risk Management principles, policies and procedures, and for reviewing the adequacy of the Risk Management framework. The Group Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Group Audit Committee.

21 RISK MANAGEMENT (continued)

21.1 Risk management structure (continued)

Risk Management Group

An independent Risk Management Group headed by the Chief Risk Officer (the 'CRO') reports to the BRC, responsible for enterprise-wide risks, to assist the Board of Directors and BRC in carrying out the risk oversight responsibility.

Risk management policies are established to identify, quantify, control, mitigate, and analyse the risks faced by the Group to set appropriate risk limits and controls and to monitor risks and ensure adherence to the risk appetite limits. Risk management policies and systems are subject to review regularly, on an ongoing basis, to reflect changes in economic environment, market conditions, products and services offered by the Group.

21.2 Credit risk

Credit risk is the risk that one party to a financial instrument will fail or delay to discharge an obligation and cause the other party to incur a financial loss. This includes the risk of decline in the credit standing of the customer. While such decline does not imply default, it increases the probability of the customer defaulting. Financial instruments that create credit risk include financing receivables and commitments to extend credit and investment in debt instruments (i.e. Sukuk).

For risk management control purposes, the Group considers and consolidates all elements of credit risk exposure such as individual obligor default risk, country risk and sector risk in one measure about the riskiness of an exposure.

Credit risk management

The Group's Board has approved Financing and Investment policies for various business groups and investment asset types. The Board has also approved the Executive Credit and Investment Committee (the 'ECIC') Charter, which is empowered for initial screening of proposals and approval within its delegated authorities. The Board has also constituted the Board Credit and Investment Committee (the 'BCIC') which by virtue of its Charter, is the next level of authority which provides guiding principles and approves the various financing and investment proposals on behalf of the Board of the Group.

The Risk Management Group provides independent opinion and assessment of risk for every financing and investment proposal presented to the approving authorities for decision making.

The Group manages its credit facilities portfolio with the objective of ensuring that it is well diversified and it earns a level of return commensurate with the risks it assumes, at the same time, seeks to ensure the quality of the credit portfolio.

In addition, the Group endeavors to manage the credit exposure by obtaining collateral where appropriate and limiting the tenor of exposure or structures that are beneficial to the overall risk profile of the Group's credit risk exposure.

As required by the CBK, the Group has established a Provisioning Committee, at the executive level which is primarily responsible for the study and evaluation of the existing credit facilities and investments of the Group, to identify any abnormal situations and difficulties associated with a customer's position which may require the exposure to be classified as irregular, and to determine an appropriate provisioning required for impaired/ potential impairment of assets and investments.

Assessment of expected credit losses

Definition of default and cure

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

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

21 RISK MANAGEMENT (continued)

21.2 Credit risk (continued)

Assessment of expected credit losses (continued)

Any credit impaired or stressed facility that has been restructured during the year would also be considered as in default. The Group considers externally-rated exposures with ratings 'D' for S&P and Fitch, and 'C' for Moody's as defaulted.

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

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

Significant increase in credit risk

The Group continuously monitors all assets subject to ECL. In order to determine whether an instrument or a portfolio of instruments is subject to 12 months ECL or life time ECL, the Group assess whether there has been a significant increase in credit risk since initial recognition. The Group applies a consistent quantitative criterion for internally and externally rated portfolio to assess significant increase in credit risk.

Internal rating and Probability of Default (PD) estimation process

In managing its portfolio, the Group utilises ratings and other measures and techniques which seek to take account of all aspects of perceived risk. The Group uses Moody's CreditLens (MC) as its internal credit-rating engine. The MC tool provides the ability to analyse a business and produce risk ratings. The analysis supports the usage of financial factors as well as non-financial subjective factors. The Group also uses external ratings by recognised rating agencies for externally rated portfolios.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's rating policy. The attributable risk ratings are assessed and updated regularly.

The standard requires the use of separate PD for a 12-month duration and lifetime duration depending on the stage allocation of the obligor. A PD used for IFRS 9 should reflect the Group's estimate of the future asset quality. The through the cycle (TTC) PDs are generated from MC based on the internal/external credit ratings. The Group converts the TTC PD to a point in time (PIT) PD term structures using appropriate models and techniques.

The Group assesses the PD for its retail portfolio through behavioural scorecards implemented in the Group. The scorecards are based on logistic regression technique. This enables the evaluation of score and PD associated against each facility. Term structure of PD is based on hazard rate concept. The survival distribution used is exponential distribution. The probability distribution function of an exponentially distributed random variable is used with the hazard rate as the PD evaluated from the Behavioural scorecard.

Incorporation of forward-looking information

The Group considers key economic variables that are expected to have an impact on the credit risk and the ECL in order to incorporate forward looking information into the ECL models. These primarily reflect reasonable and supportable forecasts of the future macro-economic conditions. The consideration of such factors increases the degree of judgment in determination of ECL. The Group employs statistical models to incorporate macro-economic factors on historical default rates. The Group considers 3 scenarios (baseline, upside and downside) of forecasts of macro-economic data and appropriate probability weights are applied to these scenarios to derive a probability weighted outcome of expected credit loss. The management reviews the methodologies and assumptions including any forecasts of future economic conditions on a regular basis.

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As at and for the year ended 31 December 2020

21 RISK MANAGEMENT (continued)**21.2 Credit risk (continued)*****Maximum exposure to credit risk without taking account of any collateral***

The following table summarises the maximum exposure to credit risk for the components of the consolidated statement of financial position, including off-consolidated statement of financial position items. The maximum exposure is shown net of impairment, before the effect of mitigation through the use of master netting and collateral agreements, where applicable.

	<i>Net maximum exposure</i>	
	<i>2020</i>	<i>2019</i>
	<i>KD'000</i>	<i>KD'000</i>
Balances with banks	99,291	98,819
Placements with banks and the CBK	357,897	225,703
Financing receivables	2,497,366	2,261,974
Financial assets at fair value through other comprehensive income (investment in Sukuk)	231,512	317,557
Other assets	12,254	14,681
	3,198,320	2,918,734
Acceptances and letters of credit	38,557	51,949
Letter of guarantees	123,398	109,207
Total	161,955	161,156
Total credit risk exposure	3,360,275	3,079,890

Where financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could give rise in the future as a result of changes in value.

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region or exposed to similar economic environment that would cause their ability to meet contractual obligations and be similarly impacted by changes in economic, political and/or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting similarly connected counterparties.

The maximum credit exposure to a single counterparty as at 31 December 2020 amounted to KD 75,748 thousand (2019: KD 78,507 thousand) before taking account of collateral.

Risk concentrations of the maximum exposure to credit risk

Geographical and industry sector concentrations of financial assets and off-consolidated statement of financial position items are as follows:

	<i>2020</i>		<i>2019</i>	
	<i>Financial assets</i>	<i>Off-balance sheet items</i>	<i>Financial assets</i>	<i>Off-balance sheet items</i>
	<i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>
<i>Geographic region:</i>				
Kuwait	2,485,780	131,229	2,036,014	131,788
Other Middle East	608,823	6,601	603,258	6,935
Rest of the World	103,717	24,125	279,462	22,433
	3,198,320	161,955	2,918,734	161,156

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

21 RISK MANAGEMENT (continued)**21.2 Credit risk (continued)***Risk concentrations of the maximum exposure to credit risk (continued)*

	2020		2019	
	Financial assets KD'000	Off-balance sheet items KD'000	Financial assets KD'000	Off-balance sheet items KD'000
<i>Industry sector:</i>				
Banks and other financial institutions	780,818	12,101	796,240	6,020
Construction and Real Estate	1,059,812	84,781	971,357	76,776
Trading and Manufacturing	425,276	51,347	323,478	58,436
Personal	443,557	-	394,762	-
Services	279,840	13,655	239,204	19,782
Other	209,017	71	193,693	142
	3,198,320	161,955	2,918,734	161,156

Credit risk mitigation

Credit risk mitigation techniques that the Group is permitted to use are obtaining collateral where appropriate and limiting the tenor of exposure or structures that are beneficial to the Group's management of risks to an exposure.

Credit quality of financial instruments

For the year ended 31 December 2020, the Group classified the various credit risk exposure which are neither past due nor impaired into two categories of credit quality as under:

High quality: Credit exposures where the ultimate risk of financial loss from the obligor's failure to discharge its obligation is assessed to be low-to-moderate. These include exposures to entities with financial strength and risk factors indicative of capacity to repay all contractual obligations, and those exposures that are significantly collateralized with tangible securities.

Standard quality: All other exposures whose payment performance is fully compliant with contractual conditions and which are not impaired.

The tables below show the credit quality of assets by class and grade before deducting the provision for impairment.

	Neither past due nor impaired		Past due or impaired	Total KD'000
	High quality KD'000	Standard quality KD'000	KD'000	
2020				
Balances with banks	99,291	-	-	99,291
Placements with banks and the CBK	358,092	-	-	358,092
Financial assets at fair value through other comprehensive income (investment in Sukuk)	162,326	69,081	105	231,512
Other assets	10,586	1,738	1,100	13,424
	630,295	70,819	1,205	702,319

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

21 RISK MANAGEMENT (continued)**21.2 Credit risk (continued)***Credit quality of financial instruments (continued)*

	<i>High quality KD'000</i>	<i>Standard quality KD'000</i>	<i>Total KD'000</i>
2019			
Balances with banks	98,819	-	98,819
Placements with banks and the CBK	225,976	-	225,976
Financial assets at fair value through other comprehensive income (investment in Sukuk)	202,308	115,249	317,557
Other assets	11,568	3,228	14,796
	<u>538,671</u>	<u>118,477</u>	<u>657,148</u>

Disclosure of credit quality and the maximum exposure for credit risk of financing receivables per categories based on the Bank's internal credit rating system and year-end stage classification are further disclosed in Note 4.

Ageing analysis of past due but not impaired finance facilities by class of financial assets:

	<i>Less than 30 days KD'000</i>	<i>31 to 60 days KD'000</i>	<i>61 to 90 days KD'000</i>	<i>Total KD'000</i>
2020				
Financing receivables	<u>40,186</u>	<u>1,917</u>	<u>1,104</u>	<u>43,207</u>
2019				
Financing receivables	<u>90,631</u>	<u>3,983</u>	<u>14,928</u>	<u>109,542</u>

Collaterals

The amount and type of collaterals required depends on an assessment of the credit risk of the counterparty. Guidelines initiated by the Bank's risk management and credit committee are implemented regarding the acceptability of types of collateral and valuation parameters.

Management monitors the fair value of collateral and requests additional collateral in accordance with the underlying agreements when necessary.

The fair value of collateral that the Bank holds relating to past due or impaired finance facilities as at 31 December 2020 was KD 87,027 thousand (2019: KD 114,683 thousand). The collaterals consist of cash, securities, sukuk, letters of guarantee, real estate assets and other forms of collateral.

21.3 Market risk

Market risk emanates from the process of fair value or future cash flows of a financial instrument which fluctuates due to changes in market prices. Market risk may arise from open positions in profit 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 or prices such as profit rates, credit spreads, foreign exchange rates and equity prices.

Market risk management

The Risk Management Group is responsible for development of detailed Market Risk Management framework and for the periodic review of their implementation, while it is the responsibility of the Treasury function to proactively manage and control market risk generated from various market positions in investments, financial instruments and over-the-counter deals.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

21 RISK MANAGEMENT (continued)**21.3 Market risk (continued)**

The market risk framework comprises of the following elements:

- ▶ Limits for all market risk parameters and regular limits monitoring to ensure that Group does not exceed aggregate risk and concentration parameters set by the CBK limits and internal limits;
- ▶ Mark-to-market valuation based on independently published market data, and continuous review of all open positions; and
- ▶ Measuring Value-at-Risk for market sensitive positions and monitoring the same against established limits

The Group is required to comply with the guidelines and regulations of the CBK. The Market Risk policies and procedures and the market risk limits are periodically set and reviewed to ensure the implementation of the Group's market risk appetite.

21.3.1. Profit rate risk

Profit rate risk arises from the changes in profit rates affecting future cash flows or the fair value of the underlying financial exposure or instrument. The Group is susceptible to profit rate risk as value of Group's fixed income investments and/ or return on financing are inversely proportional to movement in market rates. Moreover, change in profit rates might also impact Group's net earnings or earnings spread. The Group is not exposed to significant profit rate risk.

21.3.2. Prepayment risk

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier than expected, such as fixed rate financial exposures when profit rates fall. Due to the contractual terms of its Islamic products, the Group is not significantly exposed to prepayment risk.

21.3.3. Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group is susceptible to currency risk as the Group's base currency is KD and all foreign currencies are revalued against KD. Any long or short open position in any currency exposes the Group to currency risk.

Currency risk is managed on the basis of limits determined by the CBK and a continuous assessment of the Group's open positions and current and expected exchange rate movements.

The tables below indicate the currencies to which the Group had significant exposure at 31 December on its non-trading monetary assets and liabilities and its forecasted cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the KD, with all other variables held constant, on profit or loss and equity (due to changes in fair value and foreign currency translation recognised in OCI).

Currency	2020			2019		
	Change in currency rate %	Effect on profit or loss KD'000	Effect on equity KD'000	Change in currency rate %	Effect on profit or loss KD'000	Effect on equity KD'000
USD	±1	(1,880)	903	±1	(872)	733
EUR	±1	(132)	102	±1	(713)	100
GBP	±1	(186)	194	±1	(137)	136

21.3.4. Equity price risk

Equity price risk is the risk that the fair values of equities decrease as the result of change in the levels of equity prices and/or indices and the value of individual stocks.

The Group conducts sensitivity analysis on regular intervals in order to assess the potential impact of any material change in fair value of listed equity instruments. For such investments, a five percent increase in stock prices as at 31 December 2020 would have increased equity by KD 779 thousand (2019: KD 377 thousand). An equal change in the opposite direction would have had equal, but opposite effect to the amounts shown above, on the basis that all other variables remain constant.

21 RISK MANAGEMENT (continued)

21.4 Liquidity risk

Liquidity risk arises when the Group may be unable to meet its obligations associated with its financial liabilities. Liquidity risk can be caused by market disruptions, credit downgrades or market perception, which may cause certain sources of funding to dry up immediately. To limit this risk, the Group has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of High Quality Liquid Assets (HQLA) which could be used to secure additional funding and liquidity if and when required. The Group has in place a Contingency Funding Plan (CFP) to ensure required action is implemented in the event of any liquidity contingencies. ALCO is responsible for invoking the CFP.

Liquidity risk management

The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Risk Management Group and Treasury monitor the Group's liquidity profile daily and take appropriate steps, if required. The Group's liquidity profile is monitored on daily basis; overall assets and liabilities as well as for KD and foreign currencies (FCY), on the Group's position in terms of Statutory Liquidity Ratio (SLR) as well as Lending to Deposit Ratio (LDR) and Liquidity Coverage Rate (LCR). Treasury co-ordinates with all business groups, details of projected cash flows required or arising from potential ensuing business opportunities.

Treasury is required to maintain a portfolio of short-term liquid assets, largely made up of short-term high-quality liquid investment securities and availability of inter-bank lines at short notice, to ensure that sufficient liquidity is maintained with the Group. Treasury's liquidity management is performed with most optimisation, taking into account the maturity gaps. The daily liquidity position is monitored and regular stress testing is conducted under a variety of scenarios covering the mild and more severe market conditions. All liquidity policies are subject to review by the ALCO and approved by the BRC. Periodic liquidity profile report, including any exceptions and remedial action required/taken, is reviewed by the ALCO. The Group is governed by the liquidity limits and maturity ladder profile as mandated by the CBK regulations and the CBK approved limits.

The table below summarizes the maturity profile of the Group's assets and liabilities. The maturity profile of the assets and liabilities at the year-end are based on contractual repayment arrangement with the exception of some investments which are bucketed as per the CBK criteria.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

21 RISK MANAGEMENT (continued)**21.4 Liquidity risk (continued)***Liquidity risk management (continued)*

The maturity profile of assets and liabilities as at 31 December is as follows:

2020	<i>Within 3 months KD'000</i>	<i>3 to 6 months KD'000</i>	<i>6 to 12 months KD'000</i>	<i>Over 1 year KD'000</i>	<i>Total KD'000</i>
Assets					
Cash and balances with banks	110,999	-	-	-	110,999
Placements with banks and the CBK	357,897	-	-	-	357,897
Financing receivables	1,441,008	498,314	125,253	432,791	2,497,366
Financial assets at fair value through profit or loss	-	-	-	90,929	90,929
Financial assets at fair value through other comprehensive income	7,600	3,200	10,268	215,982	237,050
Investments in joint ventures	-	-	-	108,240	108,240
Investment properties	-	-	-	30,039	30,039
Other assets	4,728	2,443	187	15,716	23,074
Property and equipment	-	-	-	19,660	19,660
	<u>1,922,232</u>	<u>503,957</u>	<u>135,708</u>	<u>913,357</u>	<u>3,475,254</u>
Liabilities					
Due to banks and other financial institutions	289,510	53,507	22,163	129,175	494,355
Depositors' accounts	1,503,677	395,128	431,209	23,440	2,353,454
Sukuk issued	-	-	-	302,429	302,429
Other liabilities	37,210	-	-	7,712	44,922
	<u>1,830,397</u>	<u>448,635</u>	<u>453,372</u>	<u>462,756</u>	<u>3,195,160</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

21 RISK MANAGEMENT (continued)

21.4 Liquidity risk (continued)

Liquidity risk management (continued)

2019	Within 3 months KD'000	3 to 6 months KD'000	6 to 12 months KD'000	Over 1 year KD'000	Total KD'000
Assets					
Cash and balances with banks	102,544	-	-	-	102,544
Placements with banks and the CBK	224,945	-	758	-	225,703
Financing receivables	1,266,542	523,682	79,395	392,355	2,261,974
Financial assets at fair value through profit or loss	-	-	-	55,895	55,895
Financial assets at fair value through other comprehensive income	13,647	14,727	-	294,688	323,062
Investments in joint ventures	-	-	-	91,007	91,007
Investment properties	-	-	-	20,798	20,798
Other assets	17,745	3,136	487	18,517	39,885
Property and equipment	-	-	-	22,803	22,803
	<u>1,625,423</u>	<u>541,545</u>	<u>80,640</u>	<u>896,063</u>	<u>3,143,671</u>
Liabilities					
Due to banks and other financial institutions	489,146	149,320	154,445	160,392	953,303
Depositors' accounts	939,671	513,180	225,463	27,497	1,705,811
Sukuk issued	-	-	-	152,179	152,179
Other liabilities	29,375	-	-	8,643	38,018
	<u>1,458,192</u>	<u>662,500</u>	<u>379,908</u>	<u>348,711</u>	<u>2,849,311</u>

The table below summarises the maturity profile of the Group's financial liabilities as at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately.

2020	Within 3 months KD'000	3 to 6 months KD'000	6 to 12 months KD'000	Over 1 year KD'000	Total KD'000
Due to banks and other financial institutions					
Due to banks and other financial institutions	289,857	53,900	22,320	129,341	495,418
Depositors' accounts	1,508,540	429,517	403,885	28,360	2,370,302
Sukuk issued	-	-	-	326,149	326,149
Other liabilities	37,210	-	-	7,712	44,922
	<u>1,835,607</u>	<u>483,417</u>	<u>426,205</u>	<u>491,562</u>	<u>3,236,791</u>
2019					
Due to banks and other financial institutions					
Due to banks and other financial institutions	490,673	161,596	146,326	160,686	959,281
Depositors' accounts	943,611	518,874	231,500	30,434	1,724,419
Sukuk issued	-	-	-	174,155	174,155
Other liabilities	29,375	-	-	8,643	38,018
	<u>1,463,659</u>	<u>680,470</u>	<u>377,826</u>	<u>373,918</u>	<u>2,895,873</u>

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As at and for the year ended 31 December 2020

21 RISK MANAGEMENT (continued)**21.4 Liquidity risk (continued)***Liquidity risk management (continued)*

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

	<i>Within 3 months KD'000</i>	<i>3 to 12 months KD'000</i>	<i>Over 1 year KD'000</i>	<i>Total KD'000</i>
2020				
Acceptances and letters of credit	25,425	11,426	1,900	38,751
Letter of guarantees	26,138	37,957	63,552	127,647
Capital commitments	-	104,668	-	104,668
	<u>51,563</u>	<u>154,051</u>	<u>65,452</u>	<u>271,066</u>
2019				
Acceptances and letters of credit	30,630	21,516	64	52,210
Letter of guarantees	23,037	46,625	45,368	115,030
Capital commitments	-	28,816	-	28,816
	<u>53,667</u>	<u>96,957</u>	<u>45,432</u>	<u>196,056</u>

21.5 Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, systems failure, human error, or from external events. When controls fail to perform, it can have legal or regulatory implications, or lead to a financial or reputational loss.

Management of operational risk

The Group has a set of policies approved by the Board and are applied to identify, assess and supervise operational risk in addition to other types of risk relating to the banking and financial activities of the Group. Suitable operational risk procedures have been agreed with various groups and departments of the Group and implemented for effectively reporting, monitoring and controlling operational risks.

Operational risk is managed under the Risk Management Group. This group ensures compliance with policies and procedures to identify, assess, supervise and monitor operational risk as part of overall prudent and robust Risk Management Framework.

The Group manages operational risks in line with the CBK instructions regarding "General Guidelines for Internal Control Systems" and directives regarding "Sound Practices for the Management and Control of Operational Risks".

The Group has established its Business Continuity Management ("BCM") policy to meet any internal or external failures and eventualities enabling smooth functioning of the Group's operations.

The Group has established a Disaster Recovery ("DR") site for its IT infrastructure, and ensures that the operational risks from any potential disruption do not adversely impact the banking business. The Group pays special attention to operational risks that may arise from non-compliance to Sharf'a principles and any possible failure in fiduciary responsibilities.

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22 SEGMENT INFORMATION

The Group's operating segments are determined based on the reports reviewed by the decision makers that are used for strategic decisions. These segments are strategic business units that offer different products and services. They are managed separately since the nature of the products and services, class of customers and marketing strategies of these segments are different.

These operating segments meet the criteria for reportable segments and are as follows:

- ▶ **Corporate** - comprising of range of banking services and investment products to corporate customers, in addition to providing commodity and real estate Murabaha finance and Ijara facilities.
- ▶ **Retail** - comprising of a diversified range of products and services to individual customers. The range includes consumer finance, credit cards, deposits and other branch related services.
- ▶ **Treasury** – comprising of Bank's funding operations management, local and international Murabaha and other Islamic financing primarily with banks and financial institutions.
- ▶ **Investment** - comprising of investment in direct equity, real estate investment and other investments.
- ▶ **Other** – comprising of cost center assets and expenses.

Management monitors the operating segments separately for the purpose of making decisions about resource allocation and performance assessment.

The following table presents operating income, results for the year and total assets information regarding the Group's reportable segments.

	<i>Corporate KD'000</i>	<i>Retail KD'000</i>	<i>Treasury KD'000</i>	<i>Investment KD'000</i>	<i>Other KD'000</i>	<i>Total KD'000</i>
2020						
Operating income	39,679	14,165	3,355	21,595	-	78,794
Net (loss) profit	(8,165)	4,294	3,094	20,810	(14,399)	5,634
Total assets	2,053,066	444,300	620,464	314,691	42,733	3,475,254
Total liabilities	514,070	707,016	1,929,152	-	44,922	3,195,160
2019						
Operating income (loss)	43,212	10,378	(300)	6,472	-	59,762
Net profit (loss)	24,349	974	(485)	4,214	(12,514)	16,538
Total assets	1,866,249	399,451	515,321	299,963	62,687	3,143,671
Total liabilities	445,576	492,087	1,873,630	-	38,018	2,849,311

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23 CAPITAL MANAGEMENT

The primary objectives of the Group's capital management are to ensure that the Group complies with regulatory capital requirements and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholder value with appropriate risk level.

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may review the amount of dividend payment to shareholders or issue capital securities.

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

The Group follows Basel III regulations and the Group's regulatory capital and capital adequacy ratios for the year ended 31 December 2020 are calculated in accordance with the CBK Circular number 2/RB, RBA/336/2014 dated 24 June 2014 and its amendments are shown below:

	<i>2020</i>	<i>2019</i>
	<i>KD'000</i>	<i>KD'000</i>
Risk weighted assets	1,843,972	1,700,820
Capital required	193,617	221,107
Capital available		
Common equity Tier 1 "CET1" capital	214,457	217,997
Additional Tier 1 perpetual Sukuk	76,363	76,363
Total Tier 1 capital	290,820	294,360
Total Tier 2 capital	21,592	20,098
Total capital available	312,412	314,458
CET1 capital adequacy ratio: common equity	11.63%	12.82%
Total Tier 1 capital adequacy ratio	15.77%	17.31%
Total capital adequacy ratio	16.94%	18.49%

The Group's financial leverage ratio for the year ended 31 December 2020 is calculated in accordance with the CBK Circular number 2/I.B.S. 343/2014 dated 21 October 2014 and its amendments and is shown below:

	<i>2020</i>	<i>2019</i>
	<i>KD'000</i>	<i>KD'000</i>
Tier 1 capital	290,820	294,360
Total exposure	3,675,938	3,267,019
Financial leverage ratio	7.91%	9.01%

The disclosure relating to the capital adequacy regulations issued by the CBK as stipulated in the CBK Circular number 2/RB, RBA/336/2014 dated 24 June 2014 and its amendments and disclosures related to financial leverage ratio as stipulated in the CBK Circular number 2/I.B.S. 343/2014 dated 21 October 2014 and its amendments are included under the 'Risk Management' section in the annual report.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

24 FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial instruments comprise financial assets and financial liabilities.

Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair values of financial instruments by valuation technique:

- ▶ **Level 1:** quoted (unadjusted) prices in an active market for identical assets and liabilities;
- ▶ **Level 2:** other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- ▶ **Level 3:** other techniques which use inputs which have a significant effect on the recorded fair value are not based on observable market data.

The following table shows an analysis of financial assets recorded at fair value by level of the fair value hierarchy:

		<i>Fair value measurement</i>		
		<i>Quoted prices in active markets (Level 1)</i>	<i>Significant observable inputs (Level 2)</i>	<i>Significant unobservable inputs (Level 3)</i>
2020	Total KD'000	KD'000	KD'000	KD'000
<i>Assets measured at fair value</i>				
<i>Financial assets at FVTPL</i>				
Quoted equity instruments	15,580	15,580	-	-
Funds (unquoted)	57,792	-	-	57,792
Other securities (unquoted)	17,557	-	-	17,557
	90,929	15,580	-	75,349
<i>Financial assets at FVOCI</i>				
Quoted Sukuk				
- Sovereign Sukuk	160,834	160,834	-	-
- Corporate Sukuk	64,375	64,375	-	-
	225,209	225,209	-	-
Unquoted Sukuk	6,303	-	-	6,303
Unquoted equity instruments	5,538	-	-	5,538
	237,050	225,209	-	11,841

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

24 FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (continued)

Fair value hierarchy (continued)

2019	Total KD'000	Fair value measurement		
		Quoted prices in active markets (Level 1) KD'000	Significant observable inputs (Level 2) KD'000	Significant unobservable inputs (Level 3) KD'000
<i>Assets measured at fair value</i>				
<i>Financial assets at FVTPL</i>				
Quoted equity instruments	7,536	7,536	-	-
Funds (unquoted)	35,267	-	-	35,267
Other securities (unquoted)	13,092	-	-	13,092
	<u>55,895</u>	<u>7,536</u>	<u>-</u>	<u>48,359</u>
<i>Financial assets at FVOCI</i>				
<i>Quoted Sukuk</i>				
Sovereign Sukuk	185,015	185,015	-	-
Corporate Sukuk	126,144	126,144	-	-
	<u>311,159</u>	<u>311,159</u>	<u>-</u>	<u>-</u>
Unquoted Sukuk	6,398	-	-	6,398
Unquoted equity instruments	5,505	-	-	5,505
	<u>323,062</u>	<u>311,159</u>	<u>-</u>	<u>11,903</u>

Movements in Level 3 financial instruments measured at fair value

The following table shows a reconciliation of the opening and closing amount of Level 3 financial assets.

	At 1 January 2020 KD'000	Additions KD'000	Sales/ redemptions KD'000	Change in fair value KD'000	Exchange rate movements KD'000	At 31 December 2020 KD'000
<i>Financial assets at FVTPL</i>						
Funds (unquoted)	35,267	33,306	(10,568)	(99)	(114)	57,792
Other securities (unquoted)	13,092	4,451	(52)	(47)	113	17,557
	<u>48,359</u>	<u>37,757</u>	<u>(10,620)</u>	<u>(146)</u>	<u>(1)</u>	<u>75,349</u>
<i>Financial assets at FVOCI</i>						
Unquoted Sukuk	6,398	-	-	(99)	4	6,303
Unquoted equity instruments	5,505	-	-	33	-	5,538
	<u>11,903</u>	<u>-</u>	<u>-</u>	<u>(66)</u>	<u>4</u>	<u>11,841</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2020

24 FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (continued)**Movements in Level 3 financial instruments measured at fair value (continued)**

The following table shows a reconciliation of the opening and closing amount of Level 3 financial assets.

	<i>At</i> <i>1 January</i> <i>2019</i>		<i>Sales/</i> <i>redemptions</i>	<i>Change in fair</i> <i>value</i>	<i>Exchange rate</i> <i>movements</i>	<i>At</i> <i>31 December</i> <i>2019</i>
	<i>KD'000</i>	<i>Additions</i> <i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>
<i>Financial assets at FVTPL</i>						
Funds (unquoted)	26,430	14,078	(2,225)	(3,016)	-	35,267
Other securities (unquoted)	7,911	5,285	(112)	8	-	13,092
	<u>34,341</u>	<u>19,363</u>	<u>(2,337)</u>	<u>(3,008)</u>	<u>-</u>	<u>48,359</u>
<i>Financial assets at FVOCI</i>						
Unquoted Sukuk	8,108	-	(2,000)	295	(5)	6,398
Unquoted equity instruments	5,492	-	-	13	-	5,505
	<u>13,600</u>	<u>-</u>	<u>(2,000)</u>	<u>308</u>	<u>(5)</u>	<u>11,903</u>

There were no transfers between any levels of the fair value hierarchy during 2020 or 2019.

The fair value of financial instruments classified as level 3 are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by the prices from observable current market transactions in the same instrument and are not based on observable market data. The Group employs valuation techniques, depending on the instrument type and available market data. For example, in the absence of active market, an investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile and other factors. Favourable and unfavourable changes in the value of financial instruments are determined on the basis of changes in the value of the instruments as a result of varying the levels of the unobservable parameters, quantification of which is judgmental. The management assessed that the impact on profit or loss or other comprehensive income would be immaterial if the relevant risk variables used to fair value the financial instruments classified as Level 3 were altered by 5 percent.

For other financial assets and financial liabilities carried at amortised cost, the carrying value is not significantly different from their fair value as most of these assets and liabilities are of short-term maturity or are re-priced immediately based on market movement in profit rates.

25 IMPACT OF COVID-19

The Coronavirus ("COVID-19") pandemic has spread across various geographies globally, causing disruption to business and economic activities. COVID-19 has brought about uncertainties in the global economic environment, and governments and authorities have announced a host of support measures to counter possible adverse implications and contain or delay the spread of the virus.

COVID-19 support measures

In response to the crisis the CBK implemented various measures targeted at reinforcing the banking sectors ability to play a vital role in the economy, including but not limited to the expansion of lending capacity, strengthening financing capabilities, providing direction in lending to productive economic sectors and in the provision of liquidity to impacted customers. Some of the important measures are given below:

- ▶ Decreased the regulatory Liquidity Coverage Ratio (LCR) from 100% to 80%
- ▶ Decreased the regulatory Net Stable Financing Ratio (NSFR) from 100% to 80%
- ▶ Decreased the regulatory Liquidity Ratio from 18% to 15%
- ▶ Increased the limit for maximum negative cumulative gap for liquidity
- ▶ Released capital conservation buffer of 2.5% of risk-weighted assets in the form of CET-1
- ▶ Decreased the risk weights for lending to SMEs from 75% to 25% to be applied in the calculation of risk-weighted assets
- ▶ Increased the limit for maximum permissible financing (Loans to Deposits Ratio) from 90% to 100% of deposits
- ▶ Increased loan-to-value limits for loans granted to individuals for the purpose of purchasing and/or developing properties
- ▶ Provision of financing receivables by banks at concessional profit rates to SMEs and other companies impacted by the COVID-19 (Emergency Line of Credit programme)

25 IMPACT OF COVID-19 (continued)

COVID-19 support measures (continued)

The Group is closely monitoring the situation and has activated its Business Continuity Planning and risk management practices to manage the potential business disruption COVID-19 outbreak may have on its operations and financial performance.

During the financial reporting year, oil prices have witnessed unprecedented volatility. The uncertainties caused by COVID-19, and the volatility in oil prices have required the Group to update the inputs and assumptions used for the determination of Expected Credit Losses (“ECLs”) as at 31 December 2020. ECLs were estimated based on a range of forecast economic conditions as at that date and considering that the situation is fast evolving, the Group has considered the impact of higher volatility in the forward-looking macro-economic factors, when determining the severity and likelihood of economic scenarios for ECL determination. Further, Loss Given Default (LGD) and Exposure at Default (EAD) estimates have also been critically assessed. This assessment has considered several aspects including, the cash situation of clients, the value of collateral and the enforceability of guarantees.

Kuwait’s authorities announced certain measures to provide support to the customers which include payment holidays and funding at concessional terms to certain customers in the consumer and instalment segment.

In accordance with IASB guidance, the extension of payment relief does not automatically trigger a Significant Increase in Credit Risk (SICR) and a stage migration for the purpose of calculating expected credit losses, as these measures are being made available to assist borrowers affected by COVID-19 outbreak to resume regular payments. The Group has given specific consideration to the relevant impact of COVID-19 on the qualitative and quantitative factors when determining the significant increase in credit risk and assessing the indicators of impairment for the exposures in potentially affected sectors.

The Group has considered potential impacts of the current economic volatility in determination of the reported amounts of the Group’s financial and non-financial assets and these are considered to represent management’s best assessment based on available or observable information. Markets however remain volatile and the recorded amounts remain sensitive to market fluctuations.

Further, the Bank decided to postpone monthly payments for instalments of consumer financing, instalment financing and credit cards for all customers for a period of six months effective from April 2020 with waiving additional profits and charges during this period (“payment deferral program”). As a result, the Bank recalculated the gross carrying amount based on the revised cash flows of the financial assets and recognised a modification loss of KD 10.726 million charged to retained earnings in accordance with CBK’s instructions as set out in Note 2.